



NATIONAL RESERVE BANK OF TONGA

MONTHLY ECONOMIC UPDATE

Vol. 9

No. 8

Month Ended: August 2022

Global recession fears from accelerated monetary policy tightening

Energy shocks continue to fuel global inflation forcing monetary policy into an accelerated monetary policy tightening to tame inflation. This will bite into global growth and drive some economies into recession. Growth of major advanced economies such as the United States (US), Euro Area, and China are stalling. The higher oil prices continue to push up the cost of living, prompting many workers to seek higher compensation for the loss in purchasing power. This, however, raises more concerns about a wage-price spiral emerging. The US inflation has also reached one of its highest levels in about 40 years in August, rising by 8.3%. The Reserve Bank of Australia (RBA) raised their cash rate target again in August 2022 by 50 basis points to 1.75%, due to the rise in inflation by 6.1% over the year to the June quarter. Reserve Bank New Zealand (RBA) also raised its official cash rate from 2.5% to 3.0% in August.

Sectoral performance gradually improves

Indicators of the primary sector were positive in August 2022, coinciding with the eased travel restrictions allowing for higher exports via airfreight. The agricultural export volumes increased by 45.6% (185.0 tonnes) over the month, attributed to higher exports of cassava and coconuts. Annually, agricultural export volumes still declined by 17.0% (1,779.4 tonnes) mostly for root crops, reflecting the slow recovery from the HTHH disaster. Marine export volumes also picked up from the very low export volume in July, by 82.7 metric tons, mostly for tuna exports. Aquarium exports also rose by 29.8%, stemming from higher coral exports. Over the year to August, both marine and aquarium export volumes declined by 46.0% and 5.8% respectively, reflecting the severe impacts of the HTHH disaster and the border lockdown.

The industrial sector remains upbeat with the implementation of donor-funded development projects, and the ongoing HTHH reconstruction. The return of overseas professionals and technical expertise enables the implementation of some of the deferred infrastructure projects, boosting the construction sector, with positive spillovers to the manufacturing and quarrying sectors. Other grant-funded projects for renewable energy and resilience also support activities within the utility sector.

Sentiments for the tertiary sector have improved significantly as the country progresses towards zero isolation and quarantine requirements for fully vaccinated travelers. As a result, international passenger arrivals markedly increased by 178.8% (2,158 passengers) in August, while travel receipts rose by 49.5% (\$1.6 million). Higher demand for tourism-related services has been observed, which will also drive domestic trade and consumer spending. This is also reflected in the 6.4% (\$2.5 million) rise in import payments excluding oil, despite the 3.5% decline in container registrations.

Higher demand for labour

The Reserve Bank's job survey, recorded an increase of 59.6% (28 vacancies) in the number of job vacancies advertised during the month, and 163.7% (388 vacancies) over the year to August 2022. Positive growths were noted for public administration vacancies, in line with the rollout of infrastructure projects. Additionally, the demand for workers in accommodation and food services also increased, reflecting the gradual recovery of the tourism industry.

Domestic prices drove monthly growth in inflation

Inflation rose by 0.9% in August, driven solely by the rising domestic prices, while imported prices declined.

Table 1: Inflation Rates

Prices	Monthly		Annual	
	Aug-22	Jul-22	Aug-22	Aug-21
Headline Inflation (%)	0.9	2.0	13.8	7.0
Domestic prices	2.2	2.0	13.9	6.7
Imported prices	-0.2	1.9	13.8	7.3
Core inflation - ex. energy and imported food (%)	2.1	0.1	9.8	3.4

Source: Tonga Statistics Department

Higher domestic prices were recorded for local food items, takeaway food services, labour cost, local transport services such as local sea freight charges, and doctor visit fees. On the other hand, the declining global oil prices calmed imported inflation, further supported by the Government oil subsidy on petroleum products.

Nonetheless, headline inflation rose again to another high record of 13.8% annually, underpinned by increases in both domestic and imported

Table 2: Average annual prices of selected items

Items (\$ per kg)	Unit	Aug-22	Aug-21	Annual Change
Domestic				
Yams - early	1kg	\$19.62	\$8.19	\$11.43
Kava	1kg	\$60.00	\$52.50	\$7.50
Capsicum	1 kg	\$21.47	\$15.30	\$6.17
Eggs	1 tray	\$24.47	\$19.92	\$4.55
Imported				
Chicken pieces	1kg	\$5.68	\$4.06	\$1.62
Petrol	litre	\$4.02	\$2.98	\$1.04
Diesel	litre	\$4.40	\$2.86	\$1.54

Source: Statistics Department

prices. The rising imported prices contributed 7.8% to the headline, and was still driven mostly by higher prices of fuel, imported food items, construction materials (roofing iron and timber), and liquefied petroleum gas. This largely reflects on-going disruptions to global supply chains. The higher domestic prices contributed 6.0% to the headline, attributing to increases in prices of local food items, electricity, takeaway food services, and labour cost. The slower recovery from HTHH drove the higher domestic food prices, whereas the higher energy prices and inflation expectations have been factored in to domestic production costs and services.

Core inflation (ex. energy and imported food) jumped to 9.8% in August 2022, depicting the broadening inflationary pressures. Although the rising inflation depletes consumers' purchasing power, the temporary Government subsidies on petroleum products and electricity consumption helps in alleviating this pressure particularly on poor households and vulnerable groups.



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Effective exchange rates strengthened

Table 3: Effective Exchange Rates

	Monthly			Annual	
	Aug-22	Jul-22	% Growth	Aug-21	% Growth
Nominal Effective Exchange Rate Index	94.8	93.8	1.0	89.4	6.0
Real Effective Exchange Rate Index	121.4	119.6	1.6	106.3	14.2

Source: National Reserve Bank of Tonga

Both the Nominal Effective Exchange Rate (NEER) and the Real Effective Exchange Rate (REER) rose over the month and year to August 2022. The rising NEER indicates a general weakening of the major trading currencies against the TOP, except for the USD. The increasing REER reflects the stronger NEER coupled with Tonga's higher inflation rates relative to its major trading partners. This implies that Tongan exports becomes more expensive.

Foreign reserves fell

Table 4: Foreign Reserves

	Monthly			Annual	
	Aug-22	Jul-22	%Growth	Aug-21	% Growth
Foreign Reserves (\$ in million)	871.0	884.8	-1.6	751.7	15.9
Import Coverage (months)	14.1	14.3	-2.0	12.1	15.9

Source: National Reserve Bank Tonga

Foreign reserves fell by \$13.8 million in August, equivalent to 14.1 months of imports. This was attributed to higher outflows for large import payments during the month. Annually, foreign reserves still increased significantly by \$119.3 million underpinned by higher receipts of budget support, official grants, capital inflows, and remittances. The majority of the official foreign reserves are held in USD, NZD, and AUD.

Table 5: Remittance Receipts

	Monthly			Annual		
	Aug-22	Jul-22	% Growth	Aug-22	Aug-21	% Growth
Remittance (\$ in million)	47.6	42.1	12.9	476.9	472.2	1.0

Source: National Reserve Bank Tonga

Total remittance receipts increased over the month by 12.9% (\$5.4 million), owing to higher private transfers and employees' compensation. The easing of the Covid-19 restrictions allows for larger-scale events to be held such as birthdays, weddings, and funerals which are usually funded by remittances. During the year, remittance recorded a slower growth of 1.0% (\$4.7 million) compared to 31.2% in the previous year. The slowdown depicts the deteriorating economic conditions of our major remitting countries, and the resumption of travel activities diverting some of the remittance transfers to travel receipts.

Table 6: Overseas Exchange Transactions

	Monthly			Annual		
	Aug-22	Jul-22	%	Aug-22	Aug-21	%
Overall Balance	-13.8	13.6	-201.0	119.3	195.6	-39.0
Current Account	-13.4	-6.4	-109.3	60.2	95.6	-37.0
Merchandise Trade	-55.5	-40.9	-35.6	-509.7	-472.1	-8.0
Services	-9.1	-9.9	8.0	-86.7	-35.6	-143.7
Income	3.5	2.3	52.7	28.6	25.4	12.8
Transfers	47.8	42.2	13.2	627.9	577.8	8.7
Capital Account	0.7	0.4	69.7	13.2	40.6	-67.6
Financial Account	-1.1	19.6	-105.5	46.0	59.4	-22.6

Source: Banking Systems

The overall balance recorded a \$13.8 million deficit in August 2022, underpinned by the wider current account deficit from higher import outflows. In year-ended terms, the overall balance surplus was lower by \$76.3 million, again reflecting the worsening trade and service deficits.

Money supply declined

Table 7: Broad Money

	Monthly			Annual	
	Aug-22	Jul-22	% Growth	Aug-21	% Growth
Broad money (\$ in million)	843.5	846.2	-0.3	775.4	8.8
Net Foreign Asset	846.8	861.3	-1.7	742.8	14.0
Net Domestic Asset	-3.1	-14.8	79.2	33.4	-109.2

Source: Banking System, National Reserve Bank of Tonga

Broad money declined by 0.3% (\$2.8 million) at the end of August, stemming from the lower net foreign reserves. Net domestic assets, however, increased due to the higher net credit to Government, partially offsetting the drop in net foreign assets. During the year, broad money expanded by 8.8% (\$68.1 million) on the back of the higher foreign reserves, while net domestic assets declined in line with the lower net credit to Government.

Liquidity in the financial system shrunk

Table 8: Reserve money

	Monthly			Annual	
	Aug-22	Jul-22	%	Aug-21	%
Reserve money (\$ in million)	615.0	625.7	-1.7	515.0	19.4

Source: Banking System, National Reserve Bank of Tonga

Liquidity in the financial systems was reduced in August by 1.7% (\$10.7 million), owing to lower currency in circulation, Exchange Settlement Account (ESA) balance, and Statutory Reserve Deposits (SRD). Nevertheless, liquidity remained in excess rising by 19.4% (\$100.0 million) in the year to August, driven mostly by higher Exchange Settlement Account (ESA).

Positive credit growth

Table 9: Total Lending

Lending	Monthly			Annual	
	Aug-22	Jul-22	Growth	Aug-21	Growth
Total Lending (\$ in million)	479.5	479.2	0.1	478.9	0.1
Business lending	224.6	225.4	-0.4	221.7	1.3
Household lending	252.5	251.4	0.4	256.9	-1.7
Other lending	2.5	2.4	1.4	0.3	739.0

Source: Banking System, National Reserve Bank of Tonga



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In August 2022, the banks' total lending (with GDL) slightly rose by 0.1% (\$0.3 million), underpinned by more loans issued to households for other personal loans. Business loans declined reflecting loan repayments from public enterprises. However, loans within the agricultural, manufacturing and construction sectors increased over the month supported by higher uptake of the low-interest Government loans.

Annually, credit growth was 0.1% (\$0.6 million), returning to positive territory since July 2020. The annual growth was driven mainly by higher business loans to the distribution and professional & other services sectors. Lending to the non-profit organisation also increased and supported the annual rise. Household loans on the other hand declined, due mainly to loan repayments made by households for housing and other personal loans.

The banks' total deposits fell by 0.5% (\$4.2 million) over the month, but rose over the year by 8.1% (\$65.9 million), to a total of \$859.0 million. Combined with the rise in lending over the month, the loans-to-deposit ratio rose from 54.4% in July, to 54.7%.

Wider weighted average interest rate spread

Table 10: Weighted Average Interest Rates

Interest Rates	Monthly			Annual	
	Aug-22	Jul-22	(bps)	Aug-21	(bps)
Weighted Average Banks Deposit Rate (%)	1.641	1.633	0.8	1.872	-23.1
Weighted Average Banks Lending Rate (%)	7.765	7.727	3.8	7.765	0.0
Weighted Average Interest Rate Spread (%)	6.124	6.094	3.0	5.893	23.1

Source: Banking System, National Reserve Bank of Tonga

The weighted average interest rate spread widened to 6.12% over the month and year to August 2022. The

weighted average lending rates rose at a faster pace than the rise in weighted deposit rates during the month. Higher average lending rates were mainly for businesses in the fisheries, agricultural, and manufacturing sectors. Other personal and housing loan rates offered to households, also increased. The weighted average deposit rates rose due to the higher savings deposit rates.

Over the year, the weighted average deposit rates fell, coupled with a slight increase in weighted average lending interest rates. All three types of deposit rates declined, corresponding to the higher deposit volumes in the banking system. Meanwhile, lending rates offered to the utility, manufacturing, fisheries, and construction sectors rose.

Outlook

The Tongan economy is still on track to recover moderately in FY2022/23, aided by the recovery and reconstruction from the HTHH disaster and the reopening of international borders. Global economic growth has slowed, while inflation has remained high, as a result of the fallout from the Ukraine conflict, China's lockdowns, and the lingering supply-demand mismatches from the global pandemic. Monetary policy tightening in many advanced economies have accelerated in response to the stubborn inflation. However, recent developments are showing a slow decline in global oil prices which will help ease the imported inflationary pressure. However, adverse weather conditions have worsened domestic food prices and domestic inflation. Foreign reserves levels will remain adequate at above the minimum 3 months of imports cover, while the financial system remains sound.