



Global inflation surges underpinned by food and energy prices

Global inflation accelerates rapidly according to the International Monetary Fund (IMF) World Economic Outlook (WEO), driven mostly by food and energy prices. Inflation in the US was still high at 8.5% in July 2022, while the trade deficit narrowed. The Federal Reserve has raised the federal funds rate target range again to 2.25-2.50%. According to the Reserve Bank Australia, unemployment further declined in July 2022 to 3.4%, the lowest rate in almost 50 years. However, the Reserve Bank Australia continued to raise the cash rate by 50 basis points to 1.35%. New Zealand Statistics recorded an increase in food prices by 2.1 percent in July 2022 particularly driven by fruit and vegetable prices, prompting another increase in the official cash rate to 2.5% by the Reserve Bank New Zealand.

More active performance in the industry and tertiary sectors

The primary sector performance remained weak in July 2022 coinciding with the planting season for root crops. Total agricultural export volumes continued to decline over the month by 22.7% (117.6 tonnes), driven by lower exports of root crops particularly cassava, yam, and coconuts. On the other hand, the agricultural export proceeds rose by \$0.6 million (248.7%), reflecting the lagged receipt of proceeds. The agricultural exports also fell by 1,649.2 tonnes (15.7%) over the year, largely attributed to lower exports of root crops such as yam, cassava, and taro reflecting the damages from the HTHH disaster. The marine export volumes remained minimal in July, while aquarium exports also fell. Since the volcanic eruption and the national lockdown, some foreign fishing vessels have not returned contributing to the decline in exports. Coincidentally, the marine export proceeds fell by 43.7% (\$0.1 million). Annually, marine exports fell by 358.2 metric tons (26.7%), largely offsetting the rise in aquarium exports by 2,503 pieces (1.6%). Consequently, total marine export proceeds decreased by \$1.6 million (33.1%) over the year.

The industrial sector performance is strengthened by the disaster recovery and resilience projects for HTHH and other natural disasters, which largely involves construction activities. The easing of international travel restrictions allows for the return of technical teams from Japan to complete the National Early Warning System (NEWS) project. The World Bank also approved an additional US\$19.5 million to support recovery and resilience projects for natural hazards. Another US\$14.5 million was also offered to the Tonga Safe and Resilient Schools project, and US\$5 million to further strengthen Tonga's emergency early warning systems, and emergency responses. The New Zealand government also committed TOP\$1.3 million to build a new warehouse at Ha'apai for Tonga's National Emergency Management Office (NEMO). These projects are also anticipated to support activities and sectoral growth within the mining & quarrying, manufacturing, and utility sector.

The indicators within the service sector were mostly positive in July with the gradual reopening of the borders. The communication-related services are expected to respond positively to the resumption of major projects such as the NEWS, and the acquisition of Digicel Pacific by Australia's Telstra. Meanwhile, travel activities are more upbeat as international arrival passenger numbers are much higher in recent months, coinciding with an increase in travel receipts by \$0.9 million (39.8%) in July. The Government has also handed over travel arrangements back to airlines and travel agents signalling more travel activities in the near term. Business container registrations also rose by 11.6% reflective of a more active trading market as demand and consumption improve. Increased Government spending on goods and services also supports the growth of the private sector.

Job vacancies continued dropping

The Reserve Bank job survey showed a 32.9% (23 vacancies) decline in the job vacancies advertised during the month but increased significantly over the year by 152.7% (345 vacancies). The movement in the job advertisements is largely dominated by the public administration vacancies, which are normally advertised through the official channels, which could understate a large part of the private sector vacancies. However, as the tourism sector slowly resumes operations there may be more appetite for labour in the near term.

Headline inflation surged to 13.1%

Inflation persistently increased over the month by 2.0%, attributed to higher imported and domestic prices. The higher imported prices were largely from imported food items, fuel, alcoholic beverages, and liquefied petroleum gas. The higher domestic prices were mostly from electricity, takeaway food, and tobacco. In response to the elevated inflation, the Government rolled out additional subsidies for petroleum prices and electricity in July 2022, which mostly prevented what could have been a more drastic price increase. These Government subsidies aim at reducing the impact of inflation on poor households.

The annual headline inflation again hit a fresh high of 13.1% in July 2022, fuelled by increases in both imported and domestic prices. This is the largest annual

Table 1: Inflation Rates

Prices	Monthly		Annual	
	Jul-22	May-22	Jul-22	Jul-21
Headline Inflation (%)	2.0	0.9	13.1	6.8
Domestic prices	0.9	0.6	11.2	5.7
Imported prices	1.1	1.2	14.5	7.6
Core inflation - ex. energy and imported food (%)	0.1	0.6	7.4	2.8

Source: Tonga Statistics Department

Table 2: Average annual prices of selected items

Items (\$ per kg)	Unit	Annual		
		Jul-22	Jul-21	Change
Domestic				
Yams - early	1kg	\$21.70	\$7.33	\$14.37
Capsicum	1kg	\$26.62	\$19.93	\$6.69
Eggs	1 tray	\$24.47	\$19.25	\$5.22
Kava	1kg	\$60.00	\$55.00	\$5.00
Imported				
Oranges	1kg	\$9.33	\$7.29	\$2.04
Petrol	litre	\$4.21	\$2.92	\$1.29
Diesel	litre	\$4.43	\$2.83	\$1.60

Source: Statistics Department



increase since the 12.2% increase in June 2008, indicative of the global disruptions and adverse supply shocks over the year. Higher imported prices were largely driven by higher prices of fuels, food items, construction materials (timber), and liquefied petroleum gas. The surging prices of fuels and food items reflect intensified shocks on the energy and staple food markets from the Ukraine war. Domestic prices are also keeping up with increases in prices of local food items, electricity, and takeaway food. The increase in prices of food items indicates the supply shocks induced by the HTHH disaster, while the impact of the higher fuel prices passes-through to energy prices and production costs.

The core inflation (excluding energy and imported food) remains below the headline at 7.4%, and was marginally higher than the 7.3% in the previous month. The increasing core inflation is underpinned by the rising domestic food prices, in addition to consistent increases in prices of non-oil and non-food items.

Major trading currencies appreciated against TOP

Table 3: Effective Exchange Rates

	Monthly			Annual	
	Jul-22	Jun-22	Growth	Jul-21	Growth
Nominal Effective Exchange Rate Index	93.8	94.1	-0.3	89.2	5.1
Real Effective Exchange Rate Index	119.6	118.2	1.2	106.1	12.7

Source: National Reserve Bank of Tonga

The Nominal Effective Exchange Rate (NEER) fell over the month reflecting the general appreciation of the AUD, NZD, and FJD against the TOP (month ended). The Real Effective Exchange Rate (REER), however, increased over the month reflecting Tonga's higher inflation rates relative to its major trading partners.

Annually, the NEER still increased as trading partners' currencies generally weakened against the TOP, except the USD. This may assist in partially offsetting some of the impacts of the higher imported inflation. The REER also increased over the year in line with the increasing NEER and the higher inflation compared to its major trading partners. This indicates a loss in trade competitiveness as exports becomes more expensive.

Foreign reserves increased in July

Table 4: Foreign Reserves

	Monthly			Annual	
	Jul-22	Jun-22	%Growth	Jun-21	% Growth
Foreign Reserves (\$ in million)	884.8	871.2	1.6	704.8	25.6
Import Coverage (months)	14.3	14.4	-0.4	11.5	25.0

Source: National Reserve Bank Tonga

Foreign reserves increased over the month by \$13.6 million to \$884.8 million, equivalent to 14.3 months of imports. This was underpinned by the receipt of the Government's new external debt proceeds and official grants from development partners. Similarly, foreign reserves still increased markedly by \$180.1 million over the year to July 2022. This was attributed to 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		
	Jul-22	Jun-22	%Growth	Jul-22	Jun-21	% Growth
Remittance (\$ in million)	42.1	38.3	10.1	472.6	465.5	1.5

Source: National Reserve Bank Tonga

Total remittance receipts bounced back during the month by \$3.9 million (10.1%) to \$42.1 million, owing to higher private transfers and employee compensation which are mostly seasonal workers' receipts. Remittances from Australia drove the increase during the month by \$2.2 million (15.9%) coinciding with the growth in Australia's employment market. Annually, remittances continued to rise by \$7.1 million (1.5%) albeit at a slower rate compared to the 30.7% growth in the same month last year.

Table 6: Overseas Exchange Transactions

	Monthly			Annual		
	Jul-22	Jun-22	% Growth	Jul-22	Jul-21	% Growth
Overall Balance	13.6	-9.2	-247.9	180.1	148.8	21.0
Current Account	-6.4	-16.4	61.0	71.9	99.9	-28.1
Merchandise Trade	-40.9	-57.2	28.5	-493.4	-467.4	-5.6
Services	-9.9	-8.2	-21.5	-84.3	-29.4	-186.3
Income	2.3	3.1	-28.1	29.1	23.2	25.6
Transfers	42.2	45.8	-8.0	620.4	573.6	8.2
Capital Account	0.4	0.7	-43.3	13.9	39.9	-65.0
Financial Account	19.6	6.4	205.3	94.3	9.0	945.5

Source: Banking Systems

The overall balance recorded a \$13.6 million surplus in July 2022 due mostly to a higher surplus in the financial account. This was underpinned by the receipt of the Government's second loan from the IMF's Rapid Credit Facility. The decline in the current account deficit from lower import payments also contributed to the higher overall balance.

In year-ended terms, the overall balance surplus increased by \$31.3 million to \$180.1 million. This was largely attributed to higher surpluses in the financial account mainly from an increase in interbank receipts and capital inflows.

Broad money slightly fell

Table 7: Broad Money

	Monthly			Annual	
	Jul-22	Jun-22	% Growth	Jul-21	% Growth
Broad money (\$ in million)	846.2	846.7	-0.1	769.7	9.9
Net Foreign Asset	861.3	849.9	1.3	740.2	16.4
Net Domestic Asset	-14.8	-2.9	-406.0	30.3	-148.9

Source: Banking System, National Reserve Bank of Tonga

Over the month of July 2022, broad money declined by \$0.5 million (0.1%), owing largely to lower net domestic assets. The receipt of the new Government external debt proceeds resulted in lower net credit to the Government and net domestic assets. This was partially offset by the rise in net foreign assets in line with the growing foreign reserves.



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Annually, broad money still expanded by \$76.5 million (9.9%) underpinned by the stronger net foreign assets whilst net domestic assets declined.

Liquidity in the financial system decreased

Table 8: Reserve money

	Monthly			Annual	
	Jul-22	Jun-22	% Growth	Jul-21	% Growth
Reserve money (\$ in million)	625.7	629.5	-0.6	504.0	24.2

Source: Banking System, National Reserve Bank of Tonga

Liquidity in the financial system declined in July by \$3.7 million (0.6%), driven solely by lower Exchange Settlement Accounts (ESA). This was due mainly to net purchases of foreign currency by commercial banks for large import payments. On the other hand, both currency in circulation and Statutory Reserve Deposits increased over the month.

Over the year, liquidity still expanded by \$121.8 million (24.2%), from rises in the ESA, followed by currency in circulation and SRD.

Credit growth continues

Table 9: Total Lending

Lending	Monthly			Annual	
	Jul-22	Jun-22	% Growth	Jul-21	% Growth
Total Lending (\$ in million)	479.2	473.4	1.2	481.7	-0.5
Business lending	225.4	220.7	2.1	223.3	1.0
Household lending	251.4	250.3	0.4	258.1	-2.6
Other lending	2.4	2.4	3.9	0.4	525.9

Source: Banking System, National Reserve Bank of Tonga

In July 2022, the banks' total lending climbed further by \$5.9 million (1.2%), resulting from more loans issued to both businesses and households. Private business loans within the professional & other services, distribution, and agricultural sectors increased, as well as all categories of household loans.

However, annually, credit growth was still negative declining by \$2.5 million (0.5%). This was underpinned mainly by loan repayments made by households for housing and other personal loans. Business loans on the other hand increased, mainly for the distributions, professional & other services, and manufacturing sectors as well as lending offered by non-profit organisations to households.

The banks' total deposits fell by \$5.5 million (0.6%) over the month, but rose over the year by \$76.6 million (9.7%), to a total of \$881.5 million. Coupled with the monthly increase in lending the loans-to-deposit ratio rose from 53.4% to 54.4% over the month, but fell from 59.8% in July 2021.

Weighted average interest rate spread narrowed again in July

Table 10: Weighted Average Interest Rates

Interest Rates	Monthly			Annual	
	Jul-22	Jun-22	(bps)	Jul-21	(bps)
Weighted Average Banks Deposit Rate (%)	1.633	1.626	0.7	1.886	-25.3
Weighted Average Banks Lending Rate (%)	7.727	7.769	-4.3	7.752	-2.5
Weighted Average Interest Rate Spread (%)	6.094	6.143	-5.0	5.866	22.7

Source: Banking System, National Reserve Bank of Tonga

The weighted average interest rate spread narrowed further in July 2022, however continued to widen annually to 6.09%. The weighted average lending rate declined again over the month, mainly for businesses in the construction, fisheries, and agricultural sectors. This also partially reflects the lower rates offered by the GDL scheme. Housing and other personal loan rates offered to households also declined. The weighted average deposit rate rose solely driven by the demand deposit rates.

Over the year, the weighted average deposit rate declined at a faster pace than the fall in the weighted average lending interest rate resulting in the wider weighted average interest rate spread. All three types of deposit rates fell, along with the lending rates offered to businesses in the fisheries, tourism, and professional & other business service sectors. Household housing and other personal loan rates, and non-profit organisations' lending rates also declined over the year.

Outlook

A moderate recovery is expected for the Tongan economy in FY2022/23 supported by the reconstruction from the HTHH disaster, and re-opening of the international borders. Global economic growth has weakened while inflation remains elevated due to the spillover effects from the war in Ukraine, the China lockdowns, and the lingering supply-demand mismatches from the global pandemic. Monetary policy in many advanced economies remains hawkish in response to the elevated inflation. However, recent developments are indicating a slow decline in global oil prices which will help ease the inflationary pressure in the coming months. Inflationary pressure is mostly supply-side and driven by external factors. The Reserve Bank projects inflation to soon peak before gradually easing to desirable levels by 2023. Imports are projected to strengthen in line with the economic recovery, while remittance receipts slows down. This will reduce foreign reserves levels but will still remain adequate at above the minimum 3 months of imports cover. The financial system remains stable with ample liquidity available. Banks are also well capitalized to absorb further deteriorating asset quality in light of further deterioration in asset quality.