



NATIONAL RESERVE BANK OF TONGA

MONTHLY ECONOMIC UPDATE

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February 2023 Report¹

Major trading partners' economies growing stronger than expected amidst inflationary concern

The United States recorded a stronger than expected economic growth of 2.9% in the fourth quarter of 2022, reflecting an increase in private inventory investment and consumer spending. Additionally, annual inflation was 6.5% in December 2022, the lowest 12-month increment since October 2021, while unemployment also dropped to 3.3%. The Federal Reserve raised its federal funds rate to the range of 4.5 to 4.75%. Australia and New Zealand's inflation both increased over the year to December 2022 by 7.8% and 7.2% respectively, driven mainly by housing and food prices. Unemployment in New Zealand increased to 3.4% in December 2022.

Holiday season boosted domestic economic activities

The primary sector slowed down in December 2022 primarily due to the end of the export season of squash. Exports of root crops (cassava & taro), and watermelon also declined contributing to the decline of total agricultural exports by 52.3% (650.5 tonnes). On the other hand, kava exports still continued to grow, buoying the sector. According to Australia's Department of Foreign Affairs and Trade (DFAT), Tonga has exported around 95.7 tonnes of kava to Australia since 2021 under the Commercial Kava Pilot. Additionally, the implementation of the ePhyto system is expected to allow more exporting activities within the agricultural sector. Agricultural export proceeds, on the other hand, slightly rose over the month reflecting lagged receipts. At the same time, marine exports fell by 162.0 metric tonnes (56.6%), owing mainly to the slowdown in tuna exports. The aquarium exports also substantially declined by 92.8% (8,886.0 pieces), coinciding with the lower marine export proceeds of -41.8% (\$0.1 million).

The industrial sector showed mixed indicators over the month. Lending to the mining and quarrying, and utility sectors declined over the month while loans to the construction sector rose by 0.6% (\$0.1 million). Construction permits were valued at \$5.1 million in December 2022, declining by 37.4% (-\$3.0 million) from the previous month. Construction import payments also fell by 13.5% (\$0.7 million) over the month. Nonetheless, private and public projects, including the resettlement constructions and Tonga High School Sports Complex are progressing forward.

Activities in the service sector trended most favourably in the month of December, given the holiday season and its festivities. The total passenger arrivals hit pre-pandemic level in December 2022, rising by 105.1% (5,599 passengers) over the month. This is the highest number of passenger arrivals since December 2019. Coincidentally, total travel receipts grew by \$4.1 million (43.9%). Total passenger departures also rose by 56.3% (3,460

passengers). Tourism-related industries and the distribution sector were strongly supported by the robust demand and consumer spending by households. This is further reflected in the higher wholesale and retail import payments ¹of \$0.7 million (2.5%) over the month.

Labour demand slowed down over the month

The Reserve Bank's job survey showed a 14.9% (-10 job vacancies) decline in the number of vacancies advertised over the month. The job vacancies are attributed largely to the public administration, transport services, and hotel & restaurants. Annually, advertised job vacancies rose by 107.8% (389 job vacancies). High demand for labour over the year were also observed in the transport & communication services, hotel & restaurants, and trade sector, corresponding to the recovery and pick-up in the economic activities as lockdown restrictions were removed. This is also further reflecting the increasing participation of domestic labour force in the ongoing seasonal workers' schemes to New Zealand and Australia.

Domestic food prices persisted in January 2023

Consumer Price Index rose by 0.2% in January 2023 (lower than 0.5% in December 2022), stemming mainly from higher prices of domestic items. Increased prices of domestic items was largely driven by higher prices of local food items (i.e. suckling pigs, lobster octopus, mixed string fish, fresh palu, vegetables, and root crops). Additionally,

Table 1: Inflation Rates

Prices	Monthly		Annual	
	Jan-23	Dec-22	Jan-23	Jan-22
Headline Inflation (%)	0.2	0.5	9.7	8.2
Domestic prices	0.7	0.9	13.3	6.2
Imported prices	-0.3	0.2	7.0	9.7
Core inflation - ex. energy and imported food (%)	2.1	1.3	12.0	4.0

Source: Tonga Statistics Department

the secondary school tuition fees also recorded an increase over the month as the academic season commences, while lower electricity tariff reduced the pressure on domestic inflation. On the other hand, imported inflation declined as fuels, imported alcoholic beverages, liquefied gas, and goods for personal care were cheaper over the month.

The headline annual inflation eased to 9.2% in December 2022 after being in double figures since May of 2022. However, it rose again to 9.7% in January 2023. The uptick in inflation is mainly due to higher domestic prices as domestic inflation continues to be higher than imported inflation since August 2022. Higher prices of domestic items was largely fuelled by local food items, local transport services, electricity tariffs, takeaway food, and kava. Altogether, these domestic drivers contributed 5.8% to the headline inflation while imported inflation contributed 3.9% to the headline inflation. Imported inflation was primarily driven by prices of fuels, imported food items, construction materials, goods for personal care, and international airfares.

The core inflation (excluding energy and imported food) remained above the 5% reference rate at 12.0% in January 2023. This is higher than 8.7% in previous month, owing

¹ Report Title has been changed to reflect the month in which all available data at the end of that month is analysed.



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largely to the significant upturn in prices of local food items over the month. However, another measurement of core inflation (excluding all food (imported and domestic) and energy) show a decline from 8.8% in December 2022 to 8.3% in January 2023.

Effective exchange rates declined again

Table 2: Effective Exchange Rates

	Monthly			Annual	
	Jan-23	Dec-22	% Growth	Jan-22	% Growth
Nominal Effective Exchange Rate Index	92.4	93.0	-0.7	90.7	1.8
Real Effective Exchange Rate Index	112.5	116.2	-3.2	109.2	3.0

Source: National Reserve Bank of Tonga

The strength of the Tongan Pa'anga (TOP) as measured by the Nominal Effective Exchange Rate (NEER) decreased over the month of January 2023 by 0.7% reflecting the general appreciation of the AUD, NZD, FJD, JPY, GBP, EUR and CNY against the TOP. The TOP, however, strengthened against the USD. In year ended terms, the TOP was stronger by 1.8% as major trading partners' currencies generally weakened against the TOP except for the USD. This may assist in partially offsetting some of the impacts of the higher imported inflation.

The Real Effective Exchange Rate (REER) declined over the month (3.2%), corresponding with the lower NEER and Tonga's inflation reducing at a faster pace than our trading partners. Annually however, the REER increased in line with the higher NEER and Tonga's higher inflation rate, indicating a loss in global trade competitiveness.

Official receipts drove higher foreign reserves

Table 3: Foreign Reserves

	Monthly			Annual	
	Jan-23	Dec-22	%Growth	Jan-22	% Growth
Foreign Reserves (\$ in million)	911.1	868.9	4.9	856.1	6.4
Import Coverage (months)	14.0	13.4	4.5	13.9	0.1

Source: National Reserve Bank Tonga

Foreign reserves rose significantly over the month of January 2023 by \$42.2 million to \$911.1 million, equivalent to 14.0 months of imports. This was due to the receipt of budget support. In year ended terms, foreign reserves increased markedly by \$55 million which 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 4: Remittance and Travel Receipts

	Monthly			Annual		
	Dec-22	Nov-22	% Growth	Dec-22	Dec-21	% Growth
Remittance (\$ in million)	52.1	43.6	19.6	477.5	499.1	-4.3
Travel (\$ in million)	13.6	9.4	43.9	56.2	22.1	154.8

Source: National Reserve Bank Tonga

Total remittance receipts increased over the month by \$8.5 million (19.6%) due to higher private transfers and compensation of employees for the Christmas festivities. However, remittance receipts declined over the year by

\$21.5 million (4.3%) driven by declines in all categories (i.e., private transfers, compensation of employees, and social benefits). The negative growth can be reflected by the impact of the HTHH disaster during the first half of 2022, that led to higher in-kind remittances. With the borders opening up, remittance receipts is expected to continue to decline as families travel and bring their funds so we expect this to add to the increase in travel receipts.

Broad money expanded

Table 5: Broad Money

	Monthly			Annual	
	Dec-22	Nov-22	%	Dec-21	%
Broad money (\$ in million)	851.2	842.9	0.98	821.5	3.6
Net Foreign Asset	858.1	852.7	0.6	798.4	7.5
Net Domestic Asset	-6.6	-9.3	29.0	24.0	-127.7

Source: Banking System, National Reserve Bank of Tonga

Broad money increased over the month by \$8.3 million (1.0%) and over the year by \$29.7 million (3.6%). The rise over the month was underpinned by the higher foreign reserves and credit growth. Annually, the net foreign assets continued to rise, offsetting the decline in net domestic assets.

Liquidity in the financial system increased

Table 6: Reserve money

	Monthly			Annual	
	Dec-22	Nov-22	%	Dec-21	%
Reserve money (\$ in million)	613.1	603.0	1.7	578.8	5.9

Source: Banking System, National Reserve Bank of Tonga

Liquidity in the financial system rose over the month and year to December 2022, by \$10.1 million (1.7%) and \$34.3 million (5.9%) respectively. Currency in circulation increased, reflecting the higher demand for cash during the holiday festivities such as Christmas and New Year celebrations. Bank customers' deposits increased leading to higher balances Exchange Settlement Account (ESA) and Statutory Reserve Deposits (SRD). However, in year ended terms, currency in circulation declined but was offset by increases in both the ESA and SRD.

Credit growth increased

Table 7: Total Lending

Lending	Monthly			Annual	
	Dec-22	Nov-22	% Growth	Dec-21	% Growth
Total Lending (\$ in million)	493.3	490.3	0.6	472.1	4.5
Business lending	235.2	232.4	1.2	214.9	9.4
Household lending	255.8	255.3	0.2	256.9	-0.4
Other lending	2.3	2.5	-5.8	0.2	943.0

Source: Banking System, National Reserve Bank of Tonga

The banks' total lending grew over the month and year to December 2022, by \$3.1 million (0.6%) and \$21.3 million (4.5%) respectively. Over the month, lending to businesses within the professional & other services, manufacturing and distribution sectors increased, along with household lending. Annually, more loans were issued to the distribution sector, professional & other services and construction sectors. Household loans, however, declined over the year, mainly on lower housing loans.



Over the month and year to December 2022, the banks' total deposits rose further by \$6.3 million (0.7%) and \$47.9 million (5.8%) respectively, to a total of \$874.9 million. The monthly rise is attributed to higher deposits from private businesses, central government and non-profit organisations. Similarly, higher deposits from private businesses, retirement funds and the non-profit organisations led the annual growth. As deposits increased more than the rise in loans, the loans-to-deposit ratio slightly fell to 55.2%, compared to 55.3% last month and 55.8% last year.

Weighted average interest rate spread narrowed in December

Table 8: Weighted Average Interest Rates

Interest Rates	Monthly			Annual	
	Dec-22	Nov-22	(bps)	Dec-21	(bps)
Weighted Average Banks Deposit Rate (%)	1.592	1.618	-2.6	1.710	-11.8
Weighted Average Banks Lending Rate (%)	7.908	8.234	-32.6	7.840	6.9
Weighted Average Interest Rate Spread (%)	6.317	6.616	3.0	6.130	18.7

Source: Banking System, National Reserve Bank of Tonga

The weighted average interest rate spread narrowed in December 2022, to 6.32%, driven by a steeper decline in weighted average lending rates which outweighed the decline in weighted average deposit rates. The average lending rates offered to businesses in the agricultural, professional and tourism sectors all decreased over the month. Similarly, the time deposit and saving deposit rates both fell over the month and outweighed the slight increase in demand deposit rates. The lower weighted average deposit rate reflects higher volumes of deposits and excess liquidity, supported by the inflow of funds for Tonga's recovery efforts.

Over the year, weighted average lending rates slightly rose mainly for businesses in the mining & quarrying, construction and fisheries sectors. Furthermore, household lending rates continued to rise over the month and year mostly for housing loans. The weighted average deposit rate fell over the year as both time and savings deposit rates declined, whilst demand deposit rates slightly rose.

Outlook

The Reserve Bank continues to expect the Tongan economy to recover in the FY2022/23. Imports are projected to increase in line with the economic recovery, while remittance receipts and inflows from donor funds return to pre-pandemic levels. To sustain the ongoing economic recovery, prudent macroeconomic management and effective implementation of structural reforms including supply side measures will be critical. Meanwhile, foreign reserves is expected to remain comfortable above the optimal level of 7.3 months of imports cover, supported by inflows of development assistance for the HTHH reconstruction and implementation of donor projects back on track. Inflation is expected to have peaked in 2022 and is expected to continue declining in the near to medium term. However, uncertainties in the movements of global oil and commodity prices, as well as domestic food supply pose a risk to this outlook. The Reserve Bank February 2023 Monetary Policy Statement prioritized reducing core inflation through monetary policy measures and monitor the movements in global commodity prices to address the underlying inflation concerns to rein in inflation below its 5% reference rate in 2023. The financial system remains stable with available liquidity as credit growth improves. Banks are also well capitalized to absorb further shocks.