



Growth is evident in major economies, but inflation worries are elevated

In its February 2022 MPS, the RBA¹ reported that economic activity resumed strongly in the December 2021 quarter. They anticipate a 5.0% annual growth for 2021 and around 4.3% for 2022. The RBNZ² stated that GDP improved in its February 2022 MPS, noting a projected growth rate of 2.3% for the December 2021 quarter. However, the RBNZ anticipated a 1.3% contraction in growth for 2021. Nevertheless, a rebound in growth of 5.3% is projected for 2022. According to Reuters, the US economy accelerated in the last 2021 quarter, and more so at the beginning of 2022 as COVID-19 related restrictions were lifted. Meanwhile, central banks are unwinding monetary policy stimulus measures in response to heightening inflation worries. The Federal Reserve has indicated its willingness to tighten monetary policy more aggressively as soon as March 2022 to contain inflation. The RBA has also decided to cease further purchases under the bond purchase program in February 2022, while keeping the cash rate target unchanged at 10 basis points. The RBNZ has also increased its official cash rate from 0.75% to 1% in February 2022, while continuing to scale back its monetary stimulus measures.

Mixed performances in the domestic economy

The primary sector performance was slower than the previous month, marking the end of the squash harvesting season. Total agricultural export volumes declined in December 2021 by 54.3% (1,129.6 tonnes) driven by a 100.0% (1,233.1 tonnes) drop in squash exports, and a 87.1% (164.7 tonnes) decline in watermelon exports. Exports of root crops such as cassava, taro, and yams and kava and plantain exports, however, rose during the month, which partially offset the declines in squash and watermelon exports. Over the year to December 2021, total agricultural exports increased by 11.6% (1,163.9 tonnes), reflecting the upturn in squash exports compared to the previous year. Cassava exports also rose over the year by 10.0% (308.4 tonnes), accounting for more than 30% of total agricultural exports. Marine export volumes declined during the month by 65.4% (128.1 metric tons), yet increased over the year by 24.4% (metric tons). This corresponds to the movement in tuna exports, which fell over the month by 126.3% (126.3 metric tons) but rose over the year by 23.7% (279.2 metric tons). Aquarium exports also fell over the month by 56.98% while increasing over the year by 30.7%. In terms of proceeds, agricultural export proceeds rose over the month by 52.3% (\$0.4 million), and over the year by 14.3% (\$0.9 million). Marine export proceeds, however, fell over the month by 50.4% (\$0.2 million), while increasing over the year by 15.5% (\$0.7 million).

The industry sector indicators were mostly positive in December 2021. Lending to the manufacturing, the mining and quarrying, and the construction sectors increased in December by 1.4% (\$0.14 million), 20.9% (\$0.02 million), and 0.2% (\$0.03 million), respectively. New loan commitments for construction and individual housing during the month also support positive growth for the construction sector. Meanwhile, electricity consumption and production rose over the month by 7.0% (0.5 million kWh) and 16.7% (1.0 million kWh), respectively. This is in line with the 0.3% rise in the number of electricity consumers, the Christmas festive seasons, and the warmer summer temperatures. Over the year, electricity production continued to rise by 5.9% (4.2 million kWh), while consumption rose by 6.6% (4.3 million kWh). Electricity consumers also rose by 3.2% (797 consumers) over the year.

More consumer spending is expected for the tertiary sector during the festive season. Container registrations rose by 20.3% (187 containers) in December due to increases in both business and private containers. This coincides with the rise in the number of cargo ships that arrived during the month (3 cargo ships), in addition to the 13.7% (\$4.8 million) increase in payments for imports, excluding oil. Annually, container registrations slightly fell by 2.7% (297 containers), reflecting a marked decline in private containers by 57.8% (2,426 containers). Meanwhile, business containers increased over the year by 32.1% (2,129 containers), corresponding with the 17.9% (\$65.1 million) increase in payments for imports other than oil, which are mostly imports of wholesale and retail goods, motor vehicles, construction materials, and other imported goods mostly for Government. Tourism activities, however, remained stagnant as the international border remains closed.

Fewer vacancies advertised

The number of job vacancies being advertised declined by 42 vacancies (63.6%) in December 2021, according to the Reserve Bank's survey. Majority of the vacancies advertised are for public administration. Annually, job vacancies rose by 22 vacancies (8.7%). The preliminary results of the Population Census 2021 released by the Statistics department states that the total population has declined by 442 people (0.4%) since the last population census in 2016 to 100,029 people. One of the contributing factors to the declining population is the rising number of seasonal workers and people migrating overseas. More Tongans are now participating in the Regional Seasonal Employment (RSE) scheme in New Zealand, and the Seasonal Working Program (SWP) in Australia. This may also contribute to domestic labour shortages, especially in the primary sector and low-skilled labour supply.

December inflation, highest for 2021

The monthly inflation rose by 2.3% in December 2021, owing to imports and local price increases. Higher imported

¹ Reserve Bank of Australia

² Reserve Bank of New Zealand



NATIONAL RESERVE BANK OF TONGA

MONTHLY ECONOMIC REVIEW

Vol. 8

No. 12

Month Ended: December 2021

prices are mainly attributed to an increase in prices of fuels, food items, gas, and other fuels. On the other hand, the rise in prices of food items was the key driver of higher local prices.

Over the year to December, inflation was at its highest for 2021 at 9.3%. This is compared to 0.3% recorded in December 2020. Since the onset of the global pandemic, shocks to global demand and supply were seen in large drops in global oil prices, leading to periods of very low inflation, as Tonga had observed throughout 2020. However, because the global economy is slowly recovering from these shocks, global prices are slowly returning to their pre-pandemic levels hence the higher inflation rates seen in 2021.

Both imported and local prices rose significantly over the year. In December, the primary drivers of high imported prices were fuels, food items, dwelling maintenance and repair, and gas and other fuels. This reflects the ongoing disruptions caused by the global pandemic to global supply chains and logistics, pushing up energy, food, and commodity prices. On the domestic side, higher electricity tariffs and local food prices drove local prices up. The higher electricity prices correspond to the increasing fuel prices, a stark reminder of Tonga's vulnerability to movements in global prices, particularly oil and food prices. 55.1% of Tonga's CPI (Consumer Price Index) basket are imported goods and services, of which 37.6% consist of the Food and Transport (majority of which is fuel) groups. Fuel is a common factor input in most of our domestic production, hence it also contributes to higher domestic prices. The neighboring countries, such as Samoa and Fiji are also experiencing higher inflation levels, as well as Tonga's major source import countries like the US, Australia, and New Zealand.

Major trading currencies depreciated against the TOP

Table 3: Effective Exchange Rates

	Monthly			Annual	
	Dec-21	Nov-21	% Growth	Dec-20	% Growth
Nominal Effective Exchange Rate Index	90.2	89.9	0.2	86.5	4.2
Real Effective Exchange Rate Index	110.5	108.0	2.3	101.2	9.2

Source: National Reserve Bank of Tonga

Over the month, the Nominal Effective Exchange Rate (NEER) rose slightly as most of Tonga's trading partner currencies depreciated against the Tongan Pa'anga (TOP). The Real Effective Exchange Rate (REER) index also

Prices	Monthly		Annual	
	Dec-21	Nov-21	Dec-21	Dec-20
Headline Inflation (%)	2.3	1.3	9.3	0.3
Domestic prices	3.5	0.9	7.9	-0.7
Imported prices	1.3	1.6	10.4	1.2

Source: Tonga Statistics Department

Items (\$ per kg)	Unit	Annual Change		
		Dec-21	Dec-20	Dec-20
Domestic				
Octopus	1kg	\$47.56	\$33.08	\$14.48
Carrots	1kg	\$7.42	\$2.52	\$4.90
Tuna	1kg	\$21.00	\$17.00	\$4.00
Capsicum	1kg	\$10.36	\$6.59	\$3.77
Imported				
Turkey tails	1kg	\$13.56	\$9.72	\$3.84
Petrol	litre	\$3.26	\$2.42	\$0.84
Diesel	litre	\$3.15	\$2.38	\$0.77

Source: Statistics Department

increased in line with the higher inflation rate over the month.

In the year to December 2021, the NEER increased as trading partner currencies generally weakened against the TOP. The REER also increased over the year in line with the higher inflation rate. This implies a loss in Tonga's trade competitiveness.

Foreign reserves surge above \$800 million

Table 4: Foreign Reserves

	Monthly			Annual	
	Dec-21	Nov-21	% Growth	Dec-20	% Growth
Foreign Reserves (\$ in million)	817.5	783.9	4.3	675.6	21.0
Import Coverage (months)	12.7	12.4	2.4	12.5	1.6

Source: National Reserve Bank Tonga

Official foreign reserves edged higher in December 2021 by \$33.6 million to a new record high of \$817.5 million, equivalent to 12.7 months of imports. This was due to inflows of official budget support from international development partners, and remittances. Over the year, foreign reserves also increased substantially by \$141.9 million, supported by higher receipts of budget support, official grants, external debt proceeds, capital inflows, and remittances. The majority of the official foreign reserves are held in USD, AUD, and NZD.

Table 5: Remittance Receipts

	Monthly			Annual		
	Dec-21	Nov-21	% Growth	Dec-21	Dec-20	% Growth
Remittance (\$ in million)	51.9	41.6	24.9	498.1	398.0	25.2

Source: National Reserve Bank Tonga

Remittance receipts peaked in December 2021 as per the usual Christmas festivities. During the month, remittances rose by \$10.4 million (24.9%). This was mainly attributed to the increases in private transfer receipts for the Christmas festivities and the compensation of employees which includes receipts from seasonal workers. Over the year to December 2021, remittances increased by \$100.1 million (25.2%).

The Overseas Exchange Transactions (OET) recorded an overall balance surplus of \$33.6 million in December 2021 compared to the \$26.9 million surplus in November 2021. This stemmed mostly from increases in net transfer receipts and income, offsetting the widening trade and services deficits.

Table 6: Overseas Exchange Transactions

	Monthly			Annual		
	Dec-21	Nov-21	% Growth	Dec-21	Dec-20	% Growth
Overall Balance	33.6	26.9	25.1	141.9	188.1	-24.6
Current Account	26.9	22.3	20.6	73.6	158.2	-53.5
Merchandise Trade	-45.7	-38.5	-18.6	-498.2	-411.0	-21.2
Services	-8.3	-1.3	-534.3	-48.5	-0.5	-9044.5
Income	4.2	3.2	33.4	28.5	17.4	63.7
Transfers	76.7	59.0	30.0	591.8	552.3	7.1
Capital Account	1.2	0.9	30.9	23.9	39.7	-39.7
Financial Account	5.5	3.6	51.3	44.4	-9.7	556.7

Source: Banking Systems



NATIONAL RESERVE BANK OF TONGA

MONTHLY ECONOMIC REVIEW

Vol. 8

No. 12

Month Ended: December 2021

Annually, the OET balance surplus is lower than the previous year by \$46.2 million. Net transfers and financial receipts increased, while higher increases in the net trade and service deficits resulted in a lower surplus.

Very high money supply

Table 7: Broad Money

	Monthly			Annual	
	Dec-21	Nov-21	% Growth	Dec-20	% Growth
Broad money (\$ in million)	821.5	807.2	1.8	707.5	16.1
Net Foreign Asset	798.4	774.1	3.1	705.9	13.1
Net Domestic Asset	24.0	34.0	-29.4	2.4	880.5

Source: Banking System, National Reserve Bank of Tonga

The strong growth in foreign reserves continues to push net foreign assets higher and thus broad money. Over the month and year to December 2021, broad money rose by \$14.4 million (1.8%) and \$114.0 million (16.1%), respectively. Net domestic assets declined during the month, as Government deposits increased from the official funds received to support the Government's budget and projects. Over the year, domestic assets rose as the Government deposits declined from disbursements for the fiscal stimulus package and Tropical Cyclone Harold reconstructions.

Liquidity in the financial system increased

Table 8: Reserve money

	Monthly			Annual	
	Dec-21	Nov-21	% Growth	Dec-20	% Growth
Reserve money (\$ in million)	578.8	558.1	3.7	422.8	36.9

Source: Banking System, National Reserve Bank of Tonga

Liquidity in the financial system rose in December 2021, by \$20.8 million (3.7%) and \$156.0 million (36.9%) annually. Over the month, currency in circulation rose the most, coinciding with the rise in demand for money for the end of year festivities. The Statutory Reserve Deposits (SRD) and Exchange Settlement Accounts also rose, reflecting higher deposits and net sales of foreign currency to the Reserve Bank. Over the year, the Exchange Settlement Accounts increased the most followed by SRD and currency in circulation, reflecting the annual rise in total deposits and annual festivities such as Christmas & New Year celebrations, churches' annual donations, Kava Idol, and the Tonga High School Ex-Students' Fundraising.

Credit growth remains negative while deposits grow

Table 9: Total Lending

Lending	Monthly			Annual	
	Dec-21	Nov-21	% Growth	Dec-20	% Growth
Total Lending (\$ in million)	472.1	474.2	-0.5	495.4	-4.7
Business lending	214.9	215.9	-0.5	236.3	-9.1
Household lending	256.9	258.1	-0.4	259.1	-0.8
Other lending	0.2	0.2	-4.3	0.0	0.0

Source: Banking System, National Reserve Bank of Tonga

The banks' total lending declined by \$2.3 million (0.5%) and \$23.4 million (4.7%) over the month and year to December 2021, respectively. Over the month, lending to public enterprises and businesses within the professional & other services, agricultural, and distribution sectors declined. Household housing and other personal loans also fell during the month. Annually, loans offered to public enterprises fell

again and similarly for loans to the private sector, mainly professional and other services, construction, and agricultural loans. Household loans also declined, led by lower housing loans, followed by other personal, and vehicle loans. The slow down in credit growth also reflects loan repayments made.

In December 2021, the banks' total deposits increased by \$7.2 million (0.9%), while total loans continued to decline. This narrowed the loans to deposit ratio further from 56.6% in November 2021 to 55.8%, thus remaining below the 80% minimum.

Weighted average interest rate spread widened

Table 10: Weighted Average Interest Rates

Interest Rates	Monthly			Annual	
	Dec-21	Nov-21	(bps)	Dec-20	(bps)
Weighted Average Banks Deposit Rate (%)	1.724	1.769	-4.6	1.982	-25.9
Weighted Average Banks Lending Rate (%)	7.838	7.837	0.15	7.681	15.7
Weighted Average Interest Rate Spread (%)	6.115	6.067	4.7	5.699	41.6

Source: Banking System, National Reserve Bank of Tonga

The weighted average interest rate spread widened further to 6.11% in December 2021. The rise over the month and year are attributed to the lower weighted average deposit rates coupled with the higher weighted average lending rates. Deposit rates for all types of deposits declined over the month and year, led by time, saving, and demand deposit rates. The accumulation of deposits over the year also contributes to the lower weighted average deposit rates. On the other hand, higher lending rates over the month were mainly for businesses in the transport, construction, and distribution sectors, as well as household vehicle loan rates. Similarly, lending rates offered to non-profit organisations and businesses in the utilities, construction, and distribution sectors increased over the year. Housing and vehicle loan rates for households also increased annually.

Outlook

The global economic recovery is uneven, while geopolitical tensions worsen the inflation outlook. According to the World Bank's GRADE report, the Hunga Tonga Hunga Ha'apai (HTHH) volcanic eruption and tsunami left an estimated \$209 million in economic damages. The HTHH event left severe damages to the agricultural and fisheries sectors, residential and non-residential buildings, infrastructures, the submarine fibre cables, and a significant clean-up cost to businesses from the ashfall. Following the HTHH event, Tonga also recorded its first community outbreak of the Omicron variant. Red alert national lockdowns and curfews were imposed in Tongatapu for the most part of February before upgrading to orange alert. Meanwhile, positive cases keep rising daily, with at least 2 casualties reported so far. Thanks to the successful vaccination rollout now at 98% of the eligible population, the severity of the virus is mild so far. At this point, it is still unclear when this outbreak will end. These lockdowns hinder the recovery efforts for the HTHH event, while economic activities subside, particularly for the private sector.



NATIONAL RESERVE BANK OF TONGA

MONTHLY ECONOMIC REVIEW

Vol. 8

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Month Ended: December 2021

In light of these developments, the Reserve Bank is now projecting a contraction in GDP growth for FY2021/22, in contrast to its previous forecast of a slow recovery. Inflation is anticipated to remain above the 5% reference rate for the most of 2022. Foreign reserves will continue to increase and stay well above the minimum of 3 months of import cover due to the expected inflow of budget support, relief funds, aid, grants, and private remittances triggered by the HTHH disaster. The extended national lockdown have impacted businesses through reduced operating hours, and

lower take home pay for employees from lost employment or fewer working hours, this may result in higher non-performing loans that could weaken the stability of the financial system. Nevertheless, the Reserve Bank maintains its accommodative monetary policy stance in support of economic recovery. At the same time, it remains vigilant in closely monitoring financial and economic developments, internally and externally, and regularly reviews its monetary policy settings continues to maintain the stability of the financial system.