



Major trading partners recorded growth but could falter again under Covid-19

The U.S Bureau of Economic Analysis reported that personal income rose 1.1% in July 2021, attributed mainly to the rise in government social benefits and compensation of employees. Additionally, the monthly international trade deficit decreased by 4.2% in July 2021 as exports increased and imports decreased. According to the Australia Bureau of Statistics, the unemployment rate lowered by 0.3% to 4.6% in July 2021. A trade surplus was recorded during the month despite the 2.7% fall in retail sales due to the COVID-19 restrictions in multiple states. Meanwhile, the NZ activity index rose by 5.4% in July 2021 compared to a year ago as recorded by the NZ Treasury. This was driven by growth in online job advertisements, falling jobseeker numbers, and increase in electronic card transaction activity. However, both Australia and New Zealand expects a contraction in economic activities in the September quarter because of the delta variant outbreak and prolonged lockdown in various parts of the country.

General slowdown in domestic economic activities

Primary sector's performance declined during the month. Total agricultural export volumes decreased by 161.5 tonnes (18.2%) due to fall in the exports of root crops, indicating the end of the harvesting season and seasonality of these crops. Lower agricultural export volume coincided with the fall in the agricultural export proceeds by \$0.2 million (39.6%). Fisheries sector is still impacted by the extended lockdown of borders due to setback of exports via cargo. The high freight costs and disruptions to flight schedules affect the ability of businesses within the sector to export their products.

Indicators for secondary sector performance slowed in July 2021. Loans extended to industries, mostly the construction and manufacturing sectors fell during the month, by \$1.0 million (5.0%), and \$0.2m (1.5%) respectively. However, the sectoral growth is still supported by local projects including the \$2 million pa'anga Fungalelea Business Complex, and the new twin buildings for Queen Salote College that were commissioned during the month, the Tonga High School new library & hall project, and the US\$2 million grant for disaster management equipment under Japan's Non-Project Grant Aid that were received during the month. Tonga Electricity Commission announced a 10.5% increase in the price of electricity over the month, largely driven by higher diesel prices. However, electricity production and consumption rose during the month by 0.3 million kilowatt (5.5%) and 0.7 million kilowatt (13.9%) respectively. Electricity consumers also increased over the month by 58 consumers (0.2%).

The service sector continued to slow down, reflecting the extended COVID-19 restrictions due to outbreak of new variants in the neighboring countries. Total container registrations fell in July by 486 containers (49.4%),

coinciding with lower import payments excluding oil during the month by \$2.3 million (5.9%). The redirecting of ships that transit in Fiji before arriving Tonga also contributed to the lower number of cargo ships as well as containers arriving to Tonga. Annually, the container registrations and import payments excluding oil rose by 444 containers (4.0%) and \$77.2 million (22.9%) respectively. Additionally, the prolonged lockdown of borders and renewal of Tonga State of Emergency for another month continued to affect tourism related-sectors. Businesses that relied on tourists, such as handcrafters, continue to be heavily affected and even few have been driven out of the market. Although accommodation and food services, and arts & entertainment and recreation were supported by local activities such as the Tourism Industry & Cultural Festival Week, their performances are still considerably low. Four repatriation flights were scheduled for July 2021, however, 3 flights were delayed and only one flight arrived in Tonga from New Zealand. Consequently, international arrival passengers fell over the month by 353 passengers (69.9%). However, travel receipts rose by \$0.1m (5.6%), largely driven by credit card transactions. Over the year to July 2021, international arrival passengers and travel receipts dropped by 65,743 (95.8%) passengers and \$74.3 million (78.3%) respectively.

Slight increase in job advertisements

The NRBT's survey showed 22 job vacancies advertised in July 2021 mainly in the public administration sector, slightly higher than previous month by 5%. Annually, the number of job vacancies advertised declined by 69.3% (386 job vacancies).

Temporary inflationary hike for Tonga

Prices	Monthly		Annual	
	Jul-21	Jun-21	Jul-21	Jul-20
Headline Inflation (%)	0.3	0.9	6.8	-1.1
Domestic prices	0.9	1.0	5.7	-2.3
Imported prices	-0.1	0.9	7.6	-0.1

Source: Statistics Department

In July 2021, the monthly inflation rose by 0.3%, mainly driven by higher local prices. This increase was largely owing to higher prices of electricity. On the other hand, imported prices fell over the month, primarily due to fall in the imported prices of gas and other fuels.

The annual inflation rate was 6.8% in July 2021, compared to 6.9% in June 2021, and an annual deflation in July 2020. Higher local and imported prices both

Items (\$ per kg)	Unit	Jul-21	Jul-20	Annual Change
Domestic				
Capsicum	1kg	\$19.93	\$13.95	\$5.98
Octopus	1kg	\$16.80	\$11.78	\$5.02
Tomatoes	1kg	\$11.15	\$6.52	\$4.63
Tuna	1kg	\$19.50	\$17.00	\$2.50
Imported				
Turkey tails	1kg	\$12.28	\$8.99	\$3.29
Petrol	litre	\$2.92	\$2.18	\$0.74
Diesel	litre	\$2.83	\$2.25	\$0.58

Source: Statistics Department

contributed to the higher annual inflation rate. Imported prices were driven by the higher global oil prices, food and construction materials. Higher prices of electricity, food items and clothing increased the local prices. The NRBT



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forecasts the annual inflation to remain above the reference rate in the medium term, largely driven by the disruptions to supply chain due to outbreak of COVID-19 variants. However, headline inflation is expected to fall below the reference rate by early 2022 once global market prices normalize.

Lower effective exchange rates

Table 3: Effective Exchange Rates

	Monthly			Annual	
	Jul-21	Jun-21	Growth	Jul-20	% Growth
Nominal Effective Exchange Rate Index	89.2	89.4	-0.3	91.2	-2.2
Real Effective Exchange Rate Index	107.0	107.1	-0.1	104.7	2.2

Source: National Reserve Bank of Tonga

The Nominal Effective Exchange Rate (NEER) slightly fell in July 2021 as most of Tonga's trading currencies appreciated against the Tongan Pa'anga (TOP) over the month. Similarly, the Real Effective Exchange Rate (REER) index declined also over the month.

In year ended terms, the NEER fell as trading partners' currencies strengthened against the Tongan Pa'anga. However, the REER increased over the year indicating a loss in Tonga's trade competitiveness due to higher local prices.

Foreign reserves declined in July

Table 4: Foreign Reserves

	Monthly			Annual	
	Jul-21	Jun-21	(bps)	Jul-20	% Growth
Foreign Reserves (\$ in million)	704.8	715.2	-1.5	555.9	28.7
Import Coverage (months)	12.3	12.5	-1.6	9.6	28.1

Source: National Reserve Bank Tonga

Official foreign reserves fell over the month of July 2021 by \$10.5 million to \$704.8 million, equivalent to 12.3 months of imports. This was attributed to large payments for import of oil and other goods & services. In the year to July 2021, foreign reserves still increased substantially by \$148.8 million underpinned by receipts of budget support, project funds, and remittances. Majority of the official foreign reserves are held in USD, AUD, and NZD.

Table 5: Remittance Receipts

	Monthly			Annual		
	Jul-21	Jun-21	% Growth	Jul-21	Jul-20	%
Remittance (\$ in million)	41.9	37.6	-12.0	465.5	356.1	30.7

Source: National Reserve Bank Tonga

Remittances receipts increased over the month by \$4.2 million (11.2%) to \$41.9 million, mainly driven by higher private transfers which are mostly family support and monetary gifts. Over the year to July 2021, remittances continued to increase firmly by \$109.4 million. This was underpinned by higher private transfers, and compensation of employees mostly from seasonal workers.

Table 6: Overseas Exchange Transactions

	Monthly			Annual		
	Jul-21	Jun-21	% Growth	Jul-21	Jul-20	% Growth
Overall Balance	-10.5	25.7	-140.8	148.8	63.0	136.2
Current Account	-9.2	21.9	-142.1	122.5	57.0	115.0
Merchandise Trade	-46.6	-41.4	-12.7	-467.4	-399.1	-17.1
Services	-4.7	-3.0	-57.7	-29.4	12.5	-336.3
Income	3.7	-10.1	137.0	23.2	7.0	232.8
Transfers	38.4	76.3	-49.8	596.2	436.7	36.5
Capital Account	0.6	2.7	-76.8	39.9	23.6	69.1
Financial Account	-1.9	1.1	-269.9	-13.6	-17.5	-22.5

Source: Banking Systems

The Overseas Exchange Transactions (OET) overall balance recorded a \$10.5 deficit million in July 2021 compared to the \$25.7 million surplus in June 2021. This stemmed from declines in all of the accounts, particularly the deficit in the current account from lower official transfer receipts.

Annually, the OET balance surplus still expanded strongly by \$85.8 million supported by higher official grants, budget support and remittance receipts.

Broad money rose

Table 7: Broad Money

	Monthly			Annual	
	Jul-21	Jun-21	% Growth	Jul-20	% Growth
Broad money (\$ in million)	769.7	764.9	0.6	616.9	24.8
Net Foreign Asset	740.2	750.7	-1.4	579.0	27.9
Net Domestic Asset	30.3	15.0	102.2	38.4	-21.2

Source: Banking System, National Reserve Bank of Tonga

In July 2021, broad money increased to \$769.7 million, by \$4.8 million (0.6%) over the month and \$152.8 million (24.8%) annually. The net domestic assets grew over the month, underpinned by higher net credit to central government mainly on lower government deposits. This outweighed the decline in net foreign assets as foreign reserves decreased over the month. Over the year, the net foreign assets rose which offset the decline in net domestic assets. Higher net foreign assets is in line with the substantial annual rise in foreign reserves. The lower net domestic assets was attributed mainly to lower credit to public enterprises as well as lower net claim on the central government due to higher government deposits.

Liquidity in the financial system declined

Table 8: Reserve money

	Monthly			Annual	
	Jul-21	Jun-21	% Growth	Jul-20	% Growth
Reserve money (\$ in million)	504.0	513.4	-1.8	332.2	51.7

Source: Banking System, National Reserve Bank of Tonga

Liquidity in the financial system decreased over the month by \$9.4 million (1.8%). The commercial bank's ESA declined over the month from net sales of foreign currencies to the Reserve Bank and net withdrawals from the Reserve Bank vault. This offset the rise in both required reserves and currency in circulation which corresponded to the increase in total deposits and the festivities during the month. However, higher liquidity over the year to July 2021 by \$171.8 million (22.0%) was mostly driven by the bank's



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ESA, mainly on higher government deposits. Currency in circulation followed, in line with the festivities during the year, such as the churches annual donations, Easter and family Sundays', Christmas and New Year festivities, Kava Idol, and the Tonga High School Ex-Students' Fundraising. Required reserves also increased, corresponding to the rise in total deposits.

Credit growth remains subdued

Table 9: Total Lending

Lending	Jul-21	Monthly		Annual	
		Jun-21	% Growth	Jul-20	% Growth
Total Lending (\$ in million)	481.6	482.4	-0.2	490.4	-1.8
Business lending	223.2	223.3	-0.1	231.5	-3.6
Household lending	258.1	258.7	-0.2	258.9	-0.3
Other lending	0.4	0.4	-9.7	0.0	0.0

Source: Banking System, National Reserve Bank of Tonga

The bank's total lending declined further over the month and year to July 2021, by \$0.8 million (0.2%) and \$8.8 million (1.8%) respectively. Both declines were attributed to lower household and business loans as a result of ongoing loan run-offs and repayments made by household and public enterprises, offsetting the few lending opportunities to other private businesses. Declines in lending to businesses in the constructions, professional & other services, and manufacturing sectors led to the monthly fall as well as the annual decline in business lending. Households' housing loan decreased over the month whilst vehicle and other personal loan declined also over the year.

In July 2021, the banks' total deposits decreased by \$13.4 million (1.7%) to \$786.6 million as demand and time deposits fell over the month. The decrease in total deposits was more than the decline in total lending which resulted in a 59.8% loan to deposit ratio in July 2021, an increase from 58.9% last month, however, still below the 80% minimum.

Weighted average interest rate spread narrowed

Table 10: Weighted Average Interest Rates

Interest Rates	Jul-21	Monthly		Annual	
		Jun-21	Growth	Jul-20	Growth
Weighted Average Banks Deposit Rate (%)	1.884	1.844	4.0	2.137	-25.3
Weighted Average Banks Lending Rate (%)	7.752	7.737	1.52	7.793	-4.1
Weighted Average Interest Rate Spread (%)	5.868	5.893	-2.5	5.656	21.2

Source: Banking System, National Reserve Bank of Tonga

The weighted average interest rate spread narrowed over the month by 2.5 basis points. This resulted from the weighted average deposit rates rising more than the rise in weighted average lending rates. The higher deposit rates was solely driven by increased demand deposit rates outweighing the declined saving and time deposits rates. Lending rates offered to businesses in the professional & other services and constructions increased, as well as household housing and vehicle loans.

However, over the year, the weighted average interest rates widened by 21.2 basis points to 5.87%. The weighted average deposit rates decreased more than the fall in weighted average lending rates. All deposit rates fell, while business loan rates for constructions, utilities and agricultural sectors also declined. The lower household other personal loan rates also supported the annual decline.

Outlook

On the outlook, foreign reserves is expected to remain at comfortable levels above the minimum of 3 months of import cover. Though inflation is forecasted to remain above the Reserve Bank's reference rate of 5% in 2021, it is deemed transitory and is expected to fall below 5% in January 2022. The banking system is still expected to remain sound despite the slowdown in credit growth. Therefore, the Reserve Bank's monetary policy stance remains accommodative. The Reserve Bank will continue to monitor emerging risks prompted by uncertainties surrounding the COVID-19 pandemic, impacting economic growth and potentially impairing financial stability. The Reserve Bank remains vigilant in its regulatory and supervisory roles to ensure that financial stability is maintained while support economic recovery.