



### Global shipping costs soared amidst elevated inflation

A new IMF working paper on (Shipping Costs and Inflation) implies longer inflationary pressures stretching throughout 2022 due to the prolonging sea cargo crisis and associated higher shipping costs. Geopolitical tensions such as the Russo-Ukrainian war, are also raising more concerns about the global oil supply, and its likely impact on the global oil and commodities prices. The US Bureau of Labour Statistics recorded a 7.5% annual inflation in January 2022, the highest since February 1982, largely attributed to food and energy prices increasing by 7.0% and 27.0% respectively. Similarly, the RBA<sup>1</sup> projects inflation increasing further over the coming quarters due to increasing food and other commodities prices. Nevertheless, high job demands and the pick-up in spending and business investment are reflective of Australia's economic recovery. Businesses in New Zealand on the other hand, continue to be affected by the ongoing global supply disruptions. Vaccine passes have been scrapped for several businesses however, the geopolitical tensions, prolonged pandemic, and high shipping costs will continue to affect global supply chains.

### Natural disasters further derails recovery

The Hunga Tonga Hunga Ha'apai (HTHH) volcanic eruption and tsunami on 15<sup>th</sup> January 2022 caused severe damage to the primary sector. The tsunami inundation wiped out plantations on lowing lying areas of Tongatapu, whereas the ashfall covered almost all of Tongatapu, 'Eua, and Ha'apai. Agricultural export volumes markedly dropped in January 2022 by 754.5 tonnes (79.3%), coinciding with the \$0.7 million (64.7%) decline in proceeds. Most of the exported root crops declined particularly cassava and taro which fell by 283.5 tonnes (74.2%) and 244.1 tonnes (85.6%) respectively. However, agricultural export volumes still increased annually by 1,012.4 tonnes (10.1%) in line with the \$0.5 million increase in export proceeds.

The secondary sector also sustained major damages to electricity and water supplies mostly from the ashfall. Construction projects were also disrupted and delayed from the disaster. However, damages to residential and non-residential buildings around the seaside and the smaller islands were catastrophic and will require significant rebuilding and repairs. Lending to the construction sector rose by \$2.0 million (12.6%), while loans for utilities and manufacturing declined by \$0.02 million (3.7%) and \$0.1 million (1.0%) respectively.

In addition to the impacts of the Covid-19 travel restrictions, the tertiary sector is also faced with the significant challenges of the HTHH disaster. The volcanic eruption severed the undersea fibre optic cables cutting off international communications while local communications were very limited. Many of the tourism businesses in

Tongatapu were destroyed by the tsunami, while the internet outage largely disrupted communications, business operations, trade, and remittance flows. Many businesses also undertook significant clean-up costs before they can resume operations. As a result container registrations fell in January 2022 by 446 containers (41.3%), attributed to lower business and private containers. The number of cargo ships that arrived also declined by 4 ships. Additionally, the decrease in container registrations coincided with the lower import payments excluding oil which declined by 46.4% (\$18.4 million). Annually, container registrations decreased by 585 containers (5.4%), mainly driven by a 62.3% (2,610 containers) decline in private containers. Business containers, on the other hand, rose by 2,025 containers (30.3%), partially offsetting the decline in private containers. However, import payments excluding oil rose by \$52.2 million (14.1%) over the year, reflective of the higher freight and shipping costs and higher imported inflation.

### Job opportunities continue to decline in January 2022

The Reserve Bank's survey showed a decline in the job vacancies advertised during the month by 14 vacancies (58.3%), however, it should be noted that the HTHH volcanic eruption affected the availability of online news for the update of the job advertisements survey. The majority of the job vacancies advertised during the month were in public administration. Annually, job vacancies rose by 129 vacancies (57.1%).

### Inflation pressure remains

Headline inflation slightly declined by 0.3% in January

Table 1: Inflation Rates

Prices	Monthly		Annual	
	Jan-22	Dec-21	Jan-22	Jan-21
Headline Inflation (%)	-0.3	2.3	8.2	1.3
Domestic prices	-0.8	3.5	6.2	0.7
Imported prices	0.1	1.3	9.7	1.8

Source: Tonga Statistics Department

after rising for 7 consecutive months since June 2021. This is owed to lower domestic prices from food items and kava reflecting the harvesting seasons. This outweighed the slight rise in imported prices mostly for dwelling maintenance and repair.

Annually, headline inflation continued to exceed the 5% reference rate at 8.2%. This stemmed from higher imported and domestic prices, each contributing 5.4 and 2.8 percentage points respectively to the headline inflation. Increasing prices for fuel, food, and

Table 2: Average annual prices of selected items

Items (\$ per kg)	Unit	Jan-22	Jan-21	Annual Change
<b>Domestic</b>				
Octopus	1kg	\$37.90	\$29.13	\$8.77
Capsicum	1kg	\$17.44	\$9.85	\$7.59
Tuna	1kg	\$21.00	\$17.00	\$4.00
Lu	1kg	\$9.26	\$5.60	\$3.66
<b>Imported</b>				
Turkey tails	1kg	\$14.08	\$10.34	\$3.74
Chicken pieces	1kg	\$4.26	\$3.42	\$0.84
Apples	1kg	\$6.11	\$5.40	\$0.71

Source: Statistics Department

<sup>1</sup> Reserve Bank of Australia



# NATIONAL RESERVE BANK OF TONGA

## MONTHLY ECONOMIC REVIEW

Vol. 9

No. 1

Month Ended: January 2022

household goods drove the higher imported prices. Meanwhile, increasing prices for local food items and electricity are the main contributors to the rising domestic prices. The surging shipping costs, fuel prices, and imported inflation from our trading partners directly impact import prices and pass-through to domestic producer prices.

### Higher effective exchange rates

Table 3: Effective Exchange Rates

	Monthly			Annual	
	Jan-22	Dec-21	% Growth	Jan-21	% Growth
Nominal Effective Exchange Rate Index	90.7	90.2	0.6	85.7	5.9
Real Effective Exchange Rate Index	110.1	108.5	1.5	99.9	10.3

Source: National Reserve Bank of Tonga

The Nominal Effective Exchange Rate (NEER) rose slightly over the month, which is attributed to the general weakening of the AUD, NZD, and FJD against the TOP. The Real Effective Exchange Rate (REER) index also increased over the month in line with Tonga's higher inflation rate.

In year ended terms, the NEER still increased as trading partners' currencies weakened against the TOP, neutralising some of the imported inflation. The REER increased also over the year in line with our higher inflation rate compared to our trading partner countries, indicating a loss in trade competitiveness.

### Strong international support in response to the HTHH disaster

Table 4: Foreign Reserves

	Monthly			Annual	
	Jan-22	Dec-21	%Growth	Jan-21	% Growth
Foreign Reserves (\$ in million)	856.1	817.5	4.7	705.3	21.4
Import Coverage (months)	13.2	12.7	3.9	13.6	-2.9

Source: National Reserve Bank Tonga

Official foreign reserves increased significantly in January 2022 by \$38.6 million to \$856.1 million, equivalent to 13.2 months of import cover. This reflected the inflow of emergency relief funding from development partners in support of the country's recovery from the HTHH volcanic eruption.

Over the year, foreign reserves continued to increase substantially by \$150.8 million supported by higher receipts of budget support, official grants, capital inflows, and remittances. The majority of the official foreign reserves are held in USD, AUD, and NZD.

Table 5: Remittance Receipts

	Monthly			Annual		
	Jan-22	Dec-21	% Growth	Jan-22	Jan-21	% Growth
Remittance (\$ in million)	29.1	51.9	-44.1	494.8	403.2	22.7

Source: National Reserve Bank Tonga

The internet outage significantly impacted remittance flows as shown by the sharp decrease in January 2022 of \$22.9 million (44.1%), following the peak in December. However, remittances continued to rise over the year to January 2022

by \$91.6 million (22.7%) stemming from higher private transfers, compensation of employees, and private capital transfers.

Table 6: Overseas Exchange Transactions

	Monthly			Annual		
	Jan-22	Dec-21	% Growth	Jan-22	Jan-21	% Growth
Overall Balance	38.6	33.6	14.9	150.8	222.4	-32.2
Current Account	42.3	26.9	57.0	97.6	184.9	-47.2
Merchandise Trade	-28.7	-45.7	37.2	-490.2	-412.9	-18.7
Services	-2.5	-8.3	70.4	-48.9	-7.5	-551.4
Income	2.4	4.2	-43.1	27.6	22.0	25.2
Transfers	71.1	76.7	-7.3	609.2	583.3	4.4
Capital Account	0.5	1.2	-57.0	21.0	41.1	-49.1
Financial Account	-4.2	5.5	-176.8	32.2	-3.7	981.9

Source: Banking Systems

Overall, Overseas Exchange Transactions (OET) recorded an overall surplus of \$38.6 million in January 2022, 14.9% higher than the previous month. This reflects the improvement in the trade deficit from a sharp drop in import payments due to the disruptions from the internet outage.

In the year to January 2022, the OET balance surplus was lower by \$71.6 million as the surpluses in the current and capital account narrowed. The trade deficit widened from higher import payments, and lower net service receipts.

### Broad money expanded

Table 7: Broad Money

	Monthly			Annual	
	Jan-22	Dec-21	% Growth	Jan-21	% Growth
Broad money (\$ in million)	832.8	821.5	1.4	706.9	17.8
Net Foreign Asset	844.4	798.4	5.8	735.1	14.9
Net Domestic Asset	-10.7	24.0	-144.7	-27.3	-60.8

Source: Banking System, National Reserve Bank of Tonga

Broad money increased further in January 2022, by \$11.3 million (1.4%) over the month and \$125.8 million (17.8%) annually. Both rises are attributed to the increasing net foreign assets from the rising foreign reserves. Net domestic assets, however, declined over the month as government deposits increased. Over the year, net domestic assets increased due to the higher capital and other assets.

### Disrupted Financial services

Table 8: Reserve money

	Monthly			Annual	
	Jan-22	Dec-21	% Growth	Jan-21	% Growth
Reserve money (\$ in million)	576.6	578.8	-0.4	424.9	35.7

Source: Banking System, National Reserve Bank of Tonga

The internet outage also disrupted financial activities with a slight decline of \$2.3 million (0.4%) recorded in liquidity in January. This was mostly from a drop in currency in circulation in line with the shock to economic activities.

Over the year, however, liquidity still rose by \$151.6 million (35.7%). Exchange Settlement Accounts rose the most corresponding to the increase in sales of foreign currency from the commercial banks to the Reserve Bank. Currency in circulation followed, reflecting higher demand for cash. Statutory Reserve Deposits also rose in line with the annual rise in deposit volumes.



### Slight uptick in credit growth over the month

Table 9: Total Lending

Lending	Monthly			Annual	
	Jan-22	Dec-21	% Growth	Jan-21	% Growth
Total Lending (\$ in million)	473.9	472.1	0.4	494.5	-4.2
Business lending	216.0	214.9	0.5	236.4	-8.6
Household lending	256.3	256.9	-0.3	258.1	-0.7
Other lending	1.7	0.2	660.5	0.0	0.0

Source: Banking System, National Reserve Bank of Tonga

The banks' total lending increased in January 2022 by \$1.9 million (0.4%). The monthly rise was underpinned by increasing business loans mainly in the construction, professional & other services, and transport sectors. Over the year, credit growth still declined by \$20.6 million (4.2%) as both business and household loans declined. This was mostly from a decrease in loans to public enterprises and businesses in the professional & other services, constructions, and agriculture sectors. This corresponds to the slow economic activities and the prolonged pandemic-related uncertainties.

In January 2022, the banks' total deposits increased by \$5.1 million (0.6%) and outweighed the rise in total loans. This reduced the loans to deposit ratio to 55.7%, thus remaining below the 80% minimum.

### Weighted average interest rate spread widened

Table 10: Weighted Average Interest Rates

Interest Rates	Monthly			Annual	
	Jan-22	Dec-21	(bps)	Jan-21	(bps)
Weighted Average Banks Deposit Rate (%)	1.710	1.724	-1.4	1.982	-27.2
Weighted Average Banks Lending Rate (%)	7.840	7.838	0.15	7.681	15.8
Weighted Average Interest Rate Spread (%)	6.130	6.115	1.5	5.699	43.1

Source: Banking System, National Reserve Bank of Tonga

The weighted average interest rate spread widened over the month and year to January 2022 by 1.5 basis points and 43.1 basis points respectively, to 6.13%. The higher spread reflects the declining deposit rates whilst lending rates increased. All deposit rates declined over the month and year corresponding to the rising volume of deposits. On the other hand, the rise in lending rates over the month was mostly from interest rates on loans to businesses within the manufacturing, utilities, and professional & other services sectors. Over the year, higher lending rates were offered to non-profit organizations, businesses, and households.

### Outlook

The Tongan economy is facing multiple challenges both domestically and externally. The HTHH volcanic eruption and tsunami, and the Omicron community outbreak in early 2022 will have significant impacts on domestic activities and economic growth. This comes at a time of elevated inflationary pressures from ongoing global supply chain disruptions, higher shipping rates, and geopolitical tensions between advanced economies. Risks to the outlook are tilted to the downside as uncertainties remain high and global prospects worsen.

The Reserve Bank expects these events to further derail economic recovery and GDP growth to contract again in FY2021-22. Inflation is projected to remain above the 5% reference throughout 2022, and will ease once the global disruptions subside and the aggressive monetary policy of advanced economies take effect. 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 in response to the HTHH disaster. The stringent Covid-19 restrictions negatively impact business operations, employment, and income. Borrowers who were directly affected by the HTHH disaster and Covid-19 restrictions may also risk defaulting on their loans, however, the financial system is still sound supported by high liquidity and adequate capital.

Against this background, the Reserve Bank acknowledges that the country is facing extraordinary challenges. With regards to inflation, the Reserve Bank notes that these pressures are supply-driven and are beyond its control. Our major trading partner countries are already fighting inflation through the tightening of their monetary policies which will flow through in import prices to Tonga's inflation. The Reserve Bank adopts a wait-and-see approach on these actions to take effect, and will stand ready to realign its monetary policy should inflation continue to increase unsustainably. At the same time, the accommodative monetary policy stance will continue to facilitate the expansionary fiscal stance and support economic recovery.