



Major trading partners' growth at a highly uncertain moment

The IMF World Economic Outlook for April 2023, revised its global output growth for 2023 downwards by 0.1 percentage points to 2.8%. The revised outlook was largely due to cumulative effects of adverse shocks from the past three years resulting in pent-up demand, lingering supply disruptions, commodity price spikes, and inflation reaching multidecade highs in many economies leading to aggressive monetary policies. Global headline inflation was projected to decline from 8.7% in 2022 to 7.0% in 2023 and 76 percent of economies are expecting to experience lower headline inflation in 2023. The projected disinflation reflects declining fuel and nonfuel commodity prices as well as the expected cooling effects of monetary tightening on economic activity. The US and Australia's economies are expected to slow down in 2023 by 1.6%. However, Australia is expected to slightly increase to 1.7% in 2024 while US is to fall further to 1.1%. Australia's annual inflation eased to 6.8% in February 2023 hence the Reserve Bank left its official cash rate unchanged at 3.6% in April 2023. New Zealand's growth is expected to remain lower in 2024 by 0.8% while annual average inflation is projected to decline by 5.5% in 2023 and further decreased to 2.6% in 2024. However, unemployment rate is anticipated to rise by 4.3% this year and further rise to 5.3% in 2024.

Domestic activities mostly trending upward

Activities in the primary sector took an upturn in February 2023. The agricultural exports rose by 51.1 tonnes (12.9%), attributed to higher exports of root crops particularly cassava and yam. Coincidentally, the agricultural export proceeds also recorded an increase over the month of \$0.3 million (127.3%). Meanwhile, marine exports also rose by 2.6 metric tonnes (0.9%) along with an increase in aquarium exports as well by 4,471 pieces (99.8%). Marine export proceeds also rose by \$0.3 million (217.8%) in February 2023. Additionally, according to the monthly survey by the Ministry of Fisheries at the local markets, the marine products also rose over the month by 0.7 metric tonnes (22.2%).

The secondary sector continued to show positive signs with increase in credit to the industrial sector and infrastructure funded projects. In February 2023, lending to the utilities and construction sectors rose by \$0.1 million (27.7%) and \$0.7 million (3.4%) respectively, coinciding with the slight increase in lending to the mining & quarrying sector. At the same time, the housing reconstructions are progressing well, along with the ongoing projects funded under Tonga Renewable Energy project (TREP). This includes the new solar system and hospital waste incinerator in 'Eua, and new solar plant and battery energy storage system in Vava'u.

Indicators in the tertiary sector however continued to trend downward over the month. The passenger arrivals declined by 26.0% (1,852 passengers) in February 2023 after strong growths in December and January, while the passenger departures fell by 33.2% (3,131 passengers). Coincidentally,

the travel receipts decreased by \$4.3 million (37.0%). Meanwhile, container registrations also recorded a decline of 2.4% (19 containers). This is attributed mainly to lower business containers, coinciding with the \$1.7 million (6.9%) decline in payment for wholesale and retail imports over the month. On the upside, the return of the MV 'Otuanga'ofa is anticipated to improve inter-island transportation and facilitate the movement of goods and services for both public and private projects. Meanwhile, vehicle registrations fell by 63 vehicles (22.9%).

Fewer job vacancies advertised over the month

The Reserve Bank's survey showed a lower number of vacancies advertised over the month by 46.1% (53 job vacancies). The total job vacancies advertised during the month was attributed mostly to the public administration, transport & communications, and education sector. At annual rate, the advertised job vacancies substantially rose by 183.0% (593 job vacancies). This may be indicative of the impact of the labour mobility schemes which remains a challenge to the domestic employers. Nevertheless, according to Tonga Labour Mobility Supply Management Strategy (TLMSMS), skill shortages is a major contributor to the labour challenges faced by the employers, along with permanent migration.

Inflation jumped to 9.4% in March 2023

Table 1: Inflation Rates

Prices	Monthly		Annual	
	Mar-23	Feb-23	Mar-23	Mar-22
Headline Inflation (%)	0.9	1.0	9.4	7.8
Domestic prices	0.8	1.1	12.7	6.9
Imported prices	0.9	1.0	6.9	8.6
Core inflation - ex. energy and food (%)	0.1	0.1	7.9	2.5

Source: Tonga Statistics Department

Consumer Price Index further increased over the month by 0.9%, attributed to higher prices of imported and domestic items. Imported prices were compounded by higher prices for imported food items, fuels, alcoholic beverages, household items (detergent and mosquito coil), and goods for personal care. Meanwhile, construction materials recorded its first decline since December 2020, indicative of the developments in global supply and demand. On the other hand, the monthly rise in domestic prices is attributed largely to local food items, alcoholic beverages, tobacco, and construction labour cost. The higher labour cost moves in line with the increased cost of living and the higher demand for reconstruction that is currently underway in Tonga.

The headline inflation jumped to 9.4% in March 2023, driven by the monthly increase in both domestic and imported prices and the base effect as the headline inflation in March 2022 was the lowest rate in 2022 at 7.8%. Domestic prices contributed 5.6% to the headline inflation, primarily driven by local food items, local transport services, electricity tariff, catering services (takeaway food), secondary school tuition fees, and labour cost. The broadened inflationary pressure is proved to be more persistent than anticipated. On the other hand, the imported inflation contributed 3.8% to the headline inflation. The main contributors were imported



food items, construction materials, fuels, goods for personal care, and alcoholic beverages. Meanwhile, the lower prices of liquefied petroleum gas and clothing over the year offset some of the increases.

However, the core inflation (excluding food and energy) was 7.9% in March 2023, a slight fall from 8.0% in the previous month. The core components contributed 3.4% to the headline inflation, while food and energy contributed around 6.0%.

Effective exchange rates declined

Table 2: Effective Exchange Rates

	Monthly			Annual	
	Mar-23	Feb-23	% Growth	Mar-22	% Growth
Nominal Effective Exchange Rate Index	93.1	93.5	-0.4	90.5	2.9
Real Effective Exchange Rate Index	116.0	117.1	-0.9	111.0	4.6

Source: National Reserve Bank of Tonga

The strength of the pa'anga as measured by the Nominal Effective Exchange Rate (NEER) declined over the month of March 2023 by 0.4%, underpinned by the general depreciation of the TOP against the NZD, JPY, GBP, EUR and CNY. The TOP however appreciated against the USD, AUD and FJD. In year ended terms, the TOP remains stronger by 2.9% as major trading partners' currencies generally weakened against the TOP except for the USD and EUR. This may partially relieve some of the impacts of the higher imported inflation.

The Real Effective Exchange Rate (REER) fell also over the month by 0.9%, corresponding to the lower NEER. Annually, the REER increased by 4.6% in line with the higher NEER and Tonga's higher inflation rate, indicating a loss in global trade competitiveness.

Foreign reserves fell

Table 3: Foreign Reserves

	Monthly			Annual	
	Mar-23	Feb-23	%Growth	Mar-22	% Growth
Foreign Reserves (\$ in million)	883.7	911.2	-3.0	861.4	2.6
Import Coverage (months)	13.0	13.7	-4.5	14.5	-10.0

Source: National Reserve Bank Tonga

Foreign reserves declined over the month by \$27.4 million to \$883.7 million, equivalent to 13.0 months of imports. This was attributed to an increase in demand for export payments and Government's external loan repayments to EXIM bank. In year ended terms, foreign reserves still increased by \$22.3 million, 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		
	Feb-23	Jan-23	% Growth	Feb-23	Feb-22	% Growth
Remittance (\$ in million)	37.5	37.6	-0.4	494.9	490.8	0.8
Travel (\$ in million)	7.4	11.7	-37.0	73.1	21.3	243.7

Source: National Reserve Bank Tonga

Total remittance receipts continued to decline over the month of February 2023 by \$0.1 million (0.4%). Private transfer receipts and employees compensation receipts from New Zealand drove the monthly decline. The slowdown in the New Zealand's economy due to several

disasters and the projected rise in unemployment may have contributed to this negative movement. However, over the year, total remittance receipts recorded a growth of \$4.1 million (0.8%) as the country returned back to normal levels and is gradually recovering from disasters in the previous year.

Broad money rose

Table 5: Broad Money

	Monthly			Annual	
	Feb-23	Jan-23	% Growth	Feb-22	% Growth
Broad money (\$ in million)	845.9	844.0	0.2	851.2	-0.6
Net Foreign Asset	899.7	899.5	0.0	855.2	5.2
Net Domestic Asset	-53.5	-55.1	2.9	-3.0	1681.4

Source: Banking System, National Reserve Bank of Tonga

Broad money climbed over the month of February 2023, by \$1.9 million (0.2%) however declined annually by \$5.3 million (0.6%). Both trend corresponded to the movements in net domestic assets and net credit to central governments, mainly on lower government deposits over the month and higher government deposits annually. Net foreign assets on the other hand, increased over these periods, driven mostly by increased foreign reserves underpinned by the receipts of budget supports and development grant funds from donor partners.

Liquidity in the financial system increased

Table 6: Reserve money

	Monthly			Annual	
	Feb-23	Jan-23	% Growth	Feb-22	% Growth
Reserve money (\$ in million)	612.1	609.9	0.4	600.7	1.9

Source: Banking System, National Reserve Bank of Tonga

Liquidity in the financial system grew over the month and over the year to February 2023, by \$2.2 million (0.4%) and \$11.4 million (1.5%) respectively. Both rises attributed to higher Exchange Settlement Account (ESA) and Statutory Reserve Deposits (SRD) offsetting the lower Currency in circulation. The increased ESA and SRD were in line with the growth in deposits whilst lower currency in circulation reflected less economic activities.

Lending to both businesses and households increased

Table 7: Total Lending

Lending	Monthly			Annual	
	Feb-23	Jan-23	% Growth	Feb-22	% Growth
Total Lending (\$ in million)	501.4	497.5	0.8	472.5	6.1
Business lending	245.6	242.5	1.3	216.1	13.6
Household lending	255.8	254.9	0.3	254.6	0.5
Other lending	0.1	0.1	-1.1	1.8	-95.0

Source: Banking System, National Reserve Bank of Tonga

Over the month and year to February 2023, the banks' total lending increased by \$3.9 million (0.8%) and \$28.9 million (6.1%) respectively as both businesses and household loans increased. Lending to businesses in the professional & other services, distribution, and construction sectors increased over the month as well as personal household loans and housing loans. Similarly, over the year, more loans were issued to businesses within the distribution and constructions sectors and also to households for other personal and vehicle loans.



Over the month and year to February 2023, the banks' total deposits increased by \$4.2 million (0.5%) and \$36.4 million (4.3%) respectively, to a total of \$885.0 million. The monthly rise was solely driven by higher demand deposits from private businesses. Similarly, higher demand deposits from the central government and private businesses as well as more saving deposits from the non-profit organisations led the annual growth. The loans-to-deposit ratio rose from 55.3% last month and 54.5% last year to 55.5% in February 2023, reflecting the significant rise in deposits offsetting the increase in loans.

Weighted average interest rate spread widened

Table 8: Weighted Average Interest Rates

Interest Rates	Monthly			Annual	
	Feb-23	Jan-23	(bps)	Feb-22	(bps)
Weighted Average Banks Deposit Rate (%)	1.549	1.584	-3.5	1.695	-14.7
Weighted Average Banks Lending Rate (%)	7.859	7.891	-3.2	7.835	2.4
Weighted Average Interest Rate Spread (%)	6.310	6.307	0.3	6.140	17.0

Source: Banking System, National Reserve Bank of Tonga

Over the month and year to February 2023, the weighted average interest rate spread widened to 6.31%. The monthly rise is attributed to a steeper decline in weighted average deposit rate offsetting the fall in weighted average lending rate. Lower average deposit rate over the month stemmed from the decline in all deposit rates reflecting higher volumes of deposits and excess liquidity during the month. Moreover, lower average lending rate in February was due to the decline in lending rates offered to businesses in the agricultural, tourism, manufacturing and construction sectors coinciding with the increase in loan volumes for the month supporting higher credit growth and investment activities.

The annual rise however, resulted from the decreased in weighted average deposit rates coupled with the slight rise in weighted average lending rates. Again, all categories of deposit rates continued to decline whilst lending rates offered to businesses in the mining & quarry, construction, and fisheries sector increased.

Outlook

The Reserve Bank expects domestic activities to continue to recover in the near to medium term. To sustain the ongoing economic recovery, prudent macroeconomic management and effective implementation of structural reforms including supply side measures will be critical. Though inflation took an uptick in March 2023, it is still expected to decline towards the 5% reference rate in the second half of 2023 as core inflation continues to improve and global and local food supply ameliorates. However, uncertainties in the movements of global oil and commodity prices, as well as domestic food supply pose a risk to this outlook. The financial system remains stable with available liquidity as credit growth improves and banks are also well capitalized to absorb further shocks. Foreign reserves is projected to remain comfortable above the IMF's optimal level of 7.3 months of imports cover, sustained by expected inflows of development assistance for the HTHH reconstruction and the implementation of donor projects back on track. The Reserve Bank has started to implement some of its monetary policy measures indicated in the February 2023 Monetary Policy Statement which prioritized reducing inflation. The Reserve Bank remains committed to reducing inflation while at the same time supporting economic recovery through prudent lending and being vigilant of any pressure on foreign reserves and banks' asset quality.