



Global recovery is slowing amid widening divergences among economic sectors and regions

According to the IMF World Economic Outlook for July 2023, global growth is projected to fall from an estimated 3.5% in 2022 to 3.0% in both 2023 and 2024. The rise in central bank policy rates to fight inflation continues to weigh on economic activity. In parallel, global headline inflation is also expected to decline from 8.7% in 2022 to 6.8% in 2023 and 5.2% in 2024. Monetary policy tightening is expected to gradually dampen inflation. However, a central driver of the disinflation projected for 2023 is declining international commodity prices.

US growth increased at an annual rate of 2.4% in the second quarter of 2023, reflecting the increase in consumer spending, non-residential fixed investment, state and local government spending, private inventory investment, and federal government spending. Unemployment rate changed little at 3.5% and payroll increased by 187,000 in July 2023, a reflection of a still-tight labour market that has supported gains in real income.

Australia's annual inflation rate was 6.0% in the June 2023 quarter, lower than the 7.0% annual rise in the March 2023 quarter. This marks the second quarter of lower annual inflation, from the peak of 7.8% in the December 2022 quarter. Unemployment rate remained at 3.5% in June 2023, hence the cash rate remained unchanged in July 2023 at 4.10% and 4.00% respectively in August 2023 by the Reserve Bank of Australia.

New Zealand inflation rate was also 6.0% in the June 2023 quarter, owing to a 12.3% increase in food prices. New Zealand unemployment rate for the June 2023 quarter was 3.6% and the number of employees increased by 4.0% reaching an employment rate of 69.8%, the highest rate recorded since 1986.

Resumption of festivals boosted activities in the service industry

The primary sector demonstrated mixed performances over the month. Agricultural exports declined by 131.6 tonnes due to lower exports of root crops particularly cassava and taro, and coconut. Meanwhile, the squash (off-season export) rose over the month. Agricultural export proceeds, however, rose over the month by \$0.4 million (109.4%). Risks to the agricultural sector is tilted to the downside with the current El Nino event. On the other hand, the marine exports rose by 31.5% (44.0 metric tonnes) attributed to increased exports of tuna and shark meat. However, the aquarium exports declined by 43.9% (-1,417 pieces), coinciding with the 10.8% (\$0.02 million) decline in the marine export proceeds.

Lending to the secondary sector generally slowed down over the month while the ongoing implementation of the infrastructure projects and its spillovers continue to support growth. The Outer Island Renewable Energy Niuatoputapu Solar Hybrid System is completed. The upgrade of the Queen Salote Ports, the reconstruction housing program, and construction of the new Dialysis centre are in progress,

along with the Tonga Climate Resilient Transport project. Global logistics have gradually stabilized but the labour market constraints and skills shortages remain as limitations to the projects' implementation.

The services sector remained upbeat over the month, given the celebratory events during Tonga's mid-year busy season such as the Royal Agricultural Show, annual church conferences, Heilala Festival, and the preparation for the school anniversaries in July 2023. The resumption of these events enabled the Tongan diaspora from overseas to participate, after being halted during the pandemic and border lockdown. Distribution activities were active, while demands for accommodation & food, and transportation services were rebounding strongly. Coincidentally, travel receipts continued to rise over the month by 30.0% (\$3.1 million), aligning with the increase in the air passenger arrivals by 13.4% (1,053 passengers). The high demand contributed to an increase in international airfares which contributed to the high inflation in June.

More job opportunities in July 2023

The Reserve Bank's survey on job advertisements recorded an increase of 37 job vacancies (71.2%) over the month. The total job vacancies comprised mostly of public administration, transportation, and Embassies & High Commission Offices vacancies. The total job vacancies advertised over the year to July 2023 rose by 74.1% (423 job vacancies), stemming mainly from public administration, transport & communications, utilities, and hotel & restaurants.

Headline inflation fell below the 5% threshold in July 2023

The headline inflation eventually declined below the 5% reference rate to 4.6% in July 2023 since the 4.7% in May 2021. This is driven largely by favourable development in the energy prices (fuel, electricity & LP gas), and

Table 1: Inflation Rates

Prices	Monthly (% change)		Annual	
	Jul-23	Jun-23	Jul-23	Jul-22
Headline Inflation	-0.6	1.7	4.6	13.1
Domestic prices	-1.4	1.6	8.3	11.2
Imported prices	-0.1	1.8	1.9	14.5
Core inflation - ex. energy and food (%)	0.3	2.6	10.3	4.5

Source: Tonga Statistics Department

lower prices of food items compared to previous year. Nevertheless, these prices still remain relatively high compared to pre-pandemic level. The Consumer Price Index (CPI) declined by 0.6% over the month, attributed to decrease in the overall imported and domestic prices. In July 2023, the fuel prices declined and offset the higher imported food items, alcoholic beverages, LP gas, and goods for personal care. At the same time, the local food items declined along with the new electricity tariff for September 2023 quarter outweighing the increase from the local transport services.

Imported prices contributed around 1.0 percentage point to the headline inflation. The main imported contributors were food items, international airfares, construction materials,



clothing & footwear, and goods for personal care. Meanwhile, the main drivers of domestic prices were local food items, local transportation component, catering services, and secondary school tuition fees. However, the pressure from these components were reduced by the lower electricity and kava prices over the year. Altogether, the domestic prices contributed around 3.6 percentage point to the headline inflation.

The core inflation slightly fell to 10.3% in July 2023 from 10.9% in previous month. This is still higher than the 5% reference rate and the 4.5% in July 2022, further depicting the persistence in the core components. The main contributors to the core inflation were mainly services such as the international airfares, catering services, local transport services, local cost for the operation of personal transport equipment, secondary school tuition fees, and construction materials. On the other hand, the non-core (food & energy) inflation significantly dropped from 5.0% in previous month to 0.9% in August 2023.

Effective exchange rate remained high in July 2023

Table 2: Effective Exchange Rates

	Monthly			Annual	
	Jul-23	Jun-23	% Growth	Jul-22	% Growth
Nominal Effective Exchange Rate Index	94.3	94.8	-0.4	93.0	1.5
Real Effective Exchange Rate Index	120.9	120.8	0.1	119.0	1.6

Source: National Reserve Bank of Tonga

The Nominal Effective Exchange Rate (NEER) declined over the month by 0.4%, underpinned by the appreciation of the USD, AUD, and FJD against the Tongan Pa'anga (month ended). However, the Real Effective Exchange Rate (REER) increased by 0.1% in July, as Tonga's inflation rate remains high compared to its trading partners.

In year ended terms, the NEER remains higher by 1.5% compared to the previous year as trading partners' currencies (AUD, NZD, FJD, JPY and CNY) generally depreciated against the TOP. This may assist in containing imported inflation, except for USD denominated imports. The REER also increased over the year by 1.6% which may indicate a loss in Tonga's global trade competitiveness.

Remittances remain above \$40 million in June 2023

Table 4: Remittance and Travel Receipts

	Monthly			Annual		
	Jun-23	May-23	% Growth	Jun-23	Jun-22	% Growth
Remittance (\$ in million)	48.6	49.9	-2.5	526.9	474.5	11.0
Travel (\$ in million)	13.2	10.2	30.0	106.3	22.7	368.8

Source: National Reserve Bank Tonga

Following the hike during the family month of May, total remittances receipts slightly declined as usual over the month of June 2023 by \$1.2 million (2.5%) but still remained high. The decline during the month may also be due to the resumption of international travel activities diverting some of the remittance transfers to travel receipts as families attend church conferences and school anniversary celebrations during the month. This was in line with the \$3.0 million (30.0%) rise in travel receipts.

In contrast, remittances receipts continue to remain higher over the year by \$52.4 million (11.0%).

Broad money rose

Table 5: Broad Money

	Monthly			Annual	
	Jun-23	May-23	% Growth	Jun-22	% Growth
Broad money (\$ in million)	841.8	822.3	2.4	846.7	-0.6
Net Foreign Asset	887.1	829.6	6.9	849.9	4.4
Net Domestic Asset	-45.0	-5.9	-657.0	-2.9	-1437.5

Source: Banking System, National Reserve Bank of Tonga

In June 2023, broad money increased by \$19.6 million (2.4%) over the month but declined annually by \$4.8 million (0.6%). The net foreign assets grew over the month and over the year, in line with the higher foreign reserves. On the other hand, the net domestic assets fell, corresponding with the lower net credit to the Government mainly on higher government deposits.

Reserve money increased

Table 6: Reserve money

	Monthly			Annual	
	Jun-23	May-23	% Growth	Jun-22	% Growth
Reserve money (\$ in million)	600.7	557.5	7.8	629.5	-4.6

Source: Banking System, National Reserve Bank of Tonga

Liquidity in the financial system rose over the month of June 2023 by \$43.2 million (7.8%), however, declined annually by \$28.8 million (4.6%). Both trends corresponded to the movements in both the Exchange Settlement Accounts (ESA) and currency in circulation. The Statutory Reserve Deposits (SRD), on the other hand, fell over the month but rose annually. The higher SRD over the year was in line with the growing deposits and the increase in the SRD ratio taking effect in May 2023 as part of the Reserve Bank's monetary policy measures.

Credit climbed to a new record level

Table 7: Total Lending

Lending	Monthly			Annual	
	Jun-23	May-23	% Growth	Jun-22	% Growth
Total Lending (\$ in million)	513.0	505.2	1.5	473.4	8.4
Business lending	257.2	250.2	2.8	220.7	16.5
Household lending	255.7	254.9	-0.3	250.3	2.2
Other lending	0.1	0.1	-2.2	2.4	-95.2

Source: Banking System, National Reserve Bank of Tonga

The banks' total lending increased to a new high level in June 2023 of \$513.0 million. Over the month, lending grew further by \$7.8 million (1.5%) and by \$39.6 million (8.4%) over the year as both business and household loans continued to rise. Lending to businesses within the transport, manufacturing and tourism sectors increased, along with all the categories of household loans.

Annually, higher lending was recorded to businesses in the distribution, manufacturing, profession & other services, and transport sectors increased, as well as households' other personal loans and vehicle loans.

Total deposits in the banks increased by \$42.0 million (4.9%) over the month and over the year by \$32.7 million (3.8%) to \$919.7 million. The higher deposits over the month was mostly driven by increased demand deposits from the Government and more time deposits from the Retirement Funds. Annually, demand deposits increased,



led by private businesses and government deposits. Time deposits from the Retirement Funds also rose. The stronger growth in deposits than the rise in loans over the month resulted in a decline in the loans to deposit ratio from 57.6% in May 2023 to 55.8% in June 2023. However, over the year, the loan to deposit ratio widened from 53.6% as lending rose more and offset the growth in deposits.

Weighted average interest rate narrowed

Table 8: Weighted Average Interest Rates

Interest Rates	Monthly			Annual	
	Jun-23	May-23	(bps)	Jun-22	(bps)
Weighted Average Banks Deposit Rate (%)	7.392	7.776	-38.4	7.769	-37.7
Weighted Average Banks Lending Rate (%)	1.571	1.498	7.3	1.626	-5.5
Weighted Average Interest Rate Spread (%)	5.821	6.279	-45.7	6.143	-32.2

Source: Banking System, National Reserve Bank of Tonga

Weighted average interest rate spread narrowed by 45.7 basis points over the month and over the year by 32.2 basis points. The monthly decline was underpinned by lower lending rates coupled with increased deposit rates. Lending rates offered to businesses within the agricultural, fisheries and manufacturing sectors declined over the month as well as household vehicle and other personal loans rates. On the other hand, both saving and time deposit rates increased over the month.

The annual decline in the spread was however led by lower lending rates offered to businesses in the agricultural, constructions, fisheries, and manufacturing sectors. Household loan rates also fell, again mainly for other personal and vehicle loans. This outweighed the decreased deposit rates which was solely driven by lower saving deposit rates. The lower lending rates coincided with the higher volume of loans, both over the month and over the year.

Outlook

Headline inflation is expected to gradually slowdown, however, associated risks remain such as the El Nino weather conditions and global uncertainties which could further raise food, oil, and other commodity prices. While bank lending increases so are the risks associated with a decline in banks' asset quality. Nonetheless, the financial system remains stable with ample liquidity and banks are also well capitalized to absorb further shocks. Foreign reserves, reported at over 13 months of imports in June 2023, is projected to remain comfortable above the IMF's optimal level of 7.3 months of imports cover. The Reserve Bank will continue to closely monitor inflation movements and at the same time support economic recovery. The next Monetary Policy Statement will be issued in August 2023.