



Global economic activities expected to ease

US annual inflation fell to 4.0% in May 2023, the lowest since March 2021. Unemployment rate edged up to 3.7% while payroll employment increased by 339,000 in May 2023. Australia's inflation stood at 6.8% in April 2023. The Reserve Bank of Australia's May 2023 Monetary Policy Statement forecasted inflation to decline to 4.5% by the end of 2023 and to reach 3% by mid-2025. Unemployment rate remained at 3.5% in May 2023 but is expected to start rising later this year reaching 4.5% by late 2024. New Zealand's GDP fell by 0.1% in the March 2023 quarter attributed to large declines in business services, transport, postal and warehousing. Annual food prices rose 12.1% in May 2023 due to an increase in fruit and vegetable prices and grocery food prices. Hence, the Reserve Bank of New Zealand continued to raise its official cash rate to 5.5% in May 2023 to slow down demand and assist in reducing upward pressure on prices and lower headline inflation.

Domestic economic activities generally positive

Agricultural exports increased over the month of April 2023 by 21.1% (123.5 tonnes) indicating a lively primary sector. The monthly increase was largely owed to higher exports of taro, cassava, and coconut. At the same time, agricultural export proceeds increased by 44.8% (\$0.2 million). On the contrary, marine exports declined by 60.5% (123.9 metric tonnes) due to a large drop in the exports of tuna. Aquarium exports also fell by 39.6% (2,928 pieces) driven by a decrease in the export volumes of soft coral, live hard coral, and live fish. Marine export proceeds also declined by \$0.1 million (27.7%). Nevertheless, more marine products were sold at the local markets which increased by 2.4 metric tonnes (49.6%) over the month. Meanwhile, the sector continues to be supported, including through donation of new equipment from development partners.

Indicators in the industrial sector mostly showed active performances over the month. Lending to the construction sector rose by \$0.6 million (2.8%), along with a slight increase in lending to the mining & quarrying sector. At the same time, loans to the manufacturing sector also increased by 1.1% (\$0.2 million), while banks lending to the utilities sector slowed down.

The service sector remained vibrant over the month. International arrivals rose by 3,443 (60.4%), which is attributed to increases in both air and sea (cruise ships and yacht) passenger arrivals. With the resumption of the yacht rally here in Tonga, the tourism related activities are expected to be boosted further. Total container registrations also increased over the month, with rises in both business and private containers. However, non-oil import payments declined over the month by 10.8% (\$4.7 million), which partially reflect the slowdown in some global commodity prices.

Fewer job vacancies advertised in April 2023

The Reserve Bank's survey showed a slowdown in the total number of job vacancies advertised over the month, which declined by 8 job vacancies (10.8%). The job opportunities

were mostly for public administration, education, financial intermediation, and utilities services. Over the year to April 2023, the advertised job vacancies increased by 105.4% (465 job vacancies).

Headline inflation fell further to 6.6% in May 2023

Table 1: Inflation Rates

Prices	Monthly (% change)		Annual	
	May-23	Apr-23	May-23	May-22
Headline Inflation	1.2	-0.6^r	6.6	11.3
Domestic prices	1.9	-1.6 ^r	10.9	10.4
Imported prices	0.6	0.2	3.3	11.9
Core inflation - ex. energy and food (%)	1.0	0.4	8.3	3.3

Source: Tonga Statistics Department

The headline inflation continued to slow down in May 2023 to 6.6% from 6.9% (revised from 7.4%) in the previous month and 11.3% in May 2022. The domestic prices remained high over the year and contributed 4.7 percentage points to the headline inflation. This is owed mainly to increased prices of local food items, catering services (takeaway food), local transport services, and labour cost. Meanwhile, annual imported inflation was fuelled by high prices of imported food items, construction materials, international airfares, alcoholic beverages, and goods for personal care.

Core inflation, however, rose to 8.3% in May 2023, reflective of the increase in the prices of labour, catering services, clothing and footwear (school uniforms & flip flops), and books & stationery. Contrarily, food & energy inflation fell to 5.4% from 6.2% in the previous month (revised from 7.1%), contributing 3.0 percentage points to the headline inflation while the core components contributed 3.6 percentage points.

Effective exchange rates continue to rise

Table 2: Effective Exchange Rates

	Monthly			Annual	
	May-23	Apr-23	% Growth	May-22	% Growth
Nominal Effective Exchange Rate Index	94.3	93.6	0.8	92.0	2.5
Real Effective Exchange Rate Index	117.9	117.1	0.7	115.7	1.8

Source: National Reserve Bank of Tonga

The strength of the pa'anga as measured by the Nominal Effective Exchange Rate (NEER) increased over the month of May 2023 by 0.8%, underpinned by the appreciation of the TOP against all currencies except USD. In year ended terms, the TOP remains stronger by 2.5% as the major trading partners' currencies generally weakened except for the USD. This may assist in partially offsetting the imported inflation except for USD denominated imports.

Similarly, the Real Effective Exchange Rate (REER) also increased over the month and over the year by 0.7% and 1.8% respectively. The annual increase also reflects Tonga's higher inflation compared to its major trading partners, indicating a loss in global trade competitiveness.



Foreign reserves increased

Table 3: Foreign Reserves

	Monthly			Annual	
	May-23	Apr-23	% Growth	May-22	% Growth
Foreign Reserves (\$ in million)	864.8	860.5	0.5	880.4	-1.8
Import Coverage (months)	12.4	12.4	0.7	14.7	-15.5

Source: National Reserve Bank Tonga

Foreign reserves increased in May 2023 by \$4.3 million to \$864.8 million, equivalent to 12.4 months of imports. This was driven by higher receipts of Government budget support. In year ended terms, foreign reserves decreased by \$15.6 million. The majority of the official foreign reserves are held in USD, NZD, and AUD.

Table 4: Remittance and Travel Receipts

	Monthly			Annual		
	Apr-23	Mar-23	% Growth	Apr-23	Apr-22	% Growth
Remittance (\$ in million)	39.4	44.2	-10.8	506.9	476.5	6.4
Travel (\$ in million)	6.5	8.1	-20.3	84.3	21.0	301.1

Source: National Reserve Bank Tonga

Total remittance receipts slowed down over the month by \$4.8 million (10.8%) to \$39.4 million. The lower receipts of private transfers by \$4.4 million (11.3%) and compensation of employees by \$0.5 million (10.9%) contributed to the overall monthly decline. The decrease in Australia's real wages may have contributed to the decline in remittances during the month. However, over the year, total remittances continued to remain high, rising by \$30.5 million (6.4%).

Broad money fell

Table 5: Broad Money

	Monthly			Annual	
	Apr-23	Mar-23	% Growth	Apr-22	% Growth
Broad money (\$ in million)	836.8	843.6	-0.8	844.3	-0.9
Net Foreign Asset	848.2	872.6	-2.8	870.8	-2.6
Net Domestic Asset	-10.8	-28.5	62.1	-26.1	58.5

Source: Banking System, National Reserve Bank of Tonga

Over the month and year to April 2023, broad money decreased by \$6.9 million (0.8%) and \$7.5 million (0.9%), respectively. Both declines were solely driven by lower net foreign assets, due to payments of dividends, oil and other imports. Net domestic assets, on the hand, increased over the month, underpinned by higher net credit to the central government and credit to the private sector. Similarly, over the year, both credit to the private sector and other financial corporations increased contributed to the annual rise.

Liquidity in the financial system declined

Table 6: Reserve money

	Monthly			Annual	
	Apr-23	Mar-23	% Growth	Apr-22	% Growth
Reserve money (\$ in million)	583.7	601.3	-2.9	600.5	-2.8

Source: Banking System, National Reserve Bank of Tonga

Liquidity (Reserve money) in the financial system decreased over the month and year to April 2023, by \$17.6 million (2.9%) and \$16.7 million (2.8%) respectively. The Exchange Settlement Account (ESA) declined over the month due to banks' net purchases of foreign reserves from the Reserve Bank and lower deposits which also resulted in lowering of the banks' statutory reserve deposits (SRD). However, over the year, the fall in Reserve money is mostly

due to a decline in currency in circulation which outweighed the rises in both the ESA and SRD.

Total lending increased

Table 7: Total Lending

Lending	Monthly			Annual	
	Apr-23	Mar-23	% Growth	Apr-22	% Growth
Total Lending (\$ in million)	502.5	493.0	1.9	466.7	7.7
Business lending	247.8	238.0	4.1	213.9	15.9
Household lending	254.6	254.9	-0.3	251.0	1.4
Other lending	0.1	0.1	-2.2	1.8	-95.2

Source: Banking System, National Reserve Bank of Tonga

The banks' total lending rose by \$9.5 million (1.9%) to \$502.5 million in April 2023. The monthly growth was driven mostly by increased lending to businesses in the distribution and professional & other services sectors.

Annually, total lending grew by \$35.8 million (7.7%) as both business and household loans increased. Lending to businesses in the distribution, manufacturing and professional & other services sectors rose, reflecting recovery in these sectors. Households' personal loans and vehicle loans also increased over the year.

Total deposits in the banks decreased by \$7.7 million (0.9%) over the month to \$872.4 million. However, this is \$24.3 million (2.9%) higher compared to the same time last year. The monthly decline was mostly driven by lower time and saving deposits from public enterprises and churches. However, over the year, all deposit categories' increased, with demand deposits rising the most followed by time and saving deposits. Higher deposits by private businesses and the government led the increase in demand deposits, whilst non-profit organizations' deposits, (mainly churches) drove the growth in both the time and saving deposits. The loans to deposit ratio increased to 56.4% in April 2023 from 54.9% last month and 53.9% last year.

Weighted average interest rate widened

Table 8: Weighted Average Interest Rates

Interest Rates	Monthly			Annual	
	Apr-23	Mar-23	(bps)	Apr-22	(bps)
Weighted Average Banks Deposit Rate (%)	1.408	1.419	-1.0	1.656	-24.7
Weighted Average Banks Lending Rate (%)	7.812	7.818	-0.6	7.835	-2.3
Weighted Average Interest Rate Spread (%)	6.403	6.399	0.4	6.179	22.4

Source: Banking System, National Reserve Bank of Tonga

Weighted average interest rate spread widened by 0.4 basis points over the month and year. The weighted average deposit rate again fell, which outpaced the decline in the weighted average lending rate, both over the month and over the year. The lower weighted average deposit rate over the month, was underpinned by a slight decline in demand deposit rates, and the significant drop in the volume of deposits. Similarly, the lower weighted average lending rate over the month was due to a decline in housing loan rates as well as lower interest rates offered to businesses in the construction, professional & other services and distribution sectors.

Annually, both saving and time deposit rates declined and offset the rise in demand deposit rates. Meanwhile, lending rates offered to businesses within the tourism, distribution and professional & other services also fell over the year.



The lower lending rates coincided with the higher volume of loans, both over the month and over the year.

Outlook

The Reserve Bank policy measures under its February 2023 Monetary Policy Statement contribute to the annual headline inflation slowing down in May 2023, and is expected to continue the trend until it falls below 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 downside risks to this outlook. Tonga's

economy is rebounding from the negative growth in 2022 to above 2% in 2023. 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 implementation of donor projects. Therefore, the Reserve Bank will continue to monitor inflation movements and at the same time support economic recovery through prudent lending and being vigilant of any pressure on foreign reserves and banks' asset quality.