



NATIONAL RESERVE BANK OF TONGA

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Asia and Pacific region continues to recover amid uncertainty

According to the IMF's May 2023 Regional Economic Outlook for Asia and Pacific, growth in the region remained resilient in the second half of 2022, much like in the rest of the world, estimating growth in Asia and Pacific at 3.8%, following the strong rebound of 6.5% in 2021. Domestic demand is expected to remain as the largest growth driver. The rebound in private consumption was supported by the drawdown of excess savings built up during the pandemic. The U.S. economy grew by 1.1% over the first quarter of 2023 reflecting the increases in consumer spending, exports, government spending, and non-residential fixed investment. Moreover, inflation eased to 4.9% over the year to April 2023, its slowest pace since 2021 and unemployment declined to 3.4% in April 2023 causing the Federal Reserve to continue raising the federal funds rate from 5.0% to 5.25% in May 2023. Australia's and New Zealand's annual inflation in the first quarter of 2023, were 6.7% and 6.7% respectively. This is a decline from a 30 year high of 7.8% in the December quarter for Australia and 7.2% for New Zealand. Unemployment for both economies continue to remain unchanged at 3.5% and 3.4% in March 2023. However, the IMF's May 2023 REO update is expecting Australia's and New Zealand's economies to grow by 1.6% and 1.1% in 2023, respectively.

Activities in the services sector generally improved

The primary sector was largely buoyed by more exporting activities in the agricultural sector in March 2023. Over the month, agricultural exports rose by 140.1 tonnes (31.4%), attributed to higher exports of yam, taro, and watermelon. Nevertheless, the agricultural export proceeds recorded a \$0.1 million (1.6%) decline, indicating lag in receipts. On the contrary, marine exports fell over the month by 77.3 metric tonnes (27.4%) driven by a decrease in tuna exports, while shark meat exports rose. At the same time, total aquarium exports declined by 1,556 pieces (17.4%), coinciding with the \$0.3 million (59.7%) decline in the marine export proceeds. On the other hand, the marine products at the local markets recorded a total increase of 1.1 metric tonnes (29.3%) over the month. The ongoing recovery efforts including donation of more boat and marine motor engines from China continue to support the sectoral activities.

Loans by sector indicated mixed outcomes within the industrial sector. Lending to the construction sector fell by 2.0% (\$0.4 million) over the month, followed by a decrease of 0.9% (-\$1.9 million) in individuals' housing loans, and a 27.5% (-\$0.04 million) decline in loans to the mining & quarrying sector. Lending to the utilities sector however rose by 5.5% (\$0.03 million), indicative of the completion of some of the reconstruction projects and an expected increase in production in the utilities sector. The outlook for the sector remains strong as import payments for

construction materials rose by \$0.2 million (5.9%) over the month.

Favourable developments were observed in the tertiary sector during the month. Travel receipts rose by 10.1% (\$0.7 million), reflective of the resumption of arrivals by cruise ships during the month. Ministry of Tourism is expecting ten more cruise ships for the rest of the year, which will further support tourism-related industries, food and accommodation, and transportation services. At the same time, Tonga has also lifted the requirement for COVID-19 vaccination proof from foreign arrivals, further easing international travel restrictions. Recreational activities also remained upbeat, given the increasing overseas travels for sport tournaments, and the inflow of donations such as sports gear for local sports clubs. Container registrations, however, recorded a decline of 33 containers (-4.3%) over the month, driven by lower business containers. Nonetheless, the wholesale and retail import payments substantially rose by \$7.1 million (31.5%) over the month which may indicate more imports for the upcoming months. In April 2023, vehicle registrations was steady with a 0.5% rise (1 vehicle) over the month, but with a substantial rise of 17.3% (456 vehicles) at an annual rate.

Employment opportunities rose over the month

The Reserve Bank's survey showed an increase of 19.4% (12 job vacancies) in the total number of job vacancies advertised in March 2023. More job opportunities were advertised from hotels and restaurants, and business services compared to the previous month, as the sectoral activities increase. However, this also reflects the loss of semi-skilled and under-skilled labour to the labour mobility schemes and its new reforms¹. A team from Japan also visited Tonga and further discussed job opportunities in Japan similar to the seasonal working programmes to Australia and New Zealand, but for areas such as aviation, building cleaning, automobile repair and maintenance. More challenges are lying ahead for the domestic employers with these increasing opportunities outside Tonga. The job vacancies advertised over the year rose by 106.4% (450 job vacancies).

Inflation at lowest rate since October 2021

Table 1: Inflation Rates

Prices	Monthly (% change)		Annual	
	Apr-23	Mar-23	Apr-23	Apr-22
Headline Inflation	-0.1	0.9	7.4	9.4
Domestic prices	-0.5	0.8	11.3	8.1
Imported prices	0.2	0.9	4.4	10.5
Core inflation - ex. energy and food (%)	0.4	0.1	7.9	2.8

Source: Tonga Statistics Department

The annual headline inflation slowed to 7.4% in April 2023, following a 9.4% in both April 2022 and March 2023, reflective of the slowdown in energy prices and as inflationary pressures slowly cool down. The imported

¹ The new reforms entail expansion to other sectors such as construction and infrastructure, meat processing, seafood, to name a few, and the

inclusion of family accompaniment particularly under the work-visa to Australia.



inflation contributed 2.5 percentage point to the headline inflation, with rising prices for imported food items, construction materials, alcoholic beverages, goods for personal care, and international airfares. Meanwhile, the fuels prices recorded its first annual decline since February 2021. On the other hand, the annual rise in domestic prices was driven mainly by local food items, local transport services, electricity tariff, catering services, and cost of communication services. Overall, the domestic prices contributed 4.9 percentage point to the headline inflation.

The core inflation was 7.8%, which is higher than 2.8% in the previous year. Nevertheless, this is a slight decline from 7.9% in the previous month. Meanwhile, food and energy prices slowed down from 10.5% in the previous month to 7.1% in April 2023, indicative of the decline in local food, and fuel prices. Altogether, the non-core inflation (food and energy contributed around 4.0 percentage point to the headline inflation, while core inflation contributed around 3.4 percentage point.

Tongan Pa'anga continued to strengthen

Table 2: Effective Exchange Rates

	Monthly			Annual	
	Apr-23	Mar-23	% Growth	Apr-22	% Growth
Nominal Effective Exchange Rate Index	93.6	93.1	0.5	92.2	1.5
Real Effective Exchange Rate Index	116.7	116.1	0.5	114.7	1.8

Source: National Reserve Bank of Tonga

The strength of the pa'anga as measured by the Nominal Effective Exchange Rate (NEER) rose over the month of April 2023 by 0.5%, underpinned by the appreciation of the TOP against the AUD and NZD. In year ended terms, the TOP remains stronger by 1.5% as major trading partners' currencies generally weakened against the TOP except for the USD, GBP and EUR. This may partially assist in offsetting some of the imported inflation pressure except for USD denominated imports. Majority of food imports are denominated in NZD in which the appreciation of the Tongan pa'anga helps with keeping prices low.

Similarly, the Real Effective Exchange Rate (REER) increased over the month and over the year by 0.5% and 1.8% respectively. The annual increase is in line with Tonga's higher inflation compared to its major trading partners and the higher NEER. A higher REER indicates that Tongan products may be more expensive than those of our trading partners for a foreign buyer and therefore signifying a loss in global trade competitiveness.

Foreign reserves continue to decline

Table 3: Foreign Reserves

	Monthly			Annual	
	Apr-23	Mar-23	%Growth	Apr-22	% Growth
Foreign Reserves (\$ in million)	860.5	883.7	-2.6	884.0	-2.7
Import Coverage (months)	12.3	12.9	-4.8	14.9	-17.5

Source: National Reserve Bank Tonga

Foreign reserves declined over the month by \$23.2 million to \$860.5 million, equivalent to 12.3 months of imports. This was mostly attributed to an increase in import payments. In year ended terms, foreign reserves is also lower by \$23.5

million, as imports increased in line with economic recovery. Moreover, official and private receipts declined from historical highs due to responses to COVID and the HTHH event. The majority of the official foreign reserves are held in USD, NZD, and AUD.

Table 4: Remittance and Travel Receipts

	Monthly			Annual		
	Mar-23	Feb-23	% Growth	Mar-23	Mar-22	% Growth
Remittance (\$ in million)	44.2	37.5	17.8	506.5	479.9	5.5
Travel (\$ in million)	8.1	7.4	10.2	79.6	21.1	277.8

Source: National Reserve Bank Tonga

Total remittance receipts increased over the month of March by \$6.7 million (17.8%) to \$44.2 million contributing to the overall rise in the OET receipts. Private transfers and employees' compensation receipts drove the monthly rise by \$6.2 million (18.6%) and \$1.0 million (31.0%) respectively. The increase in employment payroll during the month in most of the source remitting countries may have contributed to the monthly growth. The preparation and fundraising for some of the upcoming school anniversary celebrations may have also driven the monthly increase. Annually, total remittance receipts recorded a growth of \$26.5 million (5.5%) as the country is gradually recovering from disasters in the previous year.

Broad money declined

Table 5: Broad Money

	Monthly			Annual	
	Mar-23	Feb-23	% Growth	Mar-22	% Growth
Broad money (\$ in million)	843.6	845.9	-0.3	844.9	-0.1
Net Foreign Asset	872.6	899.7	-3.0	852.8	2.3
Net Domestic Asset	-28.5	-53.5	46.7	-7.0	306.9

Source: Banking System, National Reserve Bank of Tonga

Broad money declined both over the month and year by \$2.3 million (0.3%) and \$1.3 million (0.1%), respectively. Monthly trend corresponded to lower net foreign asset due to higher external debt repayments and import payments resulting in lower foreign reserves. Thus the fall in net foreign assets outweighed the rise in net domestic assets. Over the year, net credit to central government was lower underpinned by higher inflow of donor funds for development.

Lower ESA during the month

Table 6: Reserve money

	Monthly			Annual	
	Mar-23	Feb-23	% Growth	Mar-22	% Growth
Reserve money (\$ in million)	601.3	612.1	-1.8	598.0	0.5

Source: Banking System, National Reserve Bank of Tonga

Liquidity in the financial system fell over the month by \$10.8 million (1.8%), but increased over the year by \$3.3 million (0.5%). The Exchange Settlement Accounts (ESA) declined during the month mainly due to the facilitation of higher import payments. This was followed by lower currency in circulation while there was an increase in statutory reserve deposits (SRD). Annually, liquidity continued to remain positive supported by higher ESA and SRD movements outweighing the decline in currency in circulation.



Total lending fell during the month

Table 7: Total Lending

Lending	Monthly			Annual	
	Mar-23	Feb-23	% Growth	Mar-22	% Growth
Total Lending (\$ in million)	493.0	501.4	-1.7	468.1	5.3
Business lending	238.0	245.6	-3.1	213.4	11.5
Household lending	254.9	255.8	-0.3	252.9	0.8
Other lending	0.1	0.1	-2.2	1.8	-95.2

Source: Banking System, National Reserve Bank of Tonga

Over the month, the banks total lending fell by \$8.4 million (1.7%) mainly due to settlement of loans in the banking system. Lending to businesses in the distribution, construction and manufacturing sector were key drivers of lower lending, outweighing the rise in loans in the professional & other services and transport sectors.

Annually, credit growth remained positive rising by \$25.0 million (5.3%), attributed to more lending to businesses in the distribution and manufacturing sectors indicating more investment activities and active recovery compared to March 2022. Household loans also picked up mainly for other personal and vehicle loans.

The banks total deposits fell by \$4.8 million (0.5%) over the month, but rose annually by \$41.1 million (4.9%), to a total of \$880.2 million. The monthly trend was solely driven by lower demand deposits mainly from public enterprises, private businesses and the central government. This coincides with the continuation and implementation of government development projects. However, the higher annual movement attributes to significant growth in all categories of deposits led by private businesses for term deposits, and similarly for demand deposits. The loans to deposit ratio fell from 55.5% last month, but rose from 54.6% last year to 54.9% in March 2023, reflecting a decline in both loans and deposits volumes.

Weighted average interest rate spread continued to widen

Table 8: Weighted Average Interest Rates

Interest Rates	Monthly			Annual	
	Mar-23	Feb-23	(bps)	Mar-22	(bps)
Weighted Average Banks Deposit Rate (%)	1.419	1.549	-13.0	1.705	-28.6
Weighted Average Banks Lending Rate (%)	7.818	7.859	-4.1	7.829	-1.1
Weighted Average Interest Rate Spread (%)	6.399	6.310	8.9	6.124	27.5

Source: Banking System, National Reserve Bank of Tonga

Weighted average interest rate spread continued to widen over the month and year to 6.4% as the weighted average deposit rate continued to fall steeper than the decline in the weighted average lending rate. A significant fall in savings interest rate was recorded during the month. Furthermore, lending interest rates offered to businesses in the fishing and agriculture sector fell over the month.

The widening of the weighted average interest rate spread over the year was driven by the large fall in the weighted average deposit rate, with all categories declining reflecting the high liquidity in the financial system. This offset the decline in lending rates which was again, attributed to lower rates offered to businesses in the fishing and agricultural sector. Over the month and year, household vehicle and other personal loan rates also fell.

Outlook

The Reserve Bank has started to implement the monetary policy measures outlined in the February 2023 Monetary Policy Statement which prioritized reducing inflation whilst recognising that the trade-off between supporting economic recovery and countering inflation requires delicate balancing actions. 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. The banks have indicated further declines in deposit rates and lending rates while awaiting the implementation of the mopping exercise by the Reserve Bank as indicated in the February 2023 MPS. Though Foreign reserves have declined, it 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 back on track. Therefore, 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.