



Growth remained strong amongst major trading partners

Growth of the US economy continued to be strong, increasing at an annual rate of 2.1% in the June 2023 quarter. This was attributed to higher consumer spending and government expenditure, and strong business investments. Annual inflation remains high at 3.7% in August 2023 amidst tight labour market conditions which could potentially trigger further tightening by the Federal Reserve later in 2023.

The Israel-Hamas war and geopolitical tensions in the Middle-East is putting pressure on global oil prices and global oil supply disruption. Brent crude oil prices is projected to rise by more than 2.0% to \$92.90 per barrel immediately following the attack early in October 2023.

Meanwhile, the Australian economy remained strong with a 2.1% year-over-year growth in the June 2023 quarter, reflecting continued recovery in demand following the COVID-19 lockdowns. Exports and investments were the key contributors to growth, specifically from ongoing large scale projects in the transport, health and education sectors across the country.

As New Zealanders head to the 2023 general elections, the country's economy has exceeded expectations by 1.8% in the June 2023 quarter. Notably, the primary catalyst for this growth was the business services sector, particularly computer system designs and related services, supported by enhancements in manufacturing and household spending.

Primary and industrial sector remained active in August 2023

The primary sector trended favourably in August 2023, attributed to upbeat activities in both the agriculture and marine sectors. Over the month, the agricultural exports rose by 42.1% (+195.6 tonnes) driven by higher export volumes of root crops, watermelon, kava, and coconut. At the same time, the marine exports substantially rose by 175.2% (+119.9 metric tonnes), reflecting an increase in tuna and shark meat exports. The aquarium exports, however, recorded a decline of 7.5% (-329 pieces). The ongoing implementation of the One Million Tree-planting project of the MEIDECC¹ to combat climate change is supporting the demand for seedlings and plants which may further support primary sector growth.

Activities in the industrial sector remained vibrant over the month given the ongoing public and private projects. Credit to the construction sector rose by 5.7% (+\$1.2 million) with slight increase in lending to the mining & quarrying sector. Housing loans also recorded new commitments of \$3.1 million in August 2023, an increase of \$1.2 million (+60.6%) from the previous month. At the same time, construction

import payments rose by 47.6% (+\$1.4 million). In addition, lending to the utilities sector increased by 12.5% (+\$0.1 million) indicative of the completion of several houses under the housing reconstruction projects particularly in the outer islands such as Ha'apai and 'Eua.

The tertiary sector slowed in August 2023 after the celebrations and festivals in prior months. Over the month, the international air passenger arrivals declined by 4.0% (-378 passengers). Travel receipts also fell by \$2.1 million (-14.2%). Over the same period, the wholesale and retail import payments decreased by 5.5% (-\$1.8 million) indicating a slowdown in the distribution sector. Additionally, vehicle registrations slightly fell over the month by 5 vehicles (-2.0%) whereas the motor vehicles import payments rose by 7.0% (+\$0.3 million).

Labor demand in September 2023

The Reserve Bank's survey on job advertisements recorded a single rise (+1) in job vacancy advertisements over the month. The total number of job vacancies advertised in September 2023 were mainly for public administration, transport & communications, health & social work, and restaurants. Annually, the total job vacancies advertised to the public increased by 44.9% (+293 job vacancies) consistent with the 2023 rebound and seasonal demand. Majority of these job vacancies were from the public administration, transport & communication, utilities, and hotel & restaurants sectors. These can be attributed to a more vibrant demand for labour in the local market as activities resumed. However, the higher demand from the public administration sector may also be indicative of the loss of labour to international demands for seasonal labour.

Headline inflation edged up to 3.1% in September 2023

Table 1: Inflation Rates

Prices	Monthly (% change)		Annual	
	Sep-23	Aug-23	Sep-23	Sep-22
Headline Inflation	0.5	-0.8	3.1	14.0
Domestic prices	-0.1	-2.0	1.3	16.7
Imported prices	0.9	0.1	4.5	11.9
Core inflation - ex. energy and food (%)	0.1	0.1	6.7	8.1

Source: Tonga Statistics Department

Consumer Price Index increased over the month by 0.5%, driven largely by rising imported inflation. This was attributed mainly to higher prices of imported fuel, goods for personal care (diaper and toilet paper), household items (dishwashing liquid and aluminium foil), and footwear (flip flops). Meanwhile, the prices of imported construction materials (timber) declined over the month. On the other hand, domestic prices further declined over the month driven largely by lower local food prices. This reflects not only improvements in supply due to the harvesting season for some root crops and vegetables, but also a slowdown in demand and consumption after the celebrations in prior months. The decline in local food prices outweighed the

¹ Ministry of Meteorology, Energy, Information, Disaster Management, Environment, Climate Change and Communications.



increase in domestic labour cost over the month. On the outlook, the El Nino weather patterns and the approaching cyclones season pose a risk to the local food supply and hence prices.

Annually, headline inflation stood at 3.1% in September 2023 remaining below the 5% reference rate. The figure is slightly higher than the 2.9% in previous month but significantly lower than the record high of 14.0% in September 2022. Imported prices contributed 2.5 percentage points to the headline inflation, mainly due to prices of imported food items, international airfares, construction materials, household items, clothing, and goods for personal care. However, imported inflation was partially offset by the lower prices of fuel and LP gas compared to previous year.

On the domestic front, annual inflation was 1.3% attributed to increases in prices for local food, transportation services, secondary school tuition fees, and local cost of communication services. Notably, electricity tariff and kava prices experienced decline over the year contributing 0.6 percentage points to the headline inflation.

While headline inflation has eased, core inflation remains although it dropped to 6.7% in September 2023 from 9.1% in the previous month and 8.1% in September 2022. The slowdown in the core inflation is largely due to base effects, supported by the decline in construction materials prices. Non-core inflation was 0.6% in September 2023 showing an increase from the previous month reflecting the rise in local fuel prices.

The continued high core inflation is putting pressure on headline inflation and the risk that it might rebound above the 5% reference rate remains. The rebound in global oil prices and uncertainties surrounding the Israel-Hamas war is putting upward pressure on inflation. As such, the Reserve Bank will continue to monitor and prioritise maintaining a low and stable inflation as indicated in its August 2023 Monetary Policy Statement. A regression analysis of Tonga's macro-economic data has shown that there is a very significant relationship between Tonga's money supply and headline inflation with a lagged effect. Controlling the money supply now would have a disinflationary impact in the next year. The Statutory Reserve Deposit ratio was raised from 10% to 15% effective in May 2023 to support efforts to contain inflation in the near term. At the same time, it was found that there were no significant relationship between output gap and inflation. Analysis also indicate that Tonga has been performing below its potential in the past few years. As such, there is room for the Reserve Bank to support economic recovery without putting too much pressure on inflation.

Effective exchange rate rose in September 2023

Table 2: Effective Exchange Rates

	Monthly			Annual	
	Sep-23	Aug-23	% Growth	Sep-22	% Growth
Nominal Effective Exchange Rate Index	95.5	95.3	0.2	95.1	0.4
Real Effective Exchange Rate Index	119.1	118.8	0.2	123.6	-3.7

Source: National Reserve Bank of Tonga

The Nominal Effective Exchange Rate (NEER) increased over the month by 0.2%, underpinned by the appreciation of the TOP against all major trading partners' currencies except against the USD, NZD and CNY. Similarly, the Real Effective Exchange Rate (REER) also increased by 0.2% in September.

The NEER remains higher by 0.4% compared to the previous year as the TOP strengthened against the trading partners' currencies (USD, AUD, NZD, FJD, JPY and CNY). The strengthened pa'anga helps keep imported inflation down as overseas payments would be cheaper in terms of local currency. Furthermore, analysis have shown that an appreciation of the NEER by 1% would have a disinflationary impact of about 0.15 percentage points. On the other hand, the REER declined over the year by 3.7% in line with the slow down in Tonga's inflation which may indicate a gain in Tonga's global trade competitiveness as local products become cheaper in comparison to those of our trading partners.

Foreign reserves declined further in September 2023

Table 3: Foreign Reserves

	Monthly			Annual	
	Sep-23	Aug-23	%Growth	Sep-22	% Growth
Foreign Reserves (\$ in million)	886.1	920.0	-3.7	895.3	-1.0
Import Coverage (months)	11.4	11.9	-4.4	13.7	-17.2

Source: National Reserve Bank Tonga

Foreign reserves decreased again over the month to September 2023 by \$33.8 million and over the year by \$9.1 million to \$886.1 million, equivalent to 11.4 months of imports which is higher than the IMF prescribed level of 7.5 months. Both declines reflect the Government loan repayments to the Exports-Imports Bank of China and higher import payments. The majority of the official foreign reserves are held in USD, NZD, and AUD.

Remittance receipts slowed in August 2023

Table 4: Remittance and Travel Receipts

	Monthly			Annual		
	Aug-23	Jul-23	% Growth	Aug-23	Aug-22	% Growth
Remittance (\$ in million)	48.3	50.1	-3.7	537.6	479.3	12.2
Travel (\$ in million)	12.7	14.8	-14.2	125.8	27.1	364.2

Source: National Reserve Bank Tonga

Total remittances fell over the month by \$1.8 million (3.7%), largely driven by the decline in compensation of employees and private transfers receipts by \$0.9 million (17.4%) and \$0.7 million (1.5%), respectively. This coincided with the end of national celebratory events such as annual church conferences, school anniversaries, and Heilala festivities amongst others. The TOP also appreciated against the AUD and NZD in August making receipts from those countries less in local currency. However, remittance receipts in AUD continued to hold the highest share, followed by the USD.

Annually, remittance receipts remained higher rising by \$58.3 million (12.2%) largely driven by private transfers and compensation of employees receipts. This reflects improvements of economies abroad supporting investment and employment opportunities.



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Broad money declined

Table 5: Broad Money ok

	Monthly			Annual	
	Aug-23	Jul-23	% Growth	Aug-22	% Growth
Broad money (\$ in million)	854.7	856.8	-0.2	843.5	1.3
Net Foreign Asset	896.4	911.5	-1.7	846.8	5.9
Net Domestic Asset	-41.4	-54.4	24.0	-3.1	-1245.8

Source: Banking System, National Reserve Bank of Tonga

Broad money decreased over the month by \$2.1 million (0.2%) but rose annually in August 2023, by \$11.2 million (1.3%). Both movements were driven mostly by the movements in net foreign assets. On the other hand, the net domestic assets increased over the month but declined annually, in line with the movements in government deposits.

Reserve money fell

Table 6: Reserve money ok

	Monthly			Annual	
	Aug-23	Jul-23	% Growth	Aug-22	% Growth
Reserve money (\$ in million)	602.5	621.4	-3.0	615.0	-2.0

Source: Banking System, National Reserve Bank of Tonga

Liquidity in the financial system decreased over the month and over the year to August 2023, by \$18.9 million (3.0%), and \$12.5 million (2.0%) respectively. Both declines were mostly driven by lower Exchange Settlement Accounts (ESA) and currency in circulation, reflecting higher import payments and lower demand for money. Statutory Reserve Deposits (SRD) on the other increased over the month and over the year coinciding with the growing deposits and the increase in the SRD ratio effective in May 2023 as part of the Reserve Bank's monetary policy tools.

Credit growth returns positive

Table 7: Total Lending

Lending	Monthly			Annual	
	Aug-23	Jul-23	% Growth	Aug-22	% Growth
Total Lending (\$ in million)	516.6	512.5	0.8	479.5	7.7
Business lending	259.6	256.3	1.3	224.6	15.6
Household lending	257.0	256.1	0.3	252.5	1.8
Other lending	0.0	0.0	-6.3	2.5	-98.2

Source: Banking System, National Reserve Bank of Tonga

The banks' total lending increased over the month and over the year to August 2023, by \$3.9 million (0.8%) and \$36.9 million (7.7%). Higher lending to both businesses and households were reported, indicating improvements in consumer and business confidence in line with the expected recovery in the economy.

Over the month, lending to the tourism, construction and distribution sectors increased, along with all categories of household loans. Annually, higher lending was recorded for businesses within the distribution, manufacturing, transport, construction and tourism sectors as well as households' other personal loans.

Total deposits in the banks declined by \$11.4 million (1.2%) over the month, however rose over the year by \$51.3 million

(6.0%) to \$910.3 million corresponding to the movements in both demand and time deposits. Over the month, demand deposits from the central government decreased, along with the time deposits of the Retirement Funds. However, annually, demand deposits from private businesses and Government remained high, as well as the time deposits of the Retirement Funds. As liquidity declines, the loans to deposit ratio increased in August 2023 to 55.6% compared to 54.5% in July 2023 and 54.7% last year.

Lending rates declined

Table 8: Weighted Average Interest Rates

Interest Rates	Monthly			Annual	
	Aug-23	Jul-23	(bps)	Aug-22	(bps)
Weighted Average Banks Lending Rate (%)	7.613	7.716	-10.2	7.765	-15.1
Weighted Average Banks Deposit Rate (%)	1.572	1.549	2.3	1.641	-6.9
Weighted Average Interest Rate Spread (%)	6.042	6.167	-12.5	6.124	-8.2

Source: Banking System, National Reserve Bank of Tonga

Weighted average interest rate spread narrowed by 12.5 basis points over the month and over the year by 8.2 basis points to 6.0%. The lending rates declined over the month while average weighted deposit rates rose. Lending rates offered to the constructions, utilities and transport sectors fell over the month along with the rates for household vehicle and housing loans. On the other hand, both savings and term deposit rates increased and outweighed the lower demand deposit rates.

Over the year, the lending rates were lower, which offset the decline in deposit rates. Lending rates offered to the agricultural, fisheries and transport sectors decreased over the year as well as all the loan rates offered to households, led by lower vehicle loans rates, and followed by the decline in housing and other personal loan rates.

Outlook

Whilst inflation containment remains a priority, the Reserve Bank retains ample policy space to bolster economic growth due to comfortable foreign reserves remain. Despite a reduction in headline inflation, the persistence of high core inflation poses risks driven by factors such as increasing global oil prices, uncertainties due to Israel-Hamas conflicts and Middle East geopolitical tensions. Additionally, El Nino weather conditions and anticipated higher demand during the Christmas and new year festivities could further contribute to inflationary pressures. Nevertheless, GDP growth for the current financial year is expected to be moderate, and domestic production is estimated to remain below potential. Foreign reserves are currently comfortable and projected to stay above the IMF's recommended level of 7.5 months of imports cover in the near to medium term. The financial system continues to remain stable with ample liquidity and banks are also well capitalized to absorb further shocks. The Reserve Bank will continue to closely monitor inflation movements and at the same time support economic recovery.