



Taming inflation remains a priority amongst major trading partners

Annual headline inflation in the US remained high at 3.2% in July 2023 above the 2% target, largely on the back of higher food, shelter and energy prices. Despite this, the general inflation trend since the beginning of the year exhibits signs of inflationary pressures cooling down in line with the continuous hike in the US federal funds rate. Meanwhile, the Reserve Bank of New Zealand anticipates inflation to remain above its 2.0% target in 2023 due to persistence in services inflation and tightness in the local labour market conditions, and slow down towards the 1-3% target range in the second half of 2024 as domestic demand and labour market conditions are anticipated to ease. The Reserve Bank of Australia continued to maintain its cash rate target at 4.1% to curb inflationary pressure and stabilize imbalances between demand and supply in the economy specifically in the labour market and services inflation. Unemployment rate remained at 3.6% in the July 2023 report whilst employment rate slightly rose by 0.2% indicating strong labour market conditions and active economic activities. However, economic growth for 2023 is expected to remain lower than projected at 1.0% due to higher cost of living and rising interest rates weighing on domestic demand.

Ongoing recovery efforts and domestic festivals supported economic activities in July 2023

The primary sector show mixed outcomes over the month. Total agricultural exports fell over the month by 141.5 tonnes (-23.3%), attributed primarily to lower export volumes of squash, root crops such as yam, and taro, and watermelon. The total agricultural export proceeds also decreased by \$0.4 million (-46.1%). The marine exports also declined by 115.2 metric tonnes (-62.7%) over the month, due to lower exports of tuna and shark meat. The aquarium exports, however, rose by 143.6% (2,597.0 pieces), along with a 30.2% (1.2 metric tonnes) increase in the total marine products sold at the domestic markets. At the same time, marine export proceeds slightly fell by 23.4% (\$0.04 million). The decline in export volumes may be reflective of supply side constraints that could not keep up with an increase in domestic demand during the national events and festivities during the month.

Credit to the industrial sector showed active performances in July 2023. Lending to the construction sector rose in July 2023 by 1.0% (\$0.2 million), along with a 6.6% (\$0.01 million) increase in credit to the mining & quarrying sector. At the same time, lending to the utilities sector also increased by 6.0% (\$0.03 million). The housing reconstruction project continues to support the sectoral growth, along with the ongoing implementation of the infrastructure projects such as the Upgrade of Nuku'alofa Port, Tonga High School Sports Complex, and Tonga Climate Resilience Transport, to name a few. With the commitment from the Government to implement other infrastructure projects, the sectoral growth is expected to correspond accordingly.

Indicators in the services sector remained highly favourable, given the ongoing festivals in July 2023. The total air passenger arrivals rose by 583 passengers (6.6%), hitting a new record high for year 2023. The air passenger departures also rose by 3,463 passengers (49.6%) as the celebrations ended during the month. Nevertheless, the arrival of cruise ships and hosting of official conferences and recreational activities here in Tonga continue to support tourism-related activities. Business and private containers both rose over the month, reflective of the high demand and consumption during the celebratory months. Trading activities remained upbeat with higher wholesale & retail imports payment of 14.0% (\$4.0 million). Overall, the imported containers increased by 572 containers (69.0%). In July 2023, the number of vehicle registrations decreased by 6.3% (17 vehicles).

Fewer job vacancies available in August 2023

The Reserve Bank's survey on job advertisements recorded a decline of 21 job vacancies (23.6%) in August 2023. Over half of the total job vacancies advertised during the month were in the public administration, followed by the transportation & communication sector. The total job vacancies advertised over the year rose by 362 job vacancies (57.9%), attributed mostly to the public administration, transport & communication, utilities, and hotel & restaurant sector.

Headline inflation further dropped to 2.9% in August 2023

Table 1: Inflation Rates

Prices	Monthly (% change)		Annual	
	Aug-23	Jul-23	Aug-23	Aug-22
Headline Inflation	-0.8	-0.6	2.9	13.8
Domestic prices	-2.0	-1.4	3.8	13.8
Imported prices	0.1	-0.1	2.2	13.9
Core inflation - ex. energy and food (%)	0.1	0.3	9.1	5.7

Source: Tonga Statistics Department

Consumer Price Index further declined over the month by 0.8%, supported by a decline in the overall domestic prices. Contrarily, the imported prices further rose over the month compounded mainly by higher prices of fuels, goods for personal care, LP gas & other fuels, and alcoholic beverages. However, the decline in the imported food items, construction materials, and footwear (flip flops) offset some of the increases. On the other hand, the lower domestic prices was largely driven by a decrease in prices of local food items. This further reflects the harvesting season and seasonality of vegetables and few root crops, further supported by a slowdown in the domestic demand as the major national events and celebrations ended.

The headline inflation has slowed to 2.9% in August 2023, lower than the 4.6% in the previous month and the 13.8% in August 2022. This is the lowest 12-month increase since 2.1% in February 2021. Despite the slowdown in the headline inflation, the overall prices still remain above the pre-pandemic level, as inflationary pressures persisted and broadened over the year. Imported inflation contributed 1.2 percentage points to the headline inflation, stemming



mainly from higher prices of imported food items, international airfares, construction materials, and clothing & footwear. Meanwhile, the fuel and LP gas prices declined over the year. On the other hand, the domestic prices contributed 1.7 percentage points to the headline inflation. The main domestic contributors were local food items, transportation component, catering services, and secondary school tuition fees. Nevertheless, the lower electricity tariff in the September 2023 quarter reduced the upward pressures on the headline inflation.

The core inflation eased from 10.3% in the previous month to 9.3% in August 2023 mainly due to base effects. While core inflation still persists above the 5% reference rate, the non-core (food & energy) prices fell by 1.2%, the first deflation since the 1.1% deflation in December 2020. This is driven primarily by lower energy prices (fuel, LP gas, and electricity) over the year.

Effective exchange rate continue to rise in August 2023

Table 2: Effective Exchange Rates

	Monthly			Annual	
	Aug-23	Jul-23	% Growth	Aug-22	% Growth
Nominal Effective Exchange Rate Index	95.3	94.3	1.0	93.7	1.7
Real Effective Exchange Rate Index	120.5	119.1	1.1	121.0	-0.4

Source: National Reserve Bank of Tonga

The Nominal Effective Exchange Rate (NEER) increased over the month by 1.0%, underpinned by the depreciation in all currencies against the Tongan Pa'anga except the USD. Similarly, the Real Effective Exchange Rate (REER) also increased by 1.1% in August.

The NEER remains higher by 1.7% compared to the previous year as the TOP strengthened against the trading partners' currencies (AUD, NZD, FJD, JPY and CNY). This may assist in partially offsetting the imported inflation, except for USD denominated imports. However, the REER declined over the year by 0.4% in line with the slow down in Tonga's inflation which may indicate a gain in Tonga's global trade competitiveness.

Foreign reserves declined in August 2023

Table 3: Foreign Reserves

	Monthly			Annual	
	Aug-23	Jul-23	%Growth	Aug-22	% Growth
Foreign Reserves (\$ in million)	920.0	945.2	-2.7	871.0	5.6
Import Coverage (months)	11.9	12.3	-3.2	13.8	-13.4

Source: National Reserve Bank Tonga

Foreign reserves declined over the month of August 2023 by \$25.2 million to \$920.0 million, equivalent to 11.9 months of imports which is higher than the optimum level of 7.5 months. The decline was largely attributed to higher import payments. In year ended terms, the level of foreign reserves is still higher in 2023 by \$49.0 million in comparison to the same period in 2022 due to higher inflow of Government funds and remittances. The majority of the official foreign reserves are held in USD, NZD, and AUD.

Higher remittances receipt in July 2023

Table 4: Remittance and Travel Receipts

	Monthly			Annual		
	Jul-23	Jun-23	% Growth	Jul-23	Jul-22	% Growth
Remittance (\$ in million)	50.1	49.1	2.1	536.9	475.1	13.0
Travel (\$ in million)	14.8	13.2	11.9	117.9	24.1	390.2

Source: National Reserve Bank Tonga

Total remittances increased over the month by \$1.0 million (2.1%). Private transfers continue to be the main driver of the overall monthly growth followed by employee compensations outweighing the decline in private capital transfers and social benefits. This was largely attributed to school celebration fundraisings and other family gatherings that was held during the month in parallel with the increase in travel receipts. Additionally, remittance receipts in Australian dollar (AUD) holds the largest share supported by the ease in Australia's unemployment and the appreciation of the Australian dollar against the Tongan Pa'anga during the month.

Over the year, remittance receipts continue to remain higher by \$61.8 million (13.0%).

Broad money continues to rise

Table 5: Broad Money

	Monthly			Annual	
	Jul-23	Jun-23	% Growth	Jul-22	% Growth
Broad money (\$ in million)	856.8	841.8	1.8	846.2	1.2
Net Foreign Asset	891.8	887.1	0.5	861.3	3.5
Net Domestic Asset	-54.4	-45.0	-21.0	-14.8	-267.6

Source: Banking System, National Reserve Bank of Tonga

Broad money increased further over the month and year to July 2023, by \$14.9 million (1.8%) and \$10.6 million (1.2%), respectively. 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	
	Jul-23	Jun-23	% Growth	Jul-22	% Growth
Reserve money (\$ in million)	621.4	600.7	3.4	625.7	-0.7

Source: Banking System, National Reserve Bank of Tonga

Liquidity in the financial system rose over the month of July 2023 by \$20.7 million (3.4%), however, declined annually by \$4.4 million (0.7%). Monthly trend corresponded to the movements in both the Exchange Settlement Accounts (ESA), currency in circulation and Statutory Reserve Deposits (SRD). Annually, lower ESA largely drove the annual movement mainly due to higher import payments supported by a slowdown in currency in circulation. Meanwhile, SRD remained high 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.



Annual credit growth remained positive

Table 7: Total Lending

Lending	Monthly			Annual	
	Jul-23	Jun-23	% Growth	Jul-22	% Growth
Total Lending (\$ in million)	512.5	513.0	-0.1	479.2	6.9
Business lending	256.3	257.2	-0.3	225.4	13.7
Household lending	256.1	255.7	0.2	251.4	1.9
Other lending	0.0	0.1	-31.4	2.4	-98.0

Source: Banking System, National Reserve Bank of Tonga

The banks' total lending over the month slightly fell by \$0.4 million (0.1%) as business lending fell specifically in the fisheries, agriculture and distribution sectors.

Over the year to July 2023, credit growth remained strong recording 12 consecutive months of positive annual growth since August 2022, indicating active investment activities in the economy. Higher lending was recorded for businesses in the manufacturing, wholesale & retail, construction and agricultural sectors as well as households' other personal loans.

Total deposits in the banks increased by \$20.4 million (2.3%) over the month, and over the year by \$58.6 million (6.8%) to \$921.7 million. The higher deposits over the month coincided with the higher Government receipts, the on-going ex-student fundraise activities, churches annual donations. Annually, demand deposits remained high due to higher deposits by businesses and Government. Time deposits from the Retirement Funds and Government also increased. Loans to deposit ratio decreased in July 2023 to 54.5% compared to 55.8% in June 2023 due to stronger growth in deposits, but slightly higher than 54.4% in July 2022.

Weighted average interest rate spread widened

Table 8: Weighted Average Interest Rates

Interest Rates	Monthly			Annual	
	Jul-23	Jun-23	(bps)	Jul-22	(bps)
Weighted Average Banks Lending Rate (%)	7.716	7.706	1.0	7.727	-1.1
Weighted Average Banks Deposit Rate (%)	1.549	1.571	-2.2	1.633	-8.4
Weighted Average Interest Rate Spread (%)	6.167	6.135	3.2	6.094	7.3

Source: Banking System, National Reserve Bank of Tonga

Weighted average interest rate spread widened by 3.2 basis points over the month and over the year by 7.3 basis points to 6.2%. The monthly increase resulted from a larger decline in deposit rates coupled with a slight rise in lending rates. Demand and time deposit rates both fell over the month. Meanwhile, lending rates offered to households housing and other personal loans rose outweighing the decline in rates offered to businesses.

Over the year, the increase in spread was attributed to deposit rates declining faster than the fall in lending rates. Lower average weighted demand deposit rate solely drove the movements in deposit rates largely in line with the high demand deposit volume at zero percent over the year. Whilst, lending rates offered to businesses in the agriculture, transport and manufacturing sectors contributed to the movement in business lending rates. Housing and other personal loans rates also fell.

Outlook

The NRBT's Monetary Policy Statement August 2023 is still focused on reducing inflation. Although headline inflation has now fallen below the 5% reference rate in both July and August 2023, risks to inflation are tilted to the upside driven by an upsurge in oil prices owing to the ongoing supply cuts by Russia and Saudi Arabia and its spillover effects. The El Nino weather conditions and expected rebound in demand and consumption during the holiday season are also anticipated to further pressure prices. The financial system continues to remain stable with ample liquidity and banks are also well capitalized to absorb further shocks. Foreign reserves, are at comfortable levels and is projected to remain above the IMF's optimal level of 7.3 months of imports cover in the near to medium term. The Reserve Bank will continue to closely monitor inflation movements and at the same time support economic recovery.