



Global economy remains in deep recession

In its October 2020 World Economic Outlook, the IMF forecasted the global economy to remain in deep recession for 2020 contracting by 4.4%, although this is less severe than its 5.2% contraction forecasted in June. The better than expected performance of mostly the advanced economies was the basis of the upward revision. A rebound is projected for 2021, the recovery is expected to be long, uneven and uncertain. Pacific Island Countries, on the other hand, are expected to be much harder hit with a sharp drop in growth of 5.5% for 2020, driven by the loss in tourism earnings, as well as the disruption to trade and remittance flows.

Domestic performance remains weak

In August, agricultural export volumes declined by 49.9 tonnes (6.0%) due to lower exports of taro, sweet potato, yams, and coconuts. Contrastingly, agricultural export volumes grew strongly during the year by 4,510.6 tonnes (50.2%). Export proceeds slightly declined over the month by \$0.1 million (8.0%) owing mostly to the lower proceeds of fish and marine exports by \$0.2 million (43.4%). Annually, export proceeds declined by \$4.5 million (21.7%) as both proceeds for agriculture and fisheries exports declined. The primary sector, specifically the agriculture sector is expected to positively contribute to Tonga's growth due to the increased participation in the sector, the upcoming squash season, and the improved harvests supported by favourable weather conditions resulting in the abundant supply of local food and increased exported volumes. However, unsuccessful export arrangements can be a setback to this forecast.

The industry sector remained active in August as reflected in the completion of construction works during the month. This included the completion of 110 classrooms in total for Tongatapu, Vava'u, and 'Eua. Additionally, other construction works continued such as the new Customs Brokers Office at Queen Salote Wharf with a total cost of around \$0.7 million. This coincided with the \$0.2 million (4.1%) rise in import payments for construction material. Over the year, lending to the construction sector increased by \$0.5 million (4.8%) while individual housing loans also grew by \$2.7 million (1.3%). Electricity consumption, on the other hand, declined by 5.3% over the month despite the 0.3% increase in the number of electricity consumers. As the Government expedites the TC Gita reconstruction projects for school buildings to be completed by November, it will continue to provide activities for the industry sector.

The services sector noted some mixed outcomes in August. Travel receipts slightly declined by \$0.1 million (3.0%) over the month as the border remains closed except for the repatriation of Tongan citizens from New Zealand. Trade, on the other hand, showed an upward movement as container registrations rose in August by 233 registrations (27.6%) driven by both higher business and private containers. Additionally, more cargo ships and oil tankers

were reported to have arrived in Tonga during the month. Import payments also rose by \$0.7 million (2.1%) due to increases in oil imports and construction goods. Some of the tourism businesses are engaging more in attracting residents through price reductions and special offers for their services. Consumption activities and aggregate demand remained relatively stable compared to the previous month, but still relatively weaker compared to pre-COVID levels as there were no major events during the month. Over the next few months, the services sector is expected to remain unchanged as our border remains closed for international travel.

Fading employment opportunities

The Reserve Bank's survey on job advertisements continued to record a declining trend of job advertisements over the month and year to August by 10 vacancies (50.0%) 53 vacancies (12.7%), respectively. New entrants to the labour force such as youth and school leavers may find it harder to get a job due to the limited opportunities available. Some businesses and employees are facing financial hardships and redundancies, while a few businesses have declared that they have ceased operations since March. The informal sector such as agriculture may be absorbing these redundant employees from the formal sector, however, this sector is highly vulnerable to many risks.

Negative annual inflation rate remains

Table 1: Inflation Rates

Prices	Monthly		Annual	
	Aug-20	Jul-20	Aug-20	Aug-19
Headline Inflation (%)	-0.1	0.5	-1.6	-0.1
Domestic prices	-1.1	-1.0	-3.4	-2.5
Imported prices	0.7	1.7	-0.2	1.9

Source: Statistics Department

Consistent declines in domestic prices, specifically for local food prices such as root crops and vegetables, contributed to the negative inflation rate recorded in the month of August 2020. This more than offset the pick-up in imported prices resulting from higher fuel prices. The global oil production cuts and stock level reductions has resulted in higher fuel prices.

Table 2: Average annual prices of selected items

Items (\$ per kg)	Unit	Aug-20	Aug-19	Annual Change
Domestic				
Kava	1kg	\$60.00	\$112.50	-\$52.50
Capsicum	1kg	\$11.68	\$15.45	-\$3.77
Octopus	1kg	\$11.66	\$15.29	-\$3.63
Tomatoes	1kg	\$5.23	\$6.55	-\$1.32
Imported				
Turkey tails	1kg	\$8.99	\$9.80	-\$0.81
Diesel	1 litre	\$2.25	\$2.79	-\$0.54
Petrol	1 litre	\$2.18	\$2.68	-\$0.50

Source: Statistics Department

Annually, headline inflation has been negative since June, as both domestic and imported

prices are relatively lower compared to the previous year. The 1.6% deflation in August 2020 is the lowest recorded since November 2015 which was -1.9%. Declining prices for electricity, gas & other fuels, kava Tonga and local food



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prices were the main drivers of lower local prices, whilst lower global oil prices supported lower import prices. This continuous deflation rate may contribute to the slowdown in aggregate demand as consumers delay spending. The NRBT projects inflation rates to remain negative for the remainder of 2020 on the back of lower domestic food prices, supported by lower global oil prices.

Lowest Effective Exchange rates

Table 3: Effective Exchange Rates

	Monthly			Annual	
	Aug-20	Jul-20	% Growth	Aug-19	% Growth
Nominal Effective Exchange Rate Index	90.8	91.2	-0.4	92.4	-1.7
Real Effective Exchange Rate Index	104.2	104.8	-0.6	108.6	-4.1

Source: National Reserve Bank of Tonga

The Nominal Effective Exchange Rate (NEER) decreased again in August 2020 as all of major trading currencies appreciated against TOP. The Real Effective Exchange Rate (REER) index also fell in line with the monthly deflation.

Both the NEER and REER were lower compared to the previous year indicating an improvement in Tonga's trade competitiveness, supporting export proceeds and remittance receipts.

Table 4: Bilateral Exchange Rates

	Aug-20	Jul-20	Aug-19
USD/TOP	0.4386	0.4390	0.4325
AUD/TOP	0.6086	0.6236	0.6371
NZD/TOP	0.6640	0.6662	0.6706
FJD/TOP	0.9028	0.9090	0.8920
JPY/TOP	46.3982	46.7876	45.8792
GBP/TOP	0.3332	0.3458	0.3548
EUR/TOP	0.3701	0.3826	0.3877
CNY/TOP	2.8536	2.8561	2.8140

Source: Banking Systems

Foreign reserves remain adequate

Table 5: Foreign Reserves

	Monthly			Annual	
	Aug-20	Jul-20	% Growth	Aug-19	% Growth
Foreign Reserves (\$ in million)	556.1	555.9	0.04	491.8	13.1
Import Coverage (months)	8.5	8.5	0.0	8.1	5.4

Source: National Reserve Bank Tonga

Official foreign reserves remain at 8.5 months of imports cover in August 2020 similar to the previous month. A marginal increase of \$0.1 million was recorded over the month, but over the year it rose significantly by \$64.3 million. This reflects the inflow of budget support, relief and project funds from development partners, and remittances. Majority of the foreign reserves are held in USD, AUD and NZD.

Table 6: Remittance Receipts

	Monthly			Annual		
	Aug-20	Jul-20	% Growth	Aug-20	Aug-19	% Growth
Remittance (\$ in million)	36.5	37.5	-2.7	359.5	350.5	2.6

Source: National Reserve Bank Tonga

Remittances slightly declined in August by \$1.0 million (2.7%), although this is still 11.5% higher than the same month last year. Lower receipts of private transfers and compensation of employees which includes receipts from seasonal workers.

Contrastingly, higher private transfers and compensation of employees drove the \$9.1 million (2.6%) rise in remittance receipts over the year.

Table 7: Overseas Exchange Transactions

	Monthly			Annual		
	Aug-20	Jul-20	% Growth	Aug-20	Aug-19	% Growth
Overall Balance	0.1	12.1	-99.2	64.3	16.8	282.7
Current Account	1.5	4.1	-63.4	59.7	1.8	3216.7
Merchandise Trade	-34.5	-33.7	-2.4	-397.4	-421.1	5.6
Services	-1.7	-0.4	-325.0	9.0	31.7	-71.6
Income	1.6	2.6	-38.5	7.8	7.0	11.4
Transfers	36.0	35.6	1.1	440.2	384.1	14.6
Capital Account	0.7	1.6	-56.3	23.1	37.3	-38.1
Financial Account	-2.0	6.4	-131.3	-18.5	-22.2	16.7

Source: Banking Systems

Overall, Overseas Exchange Transactions (OET) recorded lower net receipts in August, mostly due to a decline in OET receipts while OET payments picked up. Over the year, the overall balance rose significantly by \$47.5 million stemming from the higher surplus in the current account. The improvement in the current account is attributed to the increase in receipts of government transfers, and remittances, coupled with lower deficits in merchandise trade. The financial account deficit also improved as outflows for offshore investments declined over the year. However, the capital account surplus fell over the year due to lower receipts of capital investments.

The NRBT expects foreign reserves levels to remain comfortable in the near term with no major outflows expected for imports, external debt or offshore investment.

Broad money rises

Table 8: Broad Money

	Monthly			Annual	
	Aug-20	Jul-20	% Growth	Aug-19	% Growth
Broad money (\$ in million)	624.7	616.9	1.3	600.5	4.0
Net Foreign Asset	582.4	579.0	0.6	510.9	14.0
Net Domestic Asset	43.0	38.5	11.5	90.0	-52.3

Source: Banking System, National Reserve Bank of Tonga

Both the net foreign assets and net domestic assets rose in August 2020 and contributed to the \$7.8 million increase in broad money. Net foreign assets rose in line with the rise in demand deposits from matured investments abroad. Net domestic assets rose due to higher government drawdown of deposits from the Reserve Bank to cater for government operations, ongoing projects, and matured bonds during the month.

Liquidity in the financial system expands

Table 9: Reserve money

	Monthly			Annual	
	Aug-20	Jul-20	% Growth	Aug-19	% Growth
Reserve money (\$ in million)	336.3	332.2	1.2	311.3	8.0

Source: Banking System, National Reserve Bank of Tonga

Liquidity in the banking system rose by \$4.1 million in August 2020 attributed mainly to a \$2.3 million rise in the commercial banks' ESA (Exchange Settlement Account), coinciding with the rise in the banks' total deposits. Currency in circulation and required reserves also increased over the month and supported the higher total reserve money.



Credit growth slows down

Table 10: Total Lending

Lending	Monthly			Annual	
	Aug-20	Jul-20	% Growth	Aug-19	% Growth
Total Lending (\$ in million)	487.6	490.4	-0.6	496.5	-1.8
Business lending	229.0	231.5	-1.1	237.1	-3.4
Household lending	258.7	258.9	-0.1	259.2	-0.2
Other lending	0.0	0.0	0.0	0.2	-100.0

Source: Banking System, National Reserve Bank of Tonga

Lending activities continue to fall over the month due to slower growth in new loan commitments and the usual outstanding loan balance run-offs. Total banks' lending fell over the month and year by \$2.7 million and \$8.9 million respectively. The uncertainties of COVID-19, weakened investment appetite, and risk aversion of banks are the reasons behind the decline in both businesses and household loans.

Total deposits, however, rose by \$7.4 million (1.2%) in August 2020 as demand deposits from public enterprises and retirement funds rose. The annual church donations also contributed to the rise in non-profit organisations demand deposits over the month. As the banks' total loans decline more than the rise in total deposits, the loans to deposit ratio declined to 75.5% from 76.8% in July 2020, below the 80% minimum.

Money supply and liquidity is projected to still remain high whereas credit growth will continue to trend downwards. Deposits are also expected to remain high as demand remains weak in addition to minimal investment opportunities available locally.

Average interest rates reflect movements in lending and deposits

Table 11: Weighted Average Interest Rates

Interest Rates	Monthly			Annual	
	Aug-20	Jul-20	Growth	Aug-19	Growth
Weighted Average Banks Deposit Rate (%)	2.144	2.133	1.2	1.924	22.0
Weighted Average Banks Lending Rate (%)	7.805	7.807	-0.1	8.035	-23.0
Weighted Average Interest Rate Spread (%)	5.661	5.674	-1.3	6.111	-45.0

Source: Banking System, National Reserve Bank of Tonga

The constant monthly decline in the total loans contributes to the narrowing of the weighted average lending rates each month. For August 2020, the weighted average lending rates declined mainly for businesses in the entertainment & catering, transport, and professional & other services sectors. This was partially due to banks offering lower interest rates to sectors that are affected by COVID-19. Additionally, lending rates for other personal loans fell. Weighted average deposit rates, however, rose due to a rise in rates offered for time and demand deposits. Volume of deposits also increased and supported the monthly rise.

As a result, the weighted average interest rate spread narrowed again in August 2020 by 1.28 basis points. A similar trend was reflected in the annual movements. The weighted average lending rates declined mainly on household loans as well as business loans for the mining & quarrying, tourism, fisheries, transport, and construction sectors.

Outlook

Considering the monthly change in the indicators, slightly lower remittances, deteriorating labor market indicators, and the comfortable level of foreign reserves, the level of deflation, and excess liquidity in the banking system, the negative economic growth outlook has not changed and the Reserve Bank's monetary policy stance remains accommodative. At the same time, the Reserve Bank is monitoring the emerging risks prompted by the prolonged state of global pandemic that can impact economic growth and potentially impair financial stability. As such, the Reserve Bank remains vigilant in its regulatory and supervisory roles to ensure financial stability is maintained, while at the same time mitigate the economic downturn and support recovery.