



# NATIONAL RESERVE BANK OF TONGA

## MONTHLY ECONOMIC REVIEW

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Month Ended: June 2020

### COVID-19 restrictions continue to hinder global growth

The World Trade Organization (WTO) in June 2020 reported that the volume of world trade is expected to record its largest decline on a year-on-year basis by 18.5% for June 2020. Associated impacts of COVID-19 across the globe forced the closure of businesses and restricting trade and travel. The US Bureau of Economic Analysis in July 2020 reported that the economy in the June quarter of 2020, contracted by 32.9%. The contraction owes to sharp declines in personal consumption, exports, and private investments. Meanwhile, the Australian Bureau of Statistics reports that the June 2020 unemployment rate rose to 7.4%, its highest rate since 1998. This coincides with the increasing COVID-19 cases and the temporary shutdown of workplaces across the country.

### Domestic activities show resilience amidst COVID-19

Available indicators reflect mixed growth for the primary sector for the year 2019/20. The volume of agricultural exports rose in the year by 4,105.8 tonnes (45.1%) driven by exports of squash and root crops. Favourable weather conditions and replanting efforts from recent cyclones supported the recovery of the agricultural sector as reflected in improved harvests. The recovery in part resulted from NGOs<sup>1</sup>, such as MORDI<sup>2</sup> Tonga Trust and GroFed, distributing seeds, plants, and conducting training workshops in communities to ensure food security. This resulted in the excess supply of local produce in the domestic market, despite the recent TC Harold and the disruptions from COVID-19. Contrastingly, agricultural export proceeds declined by \$2.8 million (25.6%) over the year owing mostly to an unsuccessful squash season. Marine exports continued to rise over the year by 152.0 metric tons (8.6%), specifically for tuna exports, despite having no airfreight exports in the June quarter. Marine export proceeds also rose in the year to June by \$1.5 million (19.9%).

The secondary sector showed a pick-up in some activities following the COVID-19 disruptions from the previous months. Some TC Gita reconstruction projects were completed while other reconstruction projects are still ongoing, including the reconstruction from TC Harold. During the year to June 2020, the construction sector was supported by a 10.2% increase in lending, while private housing lending grew by 1.7%. The Road Improvement Project for the main islands of Tonga supported mining and quarrying. As for the utility sector, Tonga Power has reduced the electricity tariffs as a result of the lower fuel prices, while continuing with the Network upgrade projects.

COVID-19 disruptions continued to dampen the growth in the services sector, particularly the Tourism sector and its

<sup>1</sup> Non-Government Organization

<sup>2</sup> Mainstreaming of Rural Development Innovation

related sectors. Container registrations fell in the year to June by 18.2%, corresponding to the decline in import payments. Weak demand led to wholesale and retail businesses reporting lower sales. Nevertheless, businesses continued to diversify and expand into other economic activities such as food delivery services, landscape services, sport events, and household farming. Exemptions of import duties for private households also supported in-kind remittances, while the Government stimulus package helped sustain some of the businesses. Digital platforms for local business trading have also become popular, especially on the social media channels.

### Recruitment intentions slowed

The total number of job advertisements declined by 23 vacancies over the year. Negative impacts of COVID-19 on investments and aggregate demand severely affected many businesses who can no longer afford to employ full-time staff. Additionally, the border lockdown also grounded seasonal workers that were about to be deployed. Given the limited job opportunities available, many people have turned to the informal sector to find work such as subsistence farming and self-employment. The Government stimulus package provided financial assistance to employees that are affected by COVID-19, in addition to other relief packages offered by the Retirement Fund to its members.

### Negative headline inflation for June

Inflation fell by 1.2% over the month as both local and imported prices declined by 1.3% and 1.1%

Table 1: Inflation Rates

Prices	Monthly		Annual	
	Jun-20	May-20	Jun-20	Jun-19
Headline Inflation (%)	-1.2	-0.4	-1.4	1.8
Domestic prices	-1.3	0.7	-1.1	1.7
Imported prices	-1.1	-1.2	-1.5	1.9

Source: Statistics Department

respectively. Lower domestic prices were solely driven by the 4.7% decline in local food prices indicating abundant supply of local food products, and a fall in aggregate demand. The decline in imported prices largely reflected the lower oil price pass-through to transportation, and electricity, gas & other fuels.

Table 2: Monthly average prices of selected domestic items

Items (\$ per kg)	Unit	Monthly		
		Jun-20	May-20	Change
Capsicum	1kg	\$13.07	\$19.90	-\$6.83
Tomatoes	1kg	\$11.35	\$15.45	-\$4.10
Octopus	1kg	\$10.62	\$13.57	-\$2.95
H/Cabbage	1kg	\$3.04	\$4.85	-\$1.81
Tuna	1kg	\$15.00	\$15.64	-\$0.64

Source: Statistics Department

Annual inflation for June 2020 was -1.4% which is lower than the 1.8% in June 2019 and 0.1% in May 2020. Imported prices decreased by 1.5% over the year to June 2020 largely driven by the declining oil prices. Lower domestic prices have been consistently driven by the lower prices for kava Tonga following its hike in the

previous year due to supply shortages, in addition to the decline in domestic demand from the COVID-19 curfews. Lower prices for electricity, gas & other fuels and local food items further contributed to the decline in domestic prices.

### Major trading currencies strengthened against TOP

Table 3: Effective Exchange Rates

	Monthly			Annual	
	Jun-20	May-20	% Growth	Jun-19	% Growth
Nominal Effective Exchange Rate Index	92.9	94.8	-2.0	91.4	1.6
Real Effective Exchange Rate Index	109.0	110.4	-1.3	107.2	1.7

Source: National Reserve Bank of Tonga

In June 2020, the Nominal Effective Exchange Rate (NEER) declined as a result of the appreciating NZD and AUD. Similarly, the Real Effective Exchange Rate (REER) index also declined in line with the lower domestic inflation.

Over the year, both the NEER and REER increased implying a loss in Tonga's international trade competitiveness, however, benefitting importers of goods and services.

### Significant rise in foreign reserves

Table 5: Foreign Reserves

	Monthly			Annual	
	Jun-20	May-20	% Growth	Jun-19	% Growth
Foreign Reserves (\$ in million)	543.8	489.6	11.1	484.3	12.3
Import Coverage (months)	8.2	7.4	10.8	7.9	3.8

Source: National Reserve Bank Tonga

The official foreign reserves rose substantially by \$54.2 million over the month and by \$59.5 million in the year to June 2020, pushing foreign reserves to a new record high. This attributes to inflow of funds for budget support, government projects, and financial assistance for COVID-19 preparations and TC Harold.

Table 6: Overseas Exchange Transactions  
Overseas Exchange Transactions

	Monthly			Annual		
	Jun-20	May-20	% Growth	Jun-20	Jun-19	% Growth
<b>Overall Balance</b>	<b>54.2</b>	<b>14.5</b>	<b>273.8</b>	<b>59.5</b>	<b>15.6</b>	<b>281.4</b>
<b>Current Account</b>	<b>47.7</b>	<b>19.1</b>	<b>149.7</b>	<b>74.6</b>	<b>-2.0</b>	<b>3830.0</b>
Merchandise Trade	-36.3	-32.0	-13.4	-399.3	-424.4	5.9
Services	1.8	14.5	-87.6	43.9	32.2	36.3
Income	2.4	2.5	-4.0	1.0	8.8	-88.6
Transfers	79.9	34.1	134.3	429.1	381.4	12.5
<b>Capital Account</b>	<b>4.3</b>	<b>1.9</b>	<b>126.3</b>	<b>22.2</b>	<b>42.1</b>	<b>-47.3</b>
<b>Financial Account</b>	<b>2.2</b>	<b>-6.4</b>	<b>134.4</b>	<b>-37.3</b>	<b>-24.5</b>	<b>-52.2</b>

Source: Banking Systems

Consequently, Overseas Exchange Transactions (OET) recorded its highest overall surplus in June 2020, \$43.9 million higher than the surplus in the previous year. The current account balance improved during the year, on the back of lower imports of goods and services, coupled with

the rise in transfers from government receipts and remittances. This offset the decline in capital and financial balances mostly due to lower receipts of capital investments and the higher outflow of offshore investments.

### Net foreign asset contributes to Money Supply

Table 7: Broad Money

	Monthly			Annual	
	Jun-20	May-20	% Growth	Jun-19	% Growth
Broad money (\$ in million)	607.1	592.2	2.5	600.1	1.2
Net Foreign Asset	570.6	517.2	10.3	506.3	12.7
Net Domestic Asset	37.2	75.7	-50.9	94.2	-60.5

Source: Banking System, National Reserve Bank of Tonga

Broad money expanded over the month and year to June 2020 by \$14.9 million (2.5%) and \$7.0 million (1.2%) respectively. These movements were driven mostly by the significant rise in net foreign assets particularly on higher foreign reserves. Net domestic assets, on the other hand, declined both over the month and year due to the rise in government deposits from the receipts of budget support and COVID-19 funds.

### More liquidity in the Banking System

Table 8: Reserve money

	Monthly			Annual	
	Jun-20	May-20	% Growth	Jun-19	% Growth
Reserve money (\$ in million)	311.7	286.7	8.7	302.2	3.1

Source: Banking System, National Reserve Bank of Tonga

Reserve Money rose over the month and year to June 2020 due mainly to a rise in the commercial banks' ESA (Exchange Settlement Account), in line with the higher government deposits in June 2020. The slight rise in currency in circulation also supported the increase in liquidity.

### Subdued credit growth

Table 9: Total Lending

Lending	Monthly			Annual	
	Jun-20	May-20	% Growth	Jun-19	% Growth
Total Lending (\$ in million)	492.9	495.4	-0.5	485.9	1.4
Business lending	234.5	236.4	-0.8	226.6	3.5
Household lending	258.4	259.0	-0.2	258.9	-0.2
Other lending	0.0	0.0	0.0	0.4	-100.0

Source: Banking System, National Reserve Bank of Tonga

The banks' total loans to deposit ratio was at 77.9% in June 2020, below the 80% benchmark, after 7 months of remaining above the 80% minimum, and close to the 77.8% in June 2019. Although lending rose over the year, deposits also rose at faster pace. Bank's lending grew by 1.4% in the year to June 2020, slower than the 8.6% growth in the previous year. The annual growth stemmed from higher lending to businesses in the professional & other services, agricultural, construction sectors, and public enterprises. Starting from January 2020, lending has been steadily declining indicating weak investment appetite. Deposits however rose over the same period depicting a preference to save rather than invest given the uncertainties of the global pandemic. These savings also reflect the fall in aggregate demand due to the cancellation of annual events and festivities, government assistance for

payment of school fees, lower electricity tariffs and lower fuel prices. The payout of government relief packages to employees and businesses, together with the rising remittance receipts also contribute to household savings. These savings may cushion the impact of COVID-19 on businesses and households going forward.

### Interest rate spread continued to narrow

Table 10: Weighted Average Interest Rates

Interest Rates	Jun-20	Monthly May-20	Growth	Jun-19	Annual Growth
Weighted Average Banks Deposit Rate (%)	2.157	2.119	3.8	1.939	21.8
Weighted Average Banks Lending Rate (%)	7.815	7.814	0.1	8.029	-21.4
Weighted Average Interest Rate Spread (%)	5.658	5.695	-3.7	6.090	-43.2

Source: Banking System, National Reserve Bank of Tonga

The weighted average interest rate spread slightly narrowed over the month and year to 5.66%. This attributes to lower weighted average lending rates coupled with the higher weighted average deposit rates.

Lower lending rates were mostly for households' housing and personal loans. Business loans particularly for the mining & quarrying, tourism, and professional & other services sectors, and government enterprises also benefited from lower lending rates. Weighted average deposit rates rose on higher deposit rates for savings, demand, and term deposit rates.

### Outlook

The Reserve Bank projects an economic downturn for 2019/20 financial year as well as the 2020/21 financial year. Although based on the available data to date, the contraction in the economy for 2019/20 is lower than previously anticipated. However, extreme uncertainties regarding the duration of the COVID-19 pandemic remains a downside risk to the projections. Nevertheless, the Reserve Bank still expects foreign reserve levels to remain comfortable above the Reserve Bank's minimum of 3 months. Furthermore, the Reserve Bank forecast inflation rate to remain below the reference rate of 5%. The banking system is expected to remain sound supported by high liquidity and lower risk of overheating.

Given the latest development and outlook, the Monetary policy stance remains accommodative in support of domestic activities, macroeconomic growth, and to mitigate the impacts of COVID-19 on the economy. However, the Reserve Bank remains vigilant by closely monitoring the financial and economic indicators for early signs of vulnerability in the financial system and stands ready to adjust its monetary policy setting if required.