



NATIONAL RESERVE BANK OF TONGA

MONTHLY ECONOMIC REVIEW

Vol. 7

No. 10

Month Ended: October 2020

Signs of recovery in advanced economies

The World Bank Group reported in November 2020 that signs of recovery in global economic activities are reflected in the third quarter of 2020 data following contractions in the previous quarter. Majority of advanced economies such as the United States, Euro Area, Japan, and China, reported positive growths from improvements in manufacturing activities and the services sector. Encouraging results from the COVID-19 vaccine developments has boosted business confidence and investments despite the rising number of positive cases. In the US, the Bureau of Labor Statistics shared that unemployment fell by 1.0% to 6.9% in October 2020 in line with businesses resuming activities in the services sector. Meanwhile, the Australian economy rebounded by 3.3% in the September 2020 quarter, owing to higher demand and consumption spending as restrictions eased. Similarly, the Reserve Bank of New Zealand projected a 13.4% growth for the economy in September 2020 quarter due to swift implementation of policy measures and more fiscal spending.

Slight pick-up in domestic performances

The primary sector showed mixed outcomes in October 2020. Total volume of agricultural exports decreased over the month by 154.3 tonnes (12.1%) due to lower exports of cassava (fell by 151.9 tonnes) and yam (fell by 121.9 tonnes). This was partially offset by the increase in watermelon and squash exports by 106.9 tonnes and 57.3 tonnes, respectively. This year's squash season is not as strong as it was last year, but the watermelon season is promising with prospects for growers to export to New Zealand. However, recent biosecurity and shipping issues have delayed the export of watermelons. Kava exports to Australia was also affected by the border lockdown as it can only be hand-carried by travellers. Export proceeds rose in October by \$0.5 million (75.3%) on the increase in receipts for both marine and agricultural exports. The Chinese government donated tractors and fishing boats to the Ministry of Agriculture, Food, Forests and Fisheries to assist with the development of the sector and to achieve food security. Additionally, the government has extended and expanded its Development loan scheme at TDB, which will continue to provide cheaper financing options for agricultural and fisheries businesses.

Construction activities supported a positive performance in the secondary sector in October 2020. New classrooms commissioned under the Pacific Resilience Program (PREP) project, and new offices and church buildings were completed. Consequently, lending to the construction sector rose by \$2.0 million (13.7%) over the month and \$6.1 million (59.6%) over the year to October. The \$15 million national roads tar sealing project is slowly getting underway supporting mining and quarrying. Financial support from the European Union (EU) for Tonga's renewable energy and

energy efficiency project is also expected to aid developments in the utility sector.

The tertiary sector was slightly more active in October 2020 particularly for the trade sector. This was reflected by higher container registrations rising by 132 registrations (13.8%) driven by both higher business and private containers. This coincided with higher import payments specifically for wholesale and retail goods as businesses gear up for the upcoming festive season. Some tourist businesses are providing their services to local residents at lower prices which may attract those who are now unable to travel overseas for the holidays.

Job opportunities slightly rose yet mostly restricted

The Reserve Bank's survey shows a slight increase in vacancies over the month by 4 job vacancies (33.3%) mostly for public administration. However, job advertisements continued to decline in the year to October 2020 by 152 vacancies (33.3%). The impacts of COVID-19 continue to restrict job opportunities, particularly in the tourism and hospitality sector. In response to labour demands from Australian farms, Tonga repatriated around 150 workers in October for the Seasonal Working Program. At the same time, a few of the seasonal workers in New Zealand and Australia have been repatriated in October. The uncertainty of the COVID-19 pandemic continues to pose a downside risk for the availability of employment opportunities.

Tonga remains in negative inflation

Table 1: Inflation Rates

Prices	Monthly		Annual	
	Oct-20	Sep-20	Oct-20	Oct-19
Headline Inflation (%)	-0.1	0.6	-1.6	0.2
Domestic prices	-0.5	1.2	-2.9	-1.3
Imported prices	0.2	0.2	-0.5	1.5

Source: Statistics Department

Lower monthly prices in October 2020 was largely driven by the fall in local items outweighing the rise in imported prices. Domestic items were solely driven by the decline in prices for food items such as root crops and vegetables. However, imported prices rose over the month due to higher food prices.

The annual headline inflation remains negative in October. Both local and imported prices fell as a result of declining prices for electricity,

Table 2: Average annual prices of selected items

Items (\$ per kg)	Unit	Annual		
		Oct-20	Oct-19	Change
Domestic				
Kava	1kg	\$60.00	\$100.00	-\$40.00
Tomatoes	1kg	\$3.89	\$8.61	-\$4.72
Capsicum	1kg	\$8.04	\$11.51	-\$3.47
H/Cabbage	1kg	\$0.88	\$2.04	-\$1.16
Imported				
Chicken	1kg	\$3.30	\$4.48	-\$1.18
Turkey tails	1 kg	\$9.27	\$9.99	-\$0.72
Diesel	1 litre	\$2.44	\$2.78	-\$0.34

Source: Statistics Department

gas & other fuels, kava Tonga, and food items. Meanwhile, the decrease in crude prices and lower diesel margins coupled with the slow recovery in the oil market has flowed



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through to lower fuel prices, thus driving lower imported prices. The annual headline inflation is expected to remain in negative for the remainder of 2020.

Declining effective exchange rates

Table 3: Effective Exchange Rates

	Monthly			Annual	
	Oct-20	Sep-20	%	Oct-19	% Growth
Nominal Effective Exchange Rate Index	89.9	90.1	-0.2	92.3	-2.5
Real Effective Exchange Rate Index	103.3	103.9	-0.6	108.4	-4.7

Source: National Reserve Bank of Tonga

The Nominal Effective Exchange Rate (NEER) decreased in October 2020 as major trading currencies appreciated against the Tongan Pa'anga (TOP). The Real Effective Exchange Rate (REER) index also declined in line with Tonga's lower inflation rate.

Table 4: Bilateral Exchange Rates

	Oct-20	Sep-20	Oct-19
USD/TOP	0.4324	0.4381	0.4306
AUD/TOP	0.6044	0.6039	0.6325
NZD/TOP	0.6501	0.6558	0.6793
FJD/TOP	0.8897	0.8970	0.8896
JPY/TOP	45.4014	46.1751	46.4696
GBP/TOP	0.3321	0.3365	0.3400
EUR/TOP	0.3664	0.3705	0.3890
CNY/TOP	2.8129	2.8500	2.8015

Source: Banking Systems

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

Foreign reserve higher in October

Table 5: Foreign Reserves

	Monthly			Annual	
	Oct-20	Sep-20	% Growth	Oct-19	% Growth
Foreign Reserves (\$ in million)	581.6	576.5	0.9	489.3	7.5
Import Coverage (months)	9.7	10.0	-0.3	7.5	29.3

Source: National Reserve Bank Tonga

The foreign reserves rose by \$5.1 million in October, and significantly in the year to October by \$92.2 million to \$581.6 million, equivalent to cover 9.7 months of imports. This was from the receipt of project grant funds, budget support, and remittances. The official foreign reserves are mostly held in USD, AUD, and NZD.

Table 6: Remittance Receipts

	Monthly			Annual	
	Oct-20	Sep-20	% Growth	Oct-20	Oct-19
Remittance (\$ in million)	38.7	36.0	7.5	378.5	350.6

Source: National Reserve Bank Tonga

Remittances rose in October 2020 by \$2.7 million to a new high record of \$38.7 million owing mostly to a \$2.6 million increase in private transfers, especially AUD and USD receipts. Over the year, remittances continue to hold up, rising by \$27.9 million and attributed to higher private transfers and compensation of employees.

Overall, Overseas Exchange Transactions (OET) recorded a lower surplus of \$5.1 million in October 2020, compared to the surplus of \$20.4 million in the previous month. This was attributed to an increase in OET payments mainly for imports, and a decline in OET receipts.

Annually, the OET balance surplus rose significantly by \$60.0 million in the year to October 2020 on the back of higher current account surplus. This resulted from higher

official transfer receipts, lower merchandise trade deficits, and higher-income receipts. The financial account deficit also improved over the year due mainly to lower transfers of offshore investments. However, the capital account recorded a lower surplus driven by a decline in private capital receipts.

Table 6: Overseas Exchange Transactions

	Monthly			Annual		
	Oct-20	Sep-20	% Growth	Oct-20	Oct-19	% Growth
Overall Balance	5.1	20.4	-75.0	92.2	32.0	188.1
Current Account	-3.1	9.1	-134.1	72.8	12.5	482.4
Merchandise Trade	-40.0	-34.5	-15.9	-402.6	-409.4	1.7
Services	-2.0	-1.3	-53.8	5.1	27.9	-81.7
Income	2.8	2.6	7.7	15.1	4.6	228.3
Transfers	36.1	42.4	-14.9	455.3	389.3	17.0
Capital Account	9.1	4.0	127.5	33.3	36.0	-7.5
Financial Account	-1.0	7.3	-113.7	-13.9	-16.4	15.2

Source: Banking Systems

The NRBT expects the foreign reserves to remain well above the minimum threshold of 3 months of imports cover in the near term. Receipts of budget support from donor partners and lower import payments are expected to maintain the foreign reserves above this threshold.

Broad money rose

Table 8: Broad Money

	Monthly			Annual	
	Oct-20	Sep-20	% Growth	Oct-19	% Growth
Broad money (\$ in million)	655.2	640.8	2.3	592.5	10.6
Net Foreign Asset	610.6	605.4	0.9	503.9	21.2
Net Domestic Asset	45.7	36.6	24.9	91.4	-50.0

Source: Banking System, National Reserve Bank of Tonga

Broad money rose to a new high level of \$655.2 million in October 2020 as both net foreign and net domestic asset expanded. Net domestic assets rose due to lower government deposits and the higher net credit to the private sector. The higher foreign reserves drove net foreign assets higher.

More liquidity in the financial system

Table 9: Reserve money

	Monthly			Annual	
	Oct-20	Sep-20	% Growth	Oct-19	% Growth
Reserve money (\$ in million)	361.9	351.7	2.9	309.4	17.0

Source: Banking System, National Reserve Bank of Tonga

The continuous increase in the commercial banks' ESA (Exchange Settlement Account) resulted in higher liquidity in the banking system. This is in line with the increase in public enterprises and private businesses deposits. Required reserves also increased and supported the higher total reserve money while currency in circulation declined.

Higher lending for businesses

Table 10: Total Lending

Lending	Monthly			Annual	
	Oct-20	Sep-20	% Growth	Oct-19	% Growth
Total Lending (\$ in million)	494.0	491.1	0.6	496.9	-0.6
Business lending	235.2	232.7	1.1	238.6	-1.4
Household lending	257.4	258.4	-0.4	258.3	-0.3
Other lending	0.0	0.0	0.0	0.0	0.0

Source: Banking System, National Reserve Bank of Tonga



The banks' total lending grew in October 2020, however, it declined annually. Higher business loans mainly in the construction, professional & other services and distribution sectors as well as housing loans, drove the monthly rise. The annual decline stemmed from lower lending to both households and businesses such as manufacturing, trade, and agricultural sectors coupled with lower households' other personal loans. High uncertainties of COVID-19 impacts on the banks' willingness to lend further, and businesses and households' appetite to borrow also contributed to the annual decline in lending.

Total deposits increased again by \$5.3 million (0.8%) to \$655.8 million attributing mainly to higher demand and time deposits. This was due to higher deposits made by churches, public enterprises, and businesses. The rise in total deposits exceeded the increase in total loans hence the loans to deposit ratio declined slightly to 73.8% from 74.0% in September 2020, and below the 80% minimum.

Average interest rate spread consistently narrows

Table 11: Weighted Average Interest Rates

Interest Rates	Oct-20	Monthly		Annual	
		Sep-20	Growth	Oct-19	Growth
Weighted Average Banks Deposit Rate (%)	2.083	2.095	-1.2	1.933	15.0
Weighted Average Banks Lending Rate (%)	7.701	7.723	-2.2	7.971	-26.9
Weighted Average Interest Rate Spread (%)	5.618	5.628	-1.0	6.038	-42.0

Source: Banking System, National Reserve Bank of Tonga

The weighted average interest rate spread decreased by 1.0 basis points in October 2020. This resulted from

declining weighted average lending rates. The lower weighted average lending rates stemmed mostly from lower business loan rates offered to the utilities and constructions sectors as well as households' vehicle loans rates. The lower constructions' loans rates coincided with the growth of construction loans over the month. On the other hand, weighted average deposit rates also fell driven by lower time deposit rates.

Annually, the decrease in weighted average lending rates coupled with the increase in weighted average deposit rates narrowed the weighted average interest rate spread by 42.0 basis points to 5.6%. The higher volume of deposits also supported the higher weighted average deposit rates over the year.

Outlook

In light of recent movements, the expected downturn for economic growth still stands. The Reserve Bank's monetary policy stance remains accommodative. Furthermore, the Reserve Bank is committed to continue monitoring the emerging risks prompted by uncertainties surrounding the COVID-19 pandemic, which may impact economic growth and potentially impair financial stability. The Reserve Bank remains vigilant in its regulatory and supervisory roles to ensure financial stability is maintained whilst working to mitigate the economic downturn and supporting recovery.