



Weaker global growth for 2022 and persistent inflation expected

Global growth for 2022 is weaker than previously anticipated, while inflationary pressure is becoming more persistent, according to the IMF's World Economic Outlook in January 2022. The growth forecasts of the two largest economies (the U.S. and China) were revised lower, resulting in a downgrade in global growth forecast from 4.9% to 4.4% for 2022. Ongoing inflationary pressures largely owed to the continuous disruptions to global supply chains and high energy prices. These impacts are derived from the rapid evolution and transmission of the new Omicron variant. According to the Bureau of Economic Analysis and the U.S. Census Bureau, the U.S. recorded a trade deficit of \$80.2 billion in November 2021 due to higher imports over the month. At the same time, the U.S. reported its highest annual inflation rate of 6.8% since 1982. As a result, the Federal Reserve has signalled an earlier tightening of monetary policy through raising interest rates by March 2022 to restrain surging inflation. New Zealand recorded a 4.9% annual inflation rate in September 2021, exceeding the RBNZ's¹ medium-term inflation target band. RBNZ raised the official cash rate in November 2021 to 0.75% by 25 basis points.

Agricultural sector showing some recovery

Harvesting seasons of squash and watermelon have propped up the primary sector performance in November 2021. The total agricultural export volumes rose by 386.2 tonnes, whilst proceeds declined by \$0.4 million (36.9%), possibly due to the time lag in receipts. Both squash and watermelon exports rose by 410.1 tonnes and 83.5 tonnes respectively, driving the monthly increase. Over the year, agricultural exports increased by 1,315.8 tonnes (13.2%) due to higher squash, cassava, and watermelon exports. This coincides with the \$0.7 million (10.1%) increase in agricultural proceeds. Marine exports, however, changed little over the month and year, reflecting the ongoing impact of the Covid-19 lockdown.

The secondary sector showed mixed results during the month. Loans for utilities increased by \$0.3 million (88.1%). Meanwhile, loans for construction and manufacturing declined by \$0.9 million (5.7%), and \$0.4 million (3.8%), respectively. Electricity consumption slightly fell by 0.4% (0.02 million kW), while production increased by 5.0% (0.3 million kW). Electricity consumers also rose by 0.3% (89 consumers) over the month. The impact of the rising fuel prices is evident in the energy sector with the consistent increases in electricity tariffs over the year.

The performances in the tertiary sector remain subdued on account of the ongoing global pandemic. Tourism activities are still minimal due to the border lockdown. All repatriation

flights have been cancelled for the rest of the year, due to the first Covid-19 positive case reported in late October 2021. Travel receipts fell over the month by \$0.1 million (3.3%), and \$32.4 million (59.9%) over the year. Nonetheless, 429 passengers departed during the month, mostly seasonal workers going to Australia. The working schemes in Australia and New Zealand assist in sustaining the high inflow of remittances to Tonga. Container registrations declined over the month by 347 containers (27.9%), mostly driven by a 582 decline in business containers (5.2%) over the year, mostly private containers. The resurgence of the Omicron variant continues to disrupt global supply chains and shipping logistics, delaying transport and increasing costs. The Covid-19 national lockdown on the first week of November may also negatively impact the private business sector.

More job opportunities

More employment opportunities are available, according to the Reserve Bank's survey showing an increase in the job vacancies advertised during the month by 52 vacancies (371.4%), of which the majority is from public administration. Annually, job vacancies rose by 75 vacancies (27.3%). Many of the workers in the private sector are informally employed and are not captured in the Reserve Bank's survey.

Inflation edged higher

Inflation rose by 1.3% in November 2021, driven by increases in both local and imported prices. Higher imported prices are largely attributed to higher prices of fuels, maintenance and dwelling repairs, and food items. Higher local prices were driven by the increase in prices of electricity and food items.

Table 1: Inflation Rates

Prices	Monthly		Annual	
	Nov-21	Oct-21	Nov-21	Nov-20
Headline Inflation (%)	1.3	0.5	8.2	-0.8
Domestic prices	0.9	0.4	6.4	-2.0
Imported prices	1.6	0.5	9.6	0.3

Source: Tonga Statistics Department

The headline inflation increased substantially by 8.2% in the year to November 2021, compared to 7.2% in the previous month, and the negative 0.8% in the

Table 2: Average annual prices of selected items

Items (\$ per kg)	Unit	Nov-21	Nov-20	Annual
				Change
Domestic				
Tomatoes	1kg	\$6.33	\$2.55	\$3.78
Octopus	1kg	\$26.79	\$23.47	\$3.32
Carrots	1kg	\$5.48	\$2.34	\$3.14
Tuna	1kg	\$19.67	\$17.00	\$2.67
Imported				
Turkey tails	1kg	\$14.02	\$8.97	\$5.05
Petrol	litre	\$3.17	\$2.42	\$0.75
Diesel	litre	\$3.08	\$2.34	\$0.74

Source: Statistics Department

same month last year. The increase in prices of fuels, food items, maintenance and repairs of the dwelling, gas, and other fuels mainly drove imported prices higher. Higher

¹ Reserve Bank of New Zealand



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local prices, however, were due to higher prices of electricity and domestic food items.

Effective exchange rates increased

Table 3: Effective Exchange Rates

	Monthly			Annual	
	Nov-21	Oct-21	% Growth	Nov-20	% Growth
Nominal Effective Exchange Rate Index	89.9	89.3	0.7	87.6	2.7
Real Effective Exchange Rate Index	108.0	107.1	0.8	101.2	6.7

Source: National Reserve Bank of Tonga

The Nominal Effective Exchange Rate (NEER) rose slightly over the month as most of Tonga's trading partner currencies depreciated against the Tongan Pa'anga. Similarly, the Real Effective Exchange Rate (REER) also increased over the month in line with Tonga's higher inflation rate.

In year-ended terms, the NEER increased indicating a general strengthening of the Tongan Pa'anga. The REER also rose over the year in line with Tonga's increasing inflation rates compared to that of its major trading partners. This implies a loss in Tonga's trade competitiveness.

Budget support and project funds push foreign reserves higher

Table 4: Foreign Reserves

	Monthly			Annual	
	Nov-21	Oct-21	%Growth	Nov-20	% Growth
Foreign Reserves (\$ in million)	783.9	757.0	3.5	590.2	32.8
Import Coverage (months)	12.4	12.1	2.5	10.9	13.8

Source: National Reserve Bank Tonga

Official foreign reserves rose sharply in November 2021 by \$26.9 million to a new record high of \$783.9 million, equivalent to 12.4 months of imports. Similarly, foreign reserves rose significantly over the year to November 2021 by \$193.7 million. This stemmed from receipts of budget support and project funds from development partners, loan drawdowns, capital inflows, and remittances. The majority of the official foreign reserves are held in USD, AUD, and NZD.

Table 5: Remittance Receipts

	Monthly			Annual		
	Nov-21	Oct-21	% Growth	Nov-21	Nov-20	% Growth
Remittance (\$ in million)	41.6	43.9	-5.3	490.0	386.6	26.7

Source: National Reserve Bank Tonga

Remittance receipts declined by \$2.3 million (5.3%) in November 2021 on the back of lower private transfers, mostly family support. Annually, remittances increased by \$103.4 million, supported mostly by the higher private transfers and compensation of employees, mainly from seasonal workers. The majority of remittance receipts are in AUD, USD, and NZD.

Overall, the Overseas Exchange Transactions (OET) recorded an overall surplus of \$26.9 million in November.

This stems mostly from the increase in net transfer receipts. Moreover, the service and trade deficits have also improved, reflecting the drop in import payments of 10.2% (\$4.5 million) and the increase in service receipts by 165.6% (\$11.7 million).

Table 6: Overseas Exchange Transactions

	Monthly			Annual		
	Nov-21	Oct-21	% Growth	Nov-21	Nov-20	% Growth
Overall Balance	26.9	0.0	2917247.6	193.7	100.7	92.3
Current Account	22.3	0.5	4243.7	122.2	80.5	51.8
Merchandise Trade	-38.5	-42.7	9.8	-489.2	-406.9	-20.2
Services	-1.3	-3.8	65.9	-44.5	4.0	-1211.8
Income	3.2	4.1	-23.2	27.4	15.8	73.3
Transfers	59.0	42.9	37.4	628.5	467.5	34.4
Capital Account	0.9	3.6	-74.0	26.8	38.7	-30.6
Financial Account	3.6	-4.1	188.1	44.7	-18.4	342.4

Source: Banking Systems

Annually, the OET surplus balance expanded strongly by \$92.9 million from higher official grants, budget support, external debt, capital inflows, and remittance receipts.

Net foreign assets increased on higher foreign reserves

Table 7: Broad Money

	Monthly			Annual	
	Nov-21	Oct-21	% Growth	Nov-20	% Growth
Broad money (\$ in million)	807.2	789.7	2.2	681.4	18.5
Net Foreign Asset	774.1	743.1	4.2	622.2	24.4
Net Domestic Asset	34.0	47.5	-28.5	60.2	-43.6

Source: Banking System, National Reserve Bank of Tonga

Broad money rose again by \$17.4 million (2.2%) in November 2021 and \$125.7 million (18.5%) annually. Both rises were solely driven by the higher net foreign assets mainly stemming from the higher foreign reserves, reflecting the receipts of grants, budget support, and project funds from development partners. On the other hand, the net domestic assets declined as government deposits rose due to receipts of official funds.

Liquidity in the financial system continues to expand

Table 8: Reserve money

	Monthly			Annual	
	Nov-21	Oct-21	% Growth	Nov-20	% Growth
Reserve money (\$ in million)	558.1	534.3	4.4	389.3	43.3

Source: Banking System, National Reserve Bank of Tonga

Liquidity in the financial system increased further in November 2021 by \$23.7 million (4.4%) and \$168.7 million (43.3%) annually. Both rises are attributed mainly to higher commercial banks' Exchange Settlement Accounts (ESA) from net sales of foreign currency to the Reserve Bank. Remittance receipts underpinned these sales. Currency in circulation also increased over the month and year, reflecting the festivities during the month and year, such as churches' annual donations, Kava Idol, and the Tonga High School Ex-Students' Fundraising. On the other hand, required reserves declined over the month, although it rose



annually. The higher required reserves over the year are in line with the annual rise in total deposits.

Credit growth continues to slow down

Table 9: Total Lending

Lending	Monthly			Annual	
	Nov-21	Oct-21	% Growth	Nov-20	% Growth
Total Lending (\$ in million)	474.2	476.7	-0.5	496.5	-4.5
Business lending	215.9	218.6	-1.2	237.3	-9.0
Household lending	258.1	257.8	0.1	259.3	-0.5
Other lending	0.2	0.3	-12.7	0.0	0.0

Source: Banking System, National Reserve Bank of Tonga

Over the month and year to November 2021, the banks' total lending declined by \$2.5 million (0.5%) and \$22.3 million (4.5%), respectively. The monthly decrease was underpinned by lower business loans within the professional & other services, construction, and manufacturing sectors, in addition to lower household vehicle loans. Annually, both business and households lending fell. Lending to public enterprises fell, along with private sector loans, mainly construction, professional & other services, and agricultural loans. The lower lending balance also reflects large loan repayments. Household loans also declined, particularly housing loans, followed by other personal and vehicle loans.

In November 2021, the banks' total deposits increased by \$31.1 million (3.9%), which outweighed the decline in total loans. This reduced the loans to deposit ratio from 59.1% in October 2021 to 56.6%, which remains below the 80% minimum level.

Weighted average interest rate spread widened

Table 10: Weighted Average Interest Rates

Interest Rates	Monthly			Annual	
	Nov-21	Oct-21	(bps)	Nov-20	(bps)
Weighted Average Banks Deposit Rate (%)	1.769	1.837	-6.7	2.014	-24.5
Weighted Average Banks Lending Rate (%)	7.837	7.845	-0.81	7.671	16.5
Weighted Average Interest Rate Spread (%)	6.067	6.008	5.9	5.657	41.0

Source: Banking System, National Reserve Bank of Tonga

The weighted average interest rate spread widened to 6.07% in November 2021. The monthly rise was attributed to a higher decline in the weighted average deposit rates. The annual rise reflects the fall in the weighted average deposit rates coupled with the higher weighted average lending rates. All deposit rates declined over the month and year, reflecting the increase in the volume of deposits. The lower lending rates over the month were mainly for businesses within the professional & other business services, fisheries, and agricultural sectors, household

vehicles, and other personal loan rates. On the other hand, the higher weighted average lending rates over the year were offered mainly to non-profit organisations and businesses within the utilities, construction, and distribution sectors. Similarly, the weighted average lending rates for households housing and vehicle loans also increased.

Outlook

The slower growth in the global economy and the uncertainty of the global exit from the pandemic imply a much slower recovery for Tonga as a net importer, price taker, and with a significant portion of its businesses in the tourism industry. While advanced and developed economies experience more persistent inflation, so will Tonga, although to a greater extent. Natural disasters are becoming more frequent and more severe which pose scarring effects on the economy such as higher unemployment particularly for women and youth, lower productivity and national income, and lower business investments. The Hunga Tonga Hunga Ha'apai (HTHH) volcanic eruption and tsunami in January 2022 have significant adverse impacts on the domestic economy particularly the primary and the tertiary sectors. This will also hinder Tonga's recovery efforts from Covid-19 with severe damages to households and businesses. The internet outage contributes to limited communications and slower operations for all sectors of the economy. The Government has rolled out immediate relief packages to assist the affected households and businesses. At the same time, the financial sector is also geared up to provide further assistance to its impacted customers, and they are well-capitalised to absorb anticipated shocks to the system.

Given these latest developments, the Reserve Bank expects a further downgrade of its GDP growth outlook for the current fiscal year 2021/22. Inflation rate is now expected to persistently exceed the 5% reference rate up to mid-2022. On the other hand, foreign reserves will still be comfortable above the minimum of 3 months of import cover. The stability of the banking system is expected to be maintained supported by banks' excess liquidity and capital positions. In this regard, the current monetary policy stance is considered appropriate at this time, leaving the excess liquidity in the banking system for more prudent lending in support of economic recovery, while maintaining financial stability. Nevertheless, the Reserve Bank remains vigilant in closely monitoring financial and economic developments, internal and external, and regularly reviews its monetary policy settings as needed for macroeconomic growth.