



### More aggressive monetary actions against inflation

The Federal Reserve recorded its highest interest rate hike in over twenty years in May 2022 – a 50 basis points increase to a range of 0.75-1.0%. Inflation reached a new high of 8.6% in May 2022 since December 1981, fueled by higher food, gas, and energy prices over the year. This highlights the aggravating pressures induced by the ongoing disruptions and developments from the Ukraine war and the recurrent lockdown restrictions in China. In addition, the Federal Reserve also signaled another 50 basis points interest rate increase in the upcoming month and further interest rate hikes, intending to cool off inflation. Meanwhile, the Reserve Bank of Australia (RBA) raised its cash rate target by 25 basis points to 0.35% in May. Inflation is projected to remain above the inflation target of 2-3% in the approaching quarter. The Reserve Bank of New Zealand (RBNZ) also raised its official cash rate (OCR) in May 2022 to 2.0%. Wage-price spiral effect becomes another concern for New Zealand's economy, given the growing inflationary pressures and expectations. Further increase in the OCR is expected in the upcoming months.

### Further easing of Covid-19 restrictions supported domestic activities

Tonga remains in orange colour alert level in May, but with further easing of Covid-19 restrictions as positive cases progressively declined. Night time curfews was reduced to the hours of 12am to 5am, more businesses resumed services, secondary and tertiary students returned to school, and more activities were permitted such as family gatherings and non-contact sports.

The primary sector is showing some slight recovery from the Hunga Tonga Hunga Ha'apai (HTHH) disaster particularly for agriculture. Agricultural exports rose over the month by 72.8% (319.4 tonnes), owing to higher export of root crops mainly cassava, yam, and taro. This is higher compared to the same month last year indicating improved harvests. The agricultural export proceeds also increased over the month by \$0.3 million (79.0%). Annually, agricultural export volumes, however, declined by 10.4% (1,099.3 tonnes) driven by lower exports of yam, taro, and cassava. Nevertheless, the annual agricultural export proceeds rose by \$1.0 million (16.1%). Marine exports, on the other hand, continued declining over the month by 25.2 tons (83.7%), as tuna exports fell. The unfavourable performance of the fisheries sector reflects the extended impact of the HTHH disaster, border restrictions, and high airfreight costs. Aquarium exports, however, rose by 4,632 pieces (47.5%), coinciding with the 36.0% (\$0.1 million) increase in marine export proceeds. Annually, marine export volumes declined by 268.5 tons (19.9%), due to lower tuna and shark meat exports. Similarly, the aquarium export volumes also fell by 5,824 pieces (4.2%). As a result, the marine export proceeds fell by \$0.8 million (18.1%) over the year.

The ongoing reconstruction from the HTHH disaster continues to support growth in the industrial sector. The Government approved in May 2022, that 40 houses to be constructed under their HTHH build back-better recovery initiative. This included houses from the Mango and Fonoifua Islands that were severely affected by the HTHH disaster. The easing of the Covid-19 lockdown restrictions allowed for more private construction projects to commence. This coincides with the increase in new loan commitments in May to businesses in the construction sector and individual housing loans, by \$3.9 million and \$0.9 million, respectively. The active construction sector will have positive spillover effects on the mining & quarrying sector activities.

The indicators of the service sector also demonstrate positive performance over the month in response to the further easing of lockdown restrictions. Higher consumption and demand from households and firms, celebrations of the family month, and the resumption of the majority of service businesses support the sectoral growth. The monthly container registrations rose by 110 containers (16.1%), along with increased payment for imports excluding oil (\$8.0 million). While nightclubs remained closed, gyms, bars, and kava clubs reopened. International arrivals rose by 167 passengers (64.2%) over the month, with higher travel receipts of \$0.5 million (29.7%). Annually, passenger arrivals and travel receipts both increased by 124 passengers (5.5%), and \$0.8 million (3.6%), respectively. Given the gradual reduction in the quarantine period for incoming passengers, and the anticipated reopening of the borders, travel activities are expected to pick up strongly thereby supporting the tourism industry.

### Higher employment opportunities over the month

The Reserve Bank survey showed a 163.6% (54 vacancies) increase in the job vacancies advertised over the month. This reflects a pickup in demand for labour as economic activities start to recover from the HTHH disaster and the Omicron outbreak. The majority of the advertised vacancies were from the public administration. Annually, advertised job vacancies increased by 288 vacancies (137.1%).

### Inflation hits a multi-year high of 11.3%

Tonga, along with many countries globally, is facing very high levels of inflation. Supply and demand imbalances

Prices	Monthly			Annual		
	May-22	Apr-22	Mar-22	May-22	Apr-22	Mar-22
Headline Inflation (%)	1.5	1.8	0.2	11.3	9.4	7.8
Domestic prices	1.1	0.8	-1.2	10.4	8.1	6.9
Imported prices	1.7	2.6	1.4	11.9	10.5	8.6

Source: Tonga Statistics Department

caused by the extended global pandemic and geo-political tensions drive up global prices. As an import-dependent economy and price taker, Tonga is especially vulnerable to these global shocks. At the same time, frequent natural disasters also affect the sustainability of local supplies further compounding price pressures.



# NATIONAL RESERVE BANK OF TONGA

## MONTHLY ECONOMIC REVIEW

Vol. 9

No. 5

Month Ended: May 2022

Inflation consistently rose over the month by 1.5% stemming from increases in both domestic and imported prices. This was slightly lower than the 1.8% rise in the previous month. Higher domestic prices are attributed to an increase in food and electricity prices over the month. The imported prices, on the other hand, were driven by higher prices for fuel, food, and construction materials.

The headline annual inflation rose by 11.3% in May 2022 – the highest annual increase since the 12.2% rise in June 2008. The 14-year high inflation was driven by both domestic and imported prices.

The annual increases in local food items and electricity prices were the main contributors to the annual increase in domestic prices. Meanwhile, imported prices rose on higher prices of fuels, food items, construction materials, and liquefied petroleum gas.

The core inflation (excluding imported food and energy) also rose by 7.5% in May 2022, lower than the headline inflation but still above the 5% reference rate.

### Major trading currencies appreciated against TOP

Table 3: Effective Exchange Rates

	Monthly			Annual	
	May-22	Apr-22	% Growth	May-21	% Growth
Nominal Effective Exchange Rate Index	92.5	92.8	-0.4	88.3	4.8
Real Effective Exchange Rate Index	115.9	114.8	0.9	105.0	10.4

Source: National Reserve Bank of Tonga

The Nominal Effective Exchange Rate (NEER) declined slightly over the month reflecting the general appreciation of the major trading currencies against the Tongan Pa'anga (month ended) except for the USD. The Real Effective Exchange Rate (REER), however, increased over the month reflecting Tonga's higher inflation rate.

Annually, the NEER still increased as trading partners' currencies generally weakened against the Tongan Pa'anga. The REER also increased over the year in line with the higher inflation rate, indicating a loss in trade competitiveness.

### Foreign reserves declined in May

Table 4: Foreign Reserves

	Monthly			Annual	
	May-22	Apr-22	% Growth	May-21	% Growth
Foreign Reserves (\$ in million)	880.4	884.0	-0.4	689.5	27.7
Import Coverage (months)	12.4	12.6	-1.5	11.6	6.6

Source: National Reserve Bank Tonga

Foreign reserves declined in May 2022 by \$3.6 million to \$880.4 million, equivalent to 12.4 months of imports. This stemmed from an increase in transfers for large import payments, Government services, and external loan repayments. In year-ended terms, foreign reserves still increased notably by \$190.9 million underpinned by higher receipts of budget support, official grants, capital inflows, and remittances. The majority of the official foreign reserves are held in USD, NZD, and AUD.

Table 5: Remittance Receipts

	Monthly			Annual		
	May-22	Apr-22	% Growth	May-22	May-21	% Growth
Remittance (\$ in million)	39.5	38.7	1.9	471.5	455.4	3.5

Source: National Reserve Bank Tonga

Total remittance receipts continue to increase over the month by \$0.7 million (1.9%) to \$39.5 million owing to higher private transfer receipts. Similarly, remittances also increased by \$16.1 million (3.5%) over the year.

Table 6: Overseas Exchange Transactions

	Monthly			Annual		
	May-22	Apr-22	% Growth	May-22	May-21	% Growth
Overall Balance	-3.6	22.6	-116.0	190.9	199.9	-4.5
Current Account	-14.0	16.8	-183.3	114.6	154.8	-26.0
Merchandise Trade	-49.3	-44.4	-11.1	-483.3	-449.5	-7.5
Services	-14.0	-14.7	4.7	-73.9	-25.9	-184.7
Income	3.5	3.3	6.3	24.9	34.4	-27.8
Transfers	45.8	72.6	-36.8	646.9	595.8	8.6
Capital Account	0.9	0.7	29.5	16.1	42.5	-62.0
Financial Account	9.4	5.1	85.5	60.1	2.6	2221.2

Source: Banking Systems

The overall balance recorded a \$3.6 million deficit in May 2022 compared to the \$22.6 million surplus in the previous month. This was attributed to the decline in the current account mostly from the lower official receipts.

In year-ended terms, the OET balance surplus declined by \$9.0 million to \$190.9 million in May 2022. This stemmed mostly from lower surpluses in the current account (worsening services and trade deficits) and capital account (lower official capital receipts).

### Broad money declined

Table 7: Broad Money

	Monthly			Annual	
	May-22	Apr-22	% Growth	May-21	% Growth
Broad money (\$ in million)	842.8	844.3	-0.2	724.7	16.3
Net Foreign Asset	862.4	870.8	-1.0	724.4	19.0
Net Domestic Asset	-18.8	-26.1	28.2	1.2	-1647.3

Source: Banking System, National Reserve Bank of Tonga

In May 2022, broad money declined further by \$1.5 million (0.2%) however, continued to rise annually by \$118.1 million (16.3%). Both changes were in line with the movements in net foreign assets and foreign reserves.



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On the other hand, the net domestic assets rose over the month but declined annually reflecting the movements in government deposits.

### Liquidity in the financial system increased

Table 8: Reserve money

	Monthly			Annual	
	May-22	Apr-22	% Growth	May-21	% Growth
Reserve money (\$ in million)	613.7	600.5	2.2	457.3	34.2

Source: Banking System, National Reserve Bank of Tonga

Over the month and year to May 2022, liquidity in the financial system expanded by \$13.2 million (2.2%) and \$156.4 million (34.2%), respectively. Both the Exchange Settlement Accounts (ESA) and Statutory Reserve Deposits (SRD) rose over the month reflecting growth in deposits. These outweighed the decline in currency in circulation.

The annual increase was led by higher ESA balances owing largely to high foreign currency receipts. The currency in circulation and SRD also increased, reflecting higher demand for money and the growth in deposits over the year.

### Credit growth slowly recovered over the month

Table 9: Total Lending

Lending	Monthly			Annual	
	May-22	Apr-22	% Growth	May-21	% Growth
Total Lending (\$ in million)	470.0	466.7	0.7	486.6	-3.4
Business lending	216.8	213.9	1.4	227.7	-4.8
Household lending	250.8	251.0	-0.1	258.5	-3.0
Other lending	2.3	1.8	27.7	0.4	463.7

Source: Banking System, National Reserve Bank of Tonga

Over the month of May 2022, the banks' total lending increased by \$3.2 million (0.7%), after declining in the past three consecutive months. Lending to public enterprises and private businesses within the distribution, construction, and tourism sectors increased over the month. This was further supported by higher household other personal loans.

However, over the year, the banks' total lending fell by \$16.6 million (3.4%), as both business and household loans declined. The loan repayments made by public enterprises and businesses in the professional & other business services, constructions, and agricultural sectors continued to drive the annual decline. Similarly, all household loans fell, supporting the annual decline. The high degree of uncertainties and overall downside risks to the outlook on the economy continues to dampen credit growth.

Over the month and year to May 2022, the banks' total deposits increased by \$10.3 million (1.2%) and \$127.7 million (17.5%) respectively, to a total of \$858.5 million. The higher deposits more than offset the rise in lending thus

reducing the loans-to-deposit ratio to 53.6%, compared to 53.9% last month, and 64.9% in May last year. This is still below the minimum threshold of 70%.

### Weighted average interest rate spread narrowed

Table 10: Weighted Average Interest Rates

Interest Rates	Monthly			Annual	
	May-22	Apr-22	(bps)	May-21	(bps)
Weighted Average Banks Deposit Rate (%)	1.644	1.656	-1.2	1.997	-35.3
Weighted Average Banks Lending Rate (%)	7.808	7.835	-2.7	7.728	7.9
Weighted Average Interest Rate Spread (%)	6.164	6.179	-1.5	5.732	43.2

Source: Banking System, National Reserve Bank of Tonga

In May 2022, the weighted average interest rate spread narrowed over the month but widened over the year to 6.16%. The weighted average lending rate decreased over the month, mainly for businesses within the distribution, agricultural, and fisheries sectors as well as household lending rates for all categories. This more than offset the decline in the weighted average deposit rate, which was solely driven by lower time deposit rates. Over the year, the weighted average deposit rate declined whilst the weighted average lending rate increased. All deposit rates fell over the year, whereas lending rates for businesses such as utilities, construction, and agricultural sectors increased over the year.

### Outlook

Following a sharp contraction of 2.7% in GDP growth for FY2020/21, the Tongan economy is projected to contract again in FY2021/22 as a result of the HTHH disaster and the Omicron outbreak. Spillover effects from the war in Ukraine, the China lockdowns, and the supply-demand mismatches will keep inflation elevated. Foreign reserves are anticipated to remain comfortable with adequate capacity to sustain high probability shocks. The financial system remains stable with excess liquidity, and adequate capital to absorb any shocks to the system.

Against this background, the Reserve Bank is keeping its accommodative monetary policy stance on hold while working in tandem with the fiscal policies to revive the economy and prevent any further contraction in growth. With regards to inflation, the Reserve Bank notes that these pressures are supply-driven and are beyond its control. Our major trading partner countries are already fighting inflation through the tightening of their monetary policies which will flow through in import prices to Tonga's inflation. At the same time, the Reserve Bank continues to engage in discussions on exploring measures to curb inflation and stands ready to realign its monetary policy should inflation continue to increase unsustainably.