



Inflation in trading partners declined

US inflation stood at 3.0% for the 12-month period ending June 2023, lower than 4.0% last month and is the smallest 12-month increase since the period ending March 2021. Unemployment rate was relatively stable at 3.6% in June 2023 compared with the previous month, and payroll employment increased by 209,000 in June 2023. The US Federal Reserve therefore maintained the federal funds rate at 5 to 5.25% in June 2023.

The Australian economy grew by 0.2% in the March 2023 quarter, the weakest result since the Covid-19 outbreak in September 2021. The growth was mainly driven by domestic demand while net trade detracted from growth. Inflation rose 5.6% annually to May 2023, which was lower than the annual rise of 6.8% last month. The most significant price rises were housing and food & non-alcoholic beverages. The Reserve Bank of Australia held interest rate steady at 4.1% in July 2023 to assess the impact of the increase in interest rates to date and the economic outlook.

New Zealand's annual inflation rate slightly fell to 6.0% in the June 2023 quarter, from 6.7% in the March 2023 quarter, which was largely attributed to lower food, recreation and culture prices. Annual food prices increased by 12.5% in June 2023 as all the broad food categories rose, particularly the fruit and vegetables and grocery food prices. However, the official cash rate was left unchanged at 5.5% in July 2023 by the Reserve Bank of New Zealand.

More economic activities in May 2023

The primary sector was buoyed by higher agricultural exports during the month. Agricultural exports increased by 28.8 tonnes (4.1%), stemming from higher exports of cassava, squash (off-season export), and coconut. At the same time, the kava exports picked up compared to the previous month. On the other hand, marine exports declined by 19.8 metric tonnes (24.4%), driven by lower tuna and shark meat exports. The aquarium exports also fell over the month by 1,492 pieces (33.4%). However, marine export proceeds rose by 43.5% (\$0.1 million), which may indicate lagged receipts.

Lending to the construction sector supported upbeat activities in the sector, rising by 6.3% (\$1.3 million) over the month, coupled with a 20.3% (\$0.03 million) increase recorded for loans to the mining & quarrying sector. At the same time, lending to the manufacturing and utilities sectors both rose by 1.7% (\$0.3 million) and 12.1% (\$0.06 million) respectively. These reflect reconstruction projects as well as Government development projects that are ongoing, with positive spill overs to other industries. In May 2023, construction permits significantly rose by \$9.5 million

(144.7%), attributed mostly to construction of dwellings and MEIDECC's¹ projects.

The services sector continued to trend favourably over the month. International air arrivals rose by 17.9% (1,912 passengers), while total air passenger departures increased by 8.9% (593 passengers). These reflect increased international travels for the upcoming festivals and celebrations taking place in Tonga. Coincidentally, the travel receipts significantly increased by 57.5% (\$3.7 million). During the month, Tonga Tourism Authority also welcomed the first yacht rally to visit Tonga after the lockdown. At the same time, the distribution sector was vibrant in May 2023, given the activities during the family month and preparation for the festivities. Over the month, the container registrations increased by 23.3% (190 containers), as both business and private containers increased.

Job advertisement slowed down in June 2023

The Reserve Bank's survey on job advertisement recorded a decrease of 99 job vacancies advertised (65.6%) in June 2023. This is a slowdown from 151 job vacancies advertised in the previous month. The higher job advertisement in May 2023 were mainly in Tourism as the Ministry prepares and implements creative projects for the Heilala Festival. Annually to June 2023, the total job vacancies advertised significantly rose by 74.0% (405 job vacancies).

Strong demands in June 2023 further pressured inflation to 7.4%

Table 1: Inflation Rates

Prices	Monthly (% change)		Annual	
	Jun-23	May-23	Jun-23	Jun-22
Headline Inflation	1.7	1.2	7.4	11.2
Domestic prices	1.6	1.9	12.0	10.0
Imported prices	1.8	0.6	3.9	12.2
Core inflation - ex. energy and food (%)	2.6	1.0	10.9	3.6

Source: Tonga Statistics Department

Consumer Price Index further rose by 1.7% over the month, indicative of the stronger increase in demand and spending by both households and businesses given the commencement of national events and festivities during the month. This further aggravated the lingered supply shortages, pressuring the headline inflation to rise further from 6.6% in May 2023 to 7.4% in June 2023. Domestic prices contributed 5.2 percentage point to the headline inflation, and stemmed mainly from local food items, catering services, local transport services, secondary school tuition fees, and labour cost. At the same time, lower electricity tariff over the year continued to minimize inflationary pressures. On the other hand, the imported components contributed 2.2 percentage point to the

¹ Ministry of Meteorology, Energy, Information, Disaster Management, Environment, Climate Change and Communications



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headline inflation, attributed mainly to lower prices of imported food items, international airfares, construction materials, alcoholic beverages, clothing (school uniforms), and goods for personal care.

Core inflation reached a new record high of 10.9% in June 2023, fueled by a further increase in prices of international airfares, clothing (school uniform), construction materials, household items (i.e. dishwashing liquid, batteries, and detergent), and local cost for the operation of personal transport equipment. On the contrary, food and energy inflation declined from 5.4% in previous month to 5.0% in June 2023, supported by lower energy prices (electricity and fuel).

Real Effective exchange rate remained high in June

Table 2: Effective Exchange Rates

	Monthly			Annual	
	Jun-23	May-23	% Growth	Jun-22	% Growth
Nominal Effective Exchange Rate Index	94.2	94.3	-0.1	93.2	1.1
Real Effective Exchange Rate Index	119.3	117.9	1.2	118.2	0.9

Source: National Reserve Bank of Tonga

The strength of the pa'anga as measured by the Nominal Effective Exchange Rate (NEER) declined over the month of June 2023 by 0.1%, underpinned by the depreciation of the TOP against the AUD and NZD. In year ended terms, the TOP remains stronger by 1.1% as major trading partners' currencies generally weakened except for the USD, GBP and EUR. This may assist in offsetting the imported inflation except for USD denominated imports.

In contrast, the Real Effective Exchange Rate (REER) increased over the month and over the year by 1.2% and 0.9% respectively. The annual increase is in line with the higher NEER as well as Tonga's higher inflation compared to its major trading partners, indicating a loss in global trade competitiveness.

Foreign reserves remain high on the back of Government receipts

Table 3: Foreign Reserves

	Monthly			Annual	
	Jun-23	May-23	%Growth	Jun-22	% Growth
Foreign Reserves (\$ in million)	921.4	864.8	6.6	871.2	5.8
Import Coverage (months)	13.1	12.4	5.4	14.4	-8.9

Source: National Reserve Bank Tonga

Foreign reserves increased over the month of June 2023 by \$56.6 million to \$921.4 million, equivalent to 13.1 months of imports. The increase in foreign reserves were driven mainly by the receipt of Government budget support over the month. In year ended terms, foreign reserves was higher by \$50.2 million in comparison to the same period in 2022. The majority of the official foreign reserves are held in USD, NZD, and AUD.

Table 4: Remittance and Travel Receipts

	Monthly			Annual		
	May-23	Apr-23	% Growth	May-23	May-22	% Growth
Remittance (\$ in million)	49.9	39.4	26.6	516.8	473.6	9.1
Travel (\$ in million)	10.2	6.5	57.5	94.2	22.1	326.4

Source: National Reserve Bank Tonga

Over the month of May 2023, total remittance receipts increased by \$10.5 million (26.6%) to \$49.9 million. This was attributed to higher receipts of family support and gifts from relatives abroad. It is in line with the usual family month of May. Other activities such as church conferences and school fundraisers also contributed to the higher remittance receipts over the month.

Over the year to May 2023, total remittance receipts remain higher by \$43.1 million (9.1%) as the country continues to gradually recover from disasters in the previous year.

Broad money declined

Table 5: Broad Money

	Monthly			Annual	
	May-23	Apr-23	% Growth	May-22	% Growth
Broad money (\$ in million)	822.3	836.8	-1.7	842.8	-2.4
Net Foreign Asset	829.6	848.2	-2.2	862.4	-3.8
Net Domestic Asset	-5.9	-10.8	45.1	-19.2	69.0

Source: Banking System, National Reserve Bank of Tonga

Broad money fell again over the month and year to May 2023, by \$14.5 million (1.7%) and \$20.5 million (2.4%), respectively. Both declines are attributed to lower net foreign assets as high import payments reduced banks' reserves. Net domestic assets however increased, reflecting the credit growth and higher government deposits.

Exchange Settlement Account declined

Table 6: Reserve money

	Monthly			Annual	
	May-23	Apr-23	% Growth	May-22	% Growth
Reserve money (\$ in million)	557.5	583.7	-4.5	613.7	-9.2

Source: Banking System, National Reserve Bank of Tonga

Over the month and year to May 2023, liquidity in the financial system decreased by \$26.2 million (4.5%) and \$56.2 million (9.2%) respectively. Both declines were mostly driven by import payments which lowered commercial banks' Exchange Settlement Accounts (ESA). Furthermore, the implementation of the February 2023 MPS tool of increasing the Statutory Reserve Deposits (SRD) ratio from 10% to 15% to tame inflation, took effect during the month thereby reducing banks' ESA.

Credit continues to increase

Table 7: Total Lending

Lending	Monthly			Annual	
	May-23	Apr-23	% Growth	May-22	% Growth
Total Lending (\$ in million)	505.2	502.5	0.5	470.0	7.5
Business lending	250.2	247.8	1.0	216.8	15.4
Household lending	254.9	254.6	-0.3	250.8	1.6
Other lending	0.1	0.1	-2.2	2.3	-95.2

Source: Banking System, National Reserve Bank of Tonga

In May 2023, total bank lending climbed further by \$2.7 million (0.5%) over the month and \$35.2 million (7.5%) over the year, to a new high level of \$505.2 million. Lending to both businesses and households has grown back to pre-covid levels.

Over the month, more loans were issued to businesses within the transport, distribution, manufacturing and



agricultural sectors. Similarly, lending to businesses such as distribution, manufacturing, profession & other services and construction sectors increased over the year. Furthermore, other personal loans and vehicle loans to households also rose.

Total deposits in the banks decreased by \$13.1 million (1.5%) over the month but increased annually by \$0.8 million to \$859.3 million. The lower deposits over the month was mostly driven by the decline in demand deposits from the Retirement Funds, reflecting the mopping up of excess liquidity by the Reserve Bank in line with one of its February 2023 MPS monetary policy measures. Annually, time deposits solely increased. The relatively stronger growth in loans resulted in an increase in the loans to deposit ratio to 57.6% in May 2023 from 56.4% last month and 53.6% last year.

Weighted average interest rate narrowed

Table 8: Weighted Average Interest Rates

Interest Rates	Monthly			Annual	
	May-23	Apr-23	(bps)	May-22	(bps)
Weighted Average Banks Deposit Rate (%)	1.498	1.408	8.9	1.644	-14.6
Weighted Average Banks Lending Rate (%)	7.776	7.812	-3.5	7.808	-3.1
Weighted Average Interest Rate Spread (%)	6.279	6.403	-12.4	6.164	11.5

Source: Banking System, National Reserve Bank of Tonga

Weighted average interest rate spread narrowed by 12.4 basis points over the month, mostly driven by higher weighted average deposit rate coupled with lower weighted average lending rate. Both saving and time deposit rates increased over the month. Lending rates offered to businesses in the agricultural, fisheries, and manufacturing

sectors declined over the month. However, annually, the weighted average interest rate spread widened by 11.5 basis points to 6.3%, underpinned by deposit rates declining by more than the fall in lending rates. The saving deposit rates fell and offset the rise in both the demand and the time deposit rates. Meanwhile, lending rates offered to businesses within the agricultural, fisheries and tourism sectors also fell over the year. Furthermore, other personal and vehicle loans rates both decreased over the month and over the year. The lower lending rates coincided with the higher volume of loans, both over the month and over the year.

Outlook

Annual headline inflation is anticipated to slightly moderate below 7% in July and August 2023 whilst the core inflation trends upwards. Uncertainties in the movements of global oil and commodity prices, as well as domestic food supply continue to pose a risk to this outlook. The financial system remains stable with ample liquidity while credit growth improves and banks are also well capitalized to absorb further shocks. Foreign reserves, reported at over 13 months of imports in June 2023, is projected to remain comfortable above the IMF's optimal level of 7.3 months of imports cover. The Reserve Bank will continue to monitor closely inflation movements and at the same time support economic recovery. The next Monetary Policy Statement will be issued in August 2023.