



Economic activities in major trading partners' lead to positive output and high inflation

The United State's annual inflation was 6.0% in February 2023, the smallest 12-month rise in the past 5 months. This was largely attributed to increases in food and energy prices. Additionally, payroll employment rose by 311,000 while unemployment rate edged up to 3.6% in February 2023. Australia's economy recorded a 0.5% growth in the fourth quarter of 2022 particularly driven by an increase in international trade. Annual inflation eased to 7.4% in January following a record run of interest rate hikes. New Zealand's growth is assumed to decline by 1.1% over 2023 owing mostly to damages from the severe storms. However, the infrastructure and community reconstruction may also add to inflationary pressures. New Zealand's food prices continued to increase annually by 12.0% in February 2023, the highest since September 1989, hence the Reserve Bank of New Zealand raised its official cash rate in February 2023 from 4.25% to 4.75%.

Sectoral activities slowed down over the month

The primary sector demonstrated mixed outcomes in January 2023. Total agricultural exports continued to fall by 33.5% (-198.7 tonnes) over the month, owing largely to lower exports of squash, cassava, and watermelon. Meanwhile, exports of yam, coconut, and taro increased. Nevertheless, the overall decline coincides with the \$0.2 million (-40.8%) decline in the agricultural export proceeds. The sector continues to receive development supports which included a distribution of 1000 harvesting bins for farmers as part of the PACER Plus Sanitary and Phytosanitary related projects. On the other hand, total marine exports rose over the month by 155.5 metric tonnes (125.4%) as tuna exports substantially increased by 156.4 metric tonnes (128.6%). The aquarium exports also rose by 553.1% (3,794 pieces). The marine export proceeds however decreased by \$0.1 million (30.0%). Overall, the preparation for the return of the Royal Agriculture and Fisheries show is anticipated to boost the sector.

Loans by sector during the month indicated active performances within the industrial sector. While lending to the utilities sector slowed down over the month, the construction and mining & quarrying loans both increased by \$0.2 million (1.2%), and \$0.03 million (19.2%), respectively. At the same time, lending for individual housing recorded new commitments of \$0.9 million during the month. Under the Grass-Roots Human Security Projects (GGP), the Government of Japan will fund three new grant projects valued over US\$250,000. The fund is intended for the construction of new classrooms and water supply system for the resettlement in Kanokupolu which will continue to boost the sectoral activities.

Indicators in the service sector showed signs of slowdown over the month as the holiday season comes to an end. The passenger arrivals declined by 3,808 passengers (34.8%)

in January 2023, given there were only 65 passenger flights during the month (compared to 80 passenger flights in previous month). This coincides with the lower travel receipts, which fell by 14.4% (\$2.0 million). At the same time, total passenger departures fell by 178 passengers (1.9%). Domestically, Lulutai Airlines Ltd received assistance from the Australian government to assist domestic operations, hence it is expected to support the sectoral growth. Total container registrations also fell by 17.0% (161 containers) primarily due to lower private containers, while more business containers came in during the month. Over the month, the vehicle registrations slightly rose by 6 vehicles (2.2%).

More employment opportunities in the New Year

The Reserve Bank's job survey showed a 101.8% (58 job vacancies) rise in the number of vacancies advertised over the month. The monthly increase was attributed mostly to public administration, hotel & restaurants, and education sector. The high vacancies observed in these sectors further indicate the opening of the New Year with implementations of both public and private projects. At annual rate, the advertised job vacancies significantly increased by 500 job vacancies (140.8%). This partially reflects the increasing offers of residency visa by the Australia and New Zealand government that contribute to vacating of domestic employment, along with the ongoing labour mobility schemes.

Inflation dropped to 8.7% in February 2023

Table 1: Inflation Rates

Prices	Monthly		Annual	
	Feb-23	Jan-23	Feb-23	Feb-22
Headline Inflation (%)	1.0	0.2	8.7	9.1
Domestic prices	1.1	0.7	10.4	9.2
Imported prices	1.0	-0.3	7.4	8.9
Core inflation - ex. energy and food (%)	0.1	0.4	8.0	2.5

Source: Tonga Statistics Department

The headline inflation rate dropped from 9.7% in the previous month to 8.7% in February 2023 but still remained above the 5% reference, reflective of the stubborn high prices from the strong surge of energy prices and protracted supply disruptions throughout the year. Domestic items contributed 4.6% to the headline inflation, attributed largely to higher prices of local food items, local transport services, electricity, catering services (takeaway food), and secondary school tuition fees. Meanwhile, the imported items contributed 4.1% to the headline inflation. The main imported contributors to the headline inflation were imported food items, fuels, construction materials, goods for personal care, and international airfares.

Consumer Price Index rose over the month by 1.0%, stemming from increases in both domestic and imported prices. Higher domestic prices over the month was largely compounded by local food items (i.e., sausages, eggs, fish, vegetables, yams, and sweet potatoes), local costs for operation of personal transport equipment, and non-alcoholic beverages. Meanwhile, kava prices declined,



NATIONAL RESERVE BANK OF TONGA

MONTHLY ECONOMIC UPDATE

Vol. 11

No. 2

March 2023 Report

which partially reduced the increase in domestic prices. On the other hand, imported food items (i.e., chicken, onions, apples, sugar, and flour), goods for personal care, alcoholic beverages, and imported household items were the main contributors to higher imported prices.

Nonetheless, the core inflation (excluding energy and food) eased from 8.3% in previous month to 8.0% in February 2023. This is reflective of the lower contribution from local kava, catering services, tobacco and imported clothing compared to previous month. Overall, the core components contributed 3.5% to the headline inflation. On the other hand, the non-core components (energy and food) contributed 5.2% to the headline inflation.

Effective exchange rates increased

Table 2: Effective Exchange Rates

	Monthly			Annual	
	Feb-23	Jan-23	% Growth	Feb-22	% Growth
Nominal Effective Exchange Rate Index	93.5	92.4	1.3	90.4	3.5
Real Effective Exchange Rate Index	115.7	114.6	1.0	110.9	4.4

Source: National Reserve Bank of Tonga

The strength of the pa'anga as measured by the Nominal Effective Exchange Rate (NEER) increased over the month of February 2023 by 1.3%, underpinned by the general depreciation of the AUD, NZD, FJD, JPY, GBP, EUR and CNY against the TOP. Annually, the TOP was stronger by 3.5% as major trading partners' currencies generally weakened against the TOP except for the USD. This may assist in partially offsetting some of the impacts of the higher imported inflation.

The Real Effective Exchange Rate (REER) rose over the month by 1.0%, corresponding with the higher NEER. Annually, the REER increased also by 4.4% in line with the higher NEER and Tonga's higher inflation rate, indicating a loss in global trade competitiveness.

Foreign reserves changed slightly

Table 3: Foreign Reserves

	Monthly			Annual	
	Feb-23	Jan-23	%Growth	Feb-22	% Growth
Foreign Reserves (\$ in million)	911.2	911.1	0.0	867.3	5.1
Import Coverage (months)	13.8	14.0	-0.9	14.4	-3.8

Source: National Reserve Bank Tonga

Foreign reserves remained comfortable by the end of February at \$911.2 million, equivalent to 13.8 months of imports. In year ended terms, foreign reserves still increased by \$43.9 million attributed to higher receipts of budget support, official grants, and capital inflows. The majority of the official foreign reserves are held in USD, NZD, and AUD.

Table 4: Remittance and Travel Receipts

	Monthly			Annual		
	Jan-23	Dec-22	% Growth	Jan-23	Jan-22	% Growth
Remittance (\$ in million)	37.5	52.0	-27.9	484.6	496.0	-2.3
Travel (\$ in million)	11.6	13.6	-14.4	66.6	21.8	205.7

Source: National Reserve Bank Tonga

Total remittance receipts as usual for every year, declined over the month to January 2023 by \$14.5 million (27.9%) following the peak season of December. It also declined over the year by \$11.4 million (2.3%) due to lower private transfers and compensation of employees. The weaker economic growth in most of our remitting countries and the higher unemployment rate in both Australia and the US may have contributed to the slowdown in remittances.

Broad money decreased

Table 5: Broad Money

	Monthly			Annual	
	Jan-23	Dec-22	%	Jan-22	%
Broad money (\$ in million)	844.0	851.2	-0.84	832.8	1.3
Net Foreign Asset	899.5	858.1	4.8	844.4	6.5
Net Domestic Asset	-55.1	-6.6	-730.4	-10.7	414.9

Source: Banking System, National Reserve Bank of Tonga

Broad money fell over the month of January 2023, by \$7.2 million (0.8%) but still increased annually by \$11.2 million (1.3%). Over the month and over the year, the receipts of budget supports and development funds from donor partners, boosted government deposits to a new high level which resulted in a decline in both net credit to central government and net domestic assets. On the other hand, net foreign assets increased over the month and over the year, mainly on the higher foreign reserves underpinned by the above mentioned fund receipts.

Liquidity in the financial system declined

Table 6: Reserve money

	Monthly			Annual	
	Jan-23	Dec-22	%	Jan-22	%
Reserve money (\$ in million)	609.9	613.1	-0.5	576.6	5.8

Source: Banking System, National Reserve Bank of Tonga

Liquidity in the financial system decreased over the month of January 2023, but rose annually by \$3.2 million (0.5%) and \$33.3 million (5.8%) respectively. Currency in circulation declined over the month which offset the rise in both the Exchange Settlement Account (ESA) and Statutory Reserve Deposits (SRD). Annually, the ESA and SRD increased and outweighed the lower currency in circulation. The higher ESA and SRD corresponded to the growth in deposits whilst lower currency in circulation was in line with fewer economic activities.

Lending to businesses continued to rise

Table 7: Total Lending

Lending	Monthly			Annual	
	Jan-23	Dec-22	Growth	Jan-22	Growth
Total Lending (\$ in million)	497.5	493.3	0.9	473.9	5.0
Business lending	242.6	235.2	3.1	216.0	12.3
Household lending	254.9	255.8	-0.3	256.3	-0.5
Other lending	0.0	2.3	-98.2	1.7	-97.6

Source: Banking System, National Reserve Bank of Tonga

Over the month and year to January 2023, the banks' total lending increased by \$4.2 million (0.9%) and \$23.6 million (5.0%). Lending to businesses increased further over the month mainly for the distribution, transport and



manufacturing sectors and also over the year for businesses within the distribution, manufacturing and contructions sectors. Household loans, however, declined over the month and over the year, mostly driven by lower housing loans.

Over the month and year to January 2023, the banks' total deposits rose further by \$5.8 million (0.7%) and \$48.6 million (5.8%) respectively, to a total of \$880.7 million. The monthly rise is attributed to higher time deposits from the foreign exchange dealers and non-profit organisations. Similarly, higher deposits from the central government, private businesses and the non-profit organisations led the annual growth. The loans-to-deposit ratio slightly rose to 55.3% from 55.2% last month. However, annually, the loan to deposit ratio narrowed from 55.7% last year, driven mainly by the significant rise in deposits offsetting the increase in loans.

Weighted average interest rate spread widened in January

Table 8: Weighted Average Interest Rates

Interest Rates	Monthly			Annual	
	Jan-23	Dec-22	(bps)	Jan-22	(bps)
Weighted Average Banks Deposit Rate (%)	1.584	1.592	-0.8	1.710	-12.6
Weighted Average Banks Lending Rate (%)	7.982	7.908	7.4	7.840	14.3
Weighted Average Interest Rate Spread (%)	6.398	6.317	8.2	6.130	26.9

Source: Banking System, National Reserve Bank of Tonga

Over the month and year to January 2023, the weighted average interest rate spread widened to 6.40%, due mainly to the increase in the weighted average lending rate coupled with the decline in the weighted average deposit rate. Higher average lending rate for the month was driven by higher lending rates offered to businesses in the utilities, fisheries and manufacturing sectors, underpinned by higher loan volumes. Meanwhile, the demand and term deposit rates both fell over the month exceeding the slight increase in savings deposit rates. The lower weighted average deposit rate reflects higher volumes of deposits and excess liquidity during the month.

Annually, the weighted average lending rate continued to rise mainly for businesses in the mining & quarrying, construction and fisheries sector. Moreover, household lending rates continued to rise over the month and year mostly for housing loans. The weighted average deposit rate fell over the year as both term and savings deposit rates declined, whilst demand deposit rates slightly rose.

Outlook

The Reserve Bank continues to expect the Tongan economy to recover in the FY2022/23 whilst most of the world economies are slowing down. Imports are projected to increase in line with the economic recovery, while remittance receipts and inflows from donor funds return to pre-pandemic levels. To sustain the ongoing economic recovery, prudent macroeconomic management and effective implementation of structural reforms will be critical. Meanwhile, foreign reserves is expected to remain comfortable above the optimal level of 7.3 months of imports cover, supported by inflows of development assistance for the HTHH reconstruction and the implementation of donor projects back on track. The financial system remains stable with available liquidity as credit growth improves and banks are also well capitalized to absorb further shocks. Inflation is expected to have peaked in 2022 and is expected to continue declining in the near to medium term. However, uncertainties in the movements of global oil and commodity prices, as well as domestic food supply pose a risk to this outlook. The Reserve Bank's fight against inflation remains the priority and has started to implement some of its monetary policy measures indicated in the February 2023 Monetary Policy Statement and will continue to monitor the movements in global commodity prices to address the underlying inflation concerns to rein in inflation below its 5% reference rate in 2023. Separate measures to assist credit easing in liaison with the Government to address supply shortages and accelerate recovery in agriculture, fisheries, tourism and manufacturing are crucial to avoid unnecessary economic slowdown.