



NATIONAL RESERVE BANK OF TONGA

MONTHLY ECONOMIC UPDATE

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Global economy slowly recovers as global inflation eases

According to the IMF's October 2023 World Economic Outlook (WEO), the global economy is recovering slowly following the impacts of the COVID-19 pandemic, high cost of living and the Russia-Ukraine crisis. The unprecedented tightening of monetary policies across major economies to curb soaring inflationary pressures has slowed down the pace of global growth. Global growth is projected to slow down from 3.5% in 2022 to 3.0% in 2023 and 2.9% in 2024. Growth for 2022 and 2023 remains the same from the July 2023 WEO, whilst the 2024 growth was revised downwards by 0.1%.

Moreover, global headline inflation continues to ease and is projected to slowdown from 9.2% in 2022 to 5.9% and 4.8% in 2023 and 2024, respectively. Similarly, core inflation continues to moderate as conditions in the labour market continues to improve in advanced economies easing pressure on inflation. However, renewed geopolitical tensions in the Middle East could escalate further fragmentation in the region creating more volatility in the global oil prices and commodity prices across the board undermining global growth prospects.

Meanwhile, the US economy rose at an annual rate of 4.9% in the third quarter of 2023 compared with a 2.1% growth in the second quarter according to the US Bureau of Economic Analysis's advance estimate. The higher growth stemmed from increased consumer spending, private investments, exports and government spending. Personal disposable income rose by 1.9% during the quarter contributing positively towards household consumption and private investments.

Domestic economic activities showed mixed outcomes

The primary sector demonstrated mixed performances in September 2023. Total agricultural exports slightly rose over the month by 2.0 tonnes (+0.3%), attributed to higher exports of squash and taro. Coincidentally, agricultural export proceeds recorded an increase of 20.8% (+\$0.1 million). On the other hand, marine exports declined by 124.2 metric tonnes (-65.9%) due to lower tuna and shark meat exports. Meanwhile, aquarium exports rose by 113.0% (4,605 pieces). Total marine export proceeds however fell by \$0.1 million (-49.9%). The sectoral activities remain prone to the current El Nino weather conditions and the cyclone season.

Growth in the industrial sector over the month is buoyed largely by construction activities. Credit to the construction sector rose over the month by \$0.8 million (3.5%), along with an increase in individuals' housing loans of \$0.8 million (0.4%). This coincided with higher value of construction permits issued in September 2023 of \$3.3 million (+30.9%), due mostly to private projects. Meanwhile, the ongoing public projects such as the Upgrade of the Queen Salote Wharf, Dialysis centre, Tonga Climate Resilient Transport, and housing reconstruction projects are still progressing.

Indicators in the tertiary sector showed a slowdown over the month. Total passengers arrival (including via yacht & ship) in September 2023 fell by 22.1% (-2,578 passengers), along with a 20.9% (-2,566 passengers) decline in the passengers departure. This decline largely reflects the higher number of cruise ships' arrival & departure in the previous month. However, total travel receipts increased by \$0.6 million (4.4%) in September 2023. At the same time, container registrations continued to decline in September 2023 by 87 containers (9.8%), driven mainly by lower business containers (-94 containers). Coincidentally, import payments excluding oil imports, also fell by 39.2% (\$24.0 million).

More domestic job opportunities in October 2023

The Reserve Bank's survey on job advertisement increased over the month by 18.8% (+13 job vacancies). The total number of job vacancies advertised in October 2023 were mainly for public administration, communication, and education sectors. Total job vacancies advertised to the public also rose by 33.1% (+237 job vacancies) at annual rate. Majority of these job vacancies were from public administration, transport & communication, education, and health & social work.

Headline inflation rebounded to 6.1% in October 2023

Table 1: Inflation Rates

Prices	Monthly (% change)		Annual	
	Oct-23	Sep-23	Oct-23	Oct-22
Headline Inflation	2.7	0.4 ^r	6.1	13.1
Domestic prices	6.4	-0.1	7.4	16.6
Imported prices	-0.1	0.8 ^r	5.1	10.4
Core inflation - ex. energy and food (%)	0.3	0.1	6.9	8.2

Source: Tonga Statistics Department

r: revised

Headline inflation rose above the 5% reference rate to 6.1% in October 2023. A stronger-than-expected increase in local food prices over the month was the main driver for the higher inflation. The local food CPI is at its highest level on record. The higher local food prices reflect the additional immediate impacts of the El Nino event on the agricultural sector and growers' expectations.

The CPI rose over the month by 2.7% with 2.0 percentage points contribution from local food items only (i.e. root crops, vegetables, seafood etc.). In addition, electricity tariff, kava, and local transport services prices also increased. On the other hand, imported inflation declined over the month underpinned by lower price of imported food items, liquefied petroleum (LP) gas, construction materials, and clothing (school uniform). These lower prices outweighed the increase in price of fuel, alcoholic beverages, and goods for personal care over the month.

Over the year to October 2023, imported inflation contributed around 2.8 percentage points to the headline inflation. The main imported contributors are international airfares, imported food items, fuel, construction materials, household items, and goods for personal care. Meanwhile,



NATIONAL RESERVE BANK OF TONGA

MONTHLY ECONOMIC UPDATE

Vol. 11

No. 10

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LP gas price was still lower compared to the previous year. Domestic prices contributed 3.3 percentage points to the headline inflation with most contribution from local food items, catering services, transportation, secondary school tuition fees, and kava. Lower price of electricity over the year however supported lowering of inflation.

Core inflation rose to 6.9% in October 2023 from 6.7% in the previous month, reflective of the further increase in price of imported goods such as goods for personal care, alcoholic beverages and footwear, and local transport services and kava. At the same time, non-core inflation substantially rose to 5.7% in October 2023, compounded by the strong rebound in local food prices and increase in the electricity tariff.

Effective exchange rate rose in September 2023

Table 2: Effective Exchange Rates

	Monthly			Annual	
	Oct-23	Sep-23	% Growth	Oct-22	% Growth
Nominal Effective Exchange Rate Index	95.6	95.5	0.1	95.3	0.3
Real Effective Exchange Rate Index	119.4	119.1	0.3	118.9	0.4

Source: National Reserve Bank of Tonga

The Nominal Effective Exchange Rate (NEER) increased over the month by 0.1%, underpinned by the appreciation of the Tongan Pa'anga against the NZD and AUD (month ended). Similarly, the Real Effective Exchange Rate (REER) increased by 0.3% in October.

In year-ended terms, the NEER was higher by 0.3% compared to the previous year as the TOP generally appreciated against the trading partners' currencies (USD, AUD, FJD, JPY and CNY). This may assist in offsetting imported inflation as overseas payments would become cheaper in terms of local currency. Additionally, the REER increased over the year by 0.4% in line with the slight increase in Tonga's inflation.

Foreign reserves increased on official grants receipts

Table 3: Foreign Reserves

	Monthly			Annual	
	Oct-23	Sep-23	%Growth	Oct-22	% Growth
Foreign Reserves (\$ in million)	891.2	886.1	0.6	877.0	1.6
Import Coverage (months)	11.4	11.4	0.6	13.0	-12.2

Source: National Reserve Bank Tonga

Foreign reserves increased in October 2023 by \$5.1 million over the month and \$14.2 million annually to \$891.2 million, equivalent to 11.4 months of imports. This is well above the IMF prescribed level of 7.5 months. The inflow of government receipts and remittances continue to drive the overall increase. The majority of the official foreign reserves are held in USD, NZD, and AUD.

Remittance receipts continued to fall in September

Table 4: Remittance and Travel Receipts

	Monthly			Annual	
	Sep-23	Aug-23	% Growth	Sep-23	% Growth
Remittance (\$ in million)	39.8	48.3	-17.6	533.7	478.9
Travel (\$ in million)	13.3	12.7	4.4	131.8	302.7

Source: National Reserve Bank Tonga

Despite the women's annual roll call event in September, total remittances further declined over the month by \$8.5

million (17.6%) outweighing the rise in compensation of employees. While remittance receipts in AUD continued to hold the largest share, the weakened AUD against the TOP contributed to the overall monthly decline.

However, total remittance receipts remained stronger over the year by \$54.8 (11.4%) largely attributed to private transfers and compensation of employees receipts. This reflected improvements of economies abroad supporting investment and employment opportunities.

Broad money declined further

Table 5: Broad Money

	Monthly			Annual	
	Sep-23	Aug-23	% Growth	Sep-22	% Growth
Broad money (\$ in million)	847.8	854.7	-0.8	843.4	0.5
Net Foreign Asset	865.2	896.3	-3.5	875.0	-1.1
Net Domestic Asset	-16.9	-41.3	59.2	-31.2	46.0

Source: Banking System, National Reserve Bank of Tonga

Broad money decreased again over the month by \$6.9 million (0.8%) but rose annually in September 2023, by \$4.4 million (0.5%). The monthly decline is attributed to lower net foreign assets and foreign reserves. However, annually, net domestic assets increased and offset the lower net foreign assets, corresponding to Government spending on projects and other payments.

Reserve money fell further

Table 6: Reserve money

	Monthly			Annual	
	Sep-23	Aug-23	% Growth	Sep-22	% Growth
Reserve money (\$ in million)	590.6	602.5	-2.0	611.6	-3.4

Source: Banking System, National Reserve Bank of Tonga

Over the month and year to September 2023, liquidity in the financial system decreased by \$11.9 million (2.0%), and \$21.0 million (3.4%) respectively. Both declines reflected major Government loan repayments and import payments.

Credit growth continues

Table 7: Total Lending

Lending	Monthly			Annual	
	Sep-23	Aug-23	% Growth	Sep-22	% Growth
Total Lending (\$ in million)	521.8	516.40	1.0	482.3	8.2
Business lending	262.8	259.2	1.4	225.9	16.3
Household lending	259.0	257.1	0.7	254.0	2.0
Other lending	0.0	0.0	-13.3	2.4	-98.4

Source: Banking System, National Reserve Bank of Tonga

The banks' total lending grew further over the month and over the year to September 2023, by \$5.9 million (1.2%) and \$37.3 million (8.0%). Lending to both businesses and households continued to grow, reflecting recoveries in the economy and improved consumer and business confidence.

Over the month, lending to the professional & other services, constructions and distribution sectors increased, along with households' other personal and housing loans. Annually, higher lending was recorded for businesses within the distribution, manufacturing, transport, professional & other services and constructions sectors as well as households' other personal and vehicles loans.



NATIONAL RESERVE BANK OF TONGA

MONTHLY ECONOMIC UPDATE

Vol. 11

No. 10

November 2023 Report

Total deposits in the banks declined by \$11.3 million (1.2%) over the month, however rose over the year by \$42.4 million (5.0%) to \$898.9 million due to lower demand and time deposits over the month and lower saving deposits over the year. Demand deposits from insurance companies and churches fell over the month, as well as the time deposits from private businesses and the Retirement Funds. The loans to deposit ratio increased in September 2023 to 56.9% compared to 55.6% in August 2023 and 55.1% last year.

Interest rate spread declined

Table 8: Weighted Average Interest Rates

Interest Rates	Monthly			Annual	
	Sep-23	Aug-23	(bps)	Sep-22	(bps)
Weighted Average Banks Lending Rate (%)	7.611	7.613	-0.2	7.878	-26.7
Weighted Average Banks Deposit Rate (%)	1.606	1.572	3.5	1.656	-4.9
Weighted Average Interest Rate Spread (%)	6.005	6.042	-3.7	6.223	-21.8

Source: Banking System, National Reserve Bank of Tonga

Weighted average interest rate spread narrowed by 3.7 basis points over the month and over the year by 21.8 basis points to 6.0%. The weighted average deposit rate rose over the month and offset the declining weighted average lending rate. Both the time and deposit rates rose over the month whilst lending rates offered to the manufacturing, mining/quarrying and utilities decreased over the month along with the households' vehicle and housing lending rates.

Over the year, the lending rates were lower, which offset the decline in deposit rates. Lending rates offered to the construction, agricultural, and manufacturing sectors

decreased over the year as well as all the loan rates offered to households, led by lower vehicle loans rates, and followed by the decline in other personal loan and housing rates. This reflected some of the banks' loan campaigns during the year.

Outlook

Headline inflation has rebounded above the 5% reference rate as local food CPI hit its highest level on record and core inflation is still high. Global oil prices have seen declines recently after surging on the back of supply cuts by OPEC and oil producing countries. The continual uncertainties surrounding the Israel-Hamas war and geopolitical tensions in the Middle East are threatening to disrupt oil supplies from the region putting pressures on petroleum prices. The El Nino weather conditions affecting local food supply coupled with an expected rebound in demand and consumption during the holiday season are also anticipated to put further upward pressure on prices. GDP growth for the current financial year is anticipated to be moderate while domestic production is estimated to be still below potential thus allowing ample policy space for the Reserve Bank to support stronger economic growth without causing major inflationary pressure to the economy. Foreign reserves, are still at comfortable levels and is projected to remain above the IMF's prescribed level of 7.5 months of imports cover in the near to medium term. The financial system continues to remain stable with ample liquidity and banks are also well capitalized to absorb further shocks. The Reserve Bank will continue to closely monitor inflation movements and at the same time support economic recovery.