



**QUARTERLY ECONOMIC UPDATE
(QEU) September 2021**

**MINISTRY OF FINANCE
GOVERNMENT OF TONGA**

Notes

- a) The following definitions are used in the Quarterly Economic Update (QEU):
- 'Real' means adjusted for the effect of inflation.
 - Real Gross Domestic Products (GDP) and Nominal GDP are linked through a measure of the price level.
 - The fiscal year (FY) of Government ends on 30 June. FY before a calendar year denotes the year in which the fiscal year ends, e.g.; FY2017 ends on 30 June 2017.
 - Forecast period refers to 2020-2024.
- b) Figures in the tables and text have been rounded to one (1) decimal place. The discrepancies in tables between totals and sums of components are due to rounding off.
- c) The following notations are used:
- nil
 - na not applicable (unless otherwise specified)
 - \$ refers to Tongan Pa'anga (TOP) (unless otherwise specified)
 - \$m millions of Pa'anga (TOP) (unless otherwise specified)
 - (e) estimates (unless otherwise specified)
 - (r) revised estimates (unless otherwise specified)
 - (p) projected (unless otherwise specified)
- d) The following acronyms referred to as:
- | | |
|-------|---|
| AUD | Australian Dollars |
| CT | Consumption Tax |
| GDP | Gross Domestic Product |
| EU | European Union |
| IMF | International Monetary Fund |
| MDAs | Ministries, Departments & Agencies |
| MT | Metric Tonnes |
| MTO | Money Transfer Operators |
| NRBT | National Reserve Bank of Tonga |
| NZD | New Zealand Dollars |
| OET | Overseas Exchange Transactions |
| PAYE | Pay As You Earn |
| TASP | Tonga Agriculture Sector Plan |
| USA | United States of America |
| USD | United States' Dollars |
| WEO | World Economic Outlook |
| ESSP | Economic and Social Stimulus Package |
| TCRRP | Tourism Crisis Response and Recovery Plan |

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OVERVIEW

Global Economy

The global economy is projected to grow at 6.0 percent in 2021 and 4.9 percent in 2022 (IMF-WEO July 2021 update). The global forecast remains the same in compared to the April 2021 WEO, though there were some offsetting revisions. The forecast for the emerging market and developing economies were being revised down for 2021, particularly for Emerging Asia. On the other hand, an upward revision in forecast for advanced economies. These revisions attribute to the development progress in terms of policy support due to the pandemic. The 0.5 percentage-point upgrade for 2022 was mainly due to the upward revision in forecast for the advanced economies, particularly the United States. This reflects the additional fiscal support and improved health measures that were implemented.

Domestic Economy

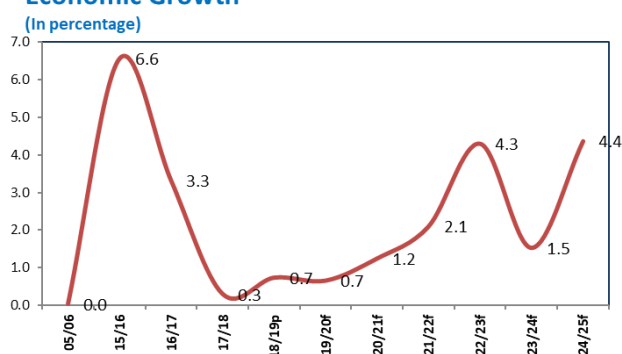
The Tongan economy continues to negatively impact by the pandemic in FY 2021. In response, Government implemented several measures to mitigate the impact, include the call being made to close the border. To date, the continuous closure of the border to international travelers, except for repatriation flights has positively contributed towards maintaining Tonga COVID-free. In contrast, all travel related activities, including the tourism industry continues to be seriously affected.

Additionally, the restriction measures worldwide have literally affected all sectors, employment, business, trade, manufacturing, and services activities. The impact has trickled down to the region and Pacific and Tonga.

The real Gross Domestic Product (GDP) growth is projected to grow by 1.2 percent in FY 2021, compared to the 0.7 percent growth in FY 2020. GDP growth, is projected to improve in FY 2022 by 2.1 percent. This reflects Government ongoing reform measures and initiatives to restore key sectors and growth in the economy.

The rounding off on the implementation of the Government Economic and Social Stimulus package of \$60 million has contributed to affected businesses and individuals. The further Stimulus package of \$70 million - equivalent to 5.5 percent of Tonga's GDP, will surely help to maintain the economy.

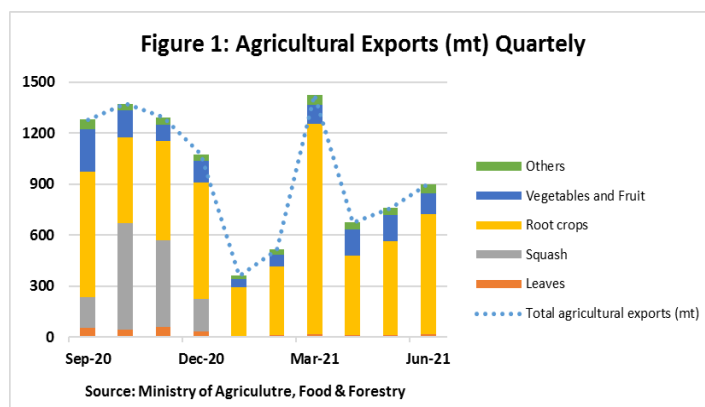
Economic Growth



REAL SECTOR

PRIMARY

The Primary Sector projects a negative growth in FY 2021, largely due to the huge decline in squash production and exports. The prolonged impact of COVID-19 had also affected the export of fresh fish. The agricultural sub-sector continues to dominate the Sector, with an average of 16 percent contribution to the overall GDP. A moderate growth is expected for the rest of the forecast period.



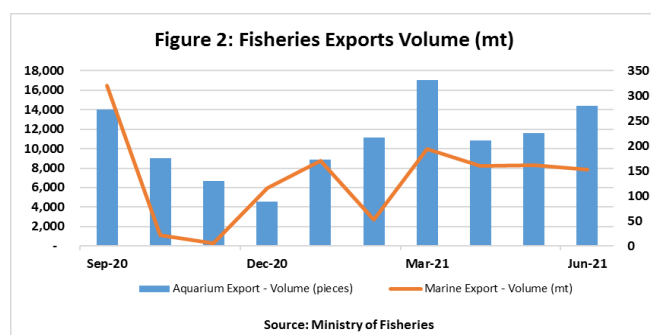
(Note: The available data is only current up to the June quarter 2021)

(a) Agriculture

The provisional data from Quarantine indicates that the total volume of Agricultural exports for June quarter 2021, had decreased by 20.2 percent, compared to the same period of 2020. The decrease was mainly due to the reduction in exports of root crops: yam, cassava and giant taro and largely on the volume of squash. The export of watermelon also added to the overall decline in agricultural exports.

In contrast, the domestic production increased in volume by 1,281mt, compared to the September quarter 2020. The increase in domestic production was largely driven by root-crops, banana and other fruits. The increase in domestic production reflects Government assistance through the Economic and Social Stimulus Package, in subsidizing the cost of plough and providing seedling for farmers, as part of Food and Security Cluster's COVID-19 Action Plan.

(b) Fisheries



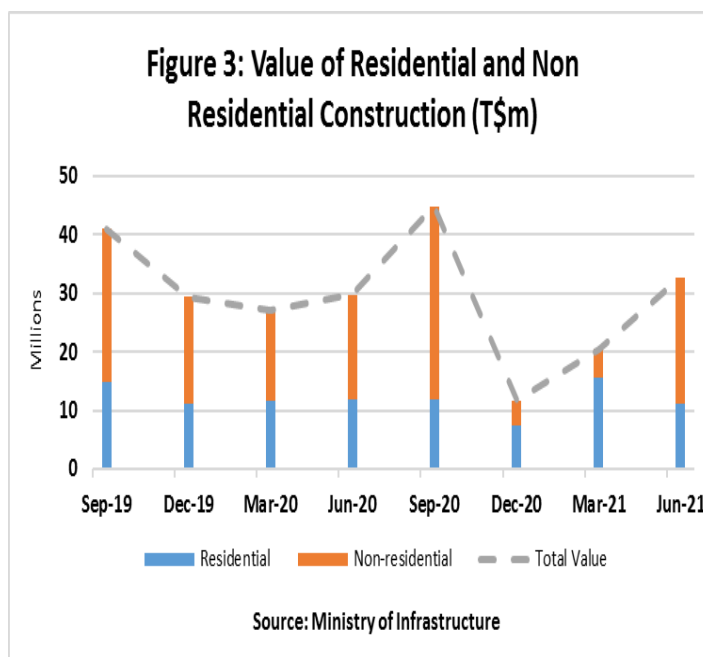
The volume of fisheries production for Aquarium Export slightly increased by 3.1 percent, compared to the corresponding period last year, attributed to the increase in export of Live fish by 45 percent. Alternatively, Marine Export production volume declined by 52.4 percent, mainly due to the decrease in the exports of tuna, snapper, shark meat and seaweed.

The domestic fish production increased in volume by 52 percent, mainly driven by andara and fin fish, compared to the September quarter 2020. The increase in domestic fish production reflects Government support through Stimulus Package, in subsidizing the selling of fish locally.

The outlook for the primary sector is positive, with an average growth of 2.3 percent in the medium-term. This is due to the ongoing effort and initiatives currently implementing in both sub-sectors. At the same, uncertainties remain due to the COVID-19 situation. The exports on both agricultural produce and fishery will affect as long as the border continues to close, and the Tonga economy's vulnerability to Climate Change and Natural Disasters.

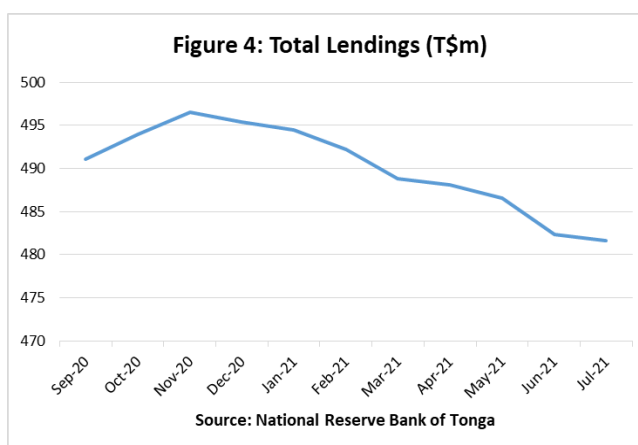
INDUSTRIAL

The Industrial Sector remains the driving factor of growth. This reflects the ongoing **construction** works and activities in the industry. These activities include TC Gita and TC Harold reconstructions, Queen Salote College twin building, Tonga Police Training Building and the commencement of Tonga Side School building. These construction activities contributed to the positive performance in the sector, which also consistent with the growth in business lending for construction and individual housing loans. Additionally, this was also reflected in the increase demand for quarrying, manufacturing–cement and building blocks and consumption of electricity and water supply sub-sectors.



(Note: The available data is only current up to the June quarter 2021)

The **total bank lending** continues to decline over the month up to July 2021 (Figure 4). The decline was attributed to the decrease in household and business loans in the construction and manufacturing sectors, led to the monthly and annual decline in total lending. This tends to slow down the value and number of issued building permits.



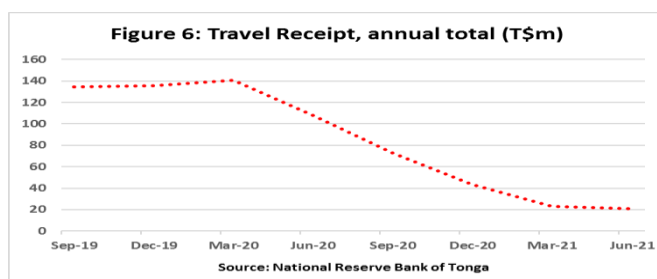
The outlook remains positive, supported by the ongoing construction activities, donor-funded construction projects include the Final Phase (Completion) of TC Gita & TC Harold Reconstruction, Road Maintenance project, Commencement of the Tonga High School Complex and the implementation of major projects, such as the upgrade of the Queen Salote Wharf and Fanga'uta Lagoon Bridge.

SERVICES

The growth in the services sector is expected to contract at a subdued level of 0.4 percent in FY 2021, down from 0.9 percent in FY 2020.

The forecast for outer years is positive, in anticipating the recovery from the pandemic. The business activities expect to resume once the border likely re-opens at the second half of FY 2022, ongoing flows of remittances from Tongan families abroad including seasonal workers.

(a) Accommodation and Food services (Tourism sector):



The travel receipts dramatically decreased by 81 percent, compared to the June 2020 quarter, primarily due to no tourist arrival, as an outcome of the border restrictions.

(b) Other sub-sectors:

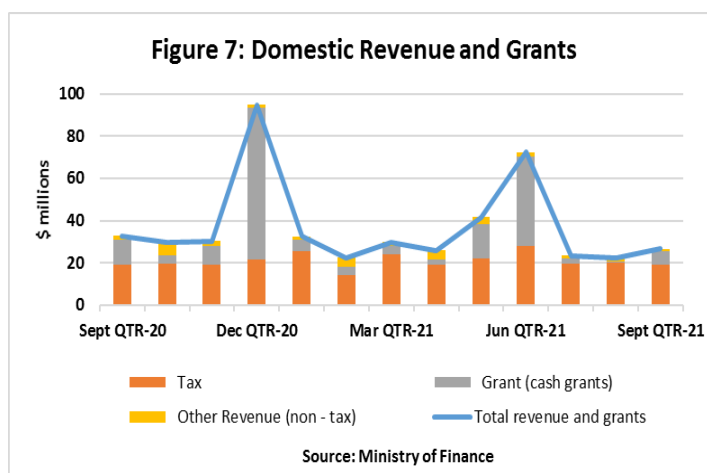
The **Wholesale and retail, Financial and Insurance Activities** are also affected from the trickled down impact of the pandemic. Banks are cautious with lending, however encourage the Commercial banks to utilize excess liquidity in the banking system for further lending to support economic growth. The **Public Administration and Defense** sub-sector data show a downward revision, reflected the implementation of control measures towards wage bill. Going forward, Government will continue to execute relevant measures to bring down the size of the wage bill to maintain at the set target of 53 percent of domestic revenue. At present, wage bill is at 61 percent.

The outlook for the sector is positive with modest growth in outer years. The expected growth is supported by the planned Government stimulus package and sector plans and support recovery and restore growth in the services sector.

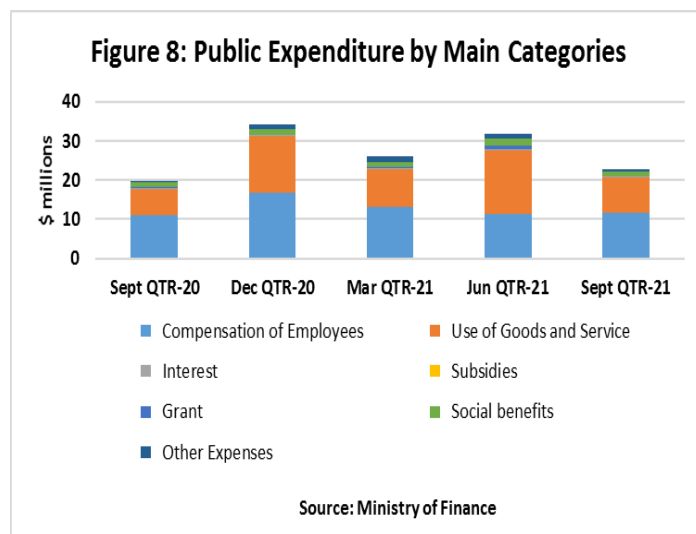
FISCAL SECTOR

(a) Revenue

The **domestic revenue and grants** recorded in the September quarter 2021 was 48 percent lower in average than the previous quarter (June 2021). The decrease was mainly due to a decrease in receipts from withholding tax for both residents and non-residents, general tax on goods and services and the consumption tax on imports. In addition, total capital grant receipt of \$6.3 million was received during the review quarter, of which \$5.5 million from World Bank/IDA and the remaining balance was from other development partner agencies, such as EU, UN agencies).



(b) Expenditure



The **Government expenditure** for the September quarter 2021 was 40 percent, lower than the previous quarter (June 2021), and 1.6 percent higher than the same period in 2020. The decrease in the quarterly expenses was mainly due to the less spending on: (i) Uses of Goods and Services (by 91 percent); and (ii) Compensation of Employees (by 8 percent).

The less expenses on the 'Use of goods and services' was mainly due to the decrease in spending on Grant, Other Special Projects, Technical Equipment, Contract Services and Maintenance of Roads.

The decrease on the **Compensation of employees** reflected the effort to control the wage bill anchor. These works included the approval and the implementation of new Overtime. The over-time cost was identified as one major cause of the exceeded target (at 61 percent) of wage bill (the target is to remain below 53 percent of domestic revenue). Other works included the tight management of new recruitments, streamline functions and responsibilities (job description) and standardized of positions.

At the end of September quarter, the **operating fiscal balance** (on Government Financial Statistic or GFS basis) recorded an average fiscal deficit of \$6.2 million, a decrease from the \$4.3 million deficit in June 2021 quarter. The deficit in the reviewed quarter was from the total receipts of tax and grants, of \$72.4 million, compared to the total spending of \$81.3 million for the quarter.

EXTERNAL SECTOR

(a) Balance of Trade (BOT)

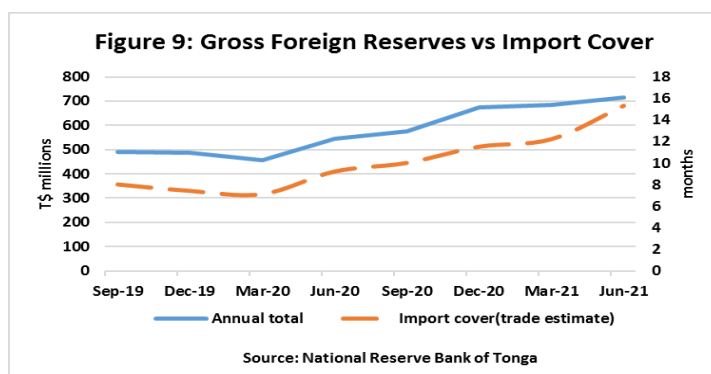
The latest provisional data available for BOT is only up to March 2021. BOT at the March quarter 2021 was negative \$120 million (Statistics Department, March 2021). Export earnings was 7 million in March 2021, compared to 8.9 million in the same period last year. The decrease in export earnings was mainly due to the decline in fisheries exports – March 2021.

(b) Overseas Exchange Transactions (OET)

The Overseas Exchange Transactions Trade balance account for March 2021 was unfavorable due to the increase in import payments, subsequently led to the increase in transfer balance. Remittances and other official transfers recorded an increasing trend despite the current situation with COVID-19.

© Foreign Reserve

The level of gross foreign reserves recorded at the end of June 2021 was \$715.2 million, an equivalent to 15.3 months of import cover. A 4 percent higher, or \$29.5 million, compared to the previous quarter and 32 percent or \$171.4 million higher than the corresponding period in 2020. The quarterly increase was mainly due to receipts of budget support and remittances recorded to the June quarter 2021.

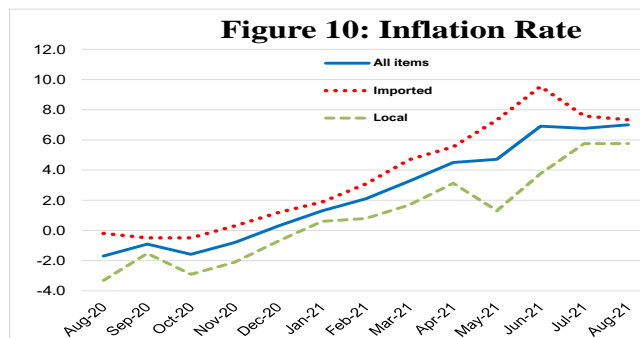


The 15.3 months of import cover reflects Tonga continued to maintain at a comfortable external position, surpassed the minimum range of 3 – 4 months set by the NRBT. The latest foreign reserve data available as of [August 2021](#) was \$751.7 million, an equivalent to 13.1 months of import cover.

MONETARY AND FINANCIAL SECTOR

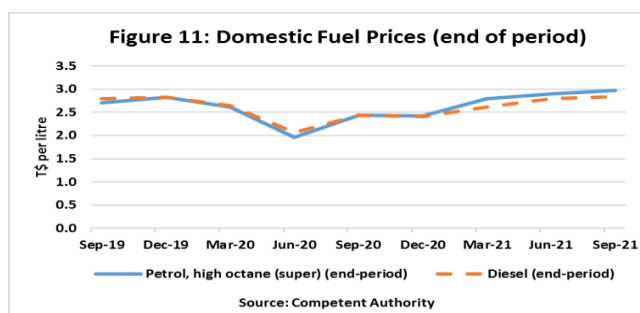
(a) Inflation

The annual headline inflation for August 2021 increased by 7.0 percent, compared to the 1.6 percent deflation recorded in August 2020, while the monthly prices increased by 0.2 percent from the previous month prices of July 2021 (6.8 percent). The inflation of 7.0 percent in August 2021 is well above the NRBT reference rate of 5 percent and the annual average inflation to August 2021 at 2.8 percent.



On annual basis, the inflation of 7.0 percent was mainly caused by the increase in domestic prices, contributing a 2.9 percent, import prices rose, contributing 4.1 percent to the overall inflation in August 2021. The increase in domestic prices was mainly due to the higher price of electricity and root crops, whereas the increase in imported prices were attributed to the increase in price of imported fuels and foods such as meats like chicken legs (16%) and turkey tail (37.9%).

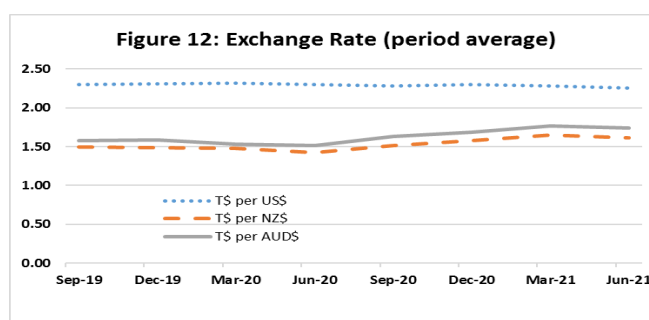
(b) Fuel Prices



Domestic price for petrol and diesel at the end of September 2021 increase by 22 percent and 17 percent respectively in comparison to September 2020 (*Figure 11*). This is inline with the upward movement in global oil prices index, as well the Tongan Pa'anga (TOP) has been steady during the month. The stable of the pa'anga and higher cost of freight also added pressure to the increasing price.

© Exchange Rate

At the end of June 2021, on period average, the US, Australian and New Zealand dollar appreciated against the Tongan pa'anga compared to previous quarter (*Figure 12*). These movements are due to change in trading partners' economies especially the risks posed by COVID-19 pandemic, and the increase in global commodity prices have affected the values of our foreign country currencies.



RISKS

Despite the positive outlook for the medium-term, there remain substantial risks. The potential risks include the:

- prolonged impact of COVID-19, particularly with the outbreak of the new variant;
- vulnerability to climate change and natural disasters;
- delays in the commencement of major construction projects;
- smallness of Tonga economy and its dependence on the global market, Tonga remains highly vulnerable to external shocks. For instance, the fluctuations in the global commodities prices have become the underlying factor for spikes in costs of production, inflationary pressure and dampening household real incomes.

CONCLUSION AND POLICY ISSUES

The outlook for Tonga economy is positive, despite the uncertainty with the COVID-19 situation. The development effort in the primary sector as well as the industrial sector contributed to the sustaining of growth. Tertiary sector provides the highest contribution of 52.3 percent to GDP, mainly due to Government services. As such, Government should continue the effort to remain prudent and focus spending of the most needed/priority areas. The monetary policy remains accommodative. Equally importance, Government notes and will attend towards the potential risks so as minimize disruptions or significant downfall.

