



QUARTERLY ECONOMIC UPDATE (QEU) March 2022

**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 2022-2025.
- 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 |
| ESSP | Economic and Social Stimulus Package |
| EU | European Union |
| GDP | Gross Domestic Product |
| 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 |
| TCRRP | Tourism Crisis Response and Recovery Plan |
| USA | United States of America |
| USD | United States' Dollars |
| WEO | World Economic Outlook |

Table of Contents

OVERVIEW	4
REAL SECTOR	4
PRIMARY	4
INDUSTRIAL	6
SERVICES	6
FISCAL SECTOR	8
EXTERNAL SECTOR	9
MONETARY AND FINANCIAL SECTOR	9
RISKS	10
CONCLUSION AND POLICY ISSUES	10

List of Figures

Figure 1: Agricultural Exports (MT), quarterly	5
Figure 2: Value and Volume of Fisheries, quarterly	5
Figure 3: Value of Residential and Non-Residential Construction	6
Figure 4: House Lending Rate (%)	6
Figure 5: Remittances. Annual Total (T\$)	7
Figure 6: Travel Receipts, annual total (T\$)	7
Figure 7: Domestic Revenue and Grant	8
Figure 8: Public Expenditure by Main Categories	8
Figure 9: Gross Foreign Reserves vs Imports Cover	9
Figure 10: Annual Inflation Rate	10
Figure 11: Domestic Fuel Prices	10
Figure 12: Exchange Rates (%)	10

OVERVIEW

Global Economy

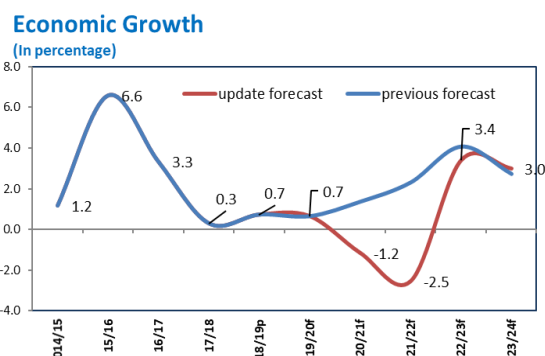
The global economy was expected to moderately decrease from 5.9 in 2021 to 4.4 percent in 2022 (IMF-WEO January 2022 update), with a 0.5 percentage point lower than in the October 2021 forecast (4.9 percent). The downward revision for 2022 reflects forecast reductions in the advanced economies—in part due to rising energy prices and supply disruptions—and for low-income developing countries, due primarily to worsening pandemic dynamics. Global growth is expected to slow to 3.8 percent in 2023. This is created by worsening health outcomes, deteriorating to low level by the end of 2022 in most countries. In addition, elevated inflation is expected to continue with the ongoing supply chain disruptions and high energy prices. This reflects the spillovers from the Russia-Ukraine war and tightening global financial conditions.



Domestic Economy

The Tongan economy has been severely disrupted by a double blow from Hunga Tonga Hunga Ha'apai (HTHH) volcanic eruption and tsunami in January, and the local outbreak of COVID-19 in February 2022. In response, the continuous closure of external borders and prompt economic support, have helped avoid a worse economic outcome. To date, the Government has extent its fiscal stimulus package to assist affected businesses and households during these difficult times.

The Gross Domestic Product (GDP) growth¹ is projected to drop further by (-2.5) percent in FY 2022, compared to the pre-estimate growth of (-1.2) percent growth in FY 2021. The performance of the primary sector remains weaker; activities in the industrial sector continue to be hampered by extended COVID-19 lockdowns and mobility restrictions with its spillover effects on to the tertiary sector. GDP growth is projected to pick up in the near-terms, taking into account the ongoing reform measures and initiatives to restore key sectors and growth within the economy. The ongoing Government policy support, and international and regional responses to expedite recovery and reconstruction activities are expected to help revive economic activities and growth of the economy.



REAL SECTOR

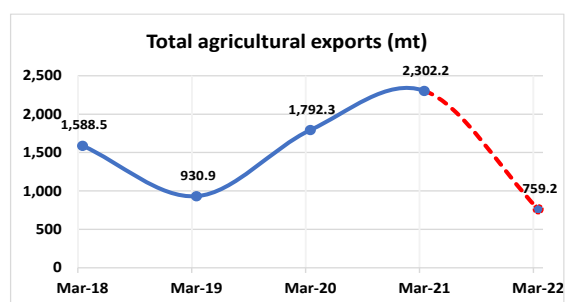
PRIMARY

The Primary Sector projects a negative growth in FY 2022, largely due to the huge decline in squash production (exports), and the impact of COVID-19 on fish-fresh exports. At the same time, the impact of the severe damages from HTHH disaster remain significant. 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.

¹ The growth estimates are based on preliminary GDP forecasting between two formal GDP forecasting during budget preparation. So, this can be slightly different from the GDP forecasting released in Budget Statement.

(a) Agriculture

The provisional data from Quarantine indicates that the total volume of Agricultural exports for March quarter 2022, has dropped significantly by 67 percent, compared to the same period of 2021. The decrease was mainly due to the reduction in exports of root crops: yam, cassava and taro tarua, giant taro and largely no record on the volume of squash. The decrease in the export of watermelon and other vegetables also added to the overall decline in agricultural exports.

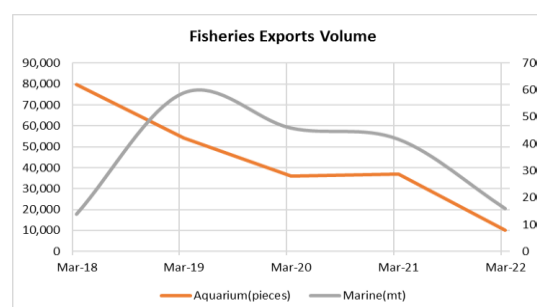


Simultaneously, the domestic production also decreased in volume by 204.3mt, compared to March quarter 2021 was largely driven by other vegetables, other fruits and root-crops.

The decrease in both quarantine and domestic production reflects the destructions caused by the HTHH volcanic eruption and tsunami estimated at \$38.9m. With the effort to support the sector, the Government continues with the assistance towards recovery through subsidizing the cost of plough, providing seedling for farmers, chickens for household and also low-cost credit loan through Government Development Loan (GDL).

(b) Fisheries

The volume of fisheries production for Aquarium Export significantly decreased by 73 percent, compared to the corresponding period last year. This is, attributed to the decrease in export of Live fish by 8,923 pieces, followed by Live hard coral of 7,546 pieces. Simultaneously, Marine Export production volume declined by 62 percent, mainly due to the decrease in the exports of tuna by 259.8 tonnes.



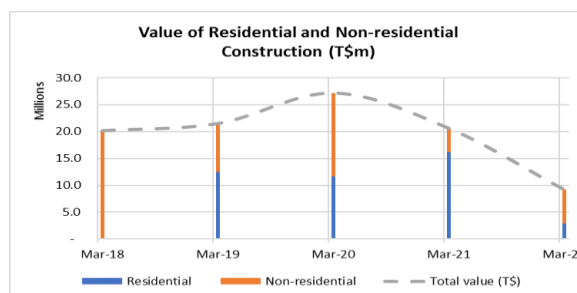
Concurrently, the domestic fish production decreased in volume by 47 percent, mainly driven by andara as no record since March 2021. The decrease in both fisheries export and domestic fish production reflects the damages caused by the HTHH eruption and tsunami, which demolished the majority of the recovery efforts following TC Harold. To assist the growth of the sector, the Government continues with the support through Stimulus Package, in subsidizing the selling of fish locally.

The outlook for the primary sector is positive, with an average growth of 1.5 percent in the medium-term. This is due to the ongoing effort and initiatives currently implementing in both sub-sectors. At the same, special attention is given to boost the import substitutions, domestic productions and volume of export. However, the sector will be affect if the border continues to remain closed, as well as Tonga's vulnerability to Climate Change and Natural Disasters.

INDUSTRIAL

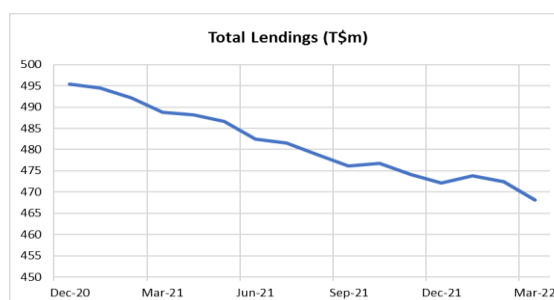
The Industrial Sector remains the driving and mitigating factor of growth behind the challenging years for the economy. The construction sub-sector becomes a vital input to the Tongan economy during a very unprecedented time.

However, the subsector declined in March 2022 compared to the same periods two years ago, in terms of residential and non-residential construction value (T\$m). This is due to COVID-19 outbreak, which caused delays in the implementation of major construction projects such as National Early Warning System and Emergency Operation Centre for natural disasters.



The medium-term outlook is promising with a positive growth forecast for the sector driven by construction sub-sectors: mining & quarrying, manufacturing, electricity, and water. The projected positive growth is mainly attributed to the new projects and activities included volcano eruption/tsunami reconstruction and recovery, Fanga’uta Lagoon Bridge, extension of Queen Salote Wharf and the New Parliament Building.

The **total bank lending** continues to decline over the month up to March 2022 by \$4.4 million. The decline was attributed to the decrease in household and business loans in the construction, tourism, and forestry sectors, leading 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 new projects and the reconstruction related activities such as HTHH Volcanic eruption and Tsunami reconstruction, donor-funded construction projects include Fanga’uta Lagoon Bridge, New Parliament Building, and the upgrade of Queen Salote Wharf.

SERVICES

The growth in the services sector is expected to grow at 2.3 percent for FY 2022, up from 0.3 percent growth in FY 2021. The projected increase is attributed to the recovery-related activities in the services sub-sectors. This is including the ongoing and significant inflow of humanitarian support and in-kind remittances from development partners, various communities and families abroad due to the HTHH disaster and the provision of government assistance to the stakeholders due to the impacts of COVID-19.

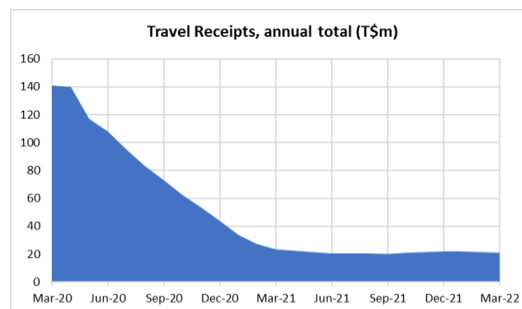
Also on the good notes, the communication was able to restore during the reviewed period after due the disruption of the cable fiber optic by the HTHH volcanic eruption. The disruption to the communication sector has impacted on the services sector including the education sub-sector, and usual services provided by both public and private sectors to the general public. On the other hand, the continuous closure of the border and the damages of tourism facilities by HTHH volcanic eruption continue to hampered activities of most of the services sector and the economy as a whole.

The forecast for outer years is projected to grow at an average of 3.8 percent, taking into account the continuous work and efforts to contain the spread of omicron and recovery. Business activities are expected to normalize once the border re-opens likely at the second half of FY 2022, with ongoing

flows of remittances from Tongan families abroad including seasonal workers, including the works under the education sub-sector to operate classes online (e-learning).

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

Tourism facilities were particularly hit hard due to extensive damage caused by the tsunami reflecting the significant decline in growth to 30.3 percent in FY2022 a further contraction from negative 11.8 percent in FY2021. These downward trends reflected the recent dual destruction caused by the eruption of the HTHH volcano, and the further battering by the outbreak of COVID-19 (omicron). The travel receipts slightly decreased by 9.1 percent, compared to the March 2021 quarter, primarily due to no tourist arrival, as an outcome of the border restrictions.



(b) Human health & social work activities:

The growth in the health sub-sector project a positive growth reflecting Government efforts to support the limited capacity during the local outbreak and strengthen the preparedness for the new norm which is to live with COVID-19. Although Omicron spreads faster than we could imagine, the Ministry of Health continues to advise the public of the precautionary measures to protect those at risk.

The vaccination coverage, as of March 2022, reached 98 percent for the first dose, 90 percent for the second dose, and 49 percent for booster doses.

The Government together with development partners continue to provide support to the vulnerable groups through the Social Welfare Scheme for Elderlies and Disability as well as Poor Households.

(c) Education Sector:

The Education sub-sector is projected to be 3 percent in FY 2022 and continues at the same level over the medium term. The positive outlook reflects ongoing works and planned initiatives to develop the sector. Despite the disruption of school programs by the COVID-19 restrictions and lockdowns, and also the damages on the school buildings from the HTHH ashfall and tsunami, the Ministry of Education and Training has implemented home school programs since the lockdown in February 2022. All relevant efforts had been put forth to enable students at all levels—Primary, Secondary and Tertiary—to access from home via Radio broadcast and printed materials, at a specific schedule to get their educational curriculum for the day/week, and online Moodle for their respective courses.

(d) Other sub-sectors:

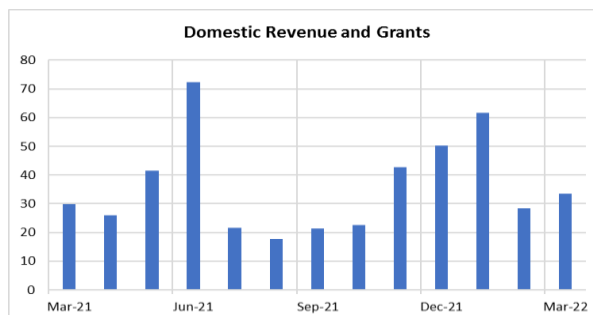
The **Wholesale and retail, Financial and Insurance Activities** are also affected from the impact of the COVID-19, with businesses continue to operate to the very high demand of consumption from the public while juggling within the national lockdown due to the spread of Omicron. Bank credit has gradually declined since mid-2020, reflecting both the weak demand for credit and banks' increased risk aversion amidst heightened economic uncertainty. Delays and cancellation of projects due to border closures and subsequent shocks have reduced credit demand. 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 99 percent which is a risk. The **Information & Communication** sub-sector shows an impact as well due to the severe breakdown of communication from HTHH disaster which cut off Tonga internet

cable which make its harder to rest of the world to communicate or received information from us during that time.

FISCAL SECTOR

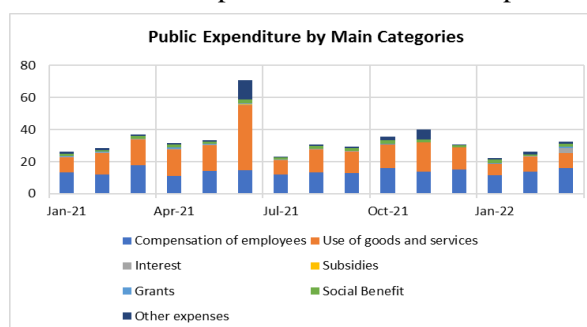
(a) Revenue

The **domestic revenue and grants** recorded in the March quarter 2022 was slightly (6.9 percent) higher compared to December 2021 quarter, and significantly increased by 46 percent at the same period in 2021. The increase was mainly due to an increase in receipts from Grants especially capital grant by \$7.7 million from \$3.9 million recorded in March 2021. This is largely received from World Bank/IDA and the remaining balance from other development partner agencies such as ADB, EU, and UN agencies. This is for various development projects as well the assistance for the damage from HTHH volcanic eruption and tsunami.



(b) Expenditure

The **Government expenditure** for the March quarter 2022 was 24 percent lower than the previous quarter (December 2021), and also 11 percent lower than the same period in 2021. The decrease in the quarterly expenses was mainly due to less spending on: (i) Uses of Goods and Services (by \$20.6 million); (ii) Other Expenses (by \$5.2 million); and (iii) Compensation of Employees (by \$3.6 million).



The less expenses on the ‘Use of goods and services’ was mainly due to the decrease in spending on Other Special Projects (by \$4.5 million), Maintenance of Roads (by \$2.2 million), Domestic Travel (by \$1.8 million), and Consultants & Technical Assistants Professional (by \$1.4 million).

The decrease on **Other Expenses** was mainly due to the less spending on Subsidies under Miscellaneous other expense by \$4.8 million. In addition, the decrease on the **Compensation of employees** reflected the effort to control the wage bill anchor. The Government is strongly enforcing the management of the public sector wage bill to align with actual commitments below the fiscal anchor focusing on recruitment of critical posts. These include overtime control and other works included the tight management of new recruitments, streamline functions and responsibilities (job description) and standardized of positions.

At the end of March quarter, the **operating fiscal balance** (on Government Financial Statistic or GFS basis) recorded an average fiscal surplus of \$9.8 million, a increase from the \$4.6 million surplus in December 2021 quarter. The surplus in the reviewed quarter was from the total receipts of tax and grants, of \$123.5 million, compared to the total spending of \$80.9 million for the quarter.

EXTERNAL SECTOR

(a) Balance of Trade (BOT)

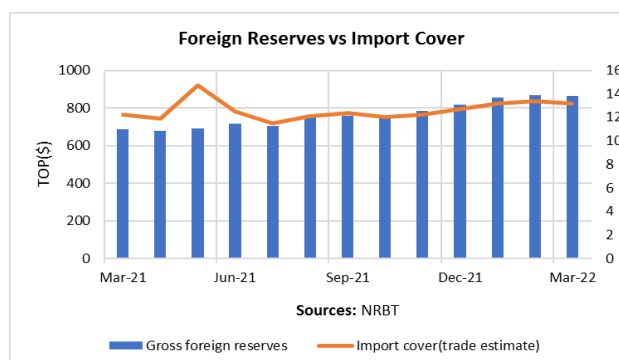
The BOT for March quarter 2022 was negative \$110.4 million (Statistics Department, March 2022). Export earnings was \$5.4 million in March 2022, compared to 7.06 million in the same period last year. The decrease in export earnings was mainly due to the decline in fisheries and agricultural exports such as end of squash season.

(b) Overseas Exchange Transactions (OET)

The Overseas Exchange Transactions Trade balance account for March 2022 was unfavorable due to the increase in import payments, subsequently leading to the increase in transfer balance. Remittances and other official transfers continue to hold up reflecting the strong bond and network of support from Tongan diasporas including families, relatives, alumni and various communities due to the unprecedented events.

(c) Foreign Reserve

The level of gross foreign reserves recorded at the end of March 2022 was \$861.4 million, an equivalent to 13.2 months of import cover (trade estimate). This is 5.4 percent higher, or \$43.9 million, compared to the end of previous quarter (December 2021) and 26 percent or \$175.7 million higher than the record in March 2021. The quarterly increase was mainly due to receipts of budget support and remittances flow into the country given the HTHH disaster and COVID-19.

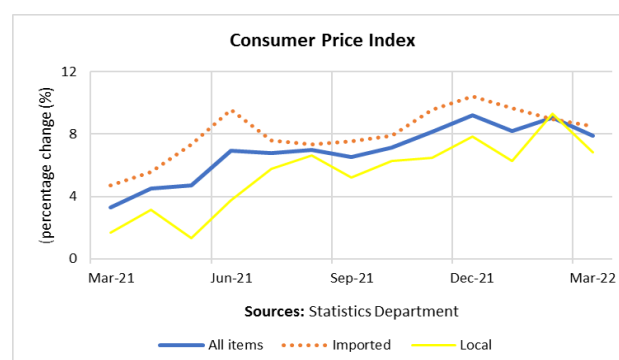


The 15.3 months of import cover reflects Tonga's commitment to continue maintaining at a comfortable external position, surpassed the minimum range of 3 – 4 months set by the NRBT. The latest foreign reserve data available as of August 2022 was \$871.0 million, an equivalent to 12.4 months of import cover.

MONETARY AND FINANCIAL SECTOR

(a) Inflation

The annual headline inflation for March 2022 is 7.8 percent, compared to 9.1 percent inflation in February 2022. The inflation rate for the same month of previous year, March 2021, was 3.3 percent. A slight rise over the month by 0.2 percent, is owed mostly to higher prices of fuel and food items. Domestic prices, however, declined and partially offset the rising prices. The inflation recorded for the review month is well above the NRBT reference rate of 5 percent target.



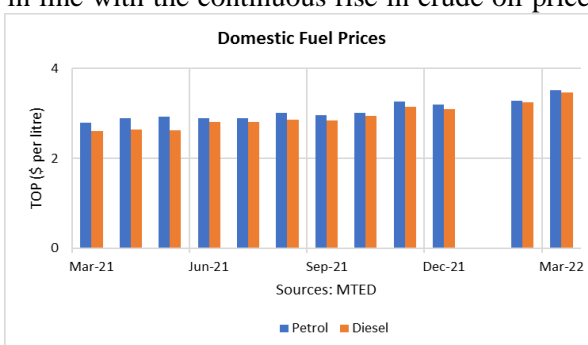
On an annual basis, the inflation of 7.8 percent was mainly caused by the increase in domestic prices, contributing a 6.9 percent, import prices rose, contributing 8.6 percent to the overall inflation in March 2022. This is due to a higher price for electricity, imported fuel (petrol/diesel) follow the prices of food item such as chicken legs and turkey tail. On the outlook, inflation rate is expected to continue rising to double digit, well above the reference target of 5 percent, due to the impacts of HTHH

on domestic component (food prices) of the Consumer Price Index (CPI). and the impacts of Russia-Ukrainian war on the fuel prices.

(b) Fuel Prices

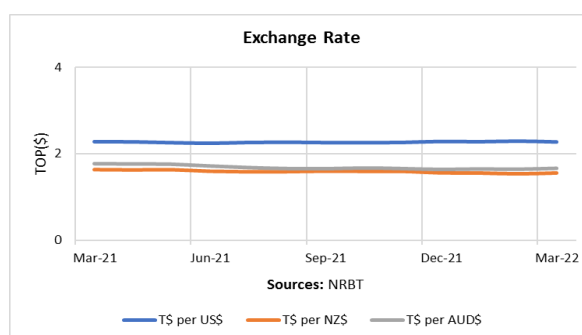
Domestic price for petrol and diesel at the end of March 2022 increase by 7 percent and 26 percent respectively in comparison to March 2021. This is in line with the continuous rise in crude oil prices both supply and demand fundamentals pressured prices. The Russian-Ukraine War had significantly contributed to this upward movement in global oil prices index as mentioned above.

The Tongan Pa'anga (TOP) remained relatively stable during the month. The stable of the pa'anga and higher cost of freight also added pressure to the increasing price.



(c) Exchange Rate

On period average for the end of March 2022, the exchange rate for US Dollar appreciates while NZ Dollar depreciates and Australian Dollar remain constant compared to previous quarter. Comparing to March 2021, US Dollar appreciates while the other two currencies depreciate. These movements are due to change in trading partners. The depreciation in the Tongan Pa'anga against the USD benefit the recipients of remittances in Tonga; while same is not the case for recipients of AUD and NZ dollar.



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-Omicron;
- vulnerability to climate change and natural disasters and the aftermath of HTHH volcano eruption and tsunami;
- delays in the implementation and commencement of major construction projects;
- smallness of Tongan 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

Despite the current devastation in the key economic sectors and activities, the outlook is positive as we seek ongoing partnership with all key stakeholders to facilitate economic recovery. This will include supporting the reconstruction and recovery plans for the affected households, business sector, and vulnerable groups. Effective partnership and collaboration with key stakeholders are crucial and we acknowledge the ongoing support by development partners during this difficult time. We also acknowledge the support both in cash and in-kind, of the Tongan diaspora overseas in maintaining remittances.

Last but not least, Government MDAs are strongly encouraged to streamline expenses to prioritize budget allocations toward the priority needs and the GPA. 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.