INTERNATIONAL MONETARY FUND

IMF Country Report No. 25/293

TONGA

2025 ARTICLE IV CONSULTATION—PRESS RELEASE; AND STAFF REPORT

November 2025

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2025 Article IV consultation with Tonga, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its November 6, 2025 consideration of the staff report that concluded the Article IV consultation with Tonga.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on November 6, 2025 following discussions that ended on August 22, 2025, with the officials of Tonga on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on October 23, 2025.
- An **Informational Annex** prepared by the IMF staff.
- A **Debt Sustainability Analysis** prepared by the staffs of the IMF and the World Bank.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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International Monetary Fund
Washington, D.C.

PRESS RELEASE

PR 25/365

IMF Executive Board Concludes 2025 Article IV Consultation with Tonga

FOR IMMEDIATE RELEASE

Washington, DC – November 10, 2025: The Executive Board of the International Monetary Fund (IMF) completed the Article IV Consultation for Tonga[1] and considered and endorsed the staff appraisal without a meeting.[2] The authorities have consented to the publication of the Staff Report prepared for this consultation.[3]

Tonga's economy expanded by 2.7 percent in FY2025, supported by robust reconstruction activity, strong remittance inflows, a rebound in tourism, and stronger-than-expected grants inflows. Growth is projected to moderate to 2.3 percent in FY2026 as reconstruction outlays normalize and supply-side constraints persist. Headline inflation has eased below the 5 percent reference rate of National Reserve Bank of Tonga (NRBT), but core inflation has risen to nearly 10 percent, reflecting strong domestic demand pressures. Risks in the banking sector remain contained but have increased and require continued vigilance.

Tonga's external position in FY2025 remained solid, with ample reserves covering about 10½ months of imports. While reconstruction-related imports widened the current account deficit from 3.8 percent of GDP in FY2024 to 5.2 percent in FY2025, this was financed by sizable capital transfers.

The outlook is favorable but subject to significant risks. A sharper global slowdown, weaker remittances, or natural disasters could weigh on growth. Tonga also faces long-standing structural constraints that limit potential growth, including high outward migration, a narrow economic base, and vulnerability to climate shocks. Addressing these challenges will require sustained reforms to deepen financial markets, improve the business environment, strengthen governance—including at state-owned financial institutions—and enhance resilience to natural disasters.

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

[2] The Executive Board takes decisions under its lapse-of-time procedure when the Board agrees that a proposal can be considered without convening formal discussions.

[3] Under the IMF's Articles of Agreement, publication of documents that pertain to member countries is voluntary and requires the member consent. The staff report will be shortly published on the www.imf.org/Tonga page.

Executive Board Assessment

In concluding the 2025 Article IV Consultation with Tonga, Executive Directors endorsed the staff's appraisal, as follows:

Tonga's economy continues to expand, driven by reconstruction, public investment, strong remittances, and rebound in tourism. Growth is projected to peak at 2.7 percent in FY2025 before moderating as large projects wind down and supply-side constraints persist. Medium-term prospects remain subdued, constrained by high disaster vulnerability, outward migration, and structural impediments from Tonga's small size and remoteness.

The proposed fiscal stance for FY2026 is appropriately contractionary. The expansionary fiscal stance in FY2025 has supported the recovery, but with the economy on firmer footing, a shift toward rebuilding buffers in FY2026 is appropriate.

Over the medium term, gradual fiscal consolidation and additional grant financing are essential to put debt on a firm downward path. Given Tonga's high risk of debt distress, consolidation should focus on mobilizing domestic revenues—including phasing out inefficient exemptions—improving tax administration, enhancing spending efficiency, and securing grants. The authorities should also refrain from non-concessional borrowing, while strengthening PFM capacity to ensure effective project implementation and support donor confidence.

With the economy on a firmer footing and incipient signs of demand-driven price pressures, monetary policy should shift from accommodative to neutral. Given the spike in core prices and the ample liquidity in the banking system, monetary policy should begin moving toward a neutral stance, with readiness to tighten further in a data-dependent manner.

This shift will be underpinned by a milestone reform—announced by the NRBT following IMF technical assistance—to transition to a mid-rate interest rate corridor monetary policy framework. The NRBT's plan to issue short-term securities and transition to a corridor-type framework will help absorb excess liquidity, establish a positive policy rate, and lay the foundation for a more effective interbank market.

The financial system is broadly stable, with banks well-capitalized and liquid, though rising credit risks call for more proactive supervision. Stronger oversight of credit unions and pension funds, alongside continued progress on AML/CFT, will be critical to safeguard financial integrity and preserve correspondent banking ties.

Structural reforms remain vital to lift Tonga's low growth potential. Priorities include advancing financial deepening and access to credit, mitigating the effects of emigration through education and training, accelerating digital adoption, cutting red tape, and addressing governance vulnerabilities. Tonga's leadership in establishing the Pacific Resilience Facility is welcome, as is the creation of the Anti-Corruption Commission. Sustained investment in statistical capacity is also needed to support policymaking and surveillance.

Tonga: Selected Economic Indicators, FY2022-2026[1/]

Population (2023): 100 thousand

Major exports: root crops, vegetables, shellfish, fish

			Est.	Projections	
	FY2022	FY2023	FY2024	FY2025	FY2026
Output and prices			(Annual percent change)		
Real GDP	-2.3	2.1	2.1	2.7	2.3
Consumer prices (period average)[2]	6.5	12.6	8.0	2.9	2.2
Consumer prices (end of period)[2]	9.9	13.7	6.4	1.4	3.1
Central government finance			(In percent of GDP)		
Revenue	44.3	54.3	55.5	60.0	43.8
of which: Grants	18.4	28.0	29.2	32.0	16.9
Expenditure	44.4	48.2	51.3	54.3	51.4
Expense	38.7	40.3	37.0	37.5	37.1
Net acquisition of nonfinancial assets	5.7	7.9	14.3	16.9	14.3
Primary balance	0.4	6.8	4.6	6.1	-7.3
Overall balance	-0.1	6.1	4.2	5.6	-7.7
Overall balance (excl. grants)	-18.5	-21.9	-25.0	-26.3	-24.6
Money and credit			(Annual percent change)		
Broad money (M2)	13.4	-0.3	8.2	3.7	4.6
Domestic credit	-3.3	-15.6	14.0	18.0	15.9
Of which: Private sector credit	-1.0	9.0	7.3	7.5	4.5
Balance of payments			(In millions of U.S. dollars)		
Current account balance	-27.8	-30.4	-21.2	-30.6	-39.3
(In percent of GDP)	-5.4	-5.9	-3.8	-5.2	-6.4
Trade balance	-201.0	-222.6	-221.1	-243.0	-251.2
Exports of goods, f.o.b.	15.1	13.1	10.8	12.0	13.5
Imports of goods, f.o.b.	216.1	235.8	231.9	255.0	264.7
Tourism receipts	9.9	44.0	61.6	66.7	70.2
Total remittances	215.9	256.4	257.0	265.5	278.5
(In percent of GDP)	41.9	50.0	46.0	45.2	45.2
Compensation of overseas workers	35.3	55.4	65.0	67.2	70.4
Personal remittances	180.6	200.9	192.0	198.4	208.1
Official grants	24.6	22.9	21.9	30.9	22.2
Capital account balance	73.2	66.2	45.9	51.1	10.2
Financial account balance	25.0	15.8	-22.3	-21.9	38.6
Gross official foreign reserves					
In millions of U.S. dollars	378.5	389.9	386.6	387.9	397.4
(In months of next year's total imports)	11.7	11.9	10.9	10.5	10.2
Debt			(In percent of GDP)		
Public debt (external and domestic)	43.8	43.8	37.0	31.5	37.7
Of which: External debt	38.2	38.3	31.7	26.6	31.0
External debt service ratio	1.4	2.2	3.8	3.6	3.5
Exchange rates					
Exchange rate (National currency per US dollar)	2.3	2.3	2.4	2.4	...
Real effective exchange rate (2010=100; +=appreciation)	115.7	112.7	118.7	119.3	...
Memorandum items:					
Nominal GDP (millions of US$)	515.2	513.1	558.1	587.5	615.7

Sources: Tonga authorities; and IMF staff estimates and projections.

[1]Fiscal year beginning July 1.

[2]CPI basket and methodology changed in September 2021.

INTERNATIONAL MONETARY FUND

TONGA

STAFF REPORT FOR THE 2025 ARTICLE IV CONSULTATION

October 23, 2025

Overview. Tonga's economy is expanding steadily, driven by stronger-than-expected grant inflows, elevated remittances, a rebound in tourism, and fiscal support for the reconstruction. Headline inflation has declined below the reference rate, driven by lower food and energy prices, but core inflation has picked up, reflecting stronger domestic demand. Risks in the banking sector remain contained but have increased and require continued vigilance. Meanwhile, Tonga continues to face significant structural challenges including geographic remoteness, a small and dispersed population, and high vulnerability to natural disasters. This persistent vulnerability discourages investment and incentivizes emigration, weighing on long-term growth prospects and requiring policies and reforms to enhance resilience and growth potential, particularly in a global environment marred by heightened policy uncertainty.

Main Policy Recommendations. The authorities should follow through on their commitment to rebuild fiscal buffers and address structural constraints to growth through policy reforms. Specifically:

- **The proposed fiscal stance** in FY2026 is appropriately contractionary. Over the medium-term, a gradual and credible fiscal consolidation is crucial to put debt on a firm downward path, which should be achieved through boosting domestic revenue mobilization, limiting spending, and securing additional grants.

- **The monetary policy stance** has been appropriately accommodative in supporting the recovery, but a shift towards neutrality is now warranted with the economy on a firmer footing and demand-driven inflationary pressures re-emerging. This shift will be underpinned by a milestone reform—announced by the NRBT—to transition to a mid-rate interest rate corridor monetary policy framework.

- **Financial sector policies** should aim at fostering a stable and inclusive financial system, including by enhancing regulatory oversight across the broader financial sector, expanding the macroprudential toolkit, and conducting regular bank stress tests. Strengthening prudential standards will help safeguard financial stability, while stricter anti-money laundering (AML) enforcement will be critical to preserve integrity and access to correspondent banking relationships.

- **Structural reforms** to foster private sector development, deepen financial markets, strengthen resilience to natural disasters, and improve governance—including in financial institutions—are critical to unlocking Tonga's long-term growth potential.

Approved By
Lamin Leigh (APD) and Bergljot Bjornson Barkbu (SPR)

Discussions took place in Nuku'alofa, Tonga during August 12-22, 2025. The mission team comprised Andrea Pescatori (Head), Xuehui Han, Ruifeng Zhang (all APD), and Shivneel Kirpal (Resident Representative Office, Fiji). Esala Masitabua (OED) and Ruth Nikijuluw (World Bank) participated in some of the meetings. Executive Director Idwan Suhardi Bin Hakim joined the concluding meetings. The mission met with the Prime Minister and Minister of Finance Aisake Valu Eke, the Governor of the National Reserve Bank of Tonga Tatafu Moeaki, other senior government officials, development partners, and private sector representatives. Data used in this report for staff analyses are as of September 5, 2025, unless otherwise noted. To-Nhu Dao, Puying Wang, Paige Brewer, and Yan Xu supported the mission and preparation of the report.

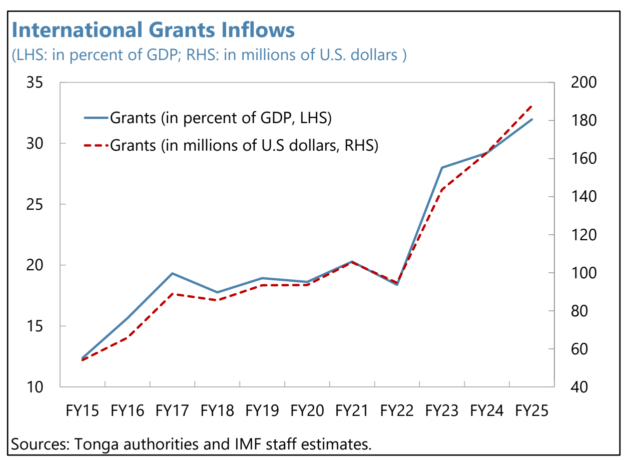
CONTENTS

ANNEXES

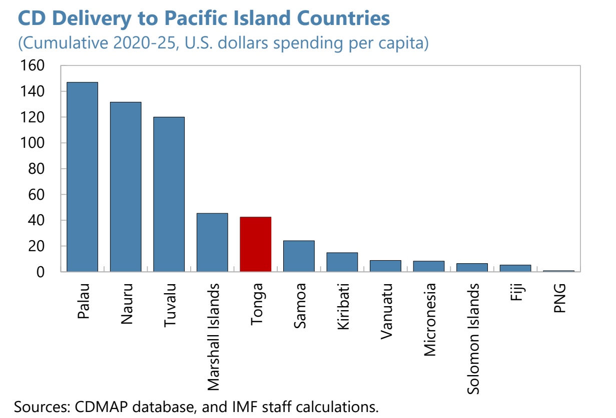
CONTEXT: PROMOTING MACROECONOMIC STABILITY AND ENHANCING ECONOMIC RESILIENCE

1. **Tonga's economy is growing at a solid pace, bolstered by external transfers and fiscal stimulus—but risks remain, including inflationary pressures, elevated global uncertainty and financial sector vulnerabilities.** Tonga's recovery has strengthened, with GDP growth estimates revised upward for both FY2024 and FY2025 by 0.3 percentage point to 2.1 and 2.7 percent, respectively, thanks to stronger-than-expected grant inflows, elevated remittances, and the effective deployment of fiscal support for the reconstruction efforts. While headline inflation has declined well below the 5 percent reference rate, driven by lower food and energy prices, core inflation has picked up in recent months, reflecting stronger domestic demand. Risks in the banking sector remain elevated and require continued vigilance. Overall, Tonga remains highly vulnerable to external shocks, particularly in a global environment marred by heightened policy uncertainty.

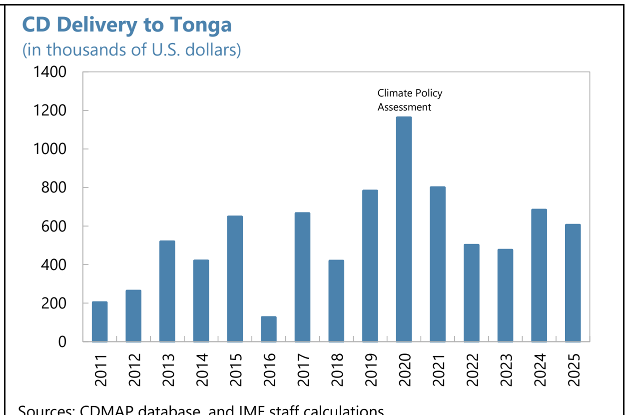
2. **Broad-based structural reforms to boost long-term growth are essential, given Tonga's high vulnerability to natural disasters, limited economies of scale, and high reliance on donors' support.** As outlined in Country Engagement Box (Annex I), Tonga faces significant structural challenges including geographic remoteness, a small and dispersed population, and high vulnerability to natural disasters. This persistent vulnerability, including governance weaknesses, discourages investment and incentivizes emigration, weighing on long-term growth prospects. Lifting long-term growth will require reforms to foster private sector development and enhance resilience, particularly in light of growing concerns about the long-term sustainability of external grant financing, including climate-related aid.



3. **Tonga has benefitted from considerable capacity development (CD) assistance from the Fund, but more support is needed (Annex IV).** Tonga is one of the largest recipients of Fund CD resources in the region (chart), and support has been continued in recent years (chart). The authorities have shown strong ownership and the capacity to absorb Fund CD. Recent CD on revenue administration, macroeconomic frameworks and nowcasting, AML/CFT and financial stability frameworks, NRBT's bank act amendments, and monetary policy operations have informed staff's policy recommendations and supported the authorities' reform agenda. Addressing macroeconomic data shortcomings remains a high priority for better policymaking CD priorities include strengthening statistics on GDP, prices, Government Finance Statistics (GFS), and the external sector, including Balance of Payments (BOP) and International Investment Position (IIP) (Annex VI).



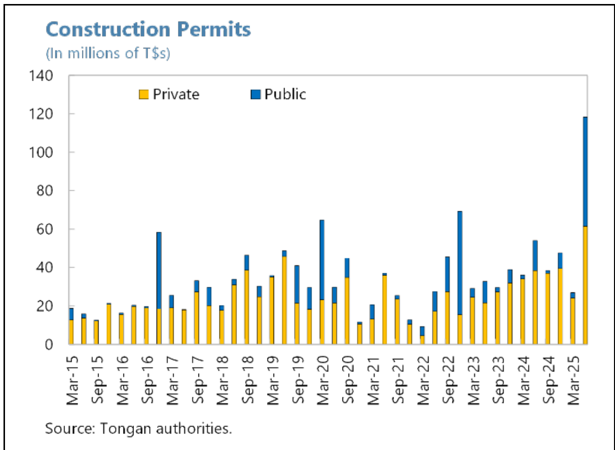
Sources: CDMAP database, and IMF staff calculations.



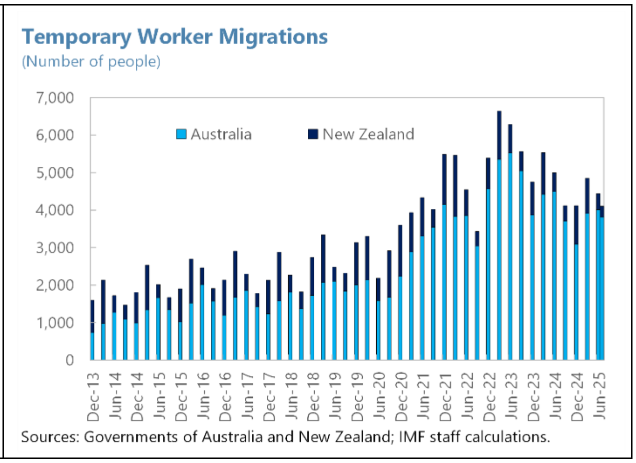
Sources: CDMAP database, and IMF staff calculations.

RECENT DEVELOPMENTS, OUTLOOK, AND RISKS: GROWTH PICK UP AMID ELEVATED INFLATION AND HEIGHTENED GLOBAL UNCERTAINTIES

4. **Tonga's economy is growing at a solid pace, backed by reconstruction efforts, fiscal stimulus, and the resurgence of tourism.** GDP growth for FY2024 is estimated at 2.1 percent, further increasing to 2.7 percent in FY2025, supported by robust domestic demand, particularly in the construction sector and consumer spending. Public and donor-funded infrastructure projects drove construction activity, while wholesale and retail trade remained strong, buoyed by high remittance inflows and the continued rebound in tourist arrivals. The Pacific Islands Forum hosted by Tonga in September 2024 likely provided an additional short-term boost to services activity. However, supply-side constraints—including labor shortages and logistical bottlenecks—continue to limit growth, especially in agriculture and service sectors such as retail.



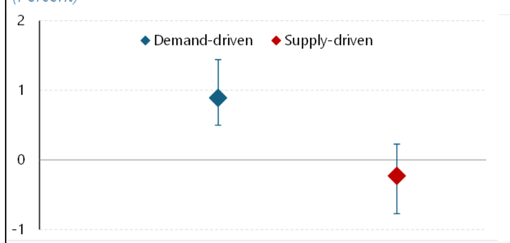
Source: Tongan authorities.



Sources: Governments of Australia and New Zealand; IMF staff calculations.

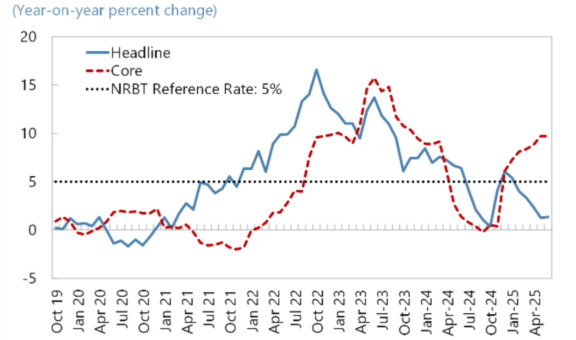
5. Headline inflation remains contained, but pressures are building. After peaking at 6 percent year-over-year in December 2024, driven by a spike in local food prices (following a disappointing agricultural output), headline inflation retreated to 1.4 percent in June 2025, driven by a fall in food and energy prices. Core inflation (staff estimates), however, has increased to 9.9 percent in the same period, mainly driven by the price increase in beverages, clothing, and restaurant and hotel services, as signs of demand price pressures are emerging (text chart).

Contribution of Excess Demand and Supply to Local Price Inflation
(Percent)



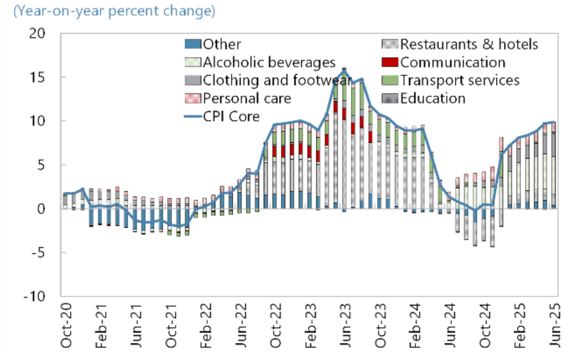
Sources: Tongan authorities; and IMF staff estimates.
Note: Contributions are from a bivariate Bayesian SVAR in GDP and local price inflation, identified using sign restrictions. Positive values indicate upward price pressures from demand (supply) shocks, contributing to raise inflation above its historical average. The 25th and 75th percentiles are included.

Headline and Core Inflation 1/
(Year-on-year percent change)



Sources: Tonga Statistics Department; and IMF staff calculations.
1/ IMF staff estimates excluding energy and food.

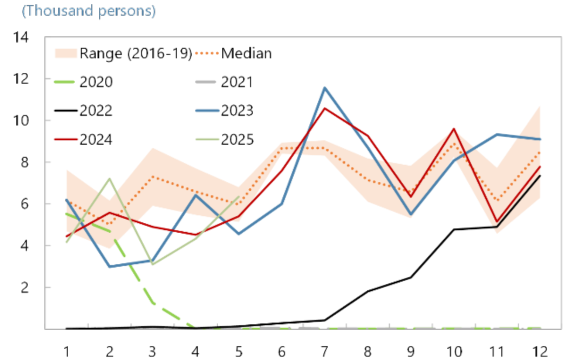
Contribution to Core Inflation
(Year-on-year percent change)



Sources: Tonga Statistics Department; and IMF staff calculations.

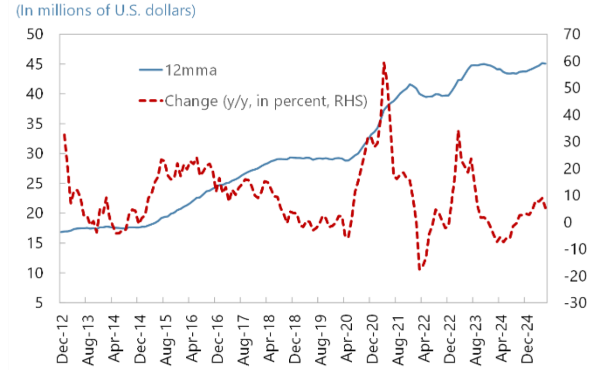
6. The external position for FY2025 is assessed to be broadly in line with the level implied by medium-term fundamentals and desirable policies (Annex II). Remittance inflows remain elevated; however, goods imports are estimated to have increased in FY2025, reflecting continued economic recovery and construction activity. As a result, the current account deficit is projected to widen from 3.8 percent of GDP in FY2024 to 5.2 percent in FY2025. Foreign exchange reserves remained stable and adequate at the end of FY2025, covering 10.5 months of imports, supported by sizable capital transfers.

Monthly Tourist Arrivals
(Thousand persons)



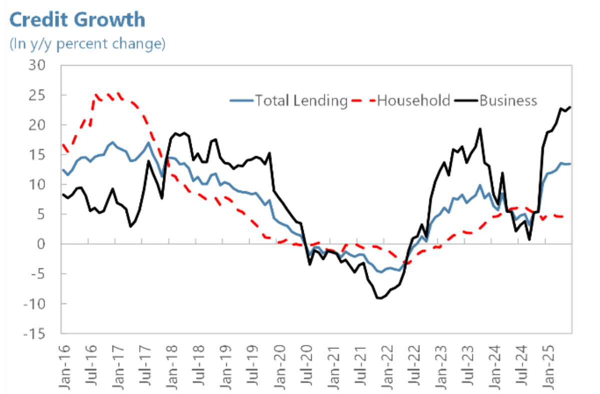
Sources: Tongan authorities; and IMF staff calculations.

Remittances
(In millions of U.S. dollars)

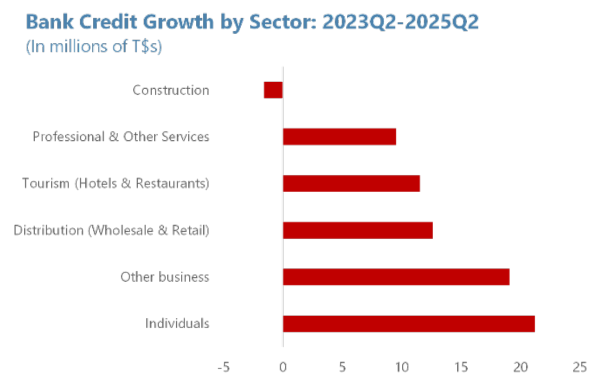


Source: Tongan authorities.

7. Credit extension has accelerated, with growth now elevated and supported by strong liquidity and rising demand across key sectors. Private credit rose by 9.6 percent year-on-year as of June 2025, driven by a 22.9 percent surge in business lending. By contrast, household credit has remained more subdued—consistent with the empirical findings that remittances tend to complement and help business credit expansion in Tonga rather than household borrowing (Annex IX). Ample bank liquidity kept credit supply responsive and interest rates stable. At the same time, non-bank financial institution (NBFI) lending—primarily from the retirement fund backed by member contributions—has slowed, totaling T$90.4 million (around 13 percent of total lending) as of June 2025, down from 14.4 percent a year earlier.



Sources: Tongan authorities; and IMF staff calculations.

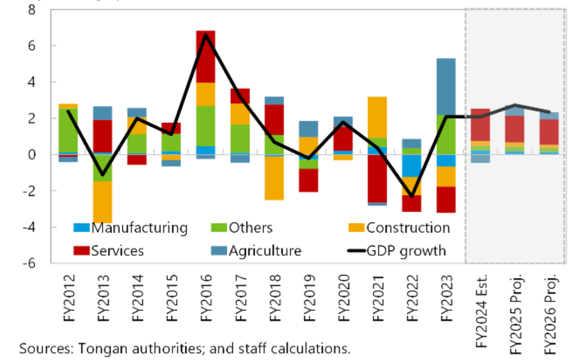


Sources: Tongan authorities; and IMF staff calculations.

8. Economic policies have also been broadly consistent with past Fund advice (Annex V). The authorities have made tangible progress in implementing recommendations from the 2024 Article IV consultation, notably in advancing tax policy reforms and operationalizing short-term monetary policy instruments to enhance liquidity management. Structural reforms have also progressed, including the establishment of the anti-corruption office. While capacity constraints persist, the authorities continue to engage with development partners and the Fund to sustain reform momentum and secure additional grants.

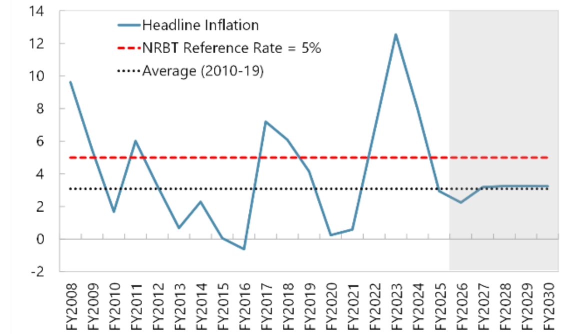
9. The short-term economic outlook remains generally favorable, although clouded by heightened global uncertainties. Real GDP is estimated to have grown by 2.7 percent in FY2025 and projected to grow by 2.3 percent in FY2026, mildly slowing down, supported by robust domestic demand, particularly public investment and household consumption, and a continued recovery in tourism. Agricultural output is expected to recover in FY2025 and FY2026, as weather conditions normalize and production rebounds from earlier droughts and natural disasters. However, softer remittance inflows will weigh in on domestic demand. Headline inflation is projected to temporarily increase from 1.4 percent at end-FY2025 to 3.1 at end-FY2026, driven by higher energy and core prices. As fiscal policy shifts toward consolidation in FY2026 and monetary policy is better positioned under the new framework to better absorb excess liquidity, inflation is expected to stabilize around its historical average of 3.2 percent.

Contribution to Growth by Sector
(In percentage point)



Sources: Tongan authorities; and staff calculations.

Annual Inflation Projection
(Percent change)



Sources: Tongan authorities; and IMF staff estimates.

10. Medium-term growth prospects are weak. Tonga's long-term growth is projected at 1.2 percent, reflecting its exposure to increasingly frequent natural disasters, persistent loss of workers to emigration, and limited economies of scale due to geographical barriers. The current account deficit is expected to continue to widen moderately over the next two years before stabilizing at around 7 percent of GDP over the medium-term, reflecting the continued normalization of remittances and heavy import dependence.

11. Risks are tilted to the downside (Annex III). Major (mostly downside) risks are both external and domestic:

- ***External risks:*** In the near term, a steeper slowdown in global growth could dampen tourism receipts and remittance inflows; escalating geopolitical tensions could trigger a spike in energy prices—intensifying the NRBT's policy trade-off between supporting growth and containing inflation. Over the medium term, a key downside risk stems from a possible reduction in concessional financing, particularly if IDA resources shrink. On the upside, tourism could rebound more strongly than anticipated due to pent-up demand, while grant inflows may exceed baseline expectations in the short term.

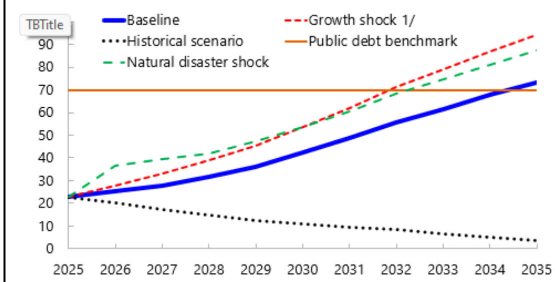
- ***Domestic risks:*** Natural disasters could place further pressures on already limited public resources and potentially weaken asset quality in the banking sector; ongoing reconstruction and donor-financed infrastructure projects may see delays weighing on activity; accelerated outmigration of Tonga workers could further reduce labor supply and amplify near-term pressures on wages and, thus, prices; and a further loss of correspondent banking relationships (CBRs) in the region due to AML/CFT-related weaknesses could disrupt transfers and remittance flows. Rising vulnerabilities in the banking sector also pose a downside tail risk.[1]

12. In a severely adverse global scenario (Annex IX), Tonga's economic growth would be modestly affected mostly through spillovers to remittances and tourism. While the country's direct exposures to tariffs shocks are limited due to the modest bilateral trade with the U.S., indirect

[1] See Annex VII and DSA for a scenario involving financial sector contingent liabilities.

spillovers from heightened trade policy uncertainty globally could lower remittances and tourism receipts. Under an illustrative sensitivity analysis (calibrated based on Box 1.1 of April 2025 World Economic Outlook), Tonga's growth will decline by 0.25 and 0.10 percentage points in FY2026 and FY2027 relative to the staff baseline, respectively.

High Risk of Public Debt Distress
(Present value of public debt in percent of GDP)



Source: IMF staff estimates.
1/ The most extreme shock scenario is the growth shock (one standard deviation below the baseline for two years starting from FY2026).

13. **Tonga is assessed as being at high risk of debt distress (DSA).** Without additional grant commitments, staff's baseline projection shows that the present value (PV) of the external and public debt-to-GDP ratios are projected to keep rising and both cross the 55 percent threshold and the 70 percent benchmark in FY2035. This reflects significant development spending needs over the long term to achieve its climate resilience goals and the SDGs. Debt obligations are largely external, with less than half of the external debt to China Exim Bank. Debt repayments surged to 3.5 percent of GDP in FY2024, mainly to Exim Bank, and remained elevated at over 2.5 percent of GDP until FY2028. The government's plan to refrain from new non-concessional borrowing would further help reduce Tonga's risk of debt distress.

Authorities' Views

14. **The authorities broadly concurred with staff's outlook, though the Ministry of Finance was more optimistic, projecting GDP growth above 3 percent in FY2026–27, compared with staff's projections of 2.3 and 1.8 percent, respectively.** They expect a stronger boost from major infrastructure projects—including the Fanga'uta Lagoon Bridge and the Hawaiki submarine cable—than staff, alongside a rebound in agriculture and sustained strength in tourism. The authorities concurred with staff's assessment of emerging demand-driven pressures but projected headline inflation to moderate more sharply, to around 1 percent by end-FY2026—below staff's forecast. They acknowledged risks from uncertain grants, project delays, and global trade tensions including taxing remittances, and agreed with staff's downside scenario, highlighting Tonga's indirect exposure through commodity prices and remittances.

POLICY DISCUSSIONS: POLICIES TO REBUILD BUFFERS AND ENHANCE ECONOMIC RESILIENCE

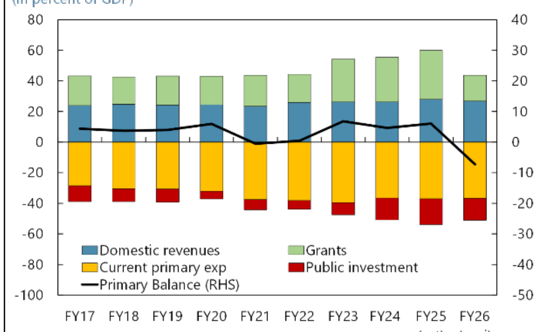
Macroeconomic policies should recalibrate toward a more neutral stance as the recovery has solidified, credit extension has accelerated, and price pressures are emerging. With fiscal policy having appropriately supported reconstruction and growth, the priority now is to rebuild buffers through gradual and credible fiscal consolidation, supported by stronger domestic revenue mobilization, spending efficiency, and additional grants. Given incipient demand-side price pressures, monetary policy should also shift to a neutral stance. The new monetary policy framework is a milestone that will, over time, enhance the NRBT's effectiveness in managing liquidity, anchoring inflation expectations, and safeguarding price and economic stability. Financial sector policies should continue *to focus on preserving stability, while promoting financial deepening, including through closer monitoring of bank asset quality, stronger provisioning for non-performing loans, and expanded supervision of non-bank financial institutions. Structural reforms should aim at lifting potential growth and resilience by enhancing disaster preparedness, advancing digitalization, improving the business environment, and addressing governance vulnerabilities.*

A. Fiscal Policy—Pivot Toward Medium-Term Fiscal Consolidation to Rebuild Buffers

15. The fiscal balance remained in a surplus in FY2025 despite an expansionary fiscal stance. Although reconstruction-related expenditures increased, the overall fiscal balance posted a surplus in FY2025 at 5.6 percent of GDP, thanks to record-high grants of about 32 percent of GDP, increased domestic revenues due to solid economic performance, and temporary wage savings from slower public-sector vacancy refilling. Staff project the fiscal balance to revert to a deficit of 7.7 percent of GDP in FY2026, assuming conservatively that only firmly committed external grants materialize, while public reconstruction expenditures remain strong.

Fiscal Balance and Components

(In percent of GDP)



Sources: Tongan authorities; and IMF staff calculations.

16. The proposed fiscal stance for FY2026 is appropriately contractionary. The expansionary fiscal stance in FY2025 has appropriately supported the recovery, but with the economy on a stronger footing, it will be important to continue building buffers to hedge against downside risks. Excluding grants, the FY2025 fiscal impulse was expansionary, about 1.3 percent of GDP, supporting the ongoing reconstruction, and it is expected to shift to contractionary in FY2026, about 1.7 percent of GDP which is appropriate given, underlying inflationary pressure and the need to build fiscal buffers.[2] Saving during good times is especially prudent given a weakening global concessional-financing environment—tapering IDA grant envelopes and tighter terms—which has not yet affected Tonga directly but poses material medium-term risks (Annex III). The fiscal consolidation in FY2026 will be driven by rationalization of reconstruction-related spending in transfers, after a record-high level in FY2025, and normalization of non-financial assets investments.

17. Over the medium term, a gradual and credible fiscal consolidation—supported by additional grants—is essential to place debt firmly on a downward path. The strategy should prioritize high-quality revenue measures (including continued effort in removing inefficient tax exemptions, which could yield at least 2.8 percent of GDP without raising statutory rates) [3] and

[2] The fiscal impulse is calculated as the difference in the primary balance excluding grants between the current and previous year. Given data limitations, a cyclical adjustment of the fiscal balance is not available.

[3] The consumption tax rate is 15 percent in Tonga, one of the highest in the PICs.

stronger tax administration, while improving spending efficiency by restraining the wage bill in line with the fiscal rule and rationalizing lower-priority current outlays. Absent these efforts—under albeit conservative grant inflows assumptions—the fiscal deficit would widen over the long term given sizable needs to meet Tonga's SDGs and climate-resilience objectives (see DSA). High grant dependence and high risk of debt distress underscore the need for gradual, credible consolidation to build buffers and safeguard sustainability. Staff recommend consolidation of about 1.4 percent of GDP in FY2027, cumulating to 4.8 percent of GDP by FY2035 (see Text Table 1).

18. Fiscal reforms will also be needed and should continue to be guided by Fund technical assistance (TA). The authorities have already launched several initiatives aligned with Fund TA. The introduction of the Medium-Term Fiscal Framework is expected to strengthen fiscal planning and discipline, mitigate fiscal risks, and support debt sustainability. The passage and implementation of the Public Financial Management (PFM) Act should enhance fiscal transparency, align budget allocations with national priorities, and improve medium-term budget processes.[4] The rollout of the Electronic Sales Register System should be accelerated following earlier delays, and efforts to reform tax exemptions should continue in consultation with the Fund and the World Bank technical assistance. The authorities have initiated the valuation and recording of government fixed assets to support the implementation of the fixed asset policy building on recent IMF technical assistance on the proper classification of net acquisition of non-financial assets in the budget. They are also evaluating options for a new Revenue Management System (RMS) to replace the current RMS 7, which is a key component of the Ministry of Revenue and Customs' (MoRC) digitalization efforts. The success of fiscal reforms hinges on addressing key governance vulnerabilities—particularly in procurement and public financial management (PFM)—which are also crucial to ensure spending efficiency and credible infrastructure scaling-up. Addressing execution bottlenecks will be essential to accelerate implementation and realize the intended growth dividends.

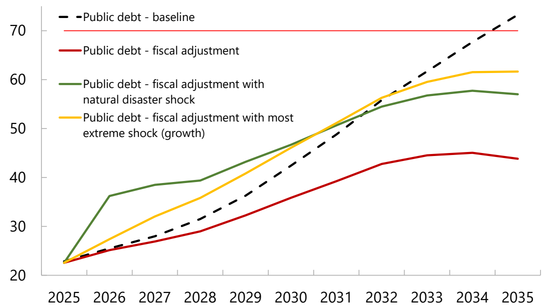
19. Under staff recommended fiscal adjustment scenario, Tonga's debt remains well below the benchmark even under extreme shocks. Under this scenario, Tonga implements a set of domestic fiscal measures of 4.8 percent of GDP over FY2027–FY2035, including an improvement in consumption tax collection compliance and reductions in tax exemptions and current spending, and additional grants in line with historical trends (Text Table 1).[5] The PV of the public debt-to-GDP ratio would then stabilize below the 70 percent benchmark with a buffer over the long term, even with a natural disaster or a multi-year growth shock which is akin to a 15 percent fall in grants from baseline. The PV of the external debt-to-GDP ratio would also stabilize below the 55 percent threshold under this scenario. Furthermore, contrary to the baseline scenario, the ratio of employee compensation to domestic revenues is projected to decline starting from 2027.

[4] See Kubasta, Neves and Kauffmann "Public Financial Management Action Plan", PFTAC, June 2020.

[5] In the baseline projection, only firmly committed grants are included, leading to a long-term decline to 4 percent of GDP. The additional grants aim to maintain the level above 10 percent of GDP, closer to the historical average.

Public Debt with Fiscal Consolidations

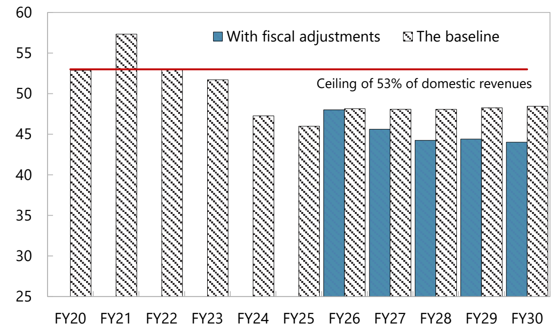
(Present value of public debt in percent of GDP)



Sources: IMF Staff estimates.
Note: The most extreme shock scenario is the growth shock.

Compensation of Employees

(In percent of domestic revenues)



Sources: Tonga authorities; and IMF staff projections.

Text Table 1. Costing of Fiscal Adjustments

(In Percentage Points of GDP)

	FY2027	FY2028	FY2029	FY2030	FY2031	FY2032	FY2033	FY2034	FY2035
Baseline primary balance	-7.8	-9.2	-10.4	-12.0	-12.0	-12.9	-11.4	-11.0	-10.4
Proposed primary balance	-6.4	-6.8	-8.0	-8.0	-7.2	-7.3	-4.6	-2.3	0.4
Domestic Consolidation needed	1.4	2.4	2.4	2.7	2.8	2.8	3.3	4.2	4.8
Contribution from tax revenue	0.8	0.8	0.8	1.1	1.2	1.2	1.7	2.4	2.8
Improved consumption tax 1/	0.3	0.3	0.3	0.3	0.4	0.4	0.4	0.6	0.7
Less tax exemptions 2/	0.5	0.5	0.5	0.8	0.8	0.8	1.3	1.8	2.1
Contribution from current spending	-0.6	-1.6	-1.6	-1.6	-1.6	-1.6	-1.6	-1.8	-2.0
Lower G&S	-0.3	-0.9	-0.9	-0.9	-0.9	-0.9	-0.9	-1.1	-1.2
Lower public sector wage bill	-0.3	-0.7	-0.7	-0.7	-0.7	-0.7	-0.7	-0.7	-0.8
Additional Grants 3/	0.0	0.0	0.0	1.3	2.0	2.8	3.5	4.5	6.0

Source: IMF staff projections.
1/ For reference IMF (SR, 2023) estimates that the potential revenue impact from such reform for Tonga at about 6.2 percent of GDP.
2/ For reference IMF (SR, 2021) estimates that an additional 2.5 percent of GDP in tax revenues could be collected by removing various tax exemptions.
3/ The additional grants are to maintain the grants above 10 percent of GDP.

Authorities' Views

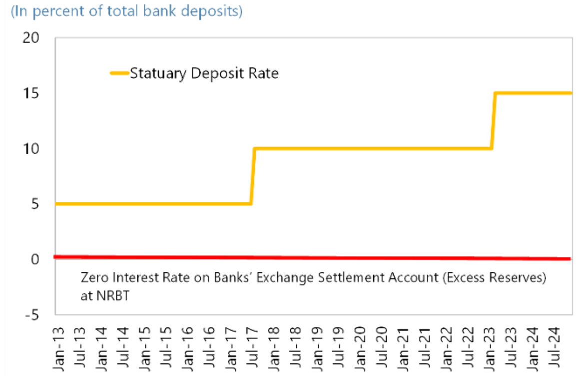
20. The authorities agreed with staff on the importance of gradually shifting toward rebuilding fiscal buffers and pursuing medium-term consolidation. The authorities have phased out consumption tax exemptions on tourism-related imports and are working on reforms of agricultural tax exemptions. The authorities have emphasized the positive impact of compliance-enhancing measures, including the use of third-party data for income verification, improved monitoring of small business tax compliance through license renewal, and the withholding of tax of nonresidence. These efforts have contributed to stronger-than-expected revenue performance. The authorities also concurred on the importance of pursuing a medium-term fiscal consolidation strategy, underpinned by high-quality revenue actions and expenditure efficiency. They acknowledge the negative fiscal impulse in FY2026, but considered the drag on near-term growth very manageable, noting expectation of stronger-than-staff grant inflows and associated project execution, which would more than offset the drag. Equally important, they remain committed to securing new grant financing from development partners, particularly through strengthening regional collaboration, to help mitigate the elevated global uncertainty, and to ensure that debt remains on a sustainable path while meeting its climate resilience and development goals.

B. Monetary and Exchange Rate Policies—Strengthen Monetary Stability

21. The monetary policy stance has been appropriately accommodative in supporting the recovery, but with the economy on a firmer footing and demand-driven inflationary pressures re-emerging, a shift toward neutrality is now warranted. With the policy rate still at zero, the real rate is negative even though activity is solid and core inflation is signaling emerging price pressures. In line with the NRBT's stated intentions, monetary policy should begin moving toward a neutral stance, with readiness to tighten further in a data-dependent manner. The NRBT has indicated its intention to lift the policy rate to 2 percent.

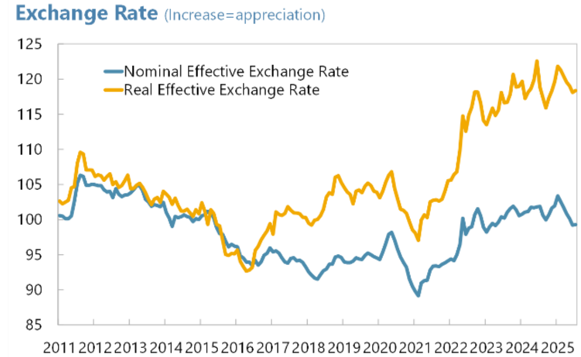
22. This shift will be underpinned by a milestone reform—announced by the NRBT following IMF technical assistance—to transition to a mid-rate interest rate corridor monetary policy framework. Under the new framework, the policy rate will be set as the midpoint between a zero percent floor (the remuneration rate on the standing deposit facility) and a ceiling (the remuneration rate on the standing lending facility), which has been announced at 4 percent. The reform serves both near- and long-term objectives. In the near term, issuing short-term central bank securities—at a fixed rate of 2 percent through full-allotment tenders—will absorb excess liquidity and allow the NRBT to lift the policy rate, thereby providing the central bank with a more effective policy tool than adjustments to the statutory reserve requirement (see Staff Report for 2024 Tonga Article IV Consultation, Annex VI). This will help anchor inflation expectations and contain demand-driven price pressures. Over the longer term, the issuance and repurchase of short-term notes will strengthen banks' liquidity management and support the development of an interbank market. The NRBT is also working on enhancing their monetary policy communication strategy and refine operational guidelines to improve the effectiveness of the monetary policy, especially in the context of elevated global uncertainties.

Monetary Policy Instrument
(In percent of total bank deposits)



Sources: Tonga authorities.

Nominal Effective Exchange Rate and Real Effective Exchange Rate (Increase=appreciation)



Sources: Tongan authorities; and IMF staff estimates.

23. Amendments to the NRBT Act should offer an opportunity to strengthen the monetary policy framework by enhancing the autonomy of the NRBT. The forthcoming legal changes should anchor the new interest-corridor system in law, clarify the policy objective around core inflation, and reinforce the Bank's autonomy, in line with IMF safeguards recommendations. While progress on the draft amendments has stalled since mid-2025, the NRBT confirmed its interest in Fund support to complete the legal reform—including ensuring that the Bank's mandate does not extend into quasi-fiscal operations, tightening the conditions to provide credit to the government to safeguard the NRBT from fiscal dominance, and enhancing the rules governing profit transfers, coverage of losses, and recapitalization so that sterilization costs do not undermine the central bank's autonomy. In parallel, the NRBT is advancing on other priority safeguards recommendations, including the establishment of an effective internal audit mechanism, and the preparation of a business continuity plan.

24. Exchange rate stability has been maintained under the current currency basket. The Tongan Pa'anga (TOP) is pegged to a basket of currencies. From July 2024 to June 2025, the average nominal effective exchange rate (NEER) appreciated by 0.3 percent compared to the previous year. The average real effective exchange rate (REER) was roughly stable during the same period, as Tonga's inflation dynamics were mostly aligned with its major trading partners.

Authorities' Views

25. The authorities concurred with staff on the need to deploy more effective instruments to contain inflation, even though they viewed current risks as limited and temporary. With the economy on a stronger footing and price pressures emerging, the NRBT also recognized the importance of moving toward a neutral stance under the new monetary policy framework announced in their August Monetary Policy Statement. The issuance of NRBT notes is intended to operationalize the policy rate. To prepare, the NRBT is also conducting market consultations and testing investor appetite for short-term securities to absorb excess liquidity.

26. The authorities emphasized that the introduction of NRBT notes should be viewed as laying the foundation for market infrastructure and supporting a gradual move toward neutrality, rather than signaling a contractionary shift. They also highlighted the importance of continued Fund technical assistance to strengthen monetary policy communication, including a clearer articulation of policy decisions, which could provide the market with a clearer understanding of the central bank's monetary policy reaction function.

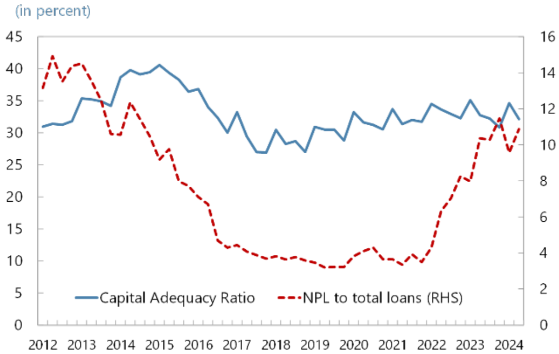
27. The authorities view the NRBT Act amendments as a key step to modernizing the monetary policy framework. They agreed that the amendments provide an opportunity to clarify policy objectives, enhance communication, and strengthen governance. While progress has been slower than envisaged, they reaffirmed their commitment to completing the reforms with Fund support and emphasized the importance of safeguarding the NRBT's operational independence. In this regard, they acknowledged the need to clarify the rules governing profit transfers, coverage of losses, and recapitalization to ensure that sterilization costs do not undermine the central bank's autonomy.

C. Financial Sector Policies—Foster a Stable and Inclusive Financial System

28. Tonga's financial system remains broadly stable, supported by strong buffers. The banking sector is well-capitalized and highly liquid, with a capital adequacy ratio of 30.7 percent as of 2025Q2—well above the 15 percent regulatory minimum—and robust profitability. Excess reserves at the NRBT remained elevated at T$296.5 million in July 2025, reflecting ample funding and banks' continued cautious lending stance.

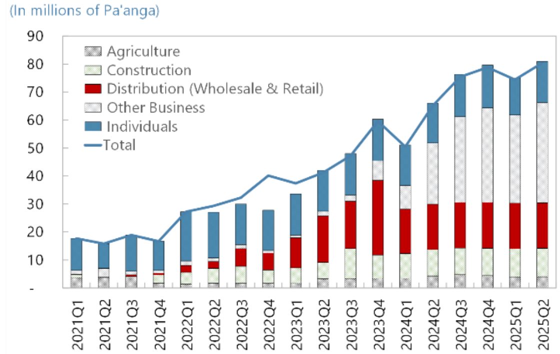
29. At the same time, credit risks have continued to increase, even though they remain relatively contained and concentrated. The banking system's non-performing loan (NPL) ratio increased from 11.2 percent at the end of June 2024 to 14.7 percent by June-2025, largely reflecting the difficulties of a single institution affected by mismanagement and post-disaster challenges. Meanwhile, the NPL coverage ratio declined from around 39.3 percent at the end of June 2024 to 33.3 percent by the end of June 2025, underscoring the need for stronger provisioning. Most NPLs are linked to large exposures in the shipping and distribution sectors, still reflecting lingering effects of the HT-HH disaster and COVID-19. Lending by NBFIs has also increased—albeit from a low base and at a slower pace—driven mainly by pension-backed loans to members. Systemic risk has, thus, increased, however it remains largely contained as the major banks operating in Tonga are well capitalized and represent the subsidiaries of relatively sizeable foreign financial institutions.

Capital Adequacy and NPL Ratio
(in percent)



Sources: NRBT.

Non-Performing Loans by Sector
(In millions of Pa'anga)



Sources: Tongan authorities; and IMF staff calculations.

30. The Tonga Development Bank would benefit from governance reforms. Reforms aimed at separating its commercial operations from its development-lending arm would strengthen governance, enhance transparency, and reduce risks to public resources. If needed, targeted capital injections—including replenishing the Government Development Loan Fund as planned—could support the transition under a time-bound plan and strong oversight. These measures will bolster confidence in key financial institutions and reinforce the effectiveness of broader governance reforms.

31. Regulatory oversight across the broader financial sector remains uneven and should be expanded. Credit unions and pension funds (NBFIs) continue to operate with limited supervision, underscoring the need to finalize regulatory frameworks for these entities. Strengthening prudential standards and regulations, enhancing provisioning requirements, and expanding the scope and frequency of data collection would help the NRBT to conduct more effective risk-based supervision and mitigate asset quality risks. Given that data gaps on non-bank financial institutions (NBFIs) impede comprehensive oversight, the NRBT's supervisory remit should be broadened to cover all NBFIs, including retirement funds.

32. **Safeguarding financial integrity and preserving correspondent banking relationships (CBRs) remains a priority**. Stronger anti-money laundering and combating the financing of terrorism (AML/CFT) enforcement—especially for foreign-exchange dealers and remittance providers—remains critical to safeguard financial integrity and preserve access to correspondent banking relationships (CBRs). A partial withdrawal of CBRs, including due to remaining AML/CFT gaps, could depress remittance inflows, weaken private consumption, and curtail credit via lower lending and tighter conditions. Policy actions should therefore focus on strengthening the AML/CFT framework and its implementation—adopting risk-based supervision and stepping up enforcement in line with Asia-Pacific Group findings—swiftly passing the Money Laundering and Proceeds of Crime Act (MLPCA) and Regulations amendments. Tonga's participation in the World Bank's regional CBR project and potential inclusion in the Fund's Safe Payment Corridor initiative provide opportunities to further strengthen financial resilience.

33. **Efforts to promote financial deepening and inclusion should continue.** The establishment of a credit registry would help improve credit risk assessment and facilitate lending to both households and businesses. In parallel, implementation of the National Financial Inclusion Strategy (2023–27), including training on responsible digital financial services and inclusive green finance, is a welcome step to broaden access. Issuing domestic government bonds to foster development of an interbank market and enhance liquidity management would also contribute to financial deepening. Taken together, these reforms—supported by capacity development—could help unlock private sector credit, enhance financial stability, and broaden the reach of financial services across the economy.

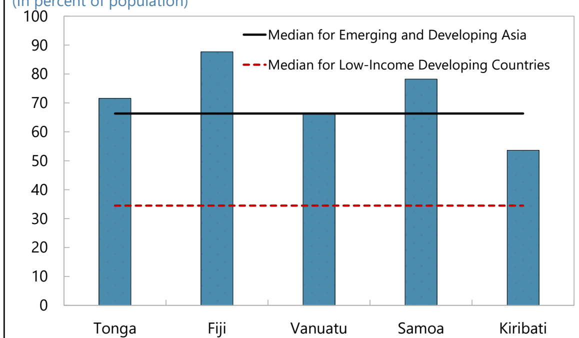
Authorities' Views

34. **The authorities view the financial system as well capitalized and liquid, with systemic risks broadly contained despite higher NPLs**. They stressed that major banks are sound, supported by strong capital and foreign parent companies. The authorities are taking steps to strengthen governance at the Tonga Development Bank, including by replenishing its managed Government Development Loan fund, and plan to extend supervision to NBFIs as part of its functions under the NRBT Act. Staff welcomed these measures and emphasized the need to maintain adequate buffers. They agreed with the importance of establishing a more effective credit registry and ongoing enhanced risk monitoring, alongside finalizing regulatory frameworks for insurance and pension funds and enhancing AML/CFT supervision and enforcement of the requirements of the newly enacted Money Laundering and Proceeds of Crime Bill 2025 to safeguard correspondent banking ties. Furthermore, the NRBT is advancing reforms to augment its regulatory and oversight mechanisms, including updating prudential standards on credit risk, adopting International Financial Reporting Standard 9 (IFRS 9) with assistance from the Pacific Financial

Technical Assistance Centre (PFTAC), and extending its regulatory cover to encompass pension funds and insurance companies, supported by technical assistance from the World Bank and the Asian Development Bank (ADB).The authorities also expressed willingness to explore participation in the Fund's Safe Payment Corridor initiative.

D. Structural Reforms—Lift Up Potential Growth and Enhance Economic Resilience

Internet Access
(In percent of population)



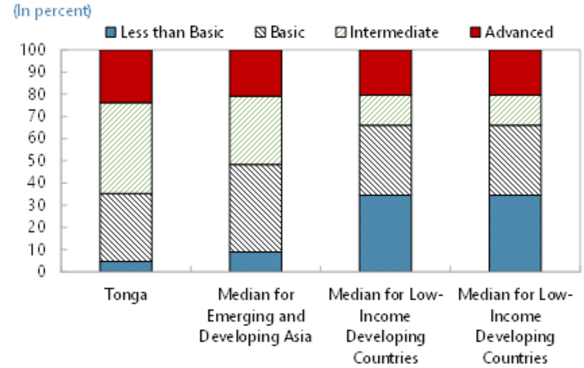
Source: IMF staff using The Global Competitiveness Index 4.0 2019 Dataset and, World Development Indicators (WDI).

35. Fostering private sector development and advancing financial deepening are critical to unlocking Tonga's long-term growth potential. Limited access to credit—identified as the top constraint to investment in the 2024 Enterprise Survey—remains a key obstacle to private sector growth, with financial deepening metrics lagging behind regional peers (Annex VIII). Supporting private sector development—such as in tourism—encouraging the use of remittances for private investment, and strengthening financial institutions to address lingering concerns from past financial stresses would help improve credit access and foster growth. Digitalization offers further potential to overcome geographic barriers and expand economic opportunities (chart). In this regard, the authorities' initiative to launch a national digital ID system is a welcome step. While emigration brings economic benefits through remittances—which also helps smooth consumption during shocks, thus, playing a countercyclical role—strengthening education access and quality, enhancing training, and improving immigration policies could help address the adverse effects of emigration on the labor force and human capital (Annex VIII). In parallel, measures to ease regulatory constraints and attract greater foreign direct investment would expand opportunities and help retain the growing working-age population.

36. Enhancing resilience to natural disasters is a top reform priority. In addition to the DRM bill, passed the Parliament in August 2021, more recently, the Tongan authorities have taken leadership in the Pacific region by supporting the establishment of the Pacific Resilience Facility (PRF) through a Treaty-based agreement endorsed by Pacific Island Forum Members. The PRF is designed to pool grant-based, non-debt creating resources from donors and climate funds to support climate adaptation and community resilience, with an initial target of US$500 million and a long-term aspirational target of US$1.5 billion. By consolidating financing through a Pacific-owned mechanism to help facilitate the pooling of non-debt creating climate finance resources with the pacific sub-region, the PRF ensures predictable, regionally governed access to funding that reaches vulnerable communities directly.

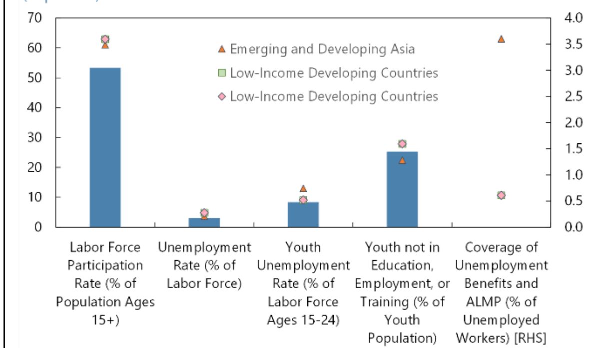
37. Addressing macro-relevant governance and corruption vulnerabilities is critical for Tonga's sustainable development. Systemic weaknesses in governance frameworks, regulatory capacity, and the AML/CFT regime highlight the need for continued reform. Building institutional capacity will be essential to strengthen transparency, safeguard public resources, and improve private sector development and thus economic growth. The 2024 establishment of Tonga's first Anti-Corruption Commission Office marks an important step in this direction that would also help mitigate vulnerabilities to corruption. While resourcing is adequate, continued support will be important to ensure the office's needs are fully met.

Employment by Education
(In percent)



Source: IMF staff using the World Development Indicators (WDI), and ILOSTAT.

Tonga Labor Market Indicators
(In percent)



Source: IMF staff using the World Development Indicators (WDI), and ILOSTAT.

Authorities' Views

38. **The authorities remain committed to measures to lift Tonga's potential growth and enhance, its long-term resilience and strengthen governance.** The authorities emphasized that lifting Tonga's long-term growth potential hinges on scaling up infrastructure, revitalizing key productive sectors, and easing financing constraints. They pointed to major public investment projects—such as the Fanga'uta Lagoon Bridge, the upgrade of wharves, and the Hawaiki submarine cable—as critical to improving connectivity and lowering costs. They also underscored their strategy to stimulate agriculture, tourism, and fisheries, supported by policies to expand access to credit and strengthen financial intermediation, including through reforms at the Tonga Development Bank. They pointed to reforms in tax policy and PFM, digitalization initiatives such as the national digital ID system, and investment in renewable energy and connectivity. The NRBT is working in collaboration with the World Bank in developing a national payment strategy as well as a National Payment System (NPS). A Payment System and Services Bill is under stakeholder consultation to provide sound legal framework for the NPS, to ensure real time and efficient payments across banks and other payment system providers such as mobile money operators. In this respect, they noted that continued support from the Fund and development partners will be essential to sustain reform momentum and build institutional capacity. They emphasized disaster preparedness as a top priority, including through the effective implementation of the Disaster Risk Management Act and Tonga's leadership in establishing the Pacific Resilience Facility to mobilize predictable climate finance. They also highlighted the establishment of Tonga's first Anti-Corruption office as a milestone for strengthening institutional integrity.

E. Improve Economic Data—Foster Better Policy Making

39. Continued efforts are needed to address the quality and adequacy of macroeconomic data for surveillance purposes. The data provided to the Fund has some shortcomings that somewhat hamper surveillance (Annex VI). While the coverage for data across real, fiscal, external, and monetary sectors is adequate to some extent, issues with consistency, frequency, and timeliness persist. Timely publication of high-quality macroeconomic statistics and improving consistency across sectors remain priorities—this would provide a robust basis for policy making. The Fund continues to support the authorities to improve their macroeconomic statistics, including through TA missions on the national account and the external sector and extensive desk-based support. To further address data quality and timeliness issues, the authorities should continue to increase statistical staffing, improve knowledge management for high staff turnover, enhance data sharing among government agencies, and implement the Fund's TA recommendations.

Authorities' Views

40. The authorities reiterated their commitment to improving the quality of macroeconomic statistics. They emphasized recent progress made in the compilation of national accounts and external sector statistics but recognized that gaps still remain regarding data reliability and timeliness. The authorities agreed with the importance of macroeconomic statistics to inform their assessment of the economic situation and thus policy making. In this context, they are committed to ensuring sufficient staff resources and improving data sharing. The authorities also welcomed continued IMF TA support to improve Tonga's statistical capacity.

STAFF APPRAISAL

41. Tonga's economy continues to expand, driven by reconstruction, public investment, strong remittances, and rebound in tourism. Growth is projected to peak at 2.7 percent in FY2025 before moderating as large projects wind down and supply-side constraints persist. Medium-term prospects remain subdued, constrained by high disaster vulnerability, outward migration, and structural impediments from Tonga's small size and remoteness.

42. The proposed fiscal stance for FY2026 is appropriately contractionary. The expansionary fiscal stance in FY2025 has supported the recovery, but with the economy on firmer footing, a shift toward rebuilding buffers in FY2026 is appropriate.

43. Over the medium term, gradual fiscal consolidation and additional grant financing are essential to put debt on a firm downward path. Given Tonga's high risk of debt distress, consolidation should focus on mobilizing domestic revenues—including phasing out inefficient exemptions—improving tax administration, enhancing spending efficiency, and securing grants. The authorities should also refrain from non-concessional borrowing, while strengthening PFM capacity to ensure effective project implementation and support donor confidence.

44. With the economy on a firmer footing and incipient signs of demand-driven price pressures, monetary policy should shift from accommodative to neutral. Given the spike in core prices and the ample liquidity in the banking system, monetary policy should begin moving toward a neutral stance, with readiness to tighten further in a data-dependent manner.

45. This shift will be underpinned by a milestone reform—announced by the NRBT following IMF technical assistance—to transition to a mid-rate interest rate corridor monetary policy framework. The NRBT's plan to issue short-term securities and transition to a corridor-type framework will help absorb excess liquidity, establish a positive policy rate, and lay the foundation for a more effective interbank market.

46. The financial system is broadly stable, with banks well-capitalized and liquid, though rising credit risks call for more proactive supervision. Stronger oversight of credit unions and pension funds, alongside continued progress on AML/CFT, will be critical to safeguard financial integrity and preserve correspondent banking ties.

47. Structural reforms remain vital to lift Tonga's low growth potential. Priorities include advancing financial deepening and access to credit, mitigating the effects of emigration through education and training, accelerating digital adoption, cutting red tape, and addressing governance vulnerabilities. Tonga's leadership in establishing the Pacific Resilience Facility is welcome, as is the creation of the Anti-Corruption Commission. Sustained investment in statistical capacity is also needed to support policymaking and surveillance.

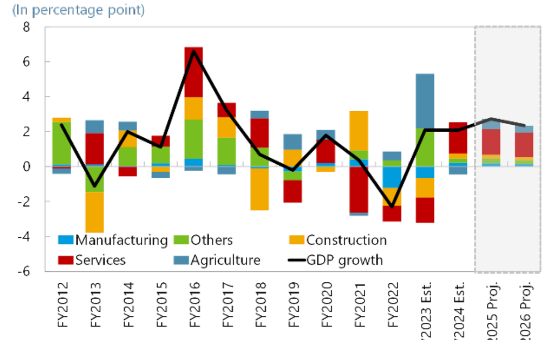
48. It is recommended that the next Article IV Consultation for Tonga take place on a standard 12-month cycle.

Figure 1. Tonga: Real Sector Developments

Construction and tourism-related services are leading the recovery.

Contribution to Growth by Sector

(In percentage point)

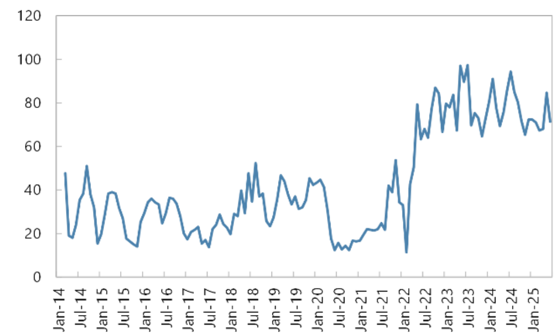


Sources: Tongan authorities; and IMF staff estimates.

The labor market has tightened significantly.

Monthly New Job Vacancy Posting

(Persons, 3-month MA)

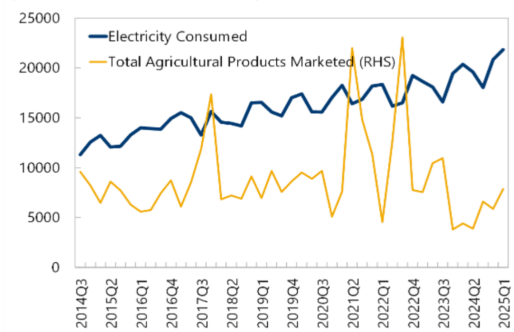


Source: Tongan authorities.

Electricity consumption has been strong, while agricultural production was affected by El Nino.

Agricultural Production and Electricity Consumption

(In thousands of Kwh, RHS in Tonnes)

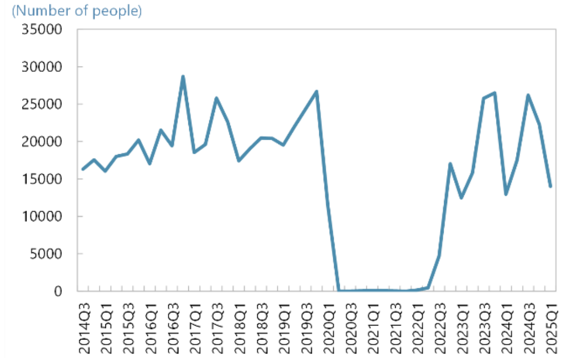


Source: Tongan authorities.

Tourists are slowly returning towards pre-pandemic levels.

Tourist Arrival

(Number of people)

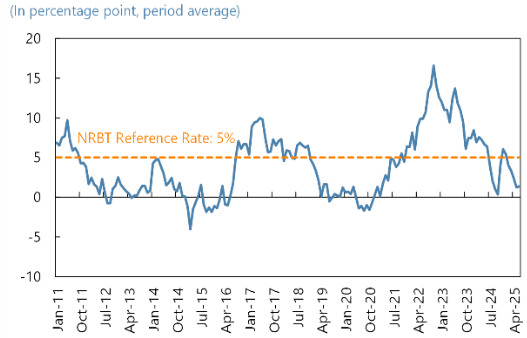


Source: Tongan authorities.

Headline inflation has declined below the NRBT's reference rate…

Consumer Price Index

(In percentage point, period average)

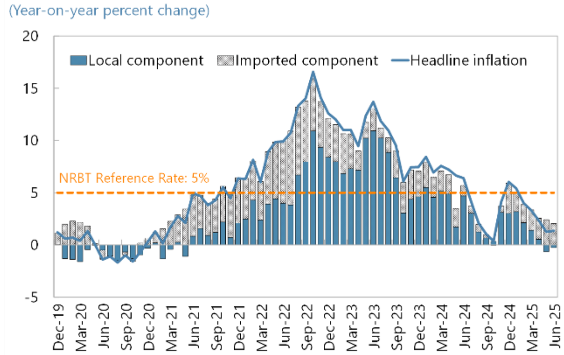


Source: Tongan authorities.

…helped by a decline in import price.

Contribution to Headline Inflation

(Year-on-year percent change)

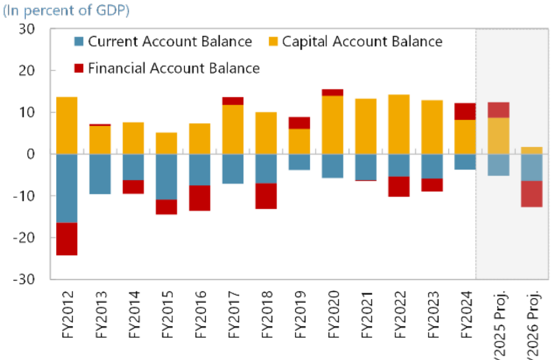


Sources: Tonga authorities; and IMF staff calculations.

Figure 2. Tonga: External Sector Developments

Donors' aids are expected to moderate after FY2024.

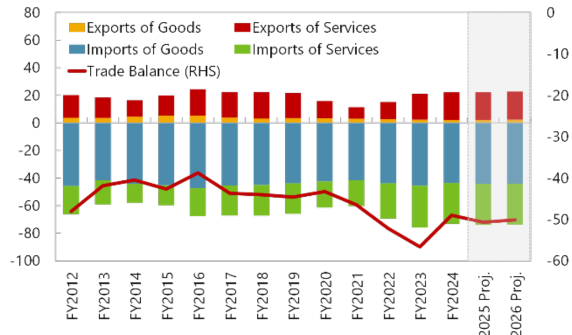
Balance of Payments Forecast
(In percent of GDP)



Sources: Tongan authorities; and IMF staff estimates.

Trade deficits remain structurally large driven by imports.

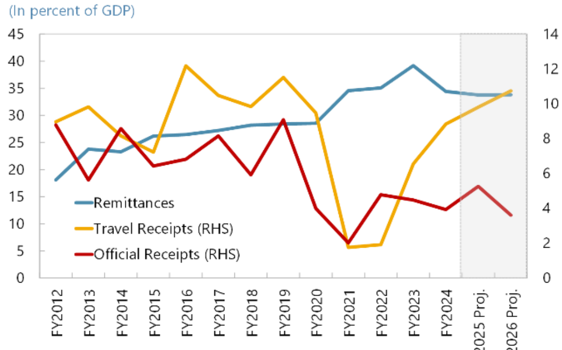
Trade Balance
(In percent of GDP)



Sources: Tongan authorities; and IMF staff estimates.

The increase in travel receipts is expected to be partially offset by the moderation in official receipts …

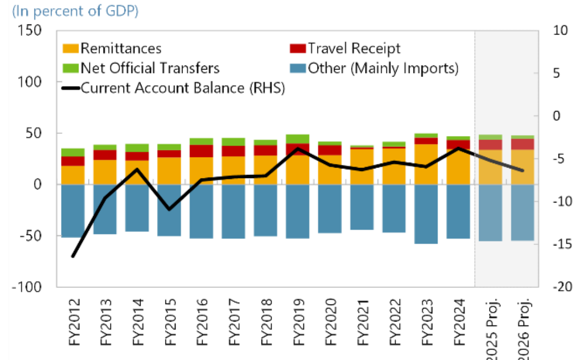
Remittances and Travel Receipts
(In percent of GDP)



Sources: Tongan authorities; and IMF staff estimates.

…contributing to a slow narrowing of current account deficits.

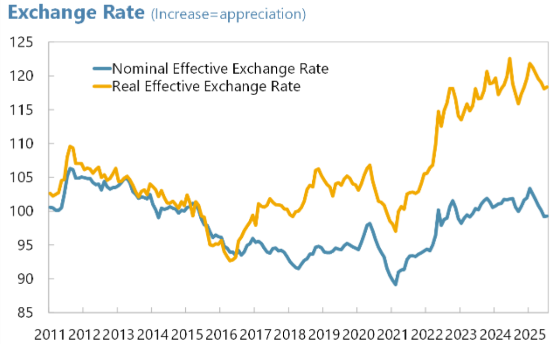
Contributions to Current Account Balance
(In percent of GDP)



Sources: Tongan authorities; and IMF staff estimates.

The REER has appreciated recently due to both nominal appreciation and high inflation.

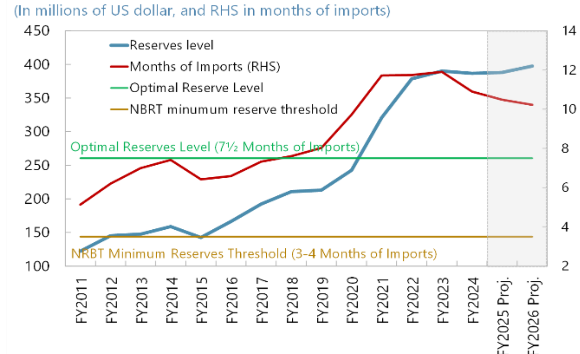
Nominal Effective Exchange Rate and Real Effective Exchange Rate (Increase=appreciation)



Sources: Tongan authorities; and IMF staff estimates.

Reserves are expected to remain more than adequate.

Reserves Level
(In millions of US dollar, and RHS in months of imports)



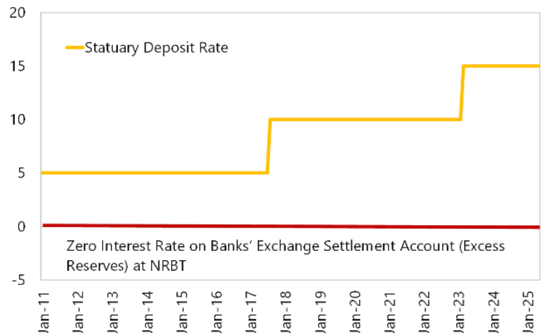
Sources: Tongan authorities; and IMF staff estimates.

Figure 3. Tonga: Monetary Sector Developments

Monetary policy was tightened in February 2023…

Monetary Policy Instrument

(In percent of total bank deposits)

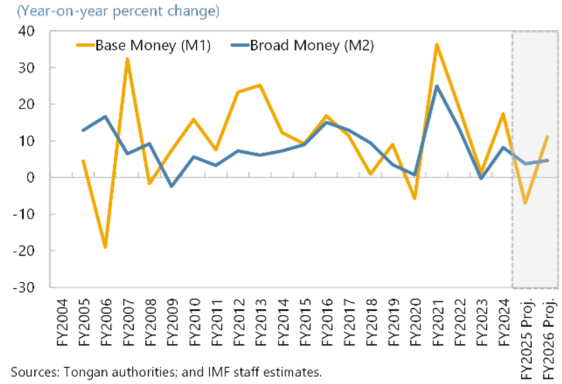


Source: Tongan authorities.

…but the stock of broad money is expected to remain largely unchanged…

Domestic Liquidity

(Year-on-year percent change)

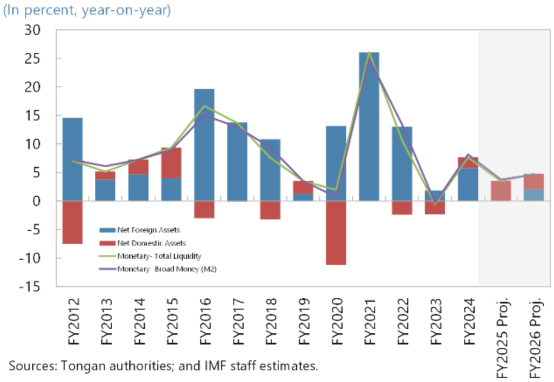


Sources: Tongan authorities; and IMF staff estimates.

…with the expected increase in net domestic assets offsetting the decrease in net foreign assets.

Contribution to Total Liquidity: M3

(In percent, year-on-year)

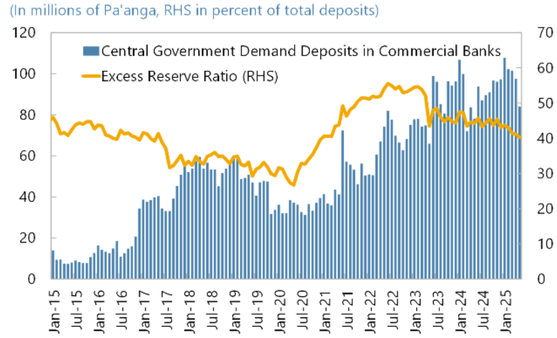


Sources: Tongan authorities; and IMF staff estimates.

The liquidity in the banking system remains high.

Excess Reserve Ratio and Central Government Demand Deposits in Commerical Banks

(In millions of Pa'anga, RHS in percent of total deposits)

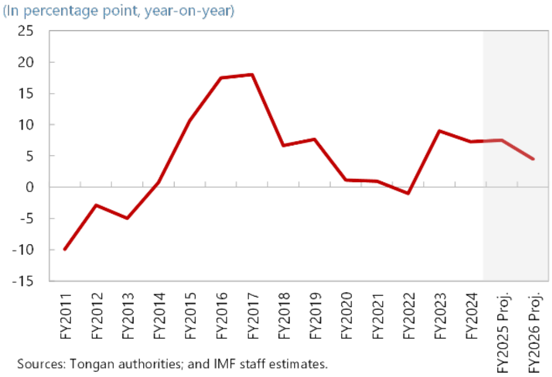


Sources: Tongan authorities; and IMF staff estimates.

Credit to the private sector is picking up.

Credit to Private Sector

(In percentage point, year-on-year)

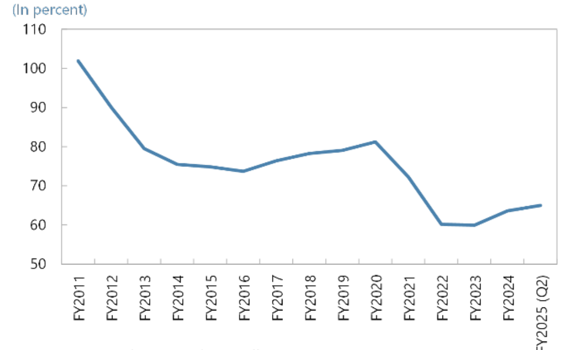


Sources: Tongan authorities; and IMF staff estimates.

However, the loan-to-deposit ratio has been low due to increase in total deposits.

Loan to Deposit Ratio

(In percent)



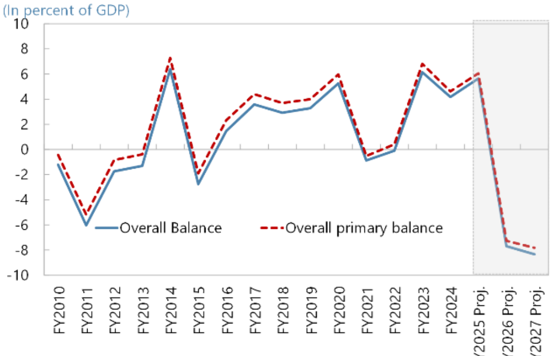
Sources: Tongan authorities; and IMF staff estimates.

Figure 4. Tonga: Fiscal Sector Developments

The primary fiscal balance is expected to deteriorate and turn into deficit in FY2026.

Overall and Primary Balance

(In percent of GDP)

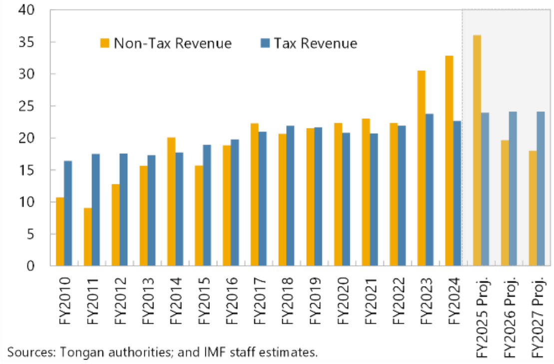


Sources: Tongan authorities; and IMF staff estimates.

Tax revenues are expected to remain stable after a small uptick thanks to tax on international trade…

Tax Revenue

(In percent of GDP)

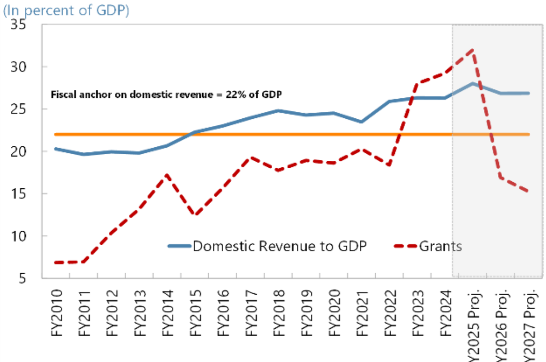


Sources: Tongan authorities; and IMF staff estimates.

…while development partners have stepped up their grant support after the natural disaster, but temporarily.

Revenues and Grants

(In percent of GDP)

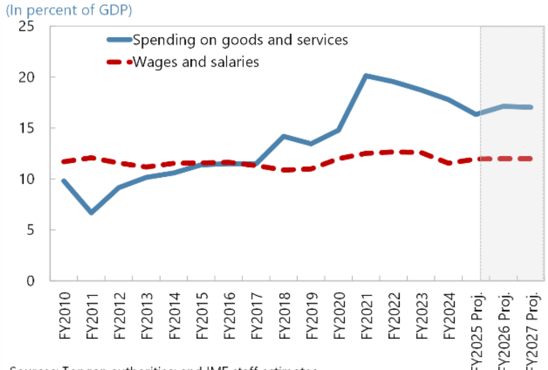


Sources: Tongan authorities; and IMF staff estimates.

Current expenditure is expected to stay elevated in the short term to support reconstruction.

Current Expenditure

(In percent of GDP)

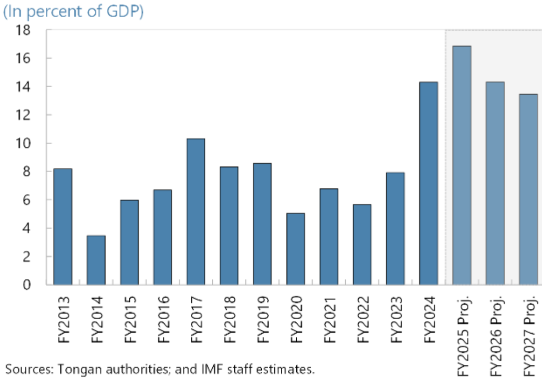


Sources: Tongan authorities; and IMF staff estimates.

Existing capital grants are expected to cover the increased post-HT-HH capital expenditure needs.

Capital Expenditure

(In percent of GDP)

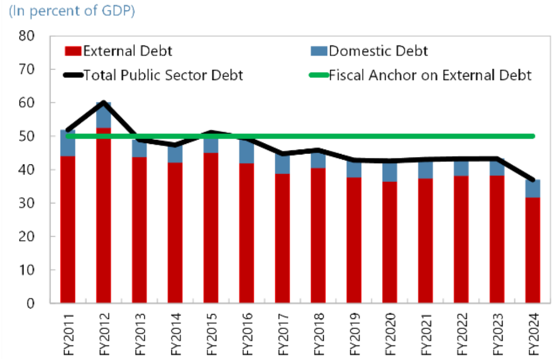


Sources: Tongan authorities; and IMF staff estimates.

Public debt remains low, while external debt remains below the fiscal anchor.

Total Debt and Fiscal Anchor

(In percent of GDP)

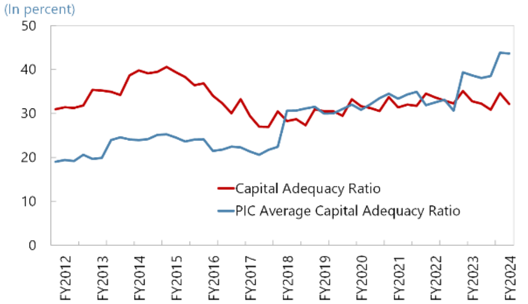


Sources: Tongan authorities; and IMF staff estimates.

Figure 5. Tonga: Financial Sector Developments

Capital buffers are similar to the PIC average.

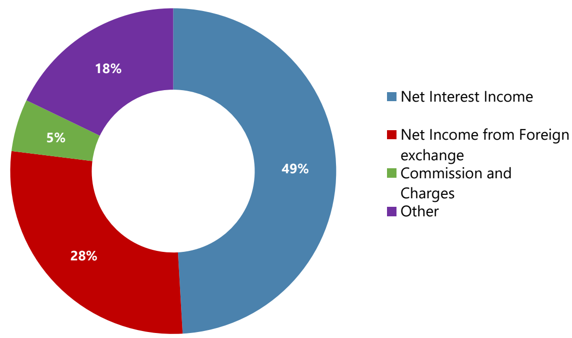
Capital Adequacy Ratio
(In percent)



Sources: IMF Financial Soundness Indicators; and IMF staff estimates.
Note: PIC Countries includes Fiji, Micronesia, Papua New Guinea, Samoa, Solomon Islands and Vanuatu.

Bank income continues to rely on net interest income…

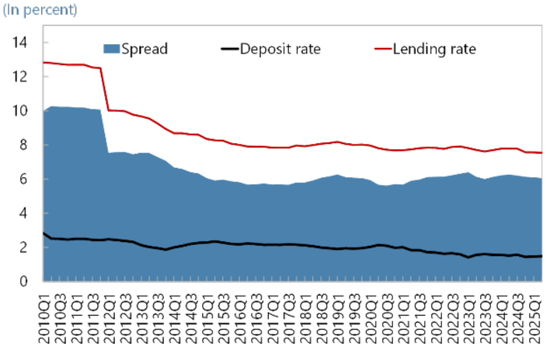
Financial Sector Operating Income Components in 2023



Source: Tongan authorities.

…as interest rate spreads remain wide.

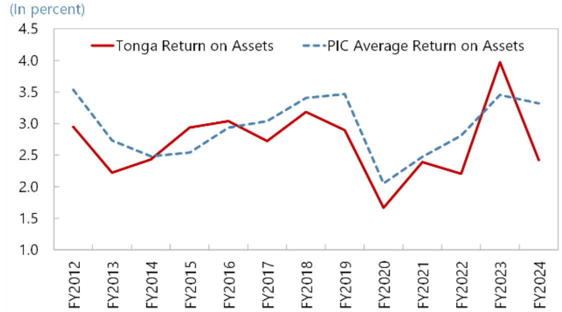
Interest Rates
(In percent)



Source: Tongan authorities.

Banks remain profitable, but…

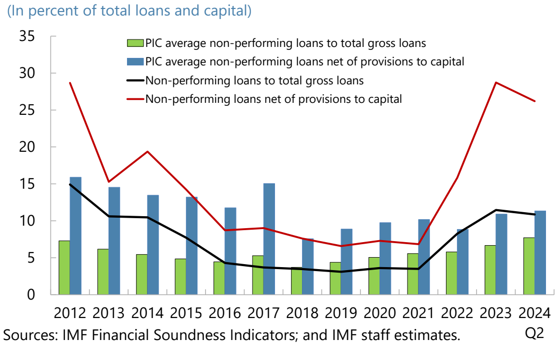
Return on Assets
(In percent)



Sources: IMF Financial Soundness Indicators; and IMF staff estimates.
Note: PIC Countries includes Fiji, Micronesia, Papua New Guines, Samoa, Solomon Islands, and Vanuatu.

…NPLs have increased, even though mostly….

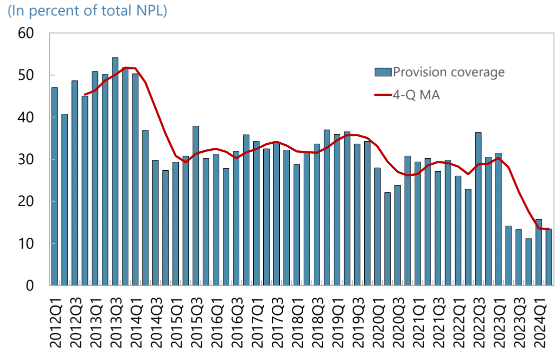
Non-Performing Loans
(In percent of total loans and capital)



Sources: IMF Financial Soundness Indicators; and IMF staff estimates.
Note: PIC countries includes Fiji, Micronesia, Papua New Guinea, Samoa, Solomon Islands. and Vanuatu.

followed by a decline in provision coverage.

NPL Provision Coverage
(In percent of total NPL)



Sources: Tonga authorities; and IMF staff calculations.

Table 1. Tonga: Selected Economic Indicators, FY2022-2026[1/]

Population (2023): 100 thousand
Major exports: root crops, vegetables, shellfish, fish

			Est.	Projections	
	FY2022	FY2023	FY2024	FY2025	FY2026
Output and prices			(Annual percent change)		
Real GDP	-2.3	2.1	2.1	2.7	2.3
Consumer prices (period average)[2]	6.5	12.6	8.0	2.9	2.2
Consumer prices (end of period)[2]	9.9	13.7	6.4	1.4	3.1
Central government finance			(In percent of GDP)		
Revenue	44.3	54.3	55.5	60.0	43.8
of which: Grants	18.4	28.0	29.2	32.0	16.9
Expenditure	44.4	48.2	51.3	54.3	51.4
Expense	38.7	40.3	37.0	37.5	37.1
Net acquisition of nonfinancial assets	5.7	7.9	14.3	16.9	14.3
Primary balance	0.4	6.8	4.6	6.1	-7.3
Overall balance	-0.1	6.1	4.2	5.6	-7.7
Overall balance (excl. grants)	-18.5	-21.9	-25.0	-26.3	-24.6
Money and credit			(Annual percent change)		
Broad money (M2)	13.4	-0.3	8.2	3.7	4.6
Domestic credit	-3.3	-15.6	14.0	18.0	15.9
Of which: Private sector credit	-1.0	9.0	7.3	7.5	4.5
Balance of payments			(In millions of U.S. dollars)		
Current account balance	-27.8	-30.4	-21.2	-30.6	-39.3
(In percent of GDP)	-5.4	-5.9	-3.8	-5.2	-6.4
Trade balance	-201.0	-222.6	-221.1	-243.0	-251.2
Exports of goods, f.o.b.	15.1	13.1	10.8	12.0	13.5
Imports of goods, f.o.b.	216.1	235.8	231.9	255.0	264.7
Tourism receipts	9.9	44.0	61.6	66.7	70.2
Total remittances	215.9	256.4	257.0	265.5	278.5
(In percent of GDP)	41.9	50.0	46.0	45.2	45.2
Compensation of overseas workers	35.3	55.4	65.0	67.2	70.4
Personal remittances	180.6	200.9	192.0	198.4	208.1
Official grants	24.6	22.9	21.9	30.9	22.2
Capital account balance	73.2	66.2	45.9	51.1	10.2
Financial account balance	25.0	15.8	-22.3	-21.9	38.6
Gross official foreign reserves					
In millions of U.S. dollars	378.5	389.9	386.6	387.9	397.4
(In months of next year's total imports)	11.7	11.9	10.9	10.5	10.2
Debt				(In percent of GDP)	
Public debt (external and domestic)	43.8	43.8	37.0	31.5	37.7
Of which: External debt	38.2	38.3	31.7	26.6	31.0
External debt service ratio	1.4	2.2	3.8	3.6	3.5
Exchange rates					
Exchange rate (National currency per US dollar)	2.3	2.3	2.4	2.4	...
Real effective exchange rate (2010=100; +=appreciation)	115.7	112.7	118.7	119.3	...
Memorandum items:					
Nominal GDP (millions of US$)	515.2	513.1	558.1	587.5	615.7

Sources: Tonga authorities; and IMF staff estimates and projections.

[1]Fiscal year beginning July 1.

[2]CPI basket and methodology changed in September 2021.

Table 2. Tonga: Balance of Payments Summary, FY2022–FY2030 [1/]

	FY2022	FY2023	Est. FY2024	Projections FY2025	FY2026	FY2027	FY2028	FY2029	FY2030
				(In millions of U.S. Dollars)					
Current account balance	**-27.8**	**-30.4**	**-21.2**	**-30.6**	**-39.3**	**-41.0**	**-45.8**	**-47.9**	**-49.7**
Goods balance	-201.0	-222.6	-221.1	-243.0	-251.2	-263.2	-275.2	-283.9	-292.2
Exports, f.o.b.	15.1	13.1	10.8	12.0	13.5	15.2	16.2	17.5	18.6
Imports, f.o.b.	-216.1	-235.8	-231.9	-255.0	-264.7	-278.4	-291.5	-301.3	-310.8
Services balance	-67.9	-68.0	-52.4	-54.7	-57.3	-59.5	-60.0	-60.4	-61.4
Receipts	44.5	83.1	108.7	115.9	122.1	128.6	134.8	140.7	146.8
Payments	-112.4	-151.1	-161.1	-170.6	-179.4	-188.1	-194.8	-201.1	-208.2
Investment income balance	30.1	50.5	54.9	55.8	57.6	58.7	59.1	59.6	60.4
Receipts	40.5	64.2	73.1	74.0	76.9	79.1	80.6	82.3	85.1
Payments	-10.4	-13.7	-18.2	-18.2	-19.2	-20.4	-21.5	-22.7	-24.8
Transfers balance	211.0	209.7	197.4	211.4	211.6	223.0	230.2	236.7	243.5
Official transfers (net)[2]	23.5	21.2	19.8	28.6	19.8	22.7	23.6	24.4	25.2
Private transfers (net)	187.5	188.5	177.6	182.8	191.8	200.3	206.7	212.4	218.3
Capital account balance	**73.2**	**66.2**	**45.9**	**51.1**	**10.2**	**5.2**	**5.2**	**5.2**	**5.2**
Financial account balance	**25.0**	**15.8**	**-22.3**	**-21.9**	**38.6**	**40.0**	**47.3**	**57.1**	**70.9**
FDI (net)	2.5	3.8	-13.3	-1.0	-1.5	-2.2	-2.2	-2.3	-2.3
Other investment (net)	22.5	11.8	-7.4	-19.3	41.8	43.8	51.2	61.0	74.9
Of which: Loan disbursements	3.1	9.6	0.9	0.3	61.3	64.5	71.6	76.3	84.7
Errors and omissions	-15.7	-40.1	-5.7	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	**54.8**	**11.5**	**-3.3**	**-1.4**	**9.5**	**4.2**	**6.7**	**14.4**	**26.5**
Financing	**-54.8**	**-11.5**	**3.3**	**-1.3**	**-9.5**	**-4.2**	**-6.7**	**-14.4**	**-26.5**
Change in reserve assets (- decrease)	57.8	11.5	-3.3	1.3	9.5	2.2	2.6	10.3	23.4
Use of IMF credit (net)	0.0	0.0	0.0	0.0	0.0	-2.0	-4.1	-4.1	-3.1
Disbursement (RCF)[3]	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Repayment	0.0	0.0	0.0	0.0	0.0	2.0	4.1	4.1	3.1
Suspended debt service under G20 DSSI[4]	3.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
				(In percent of GDP)					
Current account balance	-5.4	-5.9	-3.8	-5.2	-6.4	-6.3	-6.8	-6.9	-6.9
Trade balance	-39.0	-43.4	-39.6	-41.4	-40.8	-40.8	-41.1	-41.0	-40.8
Exports, f.o.b.	2.9	2.6	1.9	2.0	2.2	2.4	2.4	2.5	2.6
Imports, f.o.b.	-41.9	-45.9	-41.6	-43.4	-43.0	-43.1	-43.5	-43.5	-43.4
Services balance	-13.2	-13.2	-9.4	-9.3	-9.3	-9.2	-8.9	-8.7	-8.6
Receipts	8.6	16.2	19.5	19.7	19.8	19.9	20.1	20.3	20.5
Payments	-21.8	-29.4	-28.9	-29.0	-29.1	-29.1	-29.1	-29.0	-29.1
Investment income balance	5.8	9.8	9.8	9.5	9.4	9.1	8.8	8.6	8.4
Receipts	7.9	12.5	13.1	12.6	12.5	12.3	12.0	11.9	11.9
Payments	-2.0	-2.7	-3.3	-3.1	-3.1	-3.2	-3.2	-3.3	-3.5
Transfers balance	41.0	40.9	35.4	36.0	34.4	34.6	34.4	34.2	34.0
Official transfers (net)[2]	4.6	4.1	3.5	4.9	3.2	3.5	3.5	3.5	3.5
Private transfers (net)	36.4	36.7	31.8	31.1	31.1	31.0	30.8	30.6	30.5
Capital account balance	14.2	12.9	8.2	8.7	1.7	0.8	0.8	0.8	0.7
Financial account balance	4.8	3.1	-4.0	-3.7	6.3	6.2	7.1	8.2	9.9
FDI (net)	0.5	0.7	-2.4	-0.2	-0.2	-0.3	-0.3	-0.3	-0.3
Other investment (net)	4.4	2.3	-1.3	-3.3	6.8	6.8	7.6	8.8	10.4
of which : Loan disbursements	0.6	1.9	0.2	0.0	10.0	10.0	10.7	11.0	11.8
Overall balance	10.6	2.2	-0.6	-0.2	1.5	0.7	1.0	2.1	3.7
Financing	-10.6	-2.2	0.6	-0.2	-1.5	-0.7	-1.0	-2.1	-3.7
Change in reserve assets (- decrease)	11.2	2.2	-0.6	0.2	1.5	0.3	0.4	1.5	3.3
Use of IMF credit (net)	0.0	0.0	0.0	0.0	0.0	-0.3	-0.6	-0.6	-0.4
Disbursement (RCF)[3]	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Repayment	0.0	0.0	0.0	0.0	0.0	0.3	0.6	0.6	0.4
Suspended debt service under G20 DSSI[4]	0.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:									
Gross official foreign reserves	378.5	389.9	386.6	387.9	397.4	399.6	402.3	412.6	436.0
In months of next year's total imports	11.7	11.9	10.9	10.5	10.2	9.9	9.6	9.5	9.7
Exchange rate									
T$ per U.S. dollar (period average)	2.3	2.3	2.4	…	…	…	…	…	…
T$ per U.S. dollar (end of period)	2.3	2.4	2.4	…	…	…	…	…	…
Nominal GDP (in millions of US$)	515.2	513.1	558.1	587.5	615.7	645.4	670.2	693.0	716.6
Commodity price indexes (2005 = 100)									
Food	137.9	142.4	135.3	130.2	128.0	129.1	130.1	130.1	130.1
Fuel	241.3	244.5	184.5	173.3	164.7	161.2	158.7	158.7	158.7

Sources: Tonga authorities; and IMF staff estimates and projections.

[1] The revisions to historical FY2021-22 data compared to the staff report for the 2023 Article IV consultation reflect recently released data from the authorities.

[2]Includes all official grants excluding project-related funds related to capital formation.

[3]SDR 6.9 million, equivalent to 50 percent of Tonga's quota.

[4]Debt service suspended for 1 year, with a 1 year grace period and 3 years maturity.

Table 3. Tonga: Depository Corporations Survey, FY2021-FY2026 [1/]

	FY2021	FY2022	FY2023	FY2024	Projections FY2025	FY2026
			(In millions of T$, end of period)			
Net foreign assets	728.6	828.4	843.5	892.1	892.2	911.1
Claims on nonresidents	782.0	922.8	988.5	1005.6	1009.6	1028.5
NRBT	721.4	878.1	944.0	961.3	965.0	984.1
Other depository corporations	60.6	44.6	44.5	44.3	44.7	44.4
Liabilities to nonresidents	-53.4	-94.4	-145.0	-113.5	-117.5	-117.4
NRBT	-43.3	-83.4	-131.2	-105.1	-105.1	-105.1
Other depository corporations	-10.1	-11.0	-13.8	-8.4	-12.3	-12.2
Net domestic assets	36.6	18.3	-1.7	14.0	45.5	71.3
Net domestic credit	231.3	223.6	188.6	215.1	253.9	294.2
Net claims on government	-257.6	-257.0	-325.4	-325.3	-324.4	-310.9
Claims on public nonfin. corps.	50.3	46.0	35.9	26.9	26.9	29.3
Claims on private sector	436.9	432.5	471.3	505.5	543.5	567.9
Other items, net	-194.7	-205.3	-190.3	-201.1	-208.4	-222.9
Total liquidity (M3)	765.2	846.7	841.8	906.1	937.7	982.4
Broad money (M2)	723.0	820.0	817.5	884.3	917.4	959.9
Narrow money	337.0	401.5	406.8	477.3	444.0	493.3
Quasi money	386.0	418.5	410.8	406.9	473.4	466.6
FX deposits	42.2	26.7	24.3	21.8	20.3	22.5
			(Annual percentage change)			
Net foreign assets	27.7	13.7	1.8	5.8	0.0	2.1
Net domestic assets	0.1	-50.0	-109.2	-933.9	224.9	56.8
Net domestic credit	-8.2	-3.3	-15.6	14.0	18.0	15.9
Claims on private sector	1.0	-1.0	9.0	7.3	7.5	4.5
Total liquidity	26.1	10.6	-0.6	7.6	3.5	4.8
Broad money (M2)	25.0	13.4	-0.3	8.2	3.7	4.6
Memorandum items:						
Nominal GDP (in millions T$)	1180.5	1177.2	1201.4	1324.5	1400.6	1465.5
Velocity (GDP/M2)	1.6	1.4	1.5	1.5	1.5	1.5
T$ per U.S. dollar (end of period)	2.2	2.3	2.3	2.4	…	…

Sources: Tonga authorities; and IMF staff estimates and projections.

[1]Comprises the balance sheets of the National Reserve Bank of Tonga (NRBT) and other depository corporations (ODCs).

Table 4. Tonga: Summary of Government Operations, FY2023-FY2030 [1/]

		Est.	Projections					
	FY2023	FY2024	FY2025	FY2026	FY2027	FY2028	FY2029	FY2030
			(In percent of GDP)					
Total Revenue	54.3	55.5	60.0	43.8	42.1	40.4	38.8	36.8
Memo: Revenue (excluding grants)	26.3	26.3	28.0	26.9	26.9	26.9	26.9	27.0
Tax revenue	23.8	22.7	23.9	24.1	24.1	24.2	24.2	24.2
Taxes on income/profits	4.8	5.0	5.5	5.6	5.6	5.6	5.6	5.6
Taxes on property	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Taxes on goods and services	16.3	15.3	15.5	15.6	15.6	15.6	15.6	15.6
Taxes on international trade and transactions	2.6	2.3	2.9	2.9	2.9	3.0	3.0	3.0
Other taxes	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Grants[2]	28.0	29.2	32.0	16.9	15.3	13.5	11.9	9.9
Budget support (cash)	4.5	5.2	5.3	3.6	3.9	3.9	3.9	3.9
Other grants	23.5	24.0	26.7	13.3	11.4	9.6	8.0	6.0
Other Revenue	2.5	3.6	4.1	2.8	2.7	2.7	2.7	2.7
Property income	0.9	1.0	0.8	0.8	0.8	0.8	0.8	0.8
Sales of goods and services	1.4	1.3	1.3	1.3	1.3	1.3	1.3	1.3
Total Expenditure	48.2	51.3	54.3	51.4	50.5	50.2	50.0	49.7
Expense	40.3	37.0	37.5	37.1	37.0	37.1	37.0	37.1
Salaries and wages	12.6	11.5	12.0	12.0	12.0	12.0	12.1	12.1
Employers' social contribution	1.0	0.9	0.9	0.9	0.9	0.9	0.9	0.9
Interest	0.7	0.5	0.4	0.4	0.5	0.6	0.7	0.9
Of which: External	0.5	0.3	0.3	0.3	0.3	0.4	0.4	0.5
Use of goods and services	18.7	17.8	16.3	17.1	17.0	16.9	16.8	16.7
Subsidies	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Grants	1.8	2.0	3.1	2.2	2.1	2.0	1.9	1.8
Social benefits	2.3	2.2	2.2	2.2	2.2	2.2	2.2	2.2
Other expense	3.0	2.1	2.4	2.2	2.2	2.3	2.3	2.3
Net investment in nonfinancial assets	7.9	14.3	16.9	14.3	13.5	13.2	12.9	12.6
Buildings and structures	4.0	9.4	8.7	8.2	7.8	7.5	7.3	7.2
Machinery and equipment	3.6	4.3	6.0	5.2	4.7	4.7	4.7	4.6
Other fixed assets and non-produced assets	0.3	0.6	2.2	0.9	0.9	0.9	0.9	0.9
Gross Operating Balance	14.1	18.5	22.5	6.6	5.1	3.4	1.8	-0.2
Overall balance	6.1	4.2	5.6	-7.7	-8.3	-9.8	-11.1	-12.9
Primary balance	6.8	4.6	6.1	-7.3	-7.8	-9.2	-10.4	-12.0
Primary balance excluding grants	-21.2	-24.6	-25.9	-24.2	-23.1	-22.7	-22.3	-21.9
Net acquisition of financial assets	6.4	1.6	2.3	0.0	0.0	0.0	0.0	0.0
External financing (loans)	0.2	-3.3	-3.3	5.6	7.2	8.3	9.5	11.0
New disbursement	1.9	0.2	0.0	8.8	10.4	11.4	11.7	12.3
Of which : IMF RCF[3]	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Of which : G20 DSSI	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Repayment	1.7	3.5	3.3	3.2	3.2	3.0	2.2	1.4
Domestic financing (debt securities)	0.0	0.8	0.0	2.0	1.2	1.5	1.7	1.9
Memorandum items:								
Nominal GDP (in millions of T$)[4]	1201.4	1324.5	1400.6	1465.5	1539.7	1614.4	1687.0	1762.8
Fiscal anchors[4]								
Compensation of employees								
(in percent of domestic revenue) **< 53**	51.7	47.3	46.0	48.1	48.1	48.1	48.2	48.4
(in percent of current expense) **< 45**	33.8	33.6	34.4	34.8	34.9	34.9	35.1	35.2
Domestic revenue (in percent of GDP) **> 22**	26.3	26.3	28.0	26.9	26.9	26.9	26.9	27.0
External debt (in percent of GDP) **< 50**	38.3	31.7	26.6	31.0	36.9	44.0	52.0	61.3

Sources: Tonga authorities; and IMF staff estimates and p

[1] The revisions to historical FY2021-22 data compared to the staff report for the 2023 Article IV consultation reflect recently released GDP data from the

[2] Grant projections are based only on existing and highly likely commitments, consistent with the IMF's "Guidance Note on the Bank-Fund Debt Sustainability Framework for Low-income Countries" (http://www.imf.org/en/Publications/Policy-Papers/Issues/2018/02/14/pp122617guidance-note-on-lic-dsf).

[3] SDR 6.9 million, equivalent to 50 percent of Tonga's quota.

[4] Numbers in bold indicate the thresholds in Tonga's fiscal anchors.

Table 5. Tonga: Medium-Term Baseline Scenario, FY2022–FY2030 [1/]

			Est.	Projections					
	FY2022	FY2023	FY2024	FY2025	FY2026	FY2027	FY2028	FY2029	FY2030
Output and prices				(Annual percentage change)					
Real GDP	-2.3	2.1	2.1	2.7	2.3	1.8	1.5	1.2	1.2
Consumer prices (end of period)	9.9	13.7	6.4	1.4	3.1	3.3	3.2	3.2	3.2
Consumer prices (period average)	6.5	12.6	8.0	2.9	2.2	3.2	3.2	3.2	3.2
Central government finance [2]				(In percent of GDP)					
Total Revenue	44.3	54.3	55.5	60.0	43.8	42.1	40.4	38.8	36.8
Memo: Total Revenue (excluding grants)	25.9	26.3	26.3	28.0	26.9	26.9	26.9	26.9	27.0
Tax revenue	21.9	23.8	22.7	23.9	24.1	24.1	24.2	24.2	24.2
Grants	18.4	28.0	29.2	32.0	16.9	15.3	13.5	11.9	9.9
Other Revenue	4.0	2.5	3.6	4.1	2.8	2.7	2.7	2.7	2.7
Total Expenditure	44.4	48.2	51.3	54.3	51.4	50.5	50.2	50.0	49.7
Memo: Total Expenditure (excluding grants in-kind)	35.4	29.1	32.5	32.9	38.1	39.1	40.6	42.0	43.7
Expense	38.7	40.3	37.0	37.5	37.1	37.0	37.1	37.0	37.1
Salaries and wages	12.6	12.6	11.5	12.0	12.0	12.0	12.0	12.1	12.1
Employers' social contribution	1.1	1.0	0.9	0.9	0.9	0.9	0.9	0.9	0.9
Use of goods and services	19.5	18.7	17.8	16.3	17.1	17.0	16.9	16.8	16.7
Interest expense	0.5	0.7	0.5	0.4	0.4	0.5	0.6	0.7	0.9
Other expense	4.9	7.2	6.4	7.9	6.7	6.5	6.6	6.5	6.4
Transactions in Nonfinancial Assets	5.7	7.9	14.3	16.9	14.3	13.5	13.2	12.9	12.6
Gross Operating Balance	5.6	14.1	18.5	22.5	6.6	5.1	3.4	1.8	-0.2
Overall Balance	-0.1	6.1	4.2	5.6	-7.7	-8.3	-9.8	-11.1	-12.9
Primary Balance	0.4	6.8	4.6	6.1	-7.3	-7.8	-9.2	-10.4	-12.0
Net Acquisition of Financial Assets	-1.2	6.4	1.6	2.3	0.0	0.0	0.0	0.0	0.0
External financing (net)	-0.5	0.2	-3.3	-3.3	5.6	7.2	8.3	9.5	11.0
Domestic financing (net)	-0.7	0.0	0.8	0.0	2.0	1.2	1.5	1.7	1.9
Balance of payments				(In percent of GDP)					
Trade balance	-39.0	-43.4	-39.6	-41.4	-40.8	-40.8	-41.1	-41.0	-40.8
Exports, f.o.b.	2.9	2.6	1.9	2.0	2.2	2.4	2.4	2.5	2.6
Imports, f.o.b.	-41.9	-45.9	-41.6	-43.4	-43.0	-43.1	-43.5	-43.5	-43.4
Services balance	-13.2	-13.2	-9.4	-9.3	-9.3	-9.2	-8.9	-8.7	-8.6
Investment income balance	5.8	9.8	9.8	9.5	9.4	9.1	8.8	8.6	8.4
Transfers balance	41.0	40.9	35.4	36.0	34.4	34.6	34.4	34.2	34.0
Of which: Remittances	35.1	39.2	34.4	33.8	33.8	33.7	33.5	33.3	33.2
Of which: Official grants	4.8	4.5	3.9	5.3	3.6	3.9	3.9	3.9	3.9
Current account balance	-5.4	-5.9	-3.8	-5.2	-6.4	-6.3	-6.8	-6.9	-6.9
Capital account balance	14.2	12.9	8.2	8.7	1.7	0.8	0.8	0.8	0.7
Financial account balance	-4.8	-3.1	4.0	3.7	-6.3	-6.2	-7.1	-8.2	-9.9
Gross international reserves (end of period)									
In millions of U.S. dollars	378.5	389.9	386.6	387.9	397.4	399.6	402.3	412.6	436.0
In months of next year's goods and services imports	11.7	11.9	10.9	10.5	10.2	9.9	9.6	9.5	9.7
External debt (in percent of GDP)									
Public sector external debt	38.2	38.3	31.7	26.6	31.0	36.9	44.0	52.0	61.3
Debt service ratio	1.4	2.2	3.8	3.6	3.5	3.5	3.4	2.6	1.9
Public sector total debt (in percent of GDP)	43.8	43.8	37.0	31.5	37.7	44.5	52.7	62.0	72.8
Memorandum items:									
Private transfers (net, in millions of U.S. dollars)	187.5	188.5	177.6	182.8	191.8	200.3	206.7	212.4	218.3
(In percent of imports of goods and services)	57.1	48.7	45.2	42.9	43.2	42.9	42.5	42.3	42.1
Commodity price indexes (2005 = 100)									
Food	137.9	142.4	135.3	130.2	128.0	129.1	130.1	130.1	130.1
Fuel	241.3	244.5	184.5	173.3	164.7	161.2	158.7	158.7	158.7
Nominal GDP (millions of T$)	1177.2	1201.4	1324.5	1400.6	1465.5	1539.7	1614.4	1687.0	1762.8

Sources: Tonga authorities; and IMF staff estimates and projections.

[1] From FY2025 onwards, the macroeconomic forecasts incorporate the average long-term effects of natural disasters and climate change.

[2] See footnotes in Table 4 regarding underlying assumptions for fiscal projections.

Table 6. Tonga: Financial Soundness Indicators, FY2017-FY2024

	FY2017	FY2018	FY2019	FY2020	FY2021	FY2022	FY2023	FY2024
Banks								
Net domestic credit				(Year-on-year percent change)				
Public non-financial corporations	-5.9	20.5	15.2	2.4	-18.4	-8.7	-21.8	-25.0
Private sector	18.0	6.7	7.6	1.1	1.0	-1.0	9.0	7.3
				(In percent of GDP)				
Credit/GDP	40.9	41.9	43.5	43.1	41.3	40.6	42.2	40.2
Private Sector Credit/GDP	36.7	37.0	38.1	37.7	37.0	36.7	39.2	38.2
Public Nonfinancial Corporations/GDP	4.3	4.9	5.4	5.4	4.3	3.9	3.0	2.0
				(In percent)				
Regulatory Capital to Risk-Weighted Assets	29.4	28.3	30.5	31.6	31.4	33.6	32.8	32.1
Return on Assets	2.7	3.2	2.9	1.7	2.4	2.2	4.0	2.4
Return on Equity	10.7	13.7	10.9	5.8	9.6	9.0	15.9	9.5
Non-performing Loans to Total Gross Loans	4.1	3.6	3.2	4.1	3.3	6.3	10.4	10.9
Non-performing Loans Net of Provisions to Capital	8.8	8.4	6.2	9.1	6.6	12.9	23.8	26.2
Liquid Assets to Total Assets	32.4	27.1	25.6	27.9	40.2	44.6	37.6	37.0
Liquid Assets to Short-term Liabilities	63.3	51.0	49.8	60.2	73.0	76.7	64.2	60.3
Large Exposures to Capital	56.9	49.4	48.0	60.1	55.7	53.7	40.7	34.0
Personnel Expenses to Non-interest Expenses	28.0	29.8	29.5	29.1	31.5	29.5	29.1	27.7
Foreign-Currency-Denominated Loans to Total Loans	1.0	1.4	2.3	0.7	0.7	0.7	0.6	0.0
Foreign-Currency-Denominated Liabilities to Total Liabilities	6.9	5.7	7.1	6.2	6.5	4.3	4.0	3.1
Residential Real Estate loans to Total Loans	41.1	42.4	41.3	41.6	42.6	42.3	38.8	38.2
Commercial Real Estate Loans to Total Loans	2.4	2.5	2.2	2.4	4.2	3.5	4.2	3.8
Memorandum Items:								
Nominal GDP (millions T$)	1,016.8	1,074.3	1,122.8	1,147.8	1,180.5	1,177.2	1,201.4	1,324.5

Sources: National Reserve Bank of Tonga; and IMF, Financial Soundness Indicators.

Table 7. Tonga: SDGs Mapped to Tonga's Strategic Development Framework, FY2015-2025

Priority Areas	Select Tongan Outcome	Corresponding SDGs	
1. Economic Institutions	1. Improved macroeconomic management and stability with deeper financial markets.	8. Decent Work & Economic Growth	10. Reduce Inequalities
		16. Peace, Justice, and Strong Institutions	
	2. Closer public/private partnership	17. Partnerships for the Goals	
	3. Improved public enterprise performance	9. Industry, Innovation, and Infrastructure	17. Partnerships for the Goals
	4. Better access to, and use of overseas trade and employment, and foreign investment	8. Decent Work & Economic Growth	
	5. Participation of private sector in development enhanced	9. Industry, Innovation, and Infrastructure	
2. Social Institutions	6. Improved collaboration with an support to CSOs	11. Sustainable Cities and Communities	
	7. Improved education and training providing lifetime learning	4. Quality Education	5. Gender Equality
	8. Improved health care and delivery systems (universal health coverage)	3. Good Health and Well-Being	
	9. Improved collaboration with the Tangan diaspora	17. Partnerships for the Goals	
	10. Better care and support for vulnerable people, in particular the disabled	1. No Poverty	2. Zero Hunger
		3. Good Health and Well-Being	
3. Infrastructure and Techonology	11. More reliable, safe and affordable enery services	7. Affordable and clean energy	13. Climate Action
	12. More reliable, safe and affordable transport services	9. Industry, Innovation, and Infrastructure	13. Climate Action
	13. More reliable, safe, affordable innovative ICT	9. Industry, Innovation, and Infrastructure	
	14. More reliable, safe and affordable water supply and sanitatation services	6. Clean Water and Sanitation	14. Life Below Water
4. Natural Resources and Environment	15. Improved land use planning, administration and management for private and public spaces	11. Sustainable Cities and Communities	15. Life on Land
	16. Improved use of natural resources and a cleaner environment with improved waster recycling	12. Responsible Consumption and Production	13. Climate Action
	17. Improved resilience to extreme natural events and impact of climate change	13. Climate Action	

Source: Tonga's Voluntary National Review 2019

Annex I. Tonga Country Engagement Box[1]

Policy objectives and constraints: Tonga faces significant structural challenges typical of small developing states (SDS), including geographic remoteness, a small and dispersed population, and high vulnerability to natural disasters. The country's narrow economic base and reliance on agriculture, remittances, and public employment constrain productivity and growth. Recurrent climate shocks—such as cyclones and volcanic eruptions—have placed continued pressure on infrastructure, public finances, and development outcomes. Outward migration exacerbates labor shortages and undermines public sector capacity. While the authorities have maintained macroeconomic stability under a fixed exchange rate regime and prudent fiscal stance, limited fiscal space, weak capital project execution, and financial sector vulnerabilities remain key constraints. The Tonga Strategic Development Framework II (2015–25) outlines the authorities' medium-term priorities, centered on inclusive and sustainable growth, good governance, and climate resilience. The authorities have initiated several reforms in public financial management (PFM), monetary operations, and financial supervision. Over the next three years, Tonga aims to rebuild fiscal buffers, enhance financial stability, diversify the economy, and strengthen resilience to external and climate shocks. Continued Fund engagement with an integrated approach of surveillance and capacity development, alongside development partners, will support these goals through sequenced reforms.	
Engagement areas and plans. IMF engagement with Tonga focuses on surveillance and capacity development (CD), coordinated closely with other development partners (DPs), to strengthen macroeconomic stability, institutional capacity, and climate resilience.	
Lifting up potential growth and enhancing diversification	Tonga's economy remains reliant on agriculture, remittances, and public employment. The authorities seek to enhance productivity and diversification by investing in tourism, digital services, and value-added agriculture. Key reforms include improving the business environment, reducing skills gaps from emigration, and attracting private investment. The IMF coordinates closely with the World Bank and ADB, which are supporting initiatives in digital transformation, labor market development, and business climate reform.
Anchoring a credible and growth-friendly fiscal strategy	A robust medium-term fiscal strategy remains central to macroeconomic management. The authorities are implementing reforms to improve fiscal planning and credibility, including the adoption of a new PFM Act and revenue administration improvements (with FAD technical assistance). PFTAC has provided support on macro-fiscal modelling. The IMF has assessed Tonga's fiscal rule under Article IV consultations and recommended enhancements to strengthen its credibility. Building fiscal buffers is also essential amid potential aid declines and rising climate-related spending needs.
Modernizing monetary operations	Tonga maintains a fixed exchange rate regime that has helped anchor inflation expectations. However, monetary policy tools remain limited. Following IMF (MCM) TA, the National Reserve Bank of Tonga (NRBT) plans to transition from a floor interest rate to a mid-rate policy rate and issue NRBT Notes to improve policy transmission. Reforms also aim to strengthen financial oversight and market development.
Improving financial stability and supervision	To safeguard financial stability and improve credit risks, the NRBT should strengthen its financial sector oversight and supervisory capacity. Enhancing prudential standards, training in financial risk analysis, and the reporting of financial institutions, will continue to support authorities' efforts, building on IMF/PFTAC technical assistance.

[1] Prepared by Shivneel Kirpal.

Strengthening the revenue base	Efforts to broaden the tax base remain a priority under the medium-term revenue strategy. The authorities are considering reforms to tax exemptions and administration, with IMF TA supporting follow-up on earlier recommendations.
Enhancing Public Financial Management (PFM)	Through PFTAC, the IMF is supporting PFM improvements in budget formulation, debt and cash management, and climate-responsive tools. Reforms are embedding disaster risk into fiscal frameworks and addressing fiscal risks from SOEs and contingent liabilities.
Building resilience to climate risks	As one of the most climate-vulnerable countries globally, Tonga is integrating climate risks into macro-fiscal planning and improving access to adaptation finance. The IMF, through CMAP, is supporting this work alongside collaboration with ADB, WB, and the Green Climate Fund.
Addressing AML/CFT deficiencies	Ahead of its next APG mutual evaluation, Tonga is strengthening legal and institutional AML/CFT frameworks, which would also help preserve correspondent banking access. IMF CD will continue to support risk-based supervision and financial intelligence, in coordination with APG, PFTAC, and other DPs.
Enhancing data capacity	Gaps in national accounts, labor, balance of payments, and fiscal data hinder surveillance. The authorities are committed to strengthening data quality and dissemination. IMF CD through STA and PFTAC will continue, including support for Tonga's participation in the Enhanced General Data Dissemination System (e-GDDS).

Annex II. External Sector Assessment

Overall Assessment: Tonga's external position in FY2025 was broadly in line with the level implied by fundamentals and desirable policy settings, based on the results of the IMF's EBA-lite current account model.[1]

Potential Policy Responses: Strengthening public finances and promoting private sector development, together with continued strong financial support from development partners, would help Tonga preserve its external sector stability in the presence of large development spending needs.

Foreign Assets and Liabilities: Position and Trajectory

Background. Tonga's debt obligations are largely external, and less than half of its external public debt is to China, with a sharp spike in debt repayments in FY2024 and remain elevated above 2 percent of GDP until FY2028. Total public and publicly guaranteed (PPG) external debt stood at about 32 percent of GDP as of end FY2024, accounting for 84 percent of total public debt. Outstanding debt to all multilateral creditors stood at about 17 percent of GDP, or about 53 percent of the total external debt stock (Also see Debt Sustainability Analysis). Tonga remains in a net borrower position, but its Net International Investment Position (NIIP) improved in 2024, driven by the decline in international liabilities.

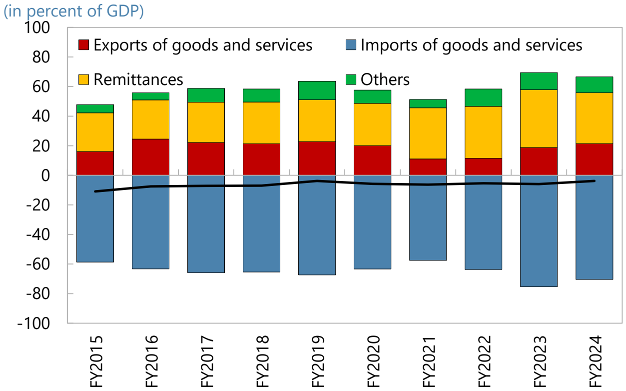
Assessment. In the near term, the external debt-to-GDP ratio is expected to decline from 32 percent in FY2024 to 27 percent in FY2025, reflecting large repayments to China Exim Bank. From FY2026 onwards, Tonga will need to incur new external debt to help finance its large spending needs to achieve SDGs and climate resilience. (Also see Debt Sustainability Analysis).

Current Account

Background. From FY2014 to FY2024, Tonga's current account (CA) deficit averaged about 6.3 percent of GDP. For FY2025, remittances continued to moderate following the decline in FY2024, but the decline was more than offset by higher external grants. However, good imports are estimated to have increased, reflecting continued economic recovery and construction activity, which would lead to a widening of the overall current account deficit from 3.8 percent of GDP in FY2024 to 5.2 percent in FY2025. The CA deficit is projected to continue to increase in FY2026, reflecting elevated imports and the decline in grants and private remittance.

Current Account Developments

(in percent of GDP)



Sources: Tonga authorities; and IMF staff estimates.

Assessment. The EBA-lite CA model estimates the adjusted CA balance at -6.4 percent of GDP and the adjusted CA norm at -6.3 percent of GDP. With a gap of around -0.1 percent of GDP, the external position in FY2025 is assessed to be broadly in line with medium-term fundamentals and desirable policies (text table).

The policy gap (3.6 percent of GDP) primarily reflects the relatively looser fiscal policy in the rest of the world.

Tonga: EBA-lite Estimates for FY2025

	CA model 1/ (in percent of GDP)
CA-Actual	**-5.2**
Cyclical contributions (from model) (-)	0.0
Additional temporary/statistical factors (-) 2/	
Natural disasters and conflicts (-)	1.2
Adjusted CA	**-6.4**
CA Norm (from model) 2/	**-6.3**
Adjustments to the norm (+)	0.0
Adjusted CA Norm	**-6.3**
CA Gap	**-0.1**
o/w Relative policy gap	3.6
Elasticity	-0.3
REER Gap (in percent)	**0.4**

1/ Based on the EBA-lite 3.0 methodology
2/ Cyclically adjusted, including multilateral consistency adjustments.

Real Exchange Rate

Background. The Tonga pa'anga exchange rate is determined by a weighted-basket of currencies comprising the US dollar, New Zealand dollar, Fijian dollar, and Australian dollar. The basket weights are primarily determined based on the share of currencies used in international payments. The currency basket weights have remained unchanged since 2018 and were last reviewed in September 2024. The real effective exchange rate (REER) appreciated by about 0.1 percent on average in July 2024-June 2025, reflecting the small depreciation of the nominal effective exchange rate (NEER) by about 0.03 percent and Tonga's inflation dynamics aligned with its major trading partners.

Assessment. The CA gap model implied that the REER gap is close to 0.4 percent (applying an estimated elasticity of the trade balance with respect to changes in the REER of -0.3). However, there is a large uncertainty surrounding our assessment given that: (i) the official BOP data for FY2025 are yet to be published; and (ii) the expected changes in grants, tourism receipts, and remittances are unusually large; (iii) the export base is relatively low and there is little scope for import substitution.

Capital and Financial Accounts: Flows and Policy Measures

Background. Tonga's recent current account deficits have been largely financed by large capital account credits in the form project support grants and grants in-kind. Foreign direct investment (FDI) inflows have been limited due to structural impediments, such as cumbersome land leasehold market operations and regulatory barriers, including longstanding restrictions that prohibit non-residents' ownership in certain sectors. Recent external borrowings have been limited and exclusively on concessional terms, including the IMF's RCF disbursed in FY2021 and FY2023.

Assessment. The authorities' continued efforts to pursue additional grants from development partners and avoid any new non-concessional borrowing from external creditors are appropriate and would help strengthen Tonga's reserve buffer, together with the ongoing reform to promote FDI including by reducing market entry barriers.

FX Intervention and Reserves Level

Background. Gross official reserves were US$388 million (about 10.5 months of the following year's imports) in FY2025, compared to US$387 million (10.9 months of imports) in FY2024. Reserves remained at a comfortable level due to inflows of foreign grants to help Tonga cope with rebuilding needs, continued remittances inflows, and the tourism recovery. Over the medium term, the pressures to reserve coverage come from moderation in remittances towards pre-pandemic levels and lower grants after current commitments are met, and continued debt repayments, while external government borrowings are expected to support reserves. Overall, reserve coverage is projected to remain stable in FY2026 and over the medium term.

Tonga: International Reserve Adequacy Metric for FY2025

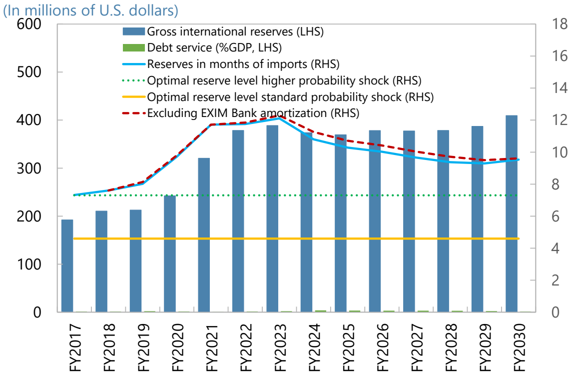
Actual Reserves (months of prospective imports)	10.5
Optimal level with standard shock probability	4.6
Optimal level with higher shock probability	7.3
Optimal level taking into account debt repayment	8.0
Broad Money coverage	101%

Source: IMF staff estimates.

Assessment. A cost-benefit analysis on the level of reserves suggests an optimal level between 4½ and 7½ months of imports. Staff's reserves adequacy framework is tailored to small credit-constrained economies. If the probability of a large shock is set at the sample average of 50 percent, the estimated optimal level of reserves would be 4½ months of imports—above the NRBT's minimum threshold of 3 months of imports. However, once Tonga's high vulnerability to natural disasters is incorporated into the assessment, the estimated adequate level of reserves would rise to about 7½ months of imports. Additional reserve buffers may be needed to cover the continued debt repayments, mostly due to China Exim Bank (text chart). Strengthening public finances (as illustrated in the main text of the staff report), implementing structural reforms aimed at enhancing Tonga's climate resilience and promoting private sector development, and new grant commitments from donors would help Tonga further enhance reserve adequacy.

International Reserves

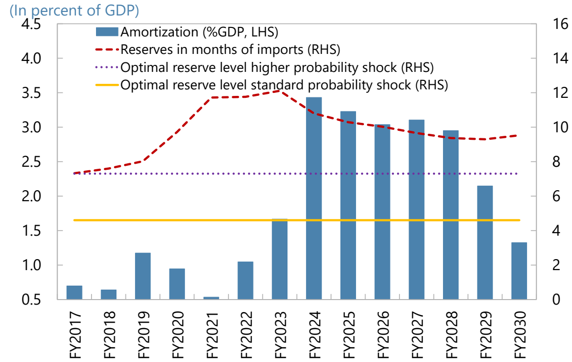
(In millions of U.S. dollars)



Sources: Tongan authorities; and IMF staff calculations.

Amortization

(In percent of GDP)



Sources: Tongan authorities; and IMF staff estimates.

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[1] The external sector assessment is based on staff estimates.

Annex III. Risk Assessment Matrix[1]

	Source of Risks	Likelihood	Expected Impact	Policy Recommendation
Global	**Escalating Trade Measures and Prolonged Uncertainty 1/**	High	Medium. Economic slowdown of Tonga's main trading and development partners and higher goods import prices, dampening investment and growth prospects in the medium term.	Provide temporary and timebound targeted fiscal support, especially to the vulnerable. Prioritize public investment in the most necessary projects.
Global	**Commodity price volatility 2/**	High	Medium-High. (Higher commodity prices). A larger import bill and current account deficit, thus, lower FX reserves; higher inflation and weaker private consumption due to lower real income; delays in reconstruction or investment projects if wage inflation pressures or construction material prices increase.	Provide targeted fiscal support to the vulnerable. Monetary policy should be tightened using the NRBT's usual monetary policy instruments if strong second-round effects materialize. Prioritize public investment in the most necessary projects. In the long term, increase public investment to expand productive capacity.
Global	**Geopolitical Tensions. 3/**	High	Medium. Growth slowdown in major economies could lead to weaker remittance, slower recovery in tourism, lower foreign demand for agricultural products, and lower fiscal revenue.	Improve the private sector business climate and diversify the economy. In the long-term, increase public investment to expand productive capacity. Accelerate the reforms aimed at broadening the tax base and improving spending efficiency.
Global	**Decline in International Aid. 4/**	High	Medium-High. Decline in international aid could delay or reduce external grants, worsening the fiscal and external positions, while geo-strategic factors could increase them.	Expedite donors' commitments. Accelerate the reforms aimed at broadening the tax base and improving spending efficiency. Implement reforms to enhance the business environment and external competitiveness.
Domestic	**Extreme climate events 5/**	High	High. Disruptions in economic activity; lower GDP growth; amplifying inflationary pressures; damages to properties and infrastructure, resulting in lower growth potential; larger fiscal burden and public debts.	Prioritize ex-ante adaptation investment and ex-post expenditure to support the affected households. Strengthen the monitoring of potential asset quality problems in the banking sector. Strengthen fiscal buffers by accelerating reforms to mobilize additional revenues.
Domestic	**Acceleration of outward migration**	High	Medium. Higher inflation pressures owing to tighter domestic labor market; lower long-term growth due to increased difficulties in expanding the narrow domestic production base. Higher remittances.	Create economic opportunities by developing the small private sector, attracting FDI, and diversifying the economy. Enhance education and skill development.
Domestic	**Tighter restrictions to migration**	Medium	Medium. Stricter migration policies in advanced economies could reduce the flow of migrant and temporary overseas workers. This would lower remittances, weaken household incomes, and reduce a key source of foreign exchange—though it could also increase labor supply domestically. .	Promote private-sector job creation, strengthen social safety nets, and diversify overseas labor markets through new bilateral agreements. Improve macroeconomic policy management and enhance competitiveness to support the current account.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.

Source of Risks	Likelihood	Expected Impact	Policy Recommendation
Higher or more persistent inflation	Medium	Medium-High. Loss in real purchasing power as wages adjust with lags, lower consumption; wage-price spiral accompanied with de-anchored inflation expectations, social unrest.	NRBT should stand ready to tighten monetary policy stance using the usual monetary policy instruments. Provide targeted fiscal support to the low-income households.
Partial withdrawal of CBRs, including due to gaps in the AML/CFT framework	Medium	High. Lower remittance inflows, leading to weaker private consumption and a larger current account deficit. Lower lending activity and tighter lending conditions.	Strengthen the AML/CFT framework and enhance its implementation, including by implementing a risk-based approach supervision and improving enforcement in line with the Asia-Pacific Group assessment. Pass the MLPCA and Regulation amendments Bill. Consider the region's CBR Roadmap and related World Bank regional project.
Further increase in non-performing loans (NPLs)	Medium	Medium-high. Lower lending activity and tighter lending conditions, resulting in lower GDP growth.	NRBT should closely monitor the asset quality and strengthen oversight of banks, particularly with high NPL ratios. Consider requesting banks to prepare a comprehensive plan to tackle NPLs, including with a minimum target provisioning level.

1/ Rising trade barriers and prolonged policy uncertainty could reduce trade, investment, and growth. Inflationary pressures may re-emerge—especially in countries imposing tariffs. These effects can be amplified by strategic complementarities or bottlenecks in global value chains or inventory overhang.

2/ Shifts in supply and demand—driven by geopolitical tensions and conflicts, OPEC+ actions, or the green transition—may fuel commodity price swings, intensifying external and fiscal pressures, social unrest, and macroeconomic instability.

3/ Intensification of conflicts, coupled with the weakening of multilateralism, may trigger commodity price volatility, increase migration pressures, reignite inflation, and weigh on growth by undermining confidence, investment, tourism, trade, and supply chains.

4/ A further sharp reduction in international financial assistance, including development aid and humanitarian support, could severely affect low-income and fragile countries. Such an additional aid withdrawal would strain public finances, worsen current accounts, increase debt vulnerabilities, and lead to a further deterioration in living conditions and food security.

5/ Extreme climate events driven by rising temperatures cause loss of human lives, severe damage to infrastructure, supply disruptions, lower growth, and financial instability.

Annex IV. Capacity Development and Surveillance Integration Matrix

(CD Activities Across IFIs Which Will Support Surveillance)

Surveillance Issues	International Monetary Fund			World Bank		Asian Development Bank	
	Past	2021-2022	Planned/ Ongoing	Past	Planned/ Ongoing	Past	Planned/ Ongoing
Fiscal Sector							
Public Financial Management	√	√		√	√	√	√
Expenditure framework	√			√	√	√	√
Revenue Framework	√	√		√	√		
Real Sector							
Macroeconomic Frameworks		√	√				
Macro-Financial Issues							
Financial supervision and regulation	√	√	√	√	√		
Financial market development	√	√	√	√	√		√
Correpondent Banking							√
Macro-Structural iIssues							
Infrastructure		√		√	√		√
Private sector development				√	√	√	√
Governance issues			√	√	√	√	√
Poverty/Gender/Inequality				√	√	√	
Climate change	√			√	√	√	√
Natural disaster management	√			√	√	√	√
Financial Inclusion						√	
Gender				√	√	√	√
Labor markets				√	√		
Land						√	
Business climate				√	√		
AML/CFT			√				
Statistics							
Data Enhancement	√	√	√				

Sources: IMF, World Bank, and Asian Development Bank (ADB).

Annex V. Recommendations from the 2024 Article IV Consultation and Their Implementation Status

Sector	Main Recommendations	Actions Since 2024 Article IV Consultation
Fiscal Policies	The fiscal adjustments should have a three-prong approach: domestic revenue mobilization, enhancing spending efficiency, and securing additional grants.	The authorities pursued additional grants from development partners such as World Bank, ADB, and the government of Australia, sustaining strong grants in FY25.
	Fiscal reforms will be needed, guided by Fund TA.	The authorities have continued reforming tax exemptions by assessing the impact of extending these reforms beyond the tourism and agriculture sectors, with support from Fund TA.
Monetary Policy	Strengthen the monetary policy framework.	The authorities have initiated preparations for issuing or repurchasing short-term notes to strengthen the interbank liquidity market and enable more proactive use of the policy rate.
Financial Sector Policies	Strengthen financial regulation and supervision.	With support from the IMF and the Pacific Financial Technical Assistance Centre (PFTAC), Tonga has been advancing the implementation of a risk-based supervision framework. This includes reviewing supervisory risk rating models for banks and enhancing institutional structures and operational procedures to align with RBS principles.
	Promote financial inclusion	NRBT launched a Fintech Regulatory Sandbox, providing a controlled environment for financial institutions and fintech innovators to test new products and services under regulatory supervision. This initiative aims to foster financial innovation, improve payment systems, facilitate cross-border remittances, and expand financial access, particularly for underserved populations
	Strengthen the AML/CFT framework.	The government has advanced with stakeholder consultations on updates to the Money Laundering and Proceeds of Crime Act and associated regulations to better supervise DNFBPs, enhance beneficial-ownership transparency, and improve data access for tax authorities.
Structural Policies	Enhance resilience to natural disasters and climate change.	Most reconstruction projects are completed. Tonga is progressing on energy security although slowly.
	Address key macro-critical corruption and governance vulnerabilities.	Tonga has appointed the anti-corruption commissioner in 2024.
	Develop the private to boost Tonga's growth potential.	Tonga is seeking to boost private sector development by improving access to credit—through a planned digital ID system, a secured transactions registry, and strengthening credit infrastructure—and by streamlining business registration and investment procedures to attract entrepreneurship and foreign investment.

Annex VI. Data Issues

Annex VI. Table 1. Tonga: Data Adequacy Assessment Rating 1/							
C							
Questionnaire Results 2/							
Assessment	National Accounts	Prices	Government Finance Statistics	External Sector Statistics	Monetary and Financial Statistics	Inter-sectoral Consistency	Median Rating
	C	C	C	C	C	D	C
Detailed Questionnaire Results							
Data Quality Characteristics							
Coverage	C	C	C	B	C		
Granularity 3/	C		C	C	C		
			C		C		
Consistency			C	C		D	
Frequency and Timeliness	C	C	C	C	C		

Note: When the questionnaire does not include a question on a specific dimension of data quality for a sector, the corresponding cell is blank.
1/ The overall data adequacy assessment is based on staff's assessment of the adequacy of the country's data for conducting analysis and formulating policy advice, and takes into consideration country-specific characteristics.
2/ The overall questionnaire assessment and the assessments for individual sectors reported in the heatmap are based on a standardized questionnaire and scoring system (see IMF *Review of the Framework for Data Adequacy Assessment for Surveillance*, January 2024, Appendix I).
3/ The top cell for "Granularity" of Government Finance Statistics shows staff's assessment of the granularity of the reported government operations data, while the bottom cell shows that of public debt statistics. The top cell for "Granularity" of Monetary and Financial Statistics shows staff's assessment of the granularity of the reported Monetary and Financial Statistics data, while the bottom cell shows that of the Financial Soundness indicators.

A	The data provided to the Fund is adequate for surveillance.
B	The data provided to the Fund has some shortcomings but is broadly adequate for surveillance.
C	The data provided to the Fund has some shortcomings that somewhat hamper surveillance.
D	The data provided to the Fund has serious shortcomings that significantly hamper surveillance.

Rationale for staff assessment. Overall data provided to the Fund has some shortcomings that somewhat hamper surveillance, partially reflecting the capacity constraints for a small island country. **National Accounts.** National accounts data has improved in the recent release with issues surrounding nominal and real GDP discrepancies in the base year being resolved. However, GDP is only released for the production side and on an annual frequency with more than 12-months of lag. More frequent GDP releases, including the expenditure components, would help assess the current economic conditions. Labor market data will help the monetary policy advice complementing the inflation data. **Prices.** Tonga Statistics Department (TSD) provides monthly CPI data with a lag of 1-2 months. Authorities also provided CPI data in local and import prices. They recently rebased to September 2021=100 with new expenditure weights from 2021 population census. Sub-indices of newly released CPI data are provided in contribution, not in index. New CPI data of major groups are provided back to 2021 but detailed components for 2024 only, affecting before 2024 core CPI estimation. Authorities are encouraged to release CPI components in index and more historical data before 2024. **GFS.** There is potential to enhance the quality of fiscal data including by improving debt reporting by including SOEs liabilities. **External Sector.** The authorities continue to compile

data on BoP and IIP, but with some delays. The data has good coverage, including merchandise trade, categories of services, income, capital account, and financial account. **Monetary and Financial.** Banking level data is provided by the authorities; however, granularity can be improved on asset and liabilities data. Delays in compilation and release of FSI data can be improved which would also help bolster confidence in financial institutions. Authorities are encouraged to improve weaknesses in data quality and governance and the release of NBFI level data. **Intersectoral Consistency.** Significant inconsistency in grants remains between the BoP and GFS. Reconciling grants in the BoP with those in the Fiscal, through improved recording and inclusion of estimates for in-kind grants, is needed for enhancing inter-sectoral consistency.
Changes since the last Article IV consultation. National accounts data has improved in the recent release with issues surrounding nominal and real GDP discrepancies in the base year being resolved. The authorities publish a new set of CPI data with September 2021=100. The authorities also made some progress in enhancing reliability and addressing delays of external sector statistics.
Corrective actions and capacity development priorities. The authorities should continue their efforts to enhance their statistical capacity, including by enhancing training, ensuring adequate staffing, and improving data sharing among government agencies. CD priorities include strengthening statistics on GDP, prices, GFS, and the external sector including BOP and IIP.
Use of data and/or estimates different from official statistics in the Article IV consultation. Staff estimates data in several areas, including core inflation, GDP (as data releases lag), and credit growth by sector. These estimates are subject to subsequent revisions, posing challenges to staff surveillance assessment.
Other data gaps. Labor Market & Gender data (unemployment, employment, labor force participation data by gender, by age), housing market data, SOE balance sheet data, Excess Reserves at the NRBT, more granular data on tourism, private sector credit, infrastructure project execution, and climate resilience indicators.

Annex VI. Table 2. Tonga: Data Standards Initiatives
Tonga participates in the Enhanced General Data Dissemination System (e-GDDS) and first posted its metadata in May 2006 but is yet to disseminate the data recommended under the e-GDDS.

Annex VI. Table 3. Tonga: Table of Common Indicators Required for Surveillance

As of September 5,2025

	Data Provision to the Fund				Publication under the Data Standards Initiatives through the National Summary Data Page			
	Date of Latest Observation	Date Received	Frequency of Data[6]	Frequency of Reporting[6]	Expected Frequency[6,7]	Tonga[8]	Expected Timeliness[6,7]	Tonga[8]
Exchange Rates	7/2025	8/2025	M	M	D	Q	...	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	7/2025	9/2025	M	M	M	...	1M	...
Reserve/Base Money	7/2025	9/2025	M	M	M	Q	2M	6W
Broad Money	7/2025	9/2025	M	M	M	Q	1Q	6W
Central Bank Balance Sheet	7/2025	9/2025	M	M	M	Q	2M	6W
Consolidated Balance Sheet of the Banking System	7/2025	9/2025	M	M	M	Q	1Q	6W
Interest Rates[2]	7/2025	8/2025	M	M	M	M	...	6W
Consumer Price Index	7/2025	9/2025	M	M	M	M	2M	2W
Revenue, Expenditure, Balance and Composition of Financing[3]–General Government[4]	2023/24	5/2025	A	A	A	...	3Q	...
Revenue, Expenditure, Balance and Composition of Financing[3]–Central Government	2023/24	5/2025	A	A	Q	SA	1Q	9-10M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	03/2025	5/2025	Q	Q	Q	A	2Q	1Y
External Current Account Balance	Q4/2024	7/2025	Q	Q	Q	A,Q	1Q	8W,4M
Exports and Imports of Goods and Services	Q4/2024	7/2025	Q	Q	M	Q	12W	4W
GDP/GNP	2022/23	11/2024	A	A	Q	A	1Q	4M
Gross External Debt	2023/24	5/2025	A	A	Q	A	2Q	9-12M
International Investment Position	2024	7/2025	Q	I	A	...	3Q	...

[1] Includes reserve assets pledged or otherwise encumbered, as well as net derivative positions.

[2] Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

[3] Foreign, domestic bank, and domestic nonbank financing.

[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

[5] Including currency and maturity composition.

[6] Frequency and timeliness: ("D") daily; ("W") weekly or with a lag of no more than one week after the reference date; ("M") monthly or with lag of no more than one month after the reference date; ("Q") quarterly or with lag of no more than one quarter after the reference date; ("A") annual,; ("SA") semiannual; ("I") irregular; ("NA") not available or not applicable; and ("NLT") not later than.

[7] Encouraged frequency of data and timeliness of reporting under the e-GDDS and required frequency of data and timeliness of reporting under the SDDS and SDDS Plus. Any flexibility options or transition plans used under the SDDS or SDDS Plus are not reflected. For those countries that do not participate in the IMF Data Standards Initiatives, the required frequency and timeliness under the SDDS are shown for New Zealand, and the encouraged frequency and timeliness under the e-GDDS are shown for Eritrea, Nauru, South Sudan, and Turkmenistan.

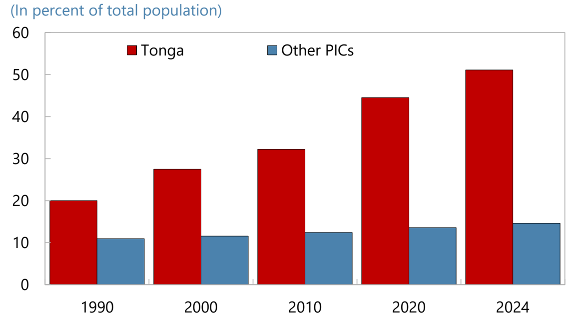
[8] Based on the information from the Summary of Observance for SDDS and SDDS Plus participants, and the Summary of Dissemination Practices for e-GDDS participants, available from the IMF Dissemination Standards Bulletin Board (https://dsbb.imf.org/). For those countries that do not participate in the Data Standards Initiatives, as well as those that do have a National Data Summary Page, the entries are shown as "..."

Annex VII. Labor Emigration and Human Capital

Tonga is among the top countries that have high flow and stock of migrants relative to its population, and labor emigration has continued to increase in recent years. Outward migration brings significant economic benefits through remittances, which have supported households' income and foreign reserves. However, emigration also poses challenges to domestic labor supply and human capital accumulation. This annex focuses on the impact of labor migration on human capital and finds that skill upgrade from labor migration appears limited, while emigration is associated with lower child education enrollment.

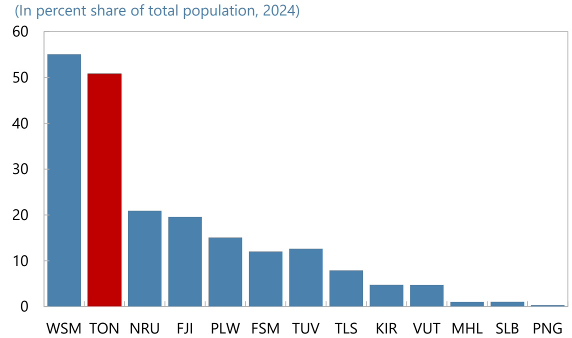
1. Tonga has one of the highest emigration rates globally when compared with its population size. Large-scale emigration from Tonga commenced in the 1960s, primarily to New Zealand, Australia, and the United Sates, seeking better economic opportunities and educational prospects. Emigration rates have continued to stay high since then, and Tonga now is among the top four countries of emigration stock in relation to its population.[1] Labor mobility arrangements (LMA) in neighboring countries, such as the Seasonal Workers Program and Pacific Labor Scheme in Australia and the Recognized Seasonal Employer (RSE) further facilitated emigration from Pacific Island countries including Tonga. United Nations' emigration stock data shows that emigration stock to population ratio of Tonga has exceeded 50 percent in 2024, the second highest ratio in the region.

Migrants Stock
(In percent of total population)



Source: United Nations Department of Economic and Social Affairs
Note: Other PICs include Fiji, Samoa, Solomon Islands, Vanuatu, Kiribati, Marshall Islands, FSM, Palau, Nauru and Tuvalu.

Emmigrant Stock
(In percent share of total population, 2024)

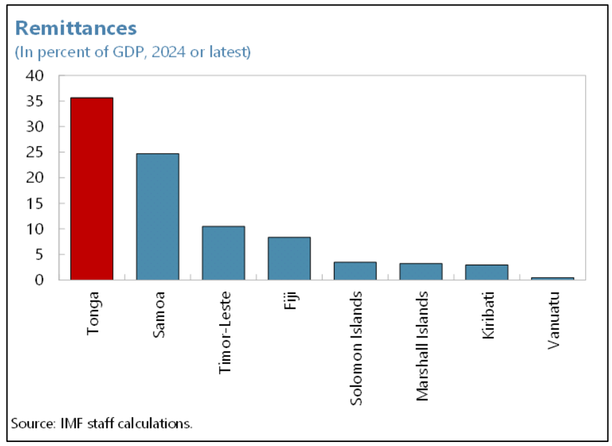


Sources: UN; and IMF staff calculations.

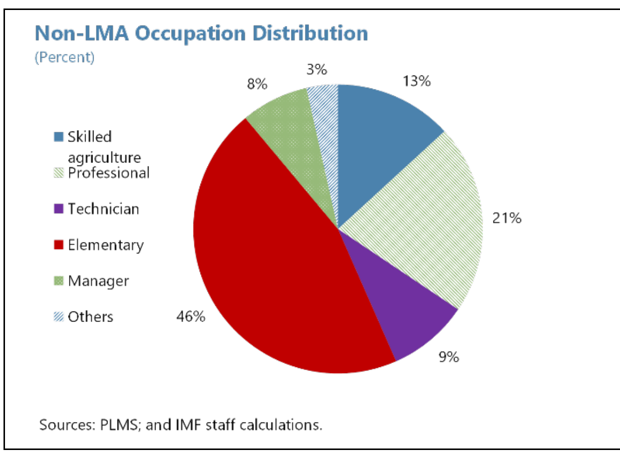
2. Emigration has provided significant economic benefits to Tonga, primarily through remittances. After decades of emigration, Tonga now has a large Tongan diaspora, which is estimated to be larger than the population of Tongans residing in country. The large Tongan diaspora and emigration play an important role in the country's economy through remittances. Four out of five Tongan households receive remittances from abroad, providing a significant source of

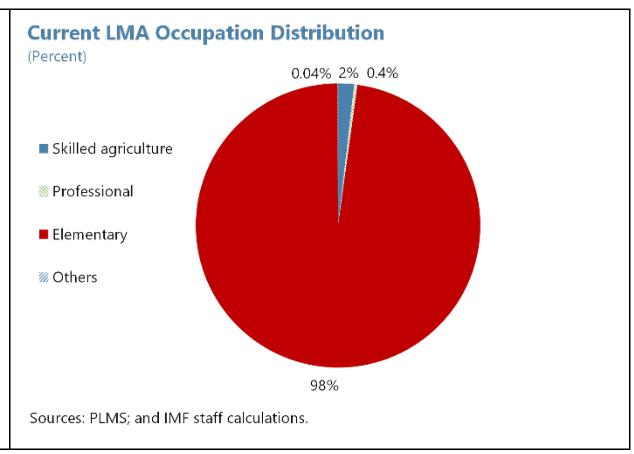
[1] World Migration Report 2020: https://publications.iom.int/books/world-migration-report-2020

income for many Tongan households.[2] Tonga is the second largest remittance-receiving countries by share of GDP in 2022),[3] and has the highest remittance to GDP ratio in the region. As the main source of foreign exchange inflows, remittances are also critical to support Tonga's import needs, finance current account deficits, and boost its foreign exchange reserves, contributing to Tonga's macroeconomic stability.



3. However, skill upgrade and transfers from labor mobility arrangements appears limited for Tonga.[4] The literature findings generally suggest there is a benefit in terms of skill acquisition and skill spillover through labor mobility when migrant workers return home. However, micro-lever data from the recent Pacific Labor Mobility Survey (PLMS) indicates that skill upgrade and transfers are small for all three countries coved by the survey, including Tonga. More than 15 percent of households in Tonga have at least one member who has participated in the LMAs, and most LMA participants have returned to their home countries. Comparing the occupation distribution between migrate workers and domestic labor, over 95 percent of migrate workers from Tonga perform elementary tasks under the LMAs, suggesting limited skill upgrade from the schemes.





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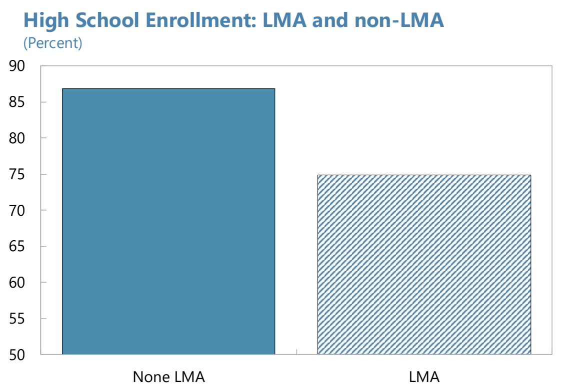
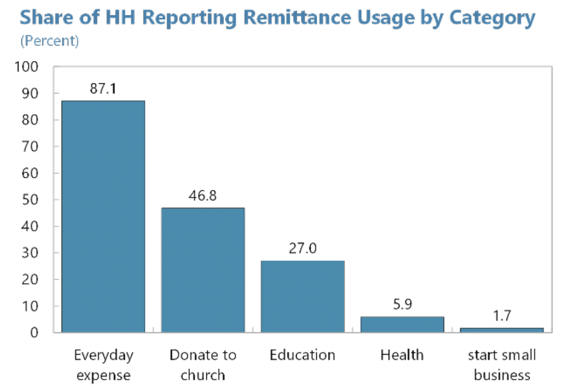
2 https://www.ifc.org/en/stories/2020/tonga-remittances-2020

3 World Migration Report 2024: https://publications.iom.int/books/world-migration-report-2024

4 The Pacific Labor Mobility Survey (PLMS), jointly conducted by the World Bank and the Development Policy Centre at the Australian National University, is the first comprehensive data collection exercise on Pacific temporary labor migration. The PLMS covered Kiribati, Tonga, and Vanuatu workers who were working in the RSE and PALM schemes in New Zealand and Australia and collected quantitative data on a wide range of economic and social indicators. The findings from the recent Pacific Labor Mobility Survey (PLMS) point to net positive impacts from temporary labor schemes, from both economic and social perspectives: https://www.worldbank.org/en/country/pacificislands/brief/pacific-labor-mobility-the-benefits-concerns-and-opportunities.



Sources: PLMS; and IMF staff calculations.



Sources: PLMS; and IMF staff calculations.

4. In addition, LMA participation is associated with lower child education enrollment in source countries. The survey results also show that the high-school enrollment rates of children in LMA participating families are over 10 percentage points lower than those in non-participating families in Tonga, implying that the next generation of LMA participating families could accumulate less human capital. In addition, survey results suggested that remittances are often prioritized for immediate needs over human capital investments like education.

5. Further investigation shows that temporary labor migration and the skill level of workers could have notable impact on human capital development.[5] Using the Propensity Score Matching (PSM) method that compares the differences in child education enrollment between LMA participants and non-participants,[6] the results show a significant impact of LMA participation on child education enrollment in source countries. In Tonga, children from LMA-participating families have 5 percent lower enrollment rate compared to those from non-participating families. The PSM estimates are different from the simple average difference, suggesting that the simple average difference of child education enrollment between migrant and non-migrant families might be biased by the endogenous migration decisions. Splitting the samples by parents' skill level shows that migrant children's education disadvantage is mainly driven by migrant families with low skill levels, whereas migrant children whose parents have higher education level do not suffer from education disadvantage.

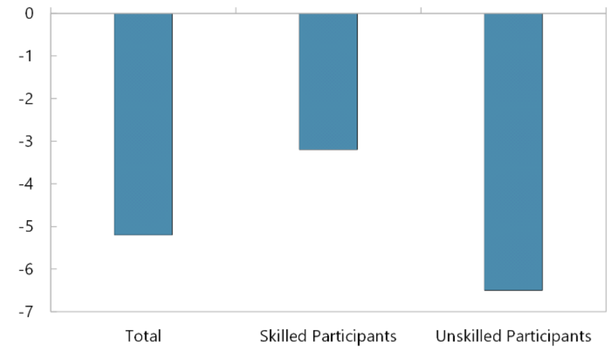
[5] Zhou, et al., "Emigration, Human Capital, and Growth in Pacific Island Countries", IMF Working Paper (forthcoming).

[6] The idea of PSM is to pair LMA participants with non-LMA participants with similar characteristics that drives migration decisions, and each LMA participant is matched with the nearest non-participant worker using the nearest neighbor matching procedure with replacement. For more discussion on the methodology of PSM, see Caliendo and Kopeinig (2008) and Abadie and Imbens (2016).

6. Policy measures can help mitigate the impact of labor emigration on human capital, while enhancing its benefits. The government could take measures to improve education access and quality of LMA participating families. Enhancing training would upgrade the skill levels and productivity of the workforce. Improving immigration policies could facilitate the recruitment of skilled workers and promote skill transfers thereby offsetting the outflow of workers. Over the medium term, the government needs to further improve business environment and create investment opportunities for returning labor.

Impact of LMA Participation on Education Enrollment

(In percent)



Source: IMF staff calculations.

Conclusions

7. Emigration has brought significant economic benefits to Tonga through remittances. However, the recent increase in labor emigration poses challenges to domestic labor supply and human capital. In particular, skill upgrade from labor migration appears limited, while emigration could affect child education enrolment. To mitigate the impact of labor emigration on human capital, the government should improve education access and quality, enhance training to upskill the workforce, and improve immigration policies to recruit foreign skilled workers. In addition, improving the business environment could attract returning labor and create more investment opportunities.

Annex VIII. Financial Deepening in Tonga

Financial deepening in Tonga remains limited, constraining private sector growth and broader economic development. This Annex explores why credit intermediation has stagnated since the global financial crisis, despite some reforms and strong remittance inflows. Key findings point to structural bottlenecks in credit provision, limited competition, and the underutilized potential of remittances to support investment and financial inclusion. A deeper financial system would also enhance the central bank's ability to transmit monetary policy effectively and stabilize the economic activity and prices.

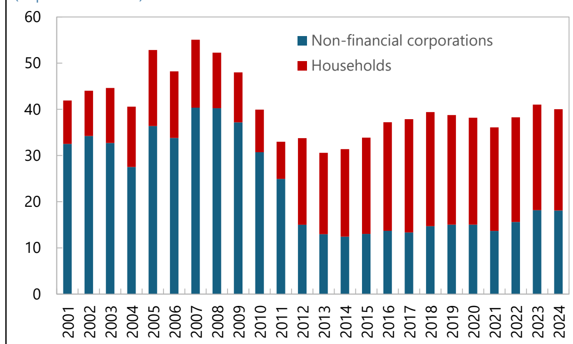
1. Financial deepening is often associated with sustainable and inclusive economic development, as higher-income countries tend to exhibit greater levels of financial depth. Empirical data show a strong positive correlation between financial depth and economic development across countries and over time. While the literature has not established a definitive direction of causality—whether economic growth drives financial development or vice versa—it does offer several lessons. First, enhanced financial services facilitate better mobilization of savings and more efficient allocation of resources, thereby promoting investment and economic expansion (Lavine, 2005). Second, improved access to diverse financial services enables individuals and businesses to invest in education, health, and enterprises, contributing significantly to poverty alleviation and reducing income disparities. (Bretton Woods Project WBG-IMF Annual Meeting Civil Society Policy Forum, 2022). Finally, a well-developed financial system provides various instruments for risk diversification, potentially bolstering economic stability.

2. Tonga is striving to make progress in financial development in recent years, supported by ongoing reforms aimed at promoting financial deepening and safeguarding financial stability. The National Reserve Bank of Tonga (NRBT) is advancing initiatives to enhance monetary operations and financial intermediation—for instance, by considering the issuance of short-term central bank notes to support interbank market liquidity. Efforts are also underway to amend the NRBT Act to strengthen transparency and the effectiveness of monetary policy. The financial sector mainly comprises four commercial banks—ANZ, the Tonga Development Bank (TDB, the only domestic bank), the Bank of South Pacific (BSP), and MBf Bank—operating under NRBT supervision. The NRBT conducts bank stress tests on a regular basis and continues to enhance prudential regulations to ensure resilience of its financial sector.

3. When financial depth is assessed through the lens of domestic credit to the private sector, Tonga's financial deepening seems to be stagnating. Notwithstanding the presence of four licensed banks operating in the country, credit extension remains subdued, with bank lending apparently constrained despite ample liquidity. A large share of bank reserves, indeed, remains parked at the central bank in non-remunerated excess balances, suggesting inefficiencies in the transmission of liquidity into credit. Prior to the 2007-08 global financial crisis (GFC), Tonga's private credit levels were broadly in line with the average of upper-middle-income countries (UMIC) and followed a comparable upward trajectory. However, post-2008, Tonga experienced a sustained decline and stagnation in private sector credit, in sharp contrast to the continued expansion observed among its upper-middle-income peers. The divergence is particularly stark: in 2007, Tonga's private sector credit lagged the UMIC average by only 6 percentage points of GDP, whereas by 2022, the gap had widened to 98 percentage points of GDP. A disaggregated analysis indicates that this stagnation has been primarily driven by a contraction in credit to firms, which declined from a peak of 39 percent of GDP in 2007 to approximately 20 percent in subsequent years. In contrast, household credit has shown gradual improvement, increasing from 13 percent of GDP in 2007 to 22 percent in 2024.

Credit to Private Sector

(In percent of GDP)

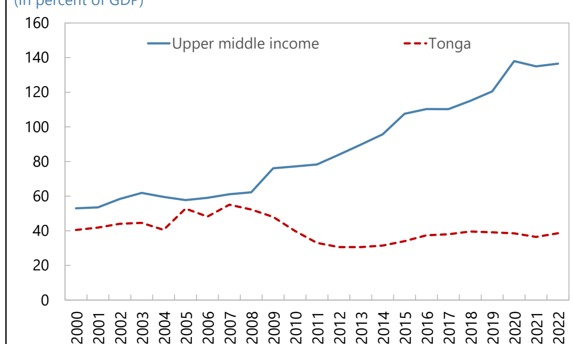


Source: IMF staff calculations.

4. Cross-country econometric analysis reinforces the view that financial deepening typically progresses alongside economic development, albeit in a non-linear fashion. This relationship is evident in trends in credit-to-GDP relative to per capita income in both PICs and other countries with historically comparable economic development levels. The pattern is confirmed also through formal empirical analysis. Using an unbalanced panel data set of 157 countries, with the longest data series going back to 1870, a relation between private credit-to-GDP and a polynomial in GDP per capita was estimated, controlling for time and country fixed effects.[1] Among the PICs with available data, this analysis has shown progress in financial deepening alongside improvements in GDP per capita (see Annex VIII. Table 1 and Appendix). Results highlight the strong positive relationship between credit-to-GDP and per capita income. They also support the presence of a Kuznets-curve non-linear relation (i.e., an S-curve) between the two variables, with the increase in credit-to-GDP levelling off and disconnecting from income growth as p.c. income crosses the 50,000 USD threshold.

Domestic Credit to Private Sector

(In percent of GDP)

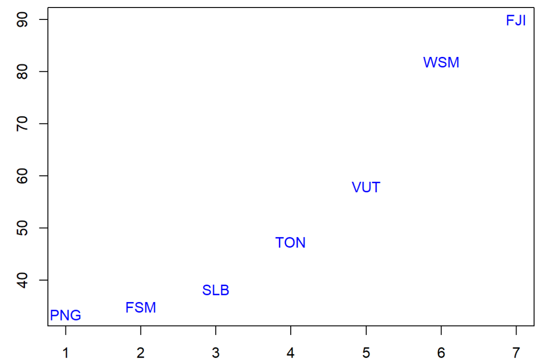


Source: World Bank's *World Development Indicators*.

[1] The long data series allows to exploit information on how financial deepening has historically behaved at different stages of the development process of today's advanced economies. See Bogmans et al. (2020) for a similar specification used to analyze energy demand.

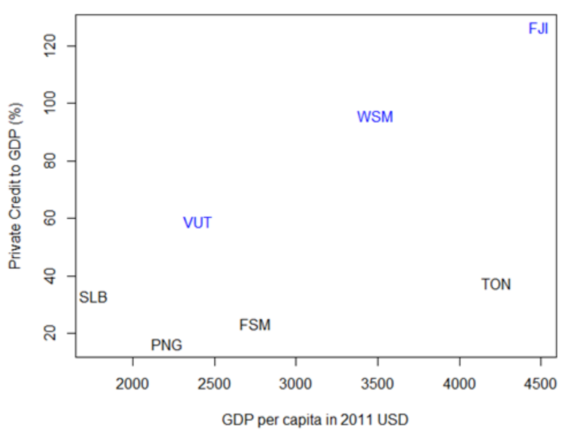
5. The empirical results from the panel show that while Tonga performs better than the global average, it underperforms compared to selected PIC best peers.[2] The distribution density of country fixed effects indicates that, compared to countries globally, including current advanced countries, and controlling for economic development by GDP per capita, Tonga is above the global average (chart). Compared to the historical performance of other countries, Tonga is comparable to India, Italy, and the USA when they were at the same income level; however, the level of financial deepening in Tonga is lower than that of three PIC countries with similar GDP per capita: Fiji, Samoa, and Vanuatu. Interestingly, these last three countries are tourism-based economies.

Country-Fixed-Effects in PICs
(in percent of GDP)



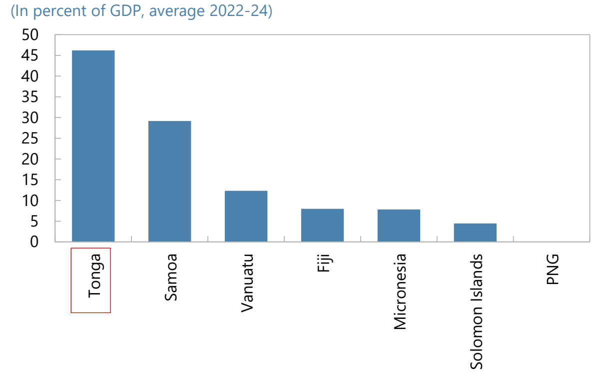
Source: Maddison; Schularick and Taylor, 2012; World Bank; and IMF staff calculations.
Note: The country-fixed-effects are from the estimates of Robustness 3 model in Table A1.

Private Credit vs. GDP per Capita in PICs



Source: Maddison; Schularick and Taylor, 2012; World Bank; and IMF staff calculations.
Note: Both the GDP per capita in 2011 USD and Private Credit to GDP represent the averages for 2011 and 2022. Countries with tourism-to-GDP ratios higher than 10 percent are highlighted in blue, including 19.8% in Fiji (2024), 21% in Samoa (2024), and 14% in Vanuatu (2023).

Remittances
(In percent of GDP, average 2022-24)



Source: IMF staff calculations.

[2] The country fixed effects in the panel regression can be interpreted as capturing country-specific characteristics that, beyond income levels, help explain differences in financial deepening —such as the strength of legal and regulatory frameworks, the quality of banking supervision, and structural features of the economy, including sectoral composition and economic diversification.

6. A comparative analysis against better PIC peers suggest that tourism and other service sectors have the potential to boost financial deepening in Tonga. Fiji, Samoa, and Vanuatu have similar or lower levels of economic development to Tonga but show higher financial development. The three best-performing countries in the region have in common a more developed tourism sector which typically involves FDI inflows.[3] The top peers also seem to enjoy lower economic informality rates, easier land alienation, a more competitive banking sector and a small public sector footprint (see Table 2). Furthermore, Tonga has relatively high remittances compared to best performing PICs: approximately 47 percent of GDP in Tonga, compared to 26 percent in Samoa, 10 percent in Vanuatu, and 8 percent in Fiji. (see Annex VIII Table 2 for a summary comparison). Thus, a natural hypothesis to test is, thus, whether remittances could crowd out bank lending, this will be explored next.

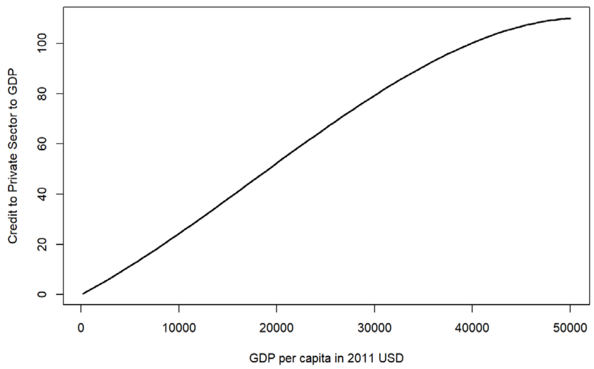
Annex VIII. Table 1. Tonga: Empirical Results of Panel Regressions

	(1) Baseline	(2) Robust 1	(3) Robust 2	(4) Robust 3	(5) Robust 4	(6) Robust 3 Quad.	(7) Robust 3 Log	(8) Robust 3 Tonga D
GDP per capita (p.c.)	2.5e-3**	3.4e-3**	2.3e-3**	2.1e-3**	2.01e-3**	3.4e-3**	365.8**	2.1e-3**
	(1.4e-4)	(1.6e-4)	(2.2e-4)	(2.8e-4)	(2.8e-4)	(1.6e-4)	(47.3)	(2.8e-4)
GDP p.c.^2	-2.8e-8**	-4.1e-8**	1.9e-8**	4.4e-8**	4.5e-8**	-2.0e-8**	-48.1**	4.4e-8**
	(2.6e-9)	(2.9e-9)	(6.6e-9)	(1.1e-8)	(1.1e-8)	(2.5e-9)	(5.5)	(1.1e-8)
GDP p.c.^3	9.9e-14*	1.5e-13*	-4.6e-13*	-8.3e-13*	-8.4e-13*	-	2.2**	-8.3e-13*
	(1.3e-14)	(1.4e-14)	(6.1e-14)	(1.4e-13)	(1.4e-13)	-	(0.21)	(1.4e-13)
α^{Tonga}	25.0**	37.5**	43.1**	47.4**	47.5**	49.8**	49.6**	
	(5.0)	(5.1)	(5.1)	(4.8)	(4.8)	(4.8)	(4.8)	
$\alpha^{Tonga}_{year\leq 2009}$								48.4**
								(5.2)
$\alpha^{Tonga}_{year\geq 2010}$								44.9**
								(6.6)
Country Fixed Effect	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year Fixed Effect	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Adjusted R Squared	0.80	0.81	0.81	0.82	0.82	0.82	0.82	0.82
Observations	8,157	7,747	7,397	7,182	7,081	7,182	7,182	7,182
No. of Countries	177	168	162	157	152	157	157	157
Model	OLS	OLS	OLS	OLS	OLS	OLS	OLS	OLS

Source: Maddison; Schularick and Taylor, 2012; World Bank; and IMF staff calculations.
Note: ** indicate 5% significant, the standard errors are robustness standard errors adjusting the heterogeneity. Baseline specification excludes: Azerbaijan, Congo, Croatia, Georgia, Kazakhstan, Panama, and South Sudan; Robust 1 specification excludes additional: Bahrein, Brunei, Equatorial Guinea, Guyana, Iran, Iraq, Kuwait, Libya, and Venezuela. Robust 2 specification excludes additional: Trinidad and Tobago, Qatar, Oman, Norway, Saudi Arabia, UAE. Robust 3 specification excludes additional financial centers: Cyprus, Macau SAR, Hong Kong SAR, Singapore, and Iceland. Robust 4 specification excludes additional countries with hyper-inflation episodes: Brazil and Zimbabwe. The Robust 3 Quad., Log, and Tonga D represent the model with only a quadratic term of GDP per capita, using logarithm-transformed GDP per capita as the right-hand-side variable, and differentiating the country fixed effect dummy for Tonga before and after the global financial crisis, respectively.

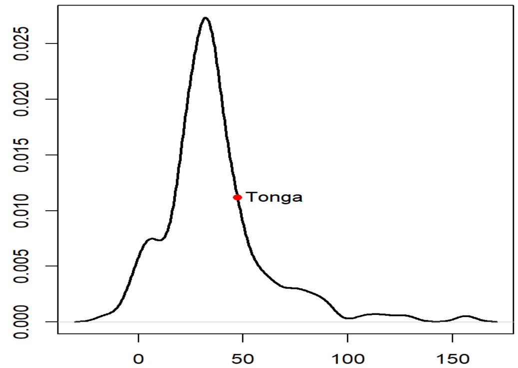
[3] Indeed, in 2024, Vanuatu, Fiji, and Samoa recorded net FDI *inflows* of 4 percent, 2 percent, and 0.4 percent of GDP, respectively, whereas Tonga experienced a net FDI *outflow* of 2 percent of GDP.

Private Credit Growth and Economic Development
(Fitted Panel Data Regression)



Sources: Maddison; Schularick and Taylor, 2012; World Bank; and IMF staff calculations.
Note: This is fitted by using the coefficient estimates of Robustness 3 model in Annex VIII. Table 1.

Country-Fixed-Effects Distribution Density
(in percent of GDP)

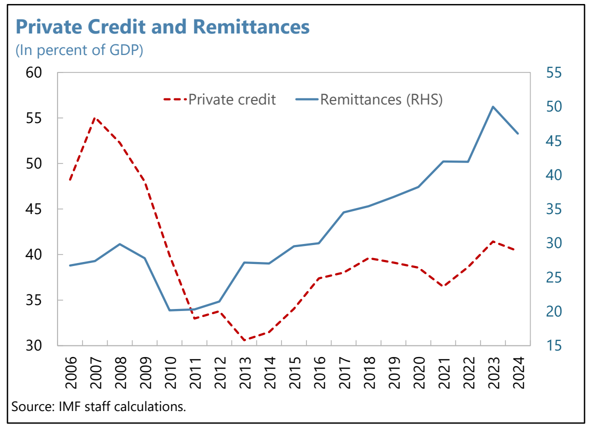


Sources: Maddison; Schularick and Taylor, 2012; World Bank; and IMF staff calculations.
Note: The country-fixed-effects are from the estimates of Robustness 3 model in Annex VIII. Table 1.

Annex VIII. Table 2. Tonga: Comparative Analysis of Financial Deepening Conditions: Tonga vs. Best PIC Peers

Conditions	Tonga	Best PIC Peers
Private sector formality	Lower: The private sector is smaller and less diversified, relying heavily on agriculture and remittances.	Higher: A more diversified economy with significant contributions from tourism and services.
Land as collateral	Difficult: Restricts land transactions and inheritance primarily to men, making it challenging to use land as a secure form of collateral for loans or other financial transactions.	Less difficult: , Foreign investors are allowed to purchase, sell, or lease freehold land for industrial or commercial purposes, facilitating its use as collateral.
Remittance use	Household consumption	More diversified
Bank competition	Low: The banking sector is relatively concentrated, with limited competition among a few commercial banks.	Moderate: The presence of multiple banks, including international ones, fosters a more competitive environment. Better financial system to channel the usage of remittance.
Public sector dominance*	Higher public expenditure and public wages	Lower public expenditure and public wages

Note: * For example, when measured by the ratio of total public expenditure to GDP, Tonga's public spending reached 49.7 percent of GDP in 2024, significantly higher than Samoa’s 29 percent in the same year. The best PIC peers include Fiji, Samoa, and Vanuatu.



7. Despite a strong rebound in remittances, private credit has remained persistently weak since the global financial crisis. Following the global financial crisis, Tonga experienced a divergence between subdued credit-to-GDP recovery and a sharp rebound in remittance inflows, with remittances 10 percentage points of GDP higher than the pre-GFC level, whereas private credit-to-GDP is around 15 percentage points lower than its pre-GFC level. Indeed, as shown in Annex VIII. Table 1, Tonga's country-fixed effect declined from 49 percent of GDP before the global financial crisis to 45 percent of GDP afterward, representing a 4-percentage point decrease.

8. Empirical analysis suggests that remittances support firm-level financial deepening, while household credit appears to attract remittances—highlighting differing implications for long-term growth. Exogenous increases in remittance inflows —such as those driven by stronger growth in destination countries—contribute to financial deepening *for firms*, while exogenous increases of household-level credit appears to crowd-in remittances (Annex VIII. Table 3). In fact, a Granger causality test using annual data from 2001 to 2024 indicates that remittances-to-GDP Granger-cause firm credit-to-GDP, suggesting that exogenous increases in remittance inflows may ease credit conditions—potentially through improved liquidity, stronger collateral positions, or by boosting bank deposits and, thus, credit supply. This procyclical relationship aligns with the panel data evidence for developing countries reported by Aggarwal et al. (2011). Conversely, credit extended to the household sector is found to Granger-causes remittances (but not vice versa), suggesting that growing household financing needs may draw higher remittance flows, possibly to support consumption smoothing or debt servicing. In other words, remittances behave countercyclically for households but procyclically for firms. If financial deepening in firms primarily supports investment, while household credit is primarily consumption-driven and associated with higher imports, then expanding firm credit is likely to be more supportive of long-term growth.[4]

[4] The remittance–investment channel in countries with less developed financial systems has been emphasized by Giuliano and Ruiz-Arranz (2009). Survey data suggest that remittances are mostly used for consumption (see Annex VIII). Businesses might aim to keep up with household consumption, which could lead to increased credit and, in turn, boost economic growth.

Annex VIII. Table 3. Tonga: Granger Causality Test Results: Remittances and Credit (2001–2024)

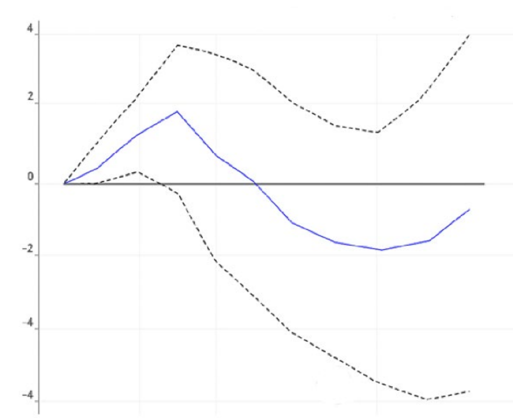
Causal Direction	Baseline p-value	Robustness p-value	Statistical Significance (Baseline / Robustness)
Credit (Household) → Remittances	0.02	0.004	Significant / Sig.
Remittances → Credit (Household)	0.12	0.79	Not Significant / Not Sig.
Credit (Firm) → Remittances	0.72	0.87	Not Significant / Not Sig.
Remittances → Credit (Firm)	0.003	0.003	Significant / Sig.

Sources: World Bank; IMF WEO dataset, and IMF staff calculations.
Note: Both series are expressed as a percentage of GDP, log-transformed, and detrended.

9. Leveraging remittances to support financial deepening in Tonga. The impulse response function indicates that a 1 percent increase in remittances leads to a peak positive response of approximately a 2 percent increase in private firm credit within 2 to 3 years. Thus, supporting policies to further harvest the benefits of remittance should be encouraged, including: (i) Encouraging automatic deposit of remittance inflows into savings or investment accounts; (ii) Promoting remittance-backed microloans using remittance history for credit assessment; (iii) Integrating remittance data into credit scoring frameworks; (iv) Supporting diaspora-financed community investment schemes; (v) Expanding financial literacy initiatives to shift behavior toward productive use of remittances.

Impulse Response Function

Impulse: Remittances; Response: Credit-to-Firms



Sources: World Bank; IMF WEO dataset, and IMF staff calculations.
Note: Both series are expressed as a percentage of GDP, log-transformed, and detrended.

10. Tonga may benefit from implementing measures that facilitate financial deepening. In conclusion, the relatively low level of financial deepening in Tonga today appears to reflect lasting scarring from the Global Financial Crisis (GFC) which affected credit supply persistently and was compounded by a sharp decline in remittances—likely exogenous shocks unrelated to domestic developments—which contributed to the initial contraction in firm credit.[5] While reversing this trend in the near term may be difficult, there are both general policy recommendations and Tonga-specific measures that could support financial deepening. General measures include the following. First, strengthening financial institutions by promoting competition in the banking sector to improve access and reduce borrowing costs, and encouraging banks to expand branches into underserved areas and supporting microfinance and cooperative institutions to extend credit to small-scale

[5] Frequent natural disasters—including Cyclone Winston in February 2016, Cyclone Gita in February 2018, Cyclone Harold in April 2020, and the tsunami caused by the Hunga Tonga–Hunga Ha'apai (HTHH) eruption in 2022—also contributed to the scarring.

borrowers (IMF, 2015). Second, enhancing credit information infrastructure by modernizing credit registries and bureaus—ensuring their comprehensive coverage, reliability, and secure data sharing across institutions—will help reduce lending risks. Third, modernizing legal and regulatory frameworks through improved collateral and insolvency frameworks can mitigate risks for lenders, while enhanced supervisory capacity and robust macroprudential policies help maintain financial stability. Strengthening anti-money laundering and combating the financing of terrorism frameworks is also essential. Lastly, developing capital markets, promoting financial literacy, enhancing financial inclusion, and ensuring robust consumer protection further support financial deepening efforts (World Bank, 2016). Additionally, and specifically to Tonga, the country should encourage the use of remittances to support private business investment, especially for small business owners. Furthermore, it is essential to develop a more conducive regulatory framework for lending, for example by facilitating the use of land or other property as collateral for loans (Annex VIII. Table 3) while expanding the supervisory oversight to encompass non-bank financial institutions, including retirement funds, could be a step toward greater financial system stability.

Conclusions

11. Tonga's financial sector remains shallow, with credit to the private sector stagnating well below peer levels, especially for firms. While remittances are sizable and resilient, they have not translated into broader financial deepening or increased formal credit. Weak competition, limited credit information, and risk-averse lending practices continue to hinder financial intermediation. Targeted reforms to strengthen credit infrastructure, promote competition, and better leverage remittance flows could help unlock private sector growth and improve the effectiveness of monetary policy transmission.

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Annex VIII. Appendix I. Financial Deepening in Tonga

1. The model is as below:

$$(1)\ Cred_{it} = \beta_0 + \beta_1 y_{it} + \beta_2 y_{it}^2 + \beta_3 y_{it}^3 + \gamma_t + \alpha_i A_i + \varepsilon_{it}.$$

2. Where $Cred_{it}$ represents the domestic credit to private sector in percent of GDP for country i and year t, y_{it} represents the logarithm of GDP per capita in 2011 USD, γ_t is the time effect dummy, and A_i is the country fixed-effect dummy. For the identification, the first year in the sample, 1870, and the first country, Aruba, are excluded. ε_{it} is the error term.

3. The data collection process entails utilizing the Maddison dataset for all countries, specifically focusing on GDP per capita in 2011 USD, as employed by both Bogmans et al. (2020) and Schularick and Taylor (2012). Given that some countries, such as Tonga, are not represented in the Maddison dataset, the World Bank's GDP per capita in 2015 USD has been used instead, with necessary conversions to 2011 USD to ensure comparability with Maddison data, utilizing U.S. data as the reference point since it encompasses both Maddison and World Bank datasets. Additionally, for private credit to GDP, reference have been made to Schularick and Taylor (2012), which provides insights over a longer horizon for advanced countries, beginning with GDP per capita around 2,500 USD, akin to Tonga's level in 1990. Furthermore, domestic credit to the private sector as a percentage of GDP for the other countries and years that Schularick and Taylor (2012) does not include, have been sourced from the World Bank. Finally, the two credit-to-GDP variables have been merged into a single dataset for the analysis.

Annex IX. Downside Scenario: Spillovers from Rising Global Trade Tensions

This annex quantifies the potential macroeconomic implications for Tonga under a hypothetical escalation of global trade tensions, building on the global downside scenario presented in the IMF's Spring 2024 World Economic Outlook (WEO, Box 1.1). The WEO scenario incorporates multiple layers of shocks—including higher tariffs, tighter financial conditions, elevated uncertainty, and weaker confidence—resulting in significant cumulative downgrades to global growth. To gauge the implications for Tonga, the scenario applies country-specific growth revisions aligned with the WEO downside assumptions. Specifically, Tonga's main trading and remittance partners are assumed to experience GDP downgrades of –1.30 percentage points in the United States, –0.58 in Australia and New Zealand, and –0.29 in Fiji in 2025, followed by –0.70 percentage points in the United States, –0.31 in Australia and New Zealand, and –0.16 in Fiji in 2026. These revisions are applied to estimate the indirect effects on Tonga through remittance inflows, tourism receipts, and energy import costs. Given Tonga's limited export exposure to the United States, the 10 percent reciprocal tariff is expected to have a negligible impact on GDP and is already built in the baseline.

1. Assumptions and Elasticities:

- ***Remittances*** account for a significant share of household incomes in Tonga. The elasticity of remittances to partner GDP growth is assumed to be 0.2, and the elasticity of consumption to remittances is 1. The distribution of remittances by partner country is estimated at 30 percent from the U.S., 30 percent from Australia and New Zealand, and 10 percent from Fiji.

- ***Tourism*** accounts for roughly 10 percent of GDP, with source markets evenly distributed among the U.S., Australia, and New Zealand. The elasticity of tourism receipts to source country GDP is assumed to be 1.

- ***Fuel imports***, primarily diesel, represent 22 percent of Tonga's total imports, equivalent to about 9 percent of GDP. Oil prices are assumed to fall by 10 percent in 2025 and 7.8 percent in 2026, in line with the global scenario assumptions where demand for oil falls. While the elasticity of consumption to oil prices is not precisely estimated, the decline in fuel prices is expected to have a positive impact on real incomes.

- ***Official grants*** are assumed to remain stable.

2. **Estimated** Spillover Effects:

- ***Remittances***: Applying the assumed elasticities and country weights, Tonga's remittance inflows are projected to decline by 0.146 percent of GDP in 2025 and 0.079 percent in 2026, reducing private consumption by an equivalent amount.

- ***Tourism***: With tourism source markets facing slower growth, tourism receipts are projected to fall by 0.087 percent of GDP in 2025 and 0.047 percent in 2026, assuming a proportional elasticity of 1.

- ***Diesel Prices***: The assumed decline in oil prices would provide some offset to these negative effects by lowering the cost of diesel imports—equivalent to a 0.9 percent of GDP boost in 2025 and 0.7 percent in 2026. This would support household purchasing power and reduce imported inflation.

- ***Net Impact on Growth:*** Combining the drag from weaker remittances and tourism with the offsetting boost from lower diesel prices, staff estimate that Tonga's GDP growth could be reduced by approximately 0.2 percentage points in FY2026 and 0.1 percentage point in FY2027 under the global downside scenario.

Annex IX. Table 1. Tonga: GDP Revision – Severe Downside Scenario

Channel	2025 (FY26)	2026 (FY27)
Remittances (% of GDP)	–0.13	–0.07
Tourism (% of GDP)	–0.06	–0.03
Oil price impact	Positive	Positive
Grants	No change	No change
Estimated total GDP impact	–0.25 ppt	–0.10 ppt

3. A combination of this downside scenario with a geopolitical-driven spike in oil prices would significantly complicate the NRBT's policy trade-offs, amplifying the challenge of balancing price stability with the need to support growth.

4. In addition, if official grants are affected due to the slowdown of Tonga's development partners, it will have negative impact of Tonga's growth outlook, fiscal revenue, and external positions. In the event of a decline in external grants, possible contingency measures could include reprioritizing and phasing public investment, enhancing domestic revenue mobilization, and identifying alternative sources of concessional financing. Building fiscal buffers in the near term would also serve as insurance against a potential drop in grant support.

INTERNATIONAL MONETARY FUND

TONGA

October 23, 2025

STAFF REPORT FOR THE 2025 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By | The Asia and Pacific Department
(In consultation with other departments)

CONTENTS

FUND RELATIONS

(As of September 5, 2025)

Membership Status: Joined September 28, 1981; Article VIII

General Resources Account:

	SDR Million	Percent Quota
Quota	13.80	100.00
Fund holdings of currency	10.36	75.1
Reserves tranche position	3.44	24.9

SDR Department:

	SDR Million	Percent Allocation
Net cumulative allocations	19.81	100.00
Holdings	18.94	95.60

Outstanding Purchases and Loans:

	SDR Million	Percent of Quota
RCF Loans	13.80	100.00

Latest Financial Arrangements:

Outright Loans

Type	Date of Commitment	Date Drawn/Expired	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
RCF	Jul 15, 2022	Jul 19, 2022	6.90	6.90
RCF	Jan 25, 2021	Jan 27, 2021	6.90	6.90

Projected Payments to the Fund[1]

(SDR million; based on existing use of resources and presenting holdings of SDRs)

	Forthcoming				
	2025	2026	2027	2028	2029
Principal		0.69	1.38	2.76	2.76

[1] When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

Charges/Interest	0.01	0.03	0.03	0.03	0.03
Total	0.01	0.72	1.41	2.79	2.79

Implementation of HIPC Initiative: Not applicable

Implementation of Multilateral Debt Relief Initiative: Not applicable

Implementation of Catastrophe Containment and Relief: Not applicable

Exchange Rate Arrangements

1. The currency of Tonga is the Tongan pa'anga. The de jure and de facto exchange rate arrangement is a pegged exchange rate within horizontal bands. The external value of the pa'anga is determined on the basis of a weighted currency basket comprising the U.S. dollar, New Zealand dollar, Fijian dollar and Australian dollar. The basket weights are determined based on the proportions of trade with trading partners. The exchange rate of the pa'anga in terms of the U.S. dollar, the intervention currency, is fixed daily by the National Reserve Bank of Tonga (NRBT) within a band of ±5 percent a month." Because the composite weights cannot be confirmed, the de facto exchange rate arrangement is classified as other managed. Tonga has accepted the obligations of Article VIII, Sections 2(a), 3 and 4 of the IMF's Articles of Agreement, and maintains an exchange system that is free of multiple currency practices and restrictions on the making of payments and transfers for current international transactions.

Safeguards Assessment

2. A first-time safeguards assessment of the NRBT completed in December 2021 found some key elements of the safeguards framework in place, including a tailored legal framework, external audits by an international firm, transparent financial statements, and basic operational controls. However, the prolonged absence of a functioning internal audit mechanism created a hiatus in the governance framework, exacerbated by vacancies at the Board-level. Since then, the Board has been fully reconstituted, an audit committee charter and an external auditor selection policy are in place, and the oversight of external audit has been strengthened. Going forward, the NRBT is advancing on the priority safeguards assessment recommendations, including drafting amendments to the NRBT Act, in consultation with IMF staff, to strengthen its autonomy and strengthening some key functions, including internal audit.

Article IV Consultation

3. Tonga is on a 12–month consultation cycle. The previous Article IV consultation was concluded on November 25, 2024 (Country Report No. 2024/326) reflecting discussions that took place between during August 12 and -August 24, 2025.

4. Technical Assistance: FAD, ICD, LEG, MCM, PFTAC, and STA have provided technical assistance on macroeconomic frameworks, revenue administration, banking supervision, AML/CFT, financial supervision, public financial management, debt management, government finance, and statistics.

5. Resident Representative: The IMF Regional Resident Representative Office based in Suva, Fiji covers 12 IMF member countries in the Pacific, including Tonga. Mr. Neil Saker is the current Resident Representative.

RELATIONS WITH OTHER INTERNATIONAL FINANCIAL INSTITUTIONS AND PACIFIC FINANCIAL TECHNICAL ASSISTANCE CENTER

Relations with other International Financial Institutions:

- Asian Development Bank:

https://www.adb.org/countries/tonga/main

- World Bank Group:

https://projects.worldbank.org/en/projects-operations/projects-summary?countrycode_exact=TO

Relations with Pacific Financial Technical Assistance Center (PFTAC):

- Pacific Financial Technical Assistance Center:

https://www.pftac.org/content/PFTAC/en1.html

INTERNATIONAL MONETARY FUND

TONGA

STAFF REPORT FOR THE 2025 ARTICLE IV CONSULTATION —DEBT SUSTAINABILITY ANALYSIS

October 23, 2025

Approved By
Lamin Y.M. Leigh, Bergljot Bjornson Barkbu (IMF), and Manuela Francisco and Lalita Moorty (IDA)

Prepared by the staff of the International Monetary Fund and the International Development Association

Joint Bank-Fund Debt Sustainability Analysis	
Risk of external debt distress	High
Overall risk of debt distress	High
Granularity in the risk rating	Sustainable
Application of judgment	Yes. Considering the expected significant breach over the extended projection horizon from FY2035 until FY2044 and the impact of natural disasters on debt dynamics.

The risk of debt distress rating for Tonga remains high.[1] Before the pandemic, public debt had gradually declined from FY2015[2] to FY2019 owing to much-needed fiscal consolidation. Since 2020, however, the economy has been hit by multiple shocks. In response, the international community provided significant financial support through grants, concessional loans, and debt service suspensions. Nevertheless, public debt rose to over 40 percent of GDP and remained elevated until FY2023. In FY2025, the public debt-to-GDP ratio is expected to decline to 31.5 percent, reflecting increased external debt repayments. At the same time, the fiscal deficit is expected to widen sharply in the coming years due to a gradual decline in grants under current commitments and continued spending needs related to the sustainable development goals (SDGs) and climate resilience. This will result in double-digit gross financing needs as a share of GDP annually from FY2026 onward. Debt service will remain elevated in FY2026 due to scheduled repayments to the China Exim Bank. Under the baseline scenario, the present value (PV) of the external debt-to-GDP ratio is expected to breach the high-risk threshold starting in FY2035, while the PV of public debt-to-GDP ratio is also expected to exceed its indicative threshold in the same year. Both debt burden indicators are projected to remain above their respective thresholds through 2044. A tailored, large natural disaster shock would further worsen debt sustainability. To rebuild fiscal buffers and enhance resilience to shocks, measures for stronger revenue mobilization and expenditure

[1] The Tonga Composite Indicator (CI) index, calculated based on the April 2025 World Economic Outlook (WEO) and the 2023 Country Policy and Institutional Assessment (CPIA), is at 3.09; hence, Tonga's debt carrying capacity classification remains "strong".

[2] All the figures are computed using fiscal year beginning in July, e.g., FY2024 runs from July 1, 2023, to June 30, 2024.

rationalization will be essential, together with continued donor support in line with historical trends.

PUBLIC DEBT COVERAGE

1. **Tonga's public debt includes obligations of the central government, local governments, other elements of the general government, and central bank**. The central bank's debt is borrowed on behalf of the government. Local governments do not incur debt, nor do other entities in the general government. As of end-December 2024, other government-guaranteed debt was small, about 1.2 percent of GDP. [3] Since the Debt Sustainability Analysis (DSA) coverage does not include debt of state-owned enterprises (guaranteed and non-guaranteed) due to data limitations, an additional 2 percent of GDP is added to the contingent liability test. Contingent liabilities also include a standard 5 percent of GDP cost to the government of a financial crisis, which is above the existing stock of financial sector NPLs.[4] The government has approved and published a revised guarantee policy and the new on-lending policy to improve contingent liabilities management, supported by the World Bank's FY25 SDFP in FY25. These measures could help mitigate fiscal risks associated with on-lending and guarantees. The DSA is conducted on a residency basis. The coverage is appropriate for the DSA but would be enhanced if the debt of SOEs were available.[5]

Text Table 1. Tonga: Public Debt Coverage

	Subsectors of the public sector	Sub-sectors covered
1	Central government	X
2	State and local government	X
3	Other elements in the general government	X
4	o/w: Social security fund	X
5	o/w: Extra budgetary funds (EBFs)	X
6	Guarantees (to other entities in the public and private sector, including to SOEs)	
7	Central bank (borrowed on behalf of the government)	X
8	Non-guaranteed SOE debt	

	The country's coverage of public debt	The general government, central bank			
1		Default		Used for the analysis	Reasons for deviations from the default settings
2	Other elements of the general government not captured in 1.	0	percent of GDP	1.1	
3	SoE's debt (guaranteed and not guaranteed by the government) 1/	2	percent of GDP	2.0	
4	PPP	35	percent of PPP stock	0.0	
5	Financial market (the default value of 5 percent of GDP is the minimum value)	5	percent of GDP	5.0	
	Total (2+3+4+5) (in percent of GDP)			8.1	

1/ The default shock of 2% of GDP will be triggered for countries whose government-guaranteed debt is not fully captured under the country's public debt definition (1.). If it is already included in the government debt (1.) and risks associated with SoE's debt not guaranteed by the government is assessed to be negligible, a country team may reduce this to 0%.

[3] The government has resumed the publication of the Quarterly Debt Bulletin, supported by the World Bank's FY24 Sustainable Development Finance Policy (SDFP) in FY24.The government-guaranteed debt is estimated to be about 1.2 percent of GDP at the end of December 2024, including 1.1 percent of GDP to private companies and 0.1 percent of GDP to public companies.

[4] Tonga does not have arrears to external creditors.

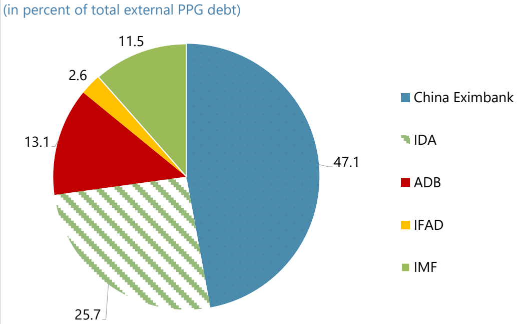
[5] The 1.1 percent other elements of the general government are to capture the $14.6 million government guarantee for private companies. With continued and timely debt publications on government guarantees, the DSA would consider extending public debt coverage to include guarantees instead of treating it as other elements of the general government.

BACKGROUND ON DEBT

2. **After rising modestly since FY2021, public debt level declined in FY2024**. The public debt-to-GDP ratio increased from 42.8 percent at end-June 2019 to 44 percent of GDP at end-June 2023 (chart) due to new issuance of domestic debt and the two concessional emergency loans under the IMF Rapid Credit Facility (RCF) in 2021 and 2022. The decline in external debt in FY2024, by 6.6 percentage points, is mainly due to the repayment of China Exim bank loan, supported by a fiscal surplus 4.2 percent of GDP in FY2024.[6] To contain unfavorable debt dynamics, the government's fiscal anchors (introduced in FY2018) limit total public external debt-to-GDP to a maximum of 50 percent. Tonga has not contracted any external non-concessional loans since FY2011, in line with their debt management strategy.

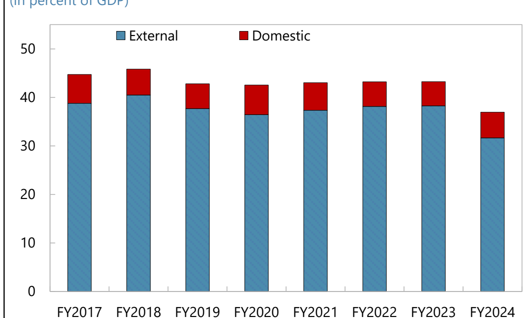
3. **Tonga's debt obligations are largely external, and less than half of its external public debt is to China, with a sharp spike in debt repayments in FY2024.** Total public and publicly guaranteed (PPG) external debt stood at USD157 million (about 32 percent of GDP) as of end-June 2024, accounting for 84 percent of total public debt. Outstanding debt to all multilateral creditors stood at USD83 million (about 17 percent of GDP), or about 53 percent of the total external debt stock. The single largest creditor remains the Export-Import Bank of China (China Exim Bank), which accounts for 47 percent of total external debt stock (chart).[7] Tonga started repayments to China Exim Bank in FY2019 with the peak repayment in FY2024, equivalent to 3 percent of GDP. The spike reflects both the previously extended grace period and the DSSI rescheduling. Tonga’s request for a temporary suspension of its calendar year 2020 and 2021 debt service to the China Exim Bank under the G20 Debt Service Suspension Initiative (DSSI) has been accepted and the rescheduled debt repayments are included in the baseline scenario (Text Table 2). Under the DSSI, debt deferral amounts to 1.4 percent of GDP in FY2021 and 0.7 percent of GDP in FY2022. The repayments to China Exim Bank have been resumed and are expected to remain elevated above 2 percent of GDP until FY2028. Debt service is projected to decline to 0.5 percent of GDP by FY2030 and will be fully repaid thereafter (Text Table 2).

Outstanding External PPG Debt by Creditor, June 2024
(in percent of total external PPG debt)



Source: Ministry of Finance.

Total Public and Publically Guaranteed Debt
(in percent of GDP)



Sources: Ministry of Finance; and IMF staff estimates.

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[6] Historical nominal GDP from FY2012 to FY2022 has been revised with support from PFTAC. The revision limits full comparability with the previous DSA. Projections of nominal GDP for FY25 and beyond have been revised upward by 2–3 percent, partly reflecting the historical nominal GDP revision.

[7] The loans from China Exim Bank are denominated in Chinese renminbi.

4. Tonga's domestic debt obligations are relatively small (Figure 5)**.** Public domestic debt stood at USD30 million (about 5.3 percent of GDP) at end-June 2024, accounting for 16 percent of total public debt. Domestic financial institutions hold about half of the total domestic debt with the rest held mainly by domestic pension funds. The authorities plan to issue TOP 30 million new domestic debt in FY2026 to support development. Following IMF technical assistance on monetary policy operations, the NRBT plans to issue notes with positive yield to support interbank market liquidity, which will allow the NRBT to raise the policy rate from its current zero level, the dollar value issuance is expected to be modest.

Text Table 2. Tonga: Repayment Schedule for Existing External Debt, FY2025–35

	FY2025	FY2026	FY2027	FY2028	FY2029	FY2030	FY2031	FY2032	FY2033	FY2034	FY2035
	(In percent of GDP)										
Total external debt	3.3	3.2	2.9	2.7	1.8	0.9	0.4	0.4	0.3	0.4	0.3
Multilateral	0.6	0.6	0.5	0.5	0.5	0.4	0.4	0.4	0.3	0.4	0.3
ADB	0.4	0.4	0.3	0.2	0.2	0.2	0.2	0.1	0.1	0.1	0.1
IDA/WB	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
IFAD 1/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
IMF	0.0	0.0	0.3	0.4	0.4	0.4	0.4	0.2	0.1	0.0	0.0
Bilateral	2.7	2.6	2.4	2.2	1.3	0.5	0.0	0.0	0.0	0.0	0.0
EXIM Bank of China	2.7	2.6	2.4	2.2	1.3	0.5	0.0	0.0	0.0	0.0	0.0

Sources: Ministry of Finance; and IMF staff estimates.
1/ Repayments are around 0.03 percent of GDP per year.

BACKGROUND ON MACROECONOMIC FORECASTS

5. The assumptions in the baseline scenario are consistent with the macroeconomic framework presented in the Staff Report for the 2025 Article IV consultation. The underlying structural factors have not meaningfully changed relative to the Staff Report for the 2024 Article IV consultation. The baseline projections reflect the authorities' commitments to undertake reforms to enhance growth and achieve Tonga's climate resilience and SDGs under Tonga Strategic Development Framework (TSDF) 2015–2025, which comprise: enhancing trade facilitation and access to credit; building more climate-resistant public infrastructure as envisaged in the National Infrastructure Plan; boosting domestic revenues, including through tax administration reforms and rationalization of tax exemptions; and containing the public sector wage bill within the fiscal target while strengthening social protection and targeted support for the vulnerable.

- **Real GDP growth is projected at 1.5 percent on average during FY2025–35** (Text Table 3). The economy has resumed activities following the impacts of the double shock in the form of COVID-19 and the HT-HH disaster, and recovery continues in FY2025 on account of stronger-than-expected grant inflows, elevated remittances, a rebound in tourism, and fiscal support for reconstruction. The higher-than-expected growth in FY25 extends into FY26-28, due to propagation effects. Over the medium to long term, GDP growth is projected to gradually converge to a potential rate of 1.2 percent, reflecting Tonga's high dependence on climate-sensitive sectors (agriculture, fisheries, and tourism), and exposure to increasingly frequent natural disasters, persistent loss of workers to emigration, and limited economies of scale due to geographical barriers[8].

- **The risks to the growth projections are tilted to the downside.** External risks stem from a steeper slowdown in global growth, escalating geopolitical tensions, and a possible reduction in concessional financing. Domestic risks include natural disasters, delays in ongoing reconstruction and donor-financed infrastructure projects, accelerated outmigration-which could exacerbate domestic price pressures-and a further loss of correspondent banking relationships (CBRs). Rising vulnerabilities in the banking sector also pose a downside tail risk. The upside risks include stronger tourism recovery and higher-than-expected grants.

- **Natural disaster**: The baseline scenario incorporates the effect of natural disasters and climate change mitigation and adaptation over the longer-term, as well as the recent progress in strengthening contingency planning through the ongoing implementation of the Tonga Disaster Risk Financing Strategy 2021 – 2025. Tonga developed an NDC Implementation Roadmap and Investment Plan in 2021 to achieve the targets of its Second NDC. This plan prioritizes mitigation and adaptation actions, specifically targeting the Agriculture, Forestry, and Other Land Use (AFOLU) sectors, waste sectors, Marine Protected Areas (MPAs), and Special Management Areas (SMAs). The plan is incorporated into the baseline and aligned with the Budget Statements. The years FY2025–FY2026 are assumed to be disaster-free to simplify the policy discussion of the near-term outlook. From FY2027 onwards, the baseline incorporates the average long-term effects of natural disasters by lowering annual GDP growth by 0.16 percentage points. These estimates are based on the findings of IMF staff analysis on the impact of natural disasters in Pacific Island countries.[9]

- **Inflation is projected to average 3.0 percent during FY2025–35** (Text Table 3). Inflation is expected to decrease to 2.2 percent of GDP in FY2026, lower than expected in DSA 2024, reflecting expected decrease in global food and fuel price. Afterwards, inflation is expected to increase and converge to 3.0 percent, similar to 2024 DSA.

- **The non-interest current account deficit is estimated to be 5.0 percent of GDP in FY2025, narrowed than projected in DSA 2024, owing to better-than-expected trade and service balances, which more than offset the lower remittances**. In the medium to long term, the non-interest current account deficit is projected to average 6.2 percent of GDP over FY2025–FY2035, reflecting persistent weakness in export competitiveness, continued heavy reliance on imports to support domestic demand, a return of remittances to pre-pandemic levels as share of GDP, and a reduction in official transfer inflows after current commitments are met (Text Table 3). Beyond FY2035, the export-to-GDP ratio is expected to gradually increase, reflecting

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[8] Discussions on the structural factors constraining Tonga's long-term growth can be found in the Tonga – Poverty and Equity Assessment 2024.

[9] Lee, D., H. Zhang and C. Nguyen, 2018, "The Economic Impact of Natural Disaster in Pacific Island Countries: Adaptation and Preparedness", the IMF Working Paper No. 18/108. The natural disaster scenario does not include sea level rise.

enhanced competitiveness and productivity in the service sector including tourism due to continued investment in climate resilience and infrastructure and trading partners' growth rates being higher than Tonga's.

- **Net FDI inflows** are expected to stand at 0.3 percent of GDP over FY2025–35.

Text Table 3. Tonga: Baseline Macroeconomic Projections
(In percent of GDP, unless otherwise stated)

Current DSA	FY2025	FY2026	FY2027	FY2028	FY2029	FY2030	FY2031	FY2032	FY2033	FY2034	FY2035	FY2014-24 Historical average	FY2025-35 average
Real GDP growth (in percent)	2.7	2.3	1.8	1.5	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.5	1.5
GDP deflator in US dollars (change in percent)	2.5	2.4	2.9	2.3	2.2	2.2	2.1	2.2	2.1	2.2	2.2	1.0	2.3
Inflation rate (GDP deflator, in percent)	2.9	2.2	3.2	3.2	3.2	3.2	3.2	3.2	3.0	3.0	3.0	3.6	3.0
Non-interest current account deficit	5.0	6.1	6.0	6.5	6.5	6.4	6.5	6.4	6.2	6.1	6.0	5.8	6.2
Net FDI (negative = inflow)	-0.2	-0.2	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	0.6	-0.3
Primary deficit	-6.1	7.3	7.8	9.2	10.4	12.0	12.0	12.9	11.4	11.0	10.4	-3.0	8.9
Government revenues	60.0	43.8	42.1	40.4	38.8	36.8	36.4	35.1	34.7	34.5	34.5	44.3	39.7
Government primary expenditure	53.9	51.0	49.9	49.6	49.3	48.8	48.3	48.0	46.1	45.6	44.9	41.4	48.7
Grants	32.0	16.9	15.3	13.5	11.9	9.9	9.1	7.8	7.1	6.5	0.0	19.9	12.4

Previous DSA	FY2025	FY2026	FY2027	FY2028	FY2029	FY2030	FY2031	FY2032	FY2033	FY2034	FY2035
Real GDP growth (in percent)	2.4	2.0	1.6	1.4	1.2	1.2	1.2	1.2	1.2	1.2	1.2
GDP deflator in US dollars (change in percent)	2.3	2.1	2.0	2.1	2.2	2.1	2.1	2.1	2.1	2.1	2.1
Inflation rate (GDP deflator, in percent)	3.2	3.0	2.8	2.9	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Non-interest current account deficit	7.5	7.5	7.0	6.8	6.7	6.7	6.7	6.6	6.4	6.1	6.0
Net FDI (negative = inflow)	0.7	0.7	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8
Primary deficit	7.5	9.1	9.4	9.9	11.3	11.1	11.6	11.8	11.0	9.4	7.9
Government revenues	41.5	38.9	37.1	35.5	33.6	33.1	31.9	31.3	30.8	31.2	31.9
Government primary expenditure	49.0	48.0	46.5	45.5	44.8	44.2	43.5	43.0	41.8	40.6	39.8
Grants	15.8	13.0	11.3	9.7	7.7	6.9	5.7	5.1	4.5	4.5	4.5

- **The baseline net investment in nonfinancial assets—averaging about 12 percent of GDP over FY2026–FY2035—reflects Tonga's SDGs and climate resilience goals.** It takes into account historical trends, recent momentum as reflected in the Budgets, and implementation capacity. New external debt is assumed to finance any needs not covered by revenue and grants in the baseline.

- **External borrowing**: The external debt in FY2025 is expected to be 27 percent of GDP, revised down from 38 percent of GDP in the 2024 DSA, mainly due to an upward revision of the primary balance from 7.5 to a surplus of 6.1 percent of GDP and an upward revision of 3.0 percent of nominal GDP. Except for the IMF's second RCF-supported financing (disbursed in July 2022), new external borrowing is expected to commence in FY2026 and to gradually increase over the medium term to refinance debt repayments coming due and the primary deficit that is expected to reach double digits over FY2029–2035. Even if the authorities were to rely on grants for their budget spending needs, under the baseline scenario, they would still need to borrow externally to meet their existing loan repayments while maintaining sufficient international reserves.[10] The

[10] All lending are assumed for all years in the projection period for which grant finance has not already been committed, consistent with "Guidance Note on the Bank-Fund Debt Sustainability Framework for Low-income

(continued)

level of international reserves, currently estimated at 10.5 months of next year's imports at end-FY2025, is expected to remain stable in the coming years despite the large repayments to China EXIM Bank that has started since FY2024 (annual payments of about 2.2 percent of GDP in FY2025–29 on average). The government is expected to be able to service the debt without facing a liquidity crunch, as debt repayment peaked in FY2024 and there is a higher-than-expected fiscal balance in FY2025. The authorities will continue to seek new concessional and grant financing commitments from bilateral donors and international financial institutions to contain external debt and to refrain from non-concessional borrowing (consistent with Tonga's compliance with a non-concessional external borrowing ceiling as part of the World Bank's Sustainable Development Finance Policy, SDFP). This commitment is reflected in the government's medium-term debt strategy, which is being used to guide fiscal policy and debt management decisions. The new public financial management (PFM) legislation, approved by the cabinet, is expected to further improve debt management. Both the debt strategy and PFM legislation are supported by the World Bank's SDFP.[11]

- **Domestic borrowing:** domestic debt financing is assumed to gradually increase to help meet financing needs, aiming to achieve the Medium-Term Debt Strategy (MTDS) target of 70 percent external concessional financing and 30 percent domestic financing in the long run, doubling from around 5 percent of GDP at end-FY2025 to 10 percent of GDP in FY2029. The authorities plan to issue an additional TOP 30 million government bonds to replenish Government Development Loans managed by TDB. Domestic debt is composed of treasury bonds with tenors ranging from 3 to 6 years. Banking system assets are about 100 percent of GDP. The projected increase in domestic debt financing would raise government securities by roughly 25 percent of bank assets over long term, which appears broadly feasible for the banking system to absorb. The planned market liquidity management, supported by NRBT note issuance and the main banks operating in Tonga, would facilitate the implementation of the transition.

- **Fiscal outlook:** The primary fiscal deficit in FY2025 has been revised to a surplus of 6.1 percent of GDP, from 7.5 percent of GDP in DSA 2024. The fiscal deficit is, however, expected to widen to 7.3 percent of GDP in FY2026, and then to double-digit during FY2029-FY2035 (Text Table 3). The upward revision from a deficit to a surplus in FY2025 was mainly driven by stronger-than-

Countries" (http://www.imf.org/en/Publications/Policy-Papers/Issues/2018/02/14/pp122617guidance-note-on-lic-dsf). Tonga, an IDA-only small island economy at high risk of debt distress, receives all IDA financing as grants. Tonga has fully utilized its IDA20 country allocation of SDR52.2m (US$69.8m). Tonga is eligible to access the Regional Window, Crisis Response Window, and Private Sector Window from the World Bank. The IDA loans are assumed to be on regular concessional credit terms for small economies starting from FY2029. The terms are 40-year maturity, 10-year grace period, 0.75 percent service charge. For other multilateral donors, new commitments from 2026 onwards are assumed to be on concessional loan terms. The discount rate used to calculate the net PV of external debt is the default value set at 5 percent.

[11] The Performance and Policy Action (PPA) for FY21 was cabinet approval of a medium-term debt strategy (covering fiscal years commencing FY21) which includes targets for external and domestic debt. The PFM bill is a PPA for FY22, FY23 and FY24, which outlines key fiscal responsibility principles to guide fiscal policy and a numerical limit on the stock of government guaranteed debt.

expected grant inflows and increased tax revenues due to solid economic performance.[12] The widened deficit in FY2026 is mainly due to the conservative assumption regarding grants recognition—only firmly committed and highly likely grants that do not change the risk rating are included in the projection (LIC DSF Guidance Note ¶37). The long-term deterioration is primarily due to lower grant inflows after existing commitments are met, as well as to sizable spending needs for covering infrastructure gaps and achieving climate resilience and SDGs. At the same time, domestic revenues are expected to improve over time, reflecting the authorities' ongoing efforts in revenue administration and tax arrears collection (see also Staff Report for further details). Public sector wage bills are estimated to temporarily drop below the fiscal target of 53 percent of domestic revenue in FY2025, thanks to stronger domestic revenues and slower public-sector vacancy refilling. However, the wage bill is expected to rise again and approach the threshold in FY2026. The fiscal deficit, as a share of GDP, is expected to narrow after FY2034, as capital spending needs moderate following the completion of the authorities' multi-year reconstruction program and the accumulation of climate- resilient capital over the next decade.

6. **The realism tools indicate that the primary balance projections are reasonable** (Figure 4). The fiscal forecasts between FY2025 and FY2027 are not overly optimistic as the projected three-year adjustment lies in the left section of the distribution of past adjustments of the primary fiscal deficit (Figure 4). The adjustment on the far end of the left section is mainly driven by the elevated grants in FY2025. The real growth forecast for FY2025 reflects a modest growth. The realism of projections for public and private investment rates and their contribution to real GDP could not be calculated due to the unavailability of private investment data. The main driver for external debt changes is current account and FDI and that for public debt changes is primary balance.

COUNTRY CLASSIFICATION AND DETERMINATION OF SCENARIO STRESS TESTS

7. **Tonga's debt-carrying capacity applied in the 2025 DSA remains strong**. Tonga's Composite Indicator (CI) index, which has been calculated based on the April 2025 WEO and the 2023 CPIA is 3.09. The current CI score implies "strong" debt-carrying capacity. [13]Thus, Tonga's debt-carrying capacity classification remains "strong.

[12] Compared to the 2024 DSA, total revenue projections for FY2026 and onward have been revised upward by 4–5 percent of GDP, reflecting the momentum from record-high grants in FY2025. To mitigate the impact of this assumption, macro projections are based on the primary balance excluding grants and on information from authorities about key infrastructure projects. Hence, higher grants mainly decrease financing needs, while macro indicators remain unaffected.

[13] The CI must be greater than 3.05 to be assessed as strong.

8. **Given the severity and frequency of natural disasters in Tonga, a tailored one-time stress test for natural disaster shocks was conducted.**[14] As a small developing state prone to natural disasters, Tonga is automatically subject to the standard natural disaster shock in the DSA. The Emergency Events Database (EM-DAT) shows that the country's largest damage from natural disasters during 1980–2016 was 28.2 percent of GDP. Since only part of the economic damage is expected to be financed by external debt, the DSA assumes a one-off shock of 14 percentage points (ppts) to the debt to-GDP ratio in FY2026. Real GDP growth and exports are lowered by 3 and 7 ppts, respectively, in the year of the shock (Lee et al., 2018). The Catastrophe Deferred Drawdown Option by the World Bank can help mitigate the impacts of natural disaster shocks.

Text Table 4. Tonga: Composite Indicator and Threshold Tables

Final	Classification based on current vintage	Classification based on the previous vintage	Classification based on the two previous vintages
Strong	Strong 3.09	Strong 3.06	Strong 3.05

Calculation of the CI Index

Components	Coefficients (A)	10-year average values (B)	CI Score components (A*B) = (C)	Contribution of components
CPIA	0.39	3.45	1.33	43%
Real growth rate (in percent)	2.72	1.25	0.03	1%
Import coverage of reserves (in percent)	4.05	57.96	2.35	76%
Import coverage of reserves^2 (in percent)	-3.99	33.60	-1.34	-43%
Remittances (in percent)	2.02	15.49	0.31	10%
World economic growth (in percent)	13.52	2.98	0.40	13%
CI Score			3.09	100%
CI rating			Strong	

Applicable thresholds

APPLICABLE	
EXTERNAL debt burden thresholds	
PV of debt in % of	
Exports	240
GDP	55
Debt service in % of	
Exports	21
Revenue	23

APPLICABLE	
TOTAL public debt benchmark	
PV of total public debt in percent of GDP	70

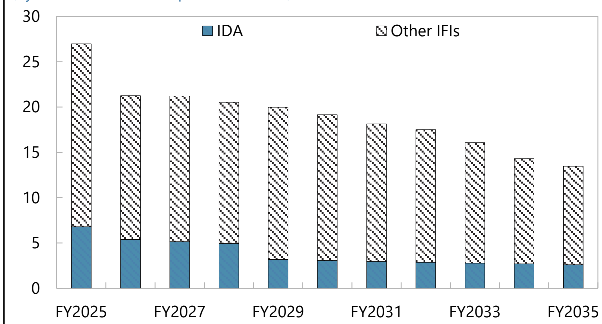
EXTERNAL DEBT SUSTAINABILITY ANALYSIS

[14] All the standardized stress tests (i.e., growth shock, export shock, combination shock, historical scenario) are described in Table 8 of the new "Guidance Note on the Bank-Fund Debt Sustainability Framework for Low-income Countries" (http://www.imf.org/en/Publications/Policy-Papers/Issues/2018/02/14/pp122617guidance-note-on-lic-dsf).

9. Judgment has been applied to reflect long-run, climate-related risks. Threshold breaches beyond the ten-year horizon for the mechanical signal reflect Tonga's vulnerability to natural disasters and the effects of climate change on debt dynamics.

Projected External Net Financing Flows

(By official creditors, in percent of GDP)



Sources: IMF Staff Projections

Note: net financing flows are calculated as grants plus new debt disbursement minus repayment

10. Under the baseline scenario, PV of external debt-to-GDP ratio will breach its threshold starting from FY2035 (Figure 1 and Table 3). In the near term, the external debt-to-GDP ratio is expected to decline from 32 percent in FY2024 to 27 percent in FY2025, reflecting large repayments to China Exim Bank. From FY2026 onwards, Tonga will need to incur new external debt to help finance its large spending needs to achieve SDGs and climate resilience. As a result, external debt-to-GDP ratio will breach the authorities' fiscal anchor of 50 percent in FY2029. The PV of the external debt-to-GDP ratio is expected to breach the threshold of 55 percent starting from FY2035. Grants surprised to the upside in FY25 remaining at record-high levels following the HT-HH disaster. In absence of major shifts in underlying structural factors, this upside forecast revision in grants has shifted the breaching of the threshold by one year from FY2034 (as reported in the 2024 Staff Report) to FY2035. The breach is not a single one-off event as external debt will continue to rise substantially until the end of the projected horizon in FY2045, with high probability in absence of policy corrections (Table 1). Under an export shock, which is the most extreme scenario, the PV of external debt-to-GDP ratio would breach the threshold earlier in FY2033.

11. The tailored natural disaster shock would significantly worsen the external debt path (Table 3). The PV of external debt-to-GDP ratio would jump up in FY2026 when the one-off shock is assumed, breaching the threshold two years earlier in FY2033. Given recent experience, there is a significant possibility that multiple severe natural disasters could occur within a ten-year timeframe. Multiple natural disasters could have a larger cumulative negative effect on external debt sustainability due to larger reconstruction needs (which may require additional debt financing) and also by lowering the long-term growth.

PUBLIC DEBT SUSTAINABILITY ANALYSIS

12. Under the baseline scenario, the PV of the public debt-to-GDP ratio would breach 70 percent from FY2035 onwards (Figure 2). The public debt dynamic is driven by large primary fiscal deficit, as shown in Figure 3. Compared to the previous DSA, nominal public debt-to-GDP ratio is lower from FY2025 onward due to higher-than-expected grants received in FY2025. The domestic debt is expected to increase to help finance large spending needs to achieve SDGs and climate resilience, and to move toward the MTDS long-term domestic debt financing target share of 30 percent (Figure 5).

13. The standardized sensitivity analysis indicates an earlier breach of debt threshold (Figure 2, Table 4).[15] The most extreme shock scenario is the growth shock, where growth rate is one standard deviation below the baseline for two years starting from 2026. The breach is not a single one-off event as public debt will continue to rise until FY2045 (Table 2). The PV of the public debt-to-GDP ratio would cross 70 percent of GDP in FY2032 under a multi-year GDP growth shock and breach the threshold in FY2033 under an exports shock.

14. The tailored one-time natural disaster shock worsens public debt. The PV of the public debt-to-GDP ratio would cross 70 percent of GDP in FY2033, two years earlier than in the baseline scenario.

15. A tailored stress test for the combined contingent liability shock also causes a deterioration in public debt sustainability. The trajectory of the PV of the public debt-to-GDP ratio shifts upwards by 4 percentage points in FY2035 from the baseline.

RISK RATING AND VULNERABILITIES

16. Tonga's risk of external debt distress is assessed as high. The analysis using the LIC debt sustainability framework (DSF) indicates a "moderate" mechanical risk rating for external debt distress. However, under the baseline scenario, the PV of the external debt-to-GDP ratio is expected to breach its indicative threshold from FY2035 until the end of the projection horizon in FY2045, due to a sustained and persistent increase in the external debt ratio over this period because of high financing needs to address risks from climate change in the long term. As the breaches are expected to be large and persistent, despite with strong foreign reserve, resulting in significant differences relative to historical averages, and occur with a high probability in the absence of a major policy correction, staff applied judgement and assessed the risk rating of external debt distress as "high."

17. The overall risk of debt distress is also assessed as high. The analysis using the LIC DSF indicates a "moderate" mechanical rating. However, the PV of the public debt-to-GDP ratio is projected to breach its indicative benchmark from FY2035 until FY2045, reflecting both large investment needs and decreasing capital grant commitments over this period.[16] Considering the expected significant breach over this extended projection horizon, together with the average long-term effects of natural disasters on Tonga's growth and fiscal position, staff assess the risk rating of the overall debt distress as "high."

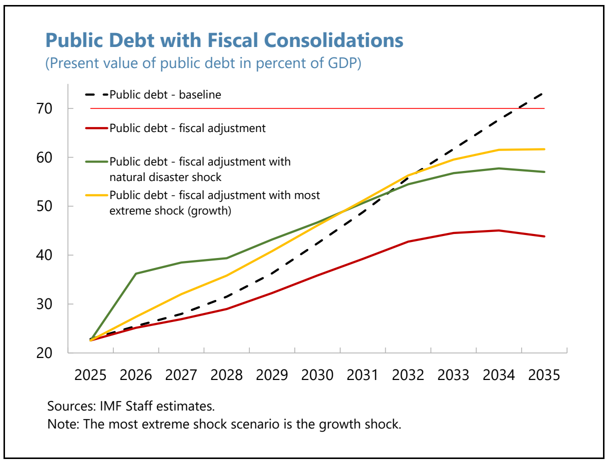
18. The expansionary fiscal stance in FY2025 has appropriately supported the recovery, but with the economy on stronger footing, it will be important to continue building buffers to hedge against downside risks. Fiscal policy should focus on building fiscal buffers while supporting

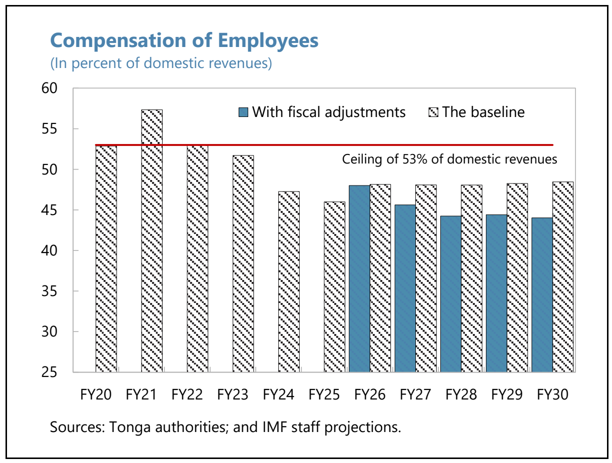
[15] Real GDP growth (in USD) is set to its historical average minus one standard deviation or the baseline projection minus one standard deviation, whichever is lower in the second and third years of the projection period.

[16] Cash and in-kind grants averaged 16.0 percent of GDP annually over FY2011–2019. Under the baseline, staff assume continued budget support in line with historical levels and capital grants falling to zero from FY2036 onwards.

vulnerable households. On the other hand, current spending, especially the recurrent portions such as public sector wages and use of goods and services, should be contained to preserve fiscal buffers.

19. A medium-term credible fiscal consolidation and new grant commitments are essential to put Tonga's debt on a sustainable path. Under an illustrative fiscal adjustment scenario, the PV of public debt-to-GDP ratio could stabilize below the 70 percent threshold over the long term, even with the natural disaster or the most extreme shock. The fiscal adjustments could include an improvement in consumption tax collection compliance and reductions in tax exemptions and current spending. New grant commitments consistent with the historical trends are also essential under this fiscal path to fund capital investment projects for SDGs and climate resilience.[17] The government's strategy to further improve revenue administration, streamline tax exemptions, collect tax arrears, improve spending efficiency including containing public wage bill within the fiscal target, and pursue additional grants from development partners[18] and avoid any new non-concessional borrowing from external creditors, supported by the development partners, is aligned with this fiscal adjustment path and feasible considering Tonga's strong policy track record in the run up to the global pandemic.





[17] The amount of grants declines over time in the baseline scenario since it only includes firmly committed or highly likely grants, in line with the LIC DSA guidance note. Given the authorities' prudent fiscal policies in the past and various reform initiatives supported by development partners, public debt can feasibly be put on a sustainable path.

[18] The additional grants are to maintain grants above 10 percent of GDP, with a high probability of materializing, as this is still well below the average of 16.0 percent of GDP annually over FY2011–2019.

Text Table 5. Tonga: Costing of Fiscal Adjustments

(In percentage points of GDP)

	FY2027	FY2028	FY2029	FY2030	FY2031	FY2032	FY2033	FY2034	FY2035
Baseline primary balance	-7.8	-9.2	-10.4	-12.0	-12.0	-12.9	-11.4	-11.0	-10.4
Proposed primary balance	-6.4	-6.8	-8.0	-8.0	-7.2	-7.3	-4.6	-2.3	0.4
Domestic Consolidation needed	1.4	2.4	2.4	2.7	2.8	2.8	3.3	4.2	4.8
Contribution from tax revenue	0.8	0.8	0.8	1.1	1.2	1.2	1.7	2.4	2.8
Improved consumption tax 1/	0.3	0.3	0.3	0.3	0.4	0.4	0.4	0.6	0.7
Less tax exemptions 2/	0.5	0.5	0.5	0.8	0.8	0.8	1.3	1.8	2.1
Contribution from current spending	-0.6	-1.6	-1.6	-1.6	-1.6	-1.6	-1.6	-1.8	-2.0
Lower G&S	-0.3	-0.9	-0.9	-0.9	-0.9	-0.9	-0.9	-1.1	-1.2
Lower public sector wage bill	-0.3	-0.7	-0.7	-0.7	-0.7	-0.7	-0.7	-0.7	-0.8
Additional Grants 3/	0.0	0.0	0.0	1.3	2.0	2.8	3.5	4.5	6.0

Source: IMF staff projections.

1/ For reference IMF (SR, 2023) estimates that the potential revenue impact from such reform for Tonga at about 6.2 percent of GDP.

2/ For reference IMF (SR, 2021) estimates that an additional 2.5 percent of GDP in tax revenues could be collected by removing various tax exemptions.

3/ The additional grants are to maintain the grants above 10 percent of GDP.

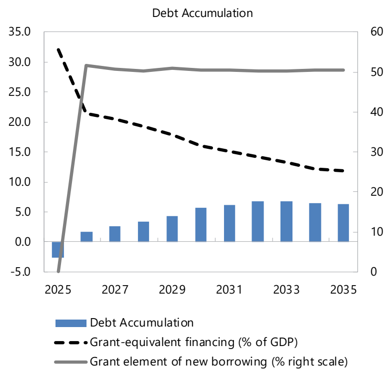
AUTHORITIES' VIEWS

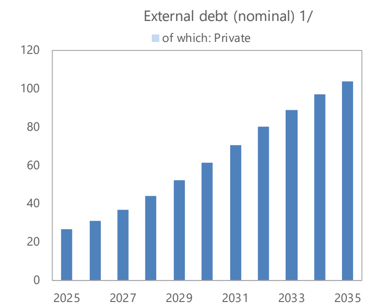
20. The authorities concurred the need for fiscal adjustment to build buffers and emphasized the importance of sustained support from development partners. They highlighted progress and achievement in revenue mobilization and tax administration, including the removal of consumption tax exemptions for the tourism sector, continued implementation of the Electronic Sales Register System, and enhanced compliance through third-party data verification. The savings in the wage bill relative to the originally budgeted amount, however, are mainly attributable to slower-than-expected vacancy refilling. The authorities also underscored their commitment to securing new grant financing from development partners to support climate resilience and development objectives—particularly in the context of heightened uncertainty—while ensuring that debt remains on a sustainable trajectory.

Table 1. Tonga: External Debt Sustainability Framework, Baseline Scenario, FY2022–2045
(In percent of GDP, unless otherwise indicated)

	Actual			Projections								Average 8/	
	2022	2023	2024	2025	2026	2027	2028	2029	2030	2035	2045	Historical	Projections
External debt (nominal) 1/	38.2	38.3	31.7	26.6	31.0	36.9	44.0	52.0	61.3	103.9	154.7	38.6	62.9
of which: public and publicly guaranteed (PPG)	38.2	38.3	31.7	26.6	31.0	36.9	44.0	52.0	61.3	103.9	154.7	38.6	62.9
Change in external debt	0.8	0.1	-6.6	-5.0	4.4	6.0	7.0	8.1	9.3	7.0	4.4		
Identified net debt-creating flows	6.2	6.8	-1.7	4.2	5.5	5.5	6.0	6.1	6.0	5.7	3.9	6.1	5.7
Non-interest current account deficit	5.0	5.4	3.5	5.0	6.1	6.0	6.5	6.5	6.4	6.0	4.2	5.8	6.2
Deficit in balance of goods and services	52.2	56.6	49.0	50.7	50.1	50.0	50.0	49.7	49.3	48.6	47.9	46.1	49.5
Exports	11.6	18.8	21.4	21.8	22.0	22.3	22.5	22.8	23.1	24.0	25.6		
Imports	63.8	75.4	70.4	72.5	72.1	72.3	72.6	72.5	72.4	72.6	73.4		
Net current transfers (negative = inflow)	-41.0	-40.9	-35.4	-36.0	-34.4	-34.6	-34.4	-34.2	-34.0	-33.3	-34.1	-34.3	-34.1
of which: official	-4.8	-4.5	-3.9	-5.3	-3.6	-3.9	-3.9	-3.9	-3.9	-3.9	-5.0		
Other current account flows (negative = net inflow)	-6.2	-10.3	-10.2	-9.7	-9.6	-9.4	-9.2	-9.0	-9.0	-9.2	-9.6		
Net FDI (negative = inflow)	0.5	0.7	-2.4	-0.2	-0.2	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	0.6	-0.3
Endogenous debt dynamics 2/	0.7	0.7	-2.8	-0.6	-0.3	-0.2	-0.2	-0.1	-0.1	-0.1	0.0		
Contribution from nominal interest rate	0.3	0.5	0.3	0.2	0.3	0.3	0.4	0.4	0.5	1.1	1.7		
Contribution from real GDP growth	0.9	-0.8	-0.7	-0.8	-0.6	-0.5	-0.6	-0.5	-0.6	-1.1	-1.8		
Contribution from price and exchange rate changes	-0.5	1.0	-2.4	...	...	...	...	...	...	...	...		
Residual 3/	-5.4	-6.7	-4.9	-9.3	-1.2	0.5	1.1	2.0	3.3	1.4	0.5	-7.2	0.9
of which: exceptional financing	-0.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Sustainability indicators													
PV of PPG external debt-to-GDP ratio	...	...	21.5	17.9	18.8	20.4	22.9	26.3	30.9	55.6	89.8		
PV of PPG external debt-to-exports ratio	...	...	100.5	82.4	85.3	91.6	101.5	115.4	134.0	231.7	351.1		
PPG debt service-to-exports ratio	12.2	11.7	17.9	16.2	15.7	15.8	15.1	11.5	8.2	7.4	17.2		
PPG debt service-to-revenue ratio	5.4	8.3	14.6	12.6	12.9	13.1	12.6	9.8	7.1	6.3	15.3		
Gross external financing need (Million of U.S. dollars)	35.7	42.9	27.4	49.2	57.3	59.4	64.0	61.0	57.2	63.4	98.6		
Key macroeconomic assumptions													
Real GDP growth (in percent)	-2.3	2.1	2.1	2.7	2.3	1.8	1.5	1.2	1.2	1.2	1.2	1.5	1.5
GDP deflator in US dollar terms (change in percent)	1.5	-2.4	6.6	2.5	2.4	2.9	2.3	2.2	2.2	2.2	2.2	1.0	2.3
Effective interest rate (percent) 4/	0.9	1.3	0.9	0.7	1.1	1.1	1.0	1.0	1.1	1.2	1.2	1.4	1.1
Growth of exports of G&S (US dollar terms, in percent)	3.2	61.6	24.3	6.9	6.0	6.1	5.1	4.7	4.5	4.1	4.0	8.6	4.9
Growth of imports of G&S (US dollar terms, in percent)	9.8	17.8	1.6	8.3	4.3	5.0	4.2	3.3	3.3	3.5	3.5	4.7	4.1
Grant element of new public sector borrowing (in percent)			20.1	...	51.6	50.8	50.3	50.9	50.5	50.4	49.2	...	50.6
Government revenues (excluding grants, in percent of GDP)	25.9	26.3	26.3	28.0	26.9	26.9	26.9	26.9	27.0	28.1	28.8	24.5	27.3
Aid flows (in Million of US dollars) 5/	269.6	305.7	303.4	307.9	243.0	222.9	198.3	176.8	158.4	124.0	132.7	...	
Grant-equivalent financing (in percent of GDP) 6/	18.4	28.0	29.2	32.0	21.5	20.5	19.2	17.8	16.1	11.9	10.9	...	17.6
Grant-equivalent financing (in percent of external financing) 6/	100.0	100.0	100.0	100.0	83.4	80.1	77.3	75.7	72.5	68.8	64.2	...	76.0
Nominal GDP (Million of US dollars)	515	513	558	587	616	645	670	693	717	846	1,183		
Nominal dollar GDP growth	-0.9	-0.4	8.8	5.3	4.8	4.8	3.9	3.4	3.4	3.4	3.4	2.5	3.9
Memorandum items:													
PV of external debt 7/	...	...	21.5	17.9	18.8	20.4	22.9	26.3	30.9	55.6	89.8		
In percent of exports	...	...	100.5	82.4	85.3	91.6	101.5	115.4	134.0	231.7	351.1		
Total external debt service-to-exports ratio	12.2	11.7	17.9	16.2	15.7	15.8	15.1	11.5	8.2	7.4	17.2		
PV of PPG external debt (in Million of US dollars)			120.2	105.4	115.7	131.7	153.3	182.5	221.7	470.6	1061.6		
(PVt-PVt-1)/GDPt-1 (in percent)				-2.6	1.7	2.6	3.3	4.4	5.7	6.3	6.1		
Non-interest current account deficit that stabilizes debt ratio	4.2	5.3	10.1	10.0	1.7	0.1	-0.6	-1.6	-2.9	-1.0	-0.2		

Definition of external/domestic debt	**Residency-based**
Is there a material difference between the two criteria?	**Yes**





Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.

2/ Derived as $[r - g - \rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, ρ = growth rate of GDP deflator in U.S. dollar terms, Ɛ=nominal appreciation of the

3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.

4/ Current-year interest payments divided by previous period debt stock.

5/ Defined as grants, concessional loans, and debt relief.

6/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

7/ Assumes that PV of private sector debt is equivalent to its face value.

8/ Historical averages are generally derived over the past 10 years, subject to data availability, whereas projections averages are over the first year of projection and the next 10 years.

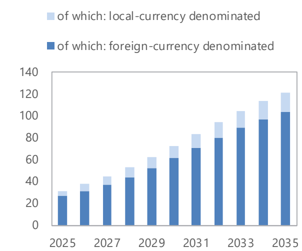
Table 2. Tonga: Public Sector Debt Sustainability Framework, Baseline Scenario, FY2022–2045

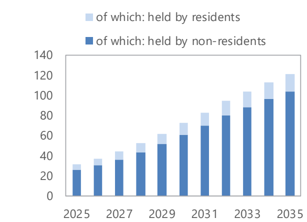
(In percent of GDP, unless otherwise indicated)

	Actual			Projections								Average 6/	
	2022	2023	2024	2025	2026	2027	2028	2029	2030	2035	2045	Historical	Projections
Public sector debt 1/	**43.8**	**43.8**	**37.0**	**31.5**	**37.7**	**44.5**	**52.7**	**62.0**	**72.8**	**121.5**	**179.9**	**44.4**	**74.4**
of which: external debt	**38.2**	**38.3**	**31.7**	**26.6**	**31.0**	**36.9**	**44.0**	**52.0**	**61.3**	**103.9**	**154.7**	**38.6**	**62.9**
Change in public sector debt	0.8	0.0	-6.9	-5.4	6.2	6.8	8.1	9.4	10.8	8.2	5.0		
Identified debt-creating flows	**1.4**	**-6.3**	**-7.9**	**-7.4**	**6.5**	**7.0**	**8.3**	**9.6**	**11.0**	**8.7**	**8.2**	**-3.4**	**7.8**
Primary deficit	**-0.4**	**-6.8**	**-4.6**	**-6.1**	**7.3**	**7.8**	**9.2**	**10.4**	**12.0**	**10.4**	**8.4**	**-3.0**	**8.9**
Revenue and grants	44.3	54.3	55.5	60.0	43.8	42.1	40.4	38.8	36.8	34.5	33.8	**44.3**	**39.7**
of which: grants	18.4	28.0	29.2	32.0	16.9	15.3	13.5	11.9	9.9	6.4	5.0		
Primary (noninterest) expenditure	43.9	47.5	50.9	53.9	51.0	49.9	49.6	49.3	48.8	44.9	42.2	**41.4**	**48.7**
Automatic debt dynamics	**1.8**	**0.5**	**-3.3**	**-1.3**	**-0.8**	**-0.8**	**-0.9**	**-0.9**	**-1.0**	**-1.7**	**-0.2**		
Contribution from interest rate/growth differential	0.8	-0.8	-1.4	-1.3	-0.8	-0.8	-0.9	-0.9	-1.0	-1.7	-0.2		
of which: contribution from average real interest rate	-0.2	0.1	-0.5	-0.3	-0.1	-0.2	-0.2	-0.2	-0.2	-0.3	1.9		
of which: contribution from real GDP growth	1.0	-0.9	-0.9	-1.0	-0.7	-0.7	-0.7	-0.6	-0.7	-1.4	-2.1		
Contribution from real exchange rate depreciation	1.0	1.3	-1.9	...	...	...	...	...	...	...	...		
Other identified debt-creating flows	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Recognition of contingent liabilities (e.g., bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Debt relief (HIPC and other)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Other debt creating or reducing flow (please specify)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Residual	**-0.6**	**6.4**	**1.1**	**1.9**	**-0.3**	**-0.2**	**-0.2**	**-0.2**	**-0.2**	**-0.5**	**-3.2**	**2.3**	**-0.1**
Sustainability indicators													
PV of public debt-to-GDP ratio 2/	**...**	**...**	**26.9**	**22.9**	**25.5**	**28.1**	**31.7**	**36.5**	**42.6**	**73.4**	**115.3**		
PV of public debt-to-revenue and grants ratio	**...**	**...**	**48.5**	**38.1**	**58.3**	**66.7**	**78.4**	**93.9**	**115.7**	**212.7**	**341.3**		
Debt service-to-revenue and grants ratio 3/	**6.8**	**6.6**	**8.8**	**6.1**	**10.3**	**11.5**	**12.0**	**18.7**	**13.0**	**25.1**	**40.0**		
Gross financing need 4/	2.6	-3.2	0.2	-2.4	11.8	12.7	14.1	17.7	16.8	19.0	21.9		
Key macroeconomic and fiscal assumptions													
Real GDP growth (in percent)	-2.3	2.1	2.1	2.7	2.3	1.8	1.5	1.2	1.2	1.2	1.2	**1.5**	**1.5**
Average nominal interest rate on external debt (in percent)	0.9	1.3	0.9	0.7	1.1	1.1	1.0	1.0	1.1	1.2	1.2	**1.4**	**1.1**
Average real interest rate on domestic debt (in percent)	0.7	3.0	-4.9	-0.9	0.7	0.0	0.0	0.1	0.2	0.5	0.5	**-0.9**	**0.2**
Real exchange rate depreciation (in percent, + indicates depreciation)	2.7	3.5	-5.2	...	...	...	...	...	...	...	...	**0.9**	**...**
Inflation rate (GDP deflator, in percent)	2.1	0.0	8.0	2.9	2.2	3.2	3.2	3.2	3.2	3.0	2.9	**3.6**	**3.0**
Growth of real primary spending (deflated by GDP deflator, in percent)	-3.2	10.6	9.3	8.9	-3.2	-0.3	0.9	0.5	0.3	-0.3	3.6	**7.1**	**0.4**
Primary deficit that stabilizes the debt-to-GDP ratio 5/	-1.2	-6.8	2.2	-0.6	1.1	1.0	1.0	1.1	1.2	2.2	3.4	**-1.9**	**1.3**
PV of contingent liabilities (not included in public sector debt)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		

Definition of external/domestic debt	**Residency-based**
Is there a material difference between the two criteria?	**Yes**

Public sector debt 1/





Sources: Country authorities; and staff estimates and projections.

1/ Coverage of debt: The general government, central bank . Definition of external debt is Residency-based.

2/ The underlying PV of external debt-to-GDP ratio under the public DSA differs from the external DSA with the size of differences depending on exchange rates projections.

3/ Debt service is defined as the sum of interest and amortization of medium and long-term, and short-term debt.

4/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period and other debt creating/reducing flows.

5/ Defined as a primary deficit minus a change in the public debt-to-GDP ratio ((-): a primary surplus), which would stabilizes the debt ratio only in the year in question.

6/ Historical averages are generally derived over the past 10 years, subject to data availability, whereas projections averages are over the first year of projection and the next 10 years.

"Other debt creating or reducing flow" is the net acquisition of financial assets.

Table 3. Tonga: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, FY2025–2045
(In percent)

	Projections 1/																				
	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034	2035	2036	2037	2038	2039	2040	2041	2042	2043	2044	2045
	PV of debt-to GDP ratio																				
Baseline	18	19	20	23	26	31	36	41	46	51	**55.6**	**60**	**64**	**67**	**70**	**74**	**77**	**81**	**84**	**87**	**90**
A. Alternative Scenarios																					
A1. Key variables at their historical averages in 2025-2035 2/	18	19	22	25	28	33	39	45	50	**56**	**61**	**66**	**71**	**76**	**80**	**85**	**89**	**94**	**98**	**103**	**108**
B. Bound Tests																					
B1. Real GDP growth	18	20	22	25	29	34	39	45	51	**56**	**61**	**66**	**70**	**74**	**77**	**81**	**85**	**88**	**92**	**95**	**98**
B2. Primary balance	18	20	22	25	29	34	39	44	49	54	**58**	**63**	**66**	**70**	**73**	**77**	**80**	**83**	**86**	**89**	**92**
B3. Exports	18	23	31	34	37	42	48	54	**59**	**64**	**69**	**73**	**77**	**81**	**84**	**87**	**90**	**93**	**96**	**99**	**102**
B4. Other flows 3/	18	23	28	31	34	39	44	49	54	**59**	**64**	**67**	**71**	**74**	**77**	**80**	**83**	**86**	**89**	**92**	**95**
B5. Depreciation	18	24	18	21	25	31	37	44	50	**56**	**62**	**68**	**73**	**78**	**82**	**87**	**91**	**95**	**100**	**104**	**108**
B6. Combination of B1-B5	18	26	29	31	35	40	46	52	**58**	**63**	**67**	**72**	**76**	**80**	**83**	**87**	**90**	**93**	**97**	**100**	**103**
C. Tailored Tests																					
C1. Combined contingent liabilities	18	21	23	26	30	35	40	45	50	**55**	**60**	**64**	**68**	**72**	**75**	**78**	**82**	**85**	**88**	**91**	**94**
C2. Natural disaster	18	24	26	30	34	40	46	52	**58**	**63**	**68**	**73**	**77**	**82**	**85**	**90**	**93**	**97**	**101**	**105**	**108**
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	55	55	55	55	55	55	55	55	55	55	55	55	55	55	55	55	55	55	55	55	55
	PV of debt-to-exports ratio																				
Baseline	82	85	92	101	115	134	154	176	196	215	232	**248**	**262**	**275**	**286**	**299**	**310**	**321**	**331**	**341**	**351**
A. Alternative Scenarios																					
A1. Key variables at their historical averages in 2025-2035 2/	82	88	98	109	124	144	166	190	213	234	**254**	**274**	**292**	**309**	**324**	**341**	**357**	**373**	**388**	**404**	**421**
B. Bound Tests																					
B1. Real GDP growth	82	85	92	101	115	134	154	176	196	215	232	**248**	**262**	**275**	**286**	**299**	**310**	**321**	**331**	**341**	**351**
B2. Primary balance	82	89	100	111	126	145	165	187	208	227	**244**	**260**	**273**	**286**	**297**	**309**	**320**	**331**	**341**	**351**	**361**
B3. Exports	82	138	**250**	**268**	**294**	**329**	**367**	**409**	**449**	**484**	**515**	**543**	**567**	**590**	**608**	**629**	**648**	**666**	**684**	**700**	**717**
B4. Other flows 3/	82	103	127	136	150	168	188	209	230	**248**	**265**	**279**	**292**	**304**	**313**	**324**	**334**	**344**	**353**	**362**	**370**
B5. Depreciation	82	85	63	74	88	107	126	148	169	188	204	222	237	**252**	**264**	**277**	**290**	**302**	**313**	**324**	**335**
B6. Combination of B1-B5	82	125	116	170	188	213	240	**269**	**297**	**322**	**343**	**364**	**381**	**398**	**411**	**427**	**441**	**455**	**468**	**480**	**492**
C. Tailored Tests																					
C1. Combined contingent liabilities	82	97	103	117	131	151	170	193	213	232	**249**	**265**	**279**	**292**	**303**	**316**	**327**	**338**	**349**	**359**	**368**
C2. Natural disaster	82	114	121	140	157	181	203	229	**253**	**275**	**295**	**314**	**331**	**347**	**360**	**375**	**389**	**403**	**416**	**428**	**441**
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	240	240	240	240	240	240	240	240	240	240	240	240	240	240	240	240	240	240	240	240	240
	Debt service-to-exports ratio																				
Baseline	16	16	16	15	12	8	6	6	6	7	7	8	9	11	12	13	14	15	16	16	17
A. Alternative Scenarios																					
A1. Key variables at their historical averages in 2025-2035 2/	16	16	17	16	12	9	7	6	7	7	8	9	11	12	14	15	16	17	18	19	21
B. Bound Tests																					
B1. Real GDP growth	16	16	16	15	12	8	6	6	6	7	7	8	9	11	12	13	14	15	16	16	17
B2. Primary balance	16	16	16	15	12	8	6	6	6	7	8	9	10	11	12	14	15	15	16	17	18
B3. Exports	16	**22**	**31**	**31**	**24**	17	13	13	13	14	17	20	**22**	**25**	**27**	**29**	**31**	**32**	**34**	**35**	**36**
B4. Other flows 3/	16	16	16	16	12	9	7	7	7	7	9	10	11	13	14	15	16	16	17	18	19
B5. Depreciation	16	16	16	14	11	8	6	5	6	6	7	6	8	9	10	11	12	13	14	15	16
B6. Combination of B1-B5	16	18	**22**	**21**	16	12	9	9	9	10	12	13	15	16	18	19	20	**21**	**23**	**24**	**25**
C. Tailored Tests																					
C1. Combined contingent liabilities	16	16	16	15	12	9	7	6	7	7	8	8	10	11	12	13	14	15	16	17	17
C2. Natural disaster	16	17	17	17	13	10	7	7	7	8	9	10	11	12	14	15	16	17	18	19	19
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	21	21	21	21	21	21	21	21	21	21	21	21	21	21	21	21	21	21	21	21	21
	Debt service-to-revenue ratio																				
Baseline	13	13	13	13	10	7	5	5	5	6	6	7	8	9	10	11	12	13	14	14	15
A. Alternative Scenarios																					
A1. Key variables at their historical averages in 2025-2035 2/	13	13	14	13	10	8	6	5	6	6	7	8	9	10	12	13	14	15	16	17	18
B. Bound Tests																					
B1. Real GDP growth	13	14	14	14	11	8	6	5	6	6	7	8	9	10	11	12	13	14	15	16	17
B2. Primary balance	13	13	13	13	10	7	5	5	6	6	7	7	9	10	11	12	13	13	14	15	16
B3. Exports	13	13	14	14	11	8	6	6	6	7	8	10	11	12	13	14	15	16	17	17	18
B4. Other flows 3/	13	13	13	13	10	8	6	6	6	6	7	9	10	11	12	13	14	14	15	16	17
B5. Depreciation	13	16	16	15	12	8	6	6	6	7	7	7	8	10	11	12	14	15	16	17	18
B6. Combination of B1-B5	13	14	15	14	11	8	6	6	6	7	8	9	10	11	13	14	14	15	16	17	18
C. Tailored Tests																					
C1. Combined contingent liabilities	13	13	13	13	10	7	6	5	6	6	7	7	8	9	10	11	12	13	14	15	16
C2. Natural disaster	13	13	13	13	10	8	6	6	6	6	7	8	9	10	11	12	13	14	15	15	16
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	23	23	23	23	23	23	23	23	23	23	23	23	23	23	23	23	23	23	23	23	23
Grant element assumed on residual financing (i.e., financing required above baseline)	50	50	50	50	50	50	50	50	50	50	**50**	49.6	49.6	49.6	49.6	49.6	49.6	49.6	49.6	49.6	49.6

Sources: Country authorities; and staff estimates and projections.
1/ A bold value indicates a breach of the threshold.
2/ Variables include real GDP growth, GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.
3/ Includes official and private transfers and FDI.

Table 4. Tonga: Sensitivity Analysis for Key Indicators of Public Debt, FY2025–2045

(In percent)

	Projections 1/																				
	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034	2035	2036	2037	2038	2039	2040	2041	2042	2043	2044	2045
PV of Debt-to-GDP Ratio																					
Baseline	22.9	25.5	28.1	31.7	36.5	42.6	49.0	56.0	61.9	67.9	**73.4**	**79**	**84**	**88**	**92**	**96**	**100**	**104**	**108**	**112**	**115**
A. Alternative Scenarios																					
A1. Key variables at their historical averages in 2025-2035 2/	23	20	17	15	13	11	10	9	7	5	4	3	1	0	-2	-3	-4	-5	-7	-8	-9
B. Bound Tests																					
B1. Real GDP growth	23	28	33	39	46	54	62	**71**	**79**	**87**	**95**	**102**	**108**	**115**	**120**	**127**	**132**	**138**	**143**	**149**	**154**
B2. Primary balance	23	27	32	35	40	46	52	59	65	**71**	**76**	**82**	**86**	**91**	**95**	**99**	**103**	**107**	**110**	**114**	**118**
B3. Exports	23	29	37	40	45	51	58	65	**71**	**77**	**82**	**87**	**91**	**96**	**99**	**103**	**107**	**111**	**114**	**117**	**121**
B4. Other flows 3/	23	29	36	40	44	50	57	64	70	**76**	**81**	**86**	**91**	**95**	**99**	**103**	**106**	**110**	**113**	**117**	**120**
B5. Depreciation	23	28	26	26	28	30	34	38	41	44	48	51	54	56	58	61	63	65	67	69	**71**
B6. Combination of B1-B5	23	26	29	31	36	42	48	55	61	67	**73**	**78**	**83**	**87**	**91**	**95**	**99**	**103**	**106**	**110**	**114**
C. Tailored Tests																					
C1. Combined contingent liabilities	23	31	34	36	41	47	53	60	66	**72**	**78**	**83**	**88**	**92**	**96**	**101**	**105**	**109**	**112**	**116**	**120**
C2. Natural disaster	23	36	39	42	47	54	61	68	**75**	**81**	**88**	**94**	**99**	**104**	**109**	**114**	**118**	**123**	**127**	**132**	**136**
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
TOTAL public debt benchmark	70	70	70	70	70	70	70	70	70	70	70	70	70	70	70	70	70	70	70	70	70
PV of Debt-to-Revenue Ratio																					
Baseline	38	58	67	78	94	116	135	159	178	197	213	230	247	261	273	297	306	318	334	340	341
A. Alternative Scenarios																					
A1. Key variables at their historical averages in 2025-2035 2/	38	46	41	37	33	30	27	24	20	16	12	8	4	(0)	(5)	(9)	(13)	(17)	(22)	(24)	(27)
B. Bound Tests																					
B1. Real GDP growth	38	62	77	94	114	143	167	199	224	248	269	293	316	336	352	386	399	416	438	448	449
B2. Primary balance	38	63	76	87	102	124	143	168	187	205	221	239	256	270	281	306	314	326	342	348	349
B3. Exports	38	65	87	100	116	139	158	184	204	222	238	254	271	284	294	319	326	337	352	358	357
B4. Other flows 3/	38	67	85	98	114	137	156	182	201	220	236	252	269	282	292	317	324	336	351	356	356
B5. Depreciation	38	65	64	67	73	84	94	109	119	130	140	150	161	169	175	189	193	200	211	212	212
B6. Combination of B1-B5	38	61	70	78	93	114	133	158	176	194	210	227	245	258	270	294	303	315	330	337	338
C. Tailored Tests																					
C1. Combined contingent liabilities	38	71	80	90	106	127	146	171	191	209	225	242	260	274	286	310	319	332	347	354	355
C2. Natural disaster	38	82	93	103	121	145	166	193	214	235	252	272	292	307	321	349	360	374	392	400	400
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Debt Service-to-Revenue Ratio																					
Baseline	6	10	12	12	19	13	12	20	18	19	25	23	25	31	31	33	37	36	38	41	40
A. Alternative Scenarios																					
A1. Key variables at their historical averages in 2025-2035 2/	6	10	11	11	18	11	10	17	15	14	19	17	17	21	19	19	21	20	20	21	20
B. Bound Tests																					
B1. Real GDP growth	6	11	12	14	22	17	17	25	24	25	32	30	33	39	39	42	47	47	49	52	52
B2. Primary balance	6	10	12	15	21	14	13	20	19	19	26	24	26	32	31	33	37	37	39	42	41
B3. Exports	6	10	12	13	19	14	13	20	19	19	26	25	27	32	32	34	38	38	39	42	41
B4. Other flows 3/	6	10	12	12	19	14	13	20	19	19	26	25	27	32	32	34	38	38	39	42	41
B5. Depreciation	6	11	14	15	20	14	13	20	18	19	25	23	25	31	30	33	36	36	38	41	40
B6. Combination of B1-B5	6	10	11	12	19	13	12	20	18	18	25	23	25	31	30	32	36	36	37	40	40
C. Tailored Tests																					
C1. Combined contingent liabilities	6	10	12	19	19	16	13	21	19	19	25	24	26	31	31	33	37	37	38	41	40
C2. Natural disaster	6	10	12	25	21	19	14	24	21	22	28	26	28	34	34	36	40	40	41	44	44
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

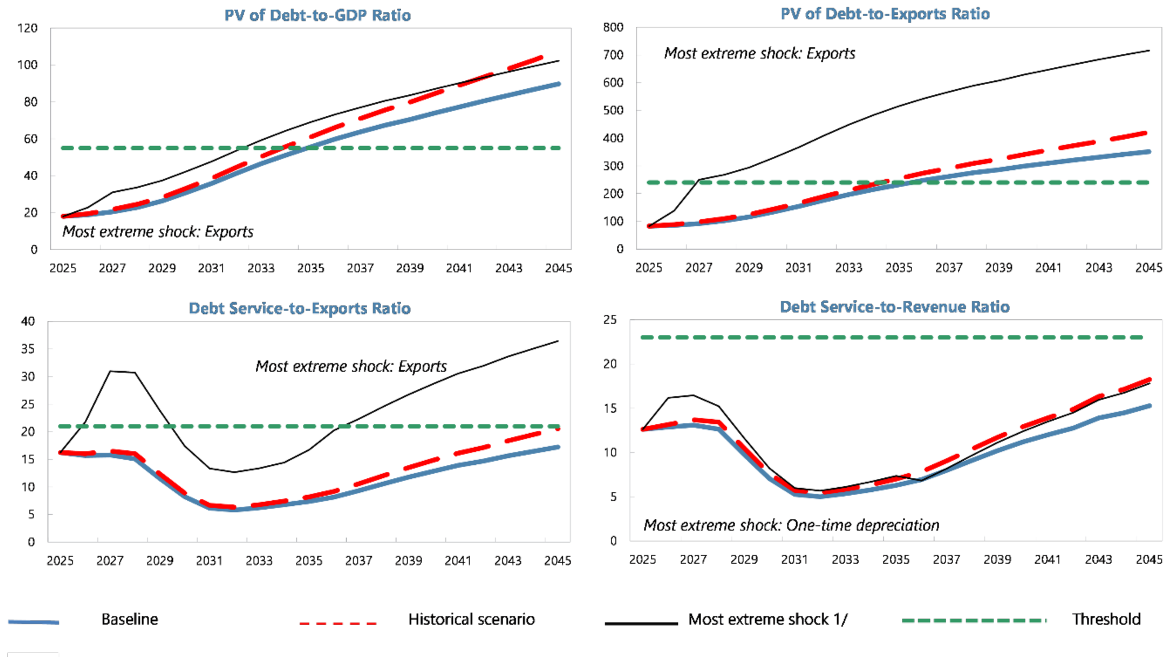
Sources: Country authorities; and staff estimates and projections.

1/ A bold value indicates a breach of the benchmark.

2/ Variables include real GDP growth, GDP deflator and primary deficit in percent of GDP.

3/ Includes official and private transfers and FDI.

Figure 1. Tonga: Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, FY2025–2045



Customization of Default Settings		
	Size	Interactions
Tailored stress		
Combined CL	Yes	
Natural disaster	Yes	Yes
Commodity price 2/	n.a.	n.a.
Market financing	n.a.	n.a.

Note: "Yes" indicates any change to the size or interactions of the default settings for the stress tests. "n.a." indicates that the stress test does not apply.

Borrowing Assumptions on Additional Financing Needs Resulting from the Stress Tests*		
	Default	User defined
Shares of marginal debt		
External PPG MLT debt	100%	
Terms of marginal debt		
Avg. nominal interest rate on new borrowing in USD	1.2%	1.2%
USD Discount rate	5.0%	5.0%
Avg. maturity (incl. grace period)	38	38
Avg. grace period	8	8

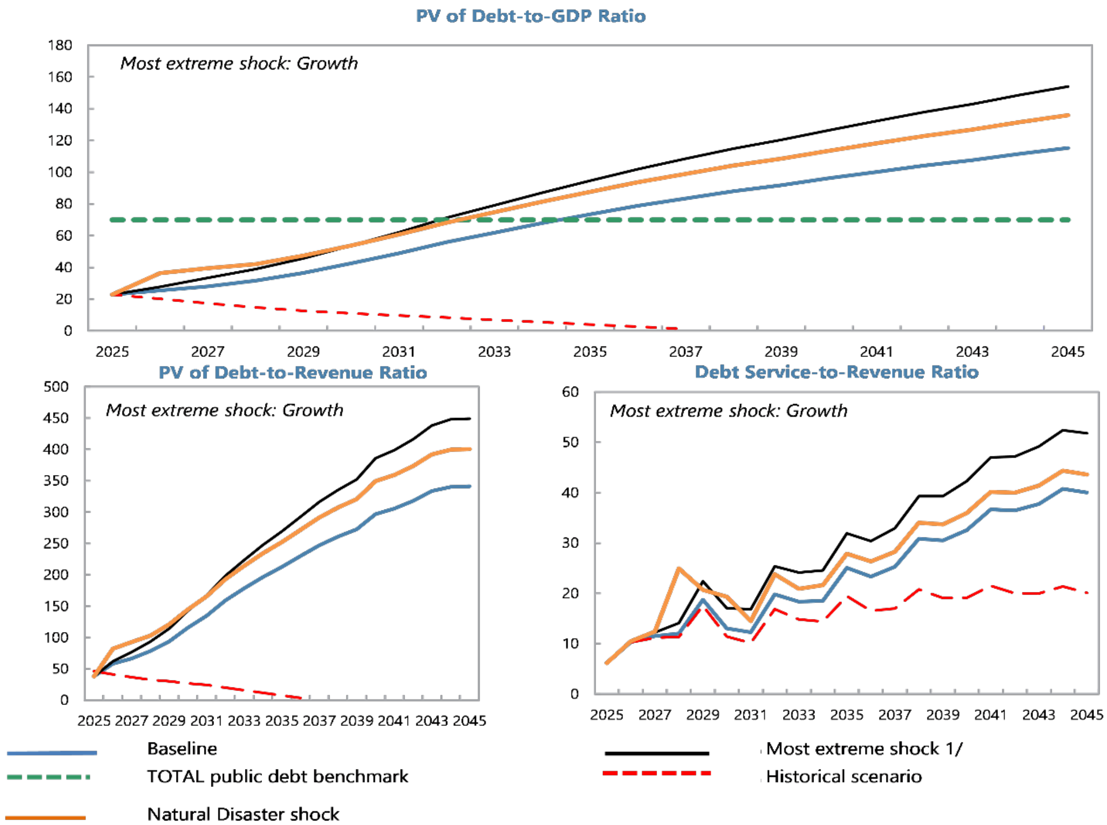
* Note: All the additional financing needs generated by the shocks under the stress tests are assumed to be covered by PPG external MLT debt in the external DSA. Default terms of marginal debt are based on baseline 10-year projections.

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2035. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most exterme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

2/ The magnitude of shocks used for the commodity price shock stress test are based on the commodity prices outlook prepared by the IMF research department.

Figure 2. Tonga: Indicators of Public Debt Under Alternative Scenarios, FY2025–2045



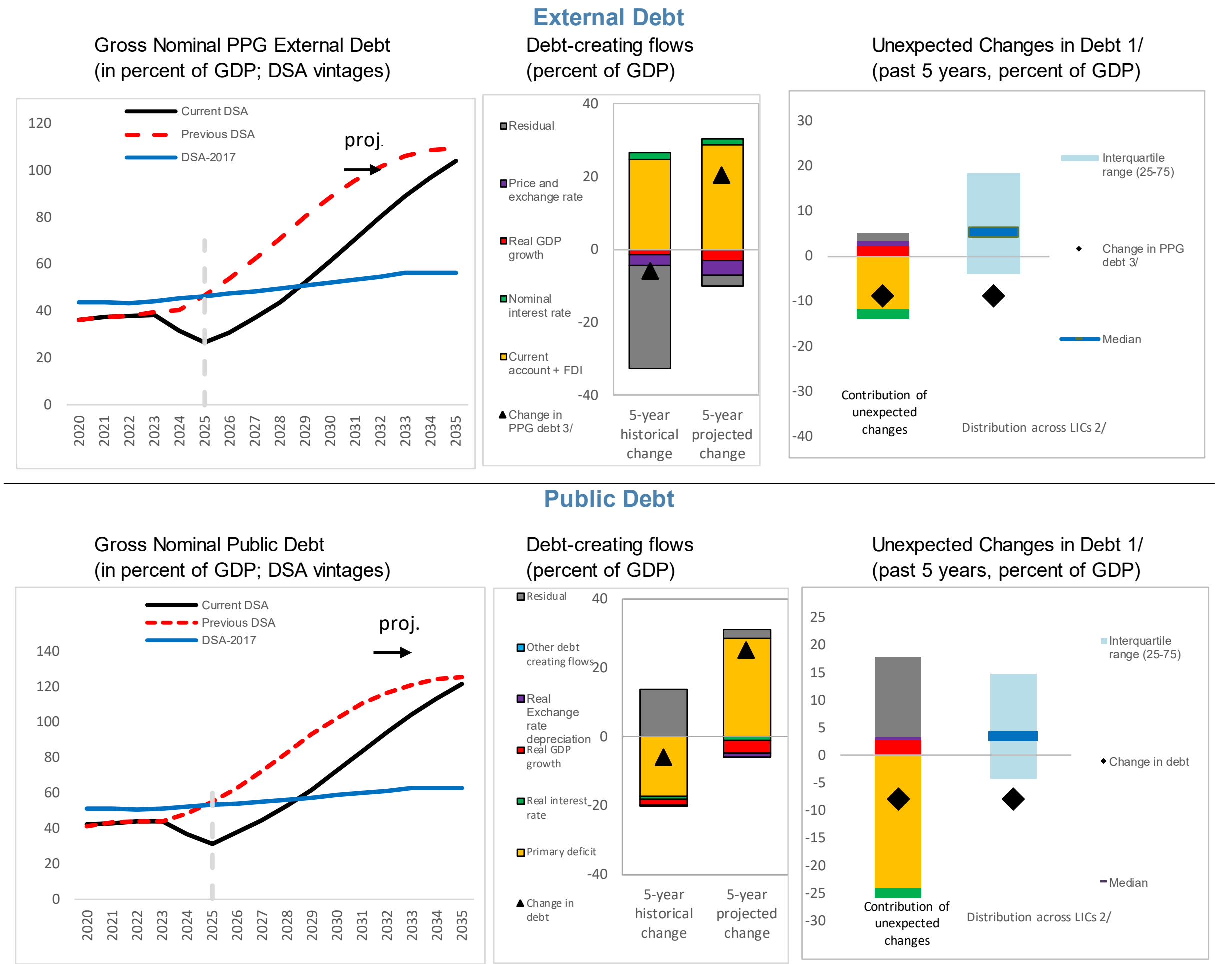
Borrowing Assumptions on Additional Financing Needs Resulting from the Stress Tests*	Default	User defined
Shares of marginal debt		
External PPG medium and long-term	64%	64%
Domestic medium and long-term	36%	36%
Domestic short-term	0%	0%
Terms of marginal debt		
External MLT debt		
Avg. nominal interest rate on new borrowing in USD	1.2%	1.2%
Avg. maturity (incl. grace period)	38	38
Avg. grace period	8	8
Domestic MLT debt		
Avg. real interest rate on new borrowing	0.4%	0.4%
Avg. maturity (incl. grace period)	2	2
Avg. grace period	1	1
Domestic short-term debt		
Avg. real interest rate	0.0%	0.0%

* Note: The public DSA allows for domestic financing to cover the additional financing needs generated by the shocks under the stress tests in the public DSA. Default terms of marginal debt are based on baseline 10-year projections.

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2035. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most exterme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

Figure 3. Tonga: Drivers of Debt Dynamics—Baseline Scenario



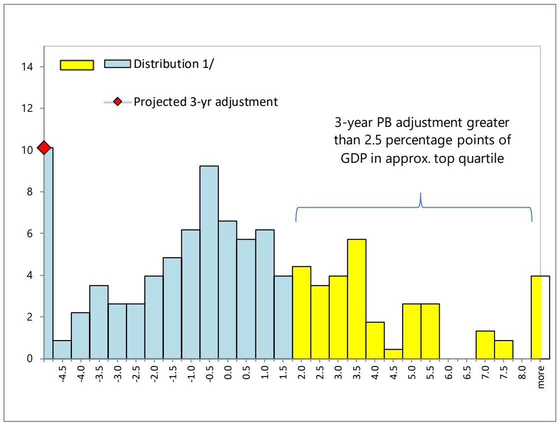
1/ Difference between anticipated and actual contributions on debt ratios.

2/ Distribution across LICs for which LIC DSAs were produced.

3/ Given the relatively low private external debt for average low-income countries, a ppt change in PPG external debt should be largely explained by the drivers of the external debt dynamics equation.

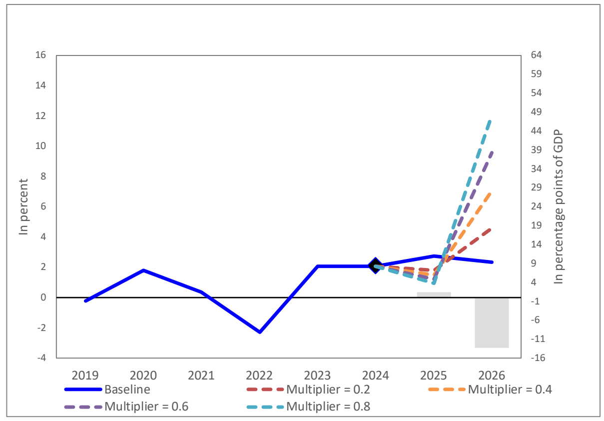
Figure 4. Tonga: Realism Tools

3-Year Adjustment in Primary Balance (Percentage points of GDP)



1/ Data cover Fund-supported programs for LICs (excluding emergency financing) approved since 1990. The size of 3-year adjustment from program inception is found on the horizontal axis; the percent of sample is found on the vertical axis.

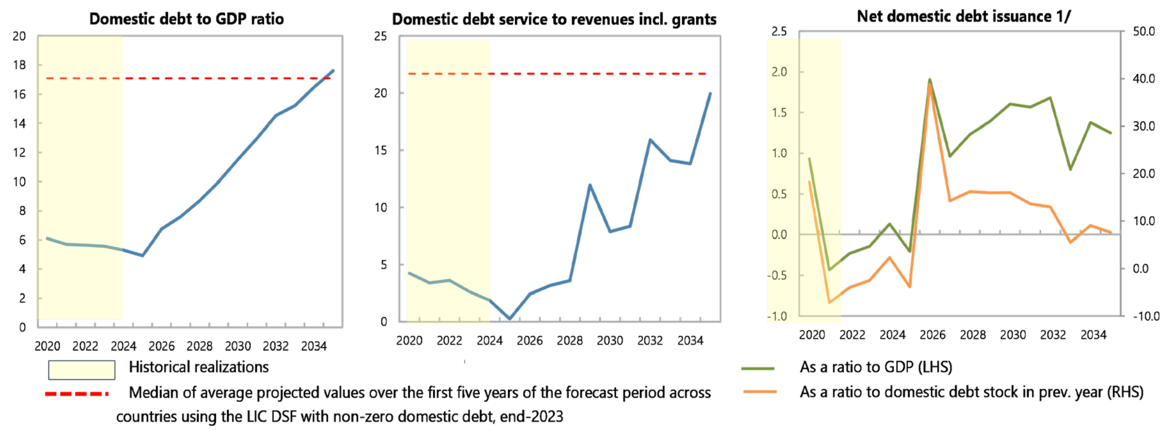
Fiscal Adjustment and Possible Growth Paths 1/



1/ Bars refer to annual projected fiscal adjustment (right-hand side scale) and lines show possible real GDP growth paths under different fiscal multipliers (left-hand side scale).

Figure 5. Tonga: Indicators of Domestic Debt, 2020-2035

(Percent)



Borrowing Assumptions (average over 10-year projection)	Value
Shares in new domestic debt issuance	
Medium and long-term	100%
Short-term	0%
Borrowing terms	
Domestic MLT debt	
Avg. real interest rate on new borrowing	0.4%
Avg. maturity (incl. grace period)	2
Avg. grace period	1
Domestic short-term debt	
Avg. real interest rate	0.0%

Sources: Country authorities; and staff estimates and projections.

1/ Net domestic debt issuance is an estimate based on the calculated public gross financing need net of gross external financing, drawdown of assets, other adjustments and domestic debt amortization. It excludes short-term debt that was issued and matured within the fiscal year.