

Banking Sector Developments May 2014

Release date: 3 July 2014

| | May 14 | Apr 14 | Mar 14 | Feb 14 |
|-----------------|--------|--------|--------|--------|
| Deposit rate | 2.09 | 2.09 | 2.04 | 2.01 |
| Lending rate | 8.95 | 9.00 | 8.95 | 8.98 |
| Total lending | 382.4 | 381.5 | 379.6 | 376.3 |
| New commitments | 7.9 | 7.5 | 10.6 | 6.1 |

Leanest interest rate spread since February 2012

Note: Data from *Pacific International Commercial Bank* has been incorporated in this report for the first time.

Interest rates

Tonga's weighted-average interest rate spread was less than 6.9 percentage points in May 2014. The lowest in at least 36 months of comparable records (see *Box A*).

The weighted average deposit rate was unchanged over May 2014. This reflects slight declines in the rates for demand and savings deposits offsetting a moderate rise in term deposit rates.

Over the past year, the forces acting on deposit rates were mixed; the NRBT's expansionary monetary policy settings encouraged low rates; while increased competition in the banking sector may place upward pressure on deposit rates as banks contest for customers. On balance, the weighted average deposit rate increased over the year, with an increase in rates on term and demand deposits, partly offset by a decline in savings deposits.

The weighted average lending rate fell 5 basis points over May, driven by a decline in all categories except 'other'. This decline can be explained by the increased competition in the banking sector together with the continued support from the NRBT's expansionary

monetary policy setting. The largest decline in lending rates was on loans to businesses, particularly for the construction sector where rates fell by 0.84 percentage points.

Over the year, all key bank lending rate categories declined, led by the 'other' and 'business' categories, whose share comprise almost half of all loans. The weighted average rate on all bank loans fell by 89 basis points, partly because the composition of lending shifted towards lower-risk lending products. The general decline in interest rates was encouraged by:

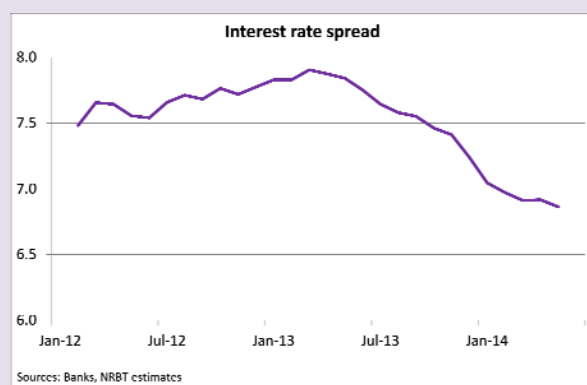
- The NRBT's expansionary monetary policy setting;
- A temporary moratorium on principal and interest payments for loans in cyclone-affected Ha'apai;
- An anticipated expansion of *Tonga Development Bank* services; and,
- Increased competition from the new *Pacific International Commercial Bank*.

Lending rates are now low by the standards of the past decade, although recent improvements to reporting requirements are complicating historical comparisons.

Box A: Tonga's narrower interest rate spread

The interest rate spread is the difference between the lending and deposit rates. It can be indicative of the competition and efficiency of the banking sector.

Existing bank reporting standards have been consistent since February 2012, enabling an accurate comparison of the weighted average lending and deposit rates. May 2014 exhibits the leanest interest rate spread in this series, suggesting increased competition, and effective monetary policy settings are working.



Using extrapolation techniques to compare lending and deposit rates data prior to 2012, it could be suggested that interest rate spreads were the leanest in May 2014 than they have been since January 2001.

Lending

Total bank lending balances changed a little over May, with slight increases in lending for 'business' and 'other' components more than offsetting a decline in lending for 'household'.

The increase in lending for business coincides with lower lending rates, and increased demand for the preparation for church conferences and special Sundays.

In year-ended terms, total bank lending balances rose by 10.9 per cent, reflecting lower lending rates. This increase coincides with a rise in the number of business container registrations, suggesting strengthening activity. Including loans extended by non-banks, the lending balance increased by 12.4 per cent over the year.

Household lending

Bank lending balances to households fell a little over the month, driven by a decline in the housing component. Over the year, bank lending balances to households increased by 3.5 per cent, consistent with a rise in the number of private container registrations.

New household commitments rose over the month, driven by rises in the 'other' and 'vehicle' components. Consistent with high vehicle registrations, the increase in commitments likely stems from more affordable Japanese cars and the rise of informal markets. New household commitments make up nearly half of the total new commitments. The headline growth figures continue to understate the strength of household lending at the moment as banks continue writing-off large quantities of loans that became impaired many years ago. Including non-banks, year-ended growth in household lending would have been much stronger, at 12.7 per cent. (Some of the household lending balances would ideally be classified under business lending.)

Business lending

While business lending rose slightly over May, it fell by 8.4 per cent in over the year. This was a result of notable declines in manufacturing, tourism and construction components. The fall in the lending for the tourism components reflect the slowdown in the tourism activity.

New business commitments fell over the month, mainly due to a decline in the 'professional & other services' and 'agriculture' categories. Including government on-loans, business lending slowed over the year as on-lending for CBD reconstruction continues to unwind.

Other lending

Much of the growth in total bank lending over the past year has come from large loans extended to two local public enterprises (classified under the category of 'other'). Some of the amounts committed remain undrawn. In liquidity terms, gross loans to deposit ratio

increased slightly, but remains well below the 80.0 trigger level indicating adequate liquidity in the banking system.

Broad money

The overall increase in bank lending balances, together with a lift in Tonga's net foreign assets, have led to an increase in broad money balances of 4.7 per cent over the year, to about 44 per cent of GDP. The high growth components were those that earn the lowest interest and are most suited for transactional purposes, consistent with the NRBT's expectations for faster economic growth this year. Meanwhile, term deposits balances have contracted markedly.

Outlook

As the moratorium on Ha'apai loan repayments expired at the end of June 2014, official measures of interest rates are expected to rise somewhat. However, taking a longer term perspective, scope remains for lending rates to fall.

Since reducing the interest rates on Exchange Settlement Account balances by 100 basis points (to 0.0 per cent) in November 2012, banks' lending rates have only fallen by 113 basis points on average. Furthermore, continued improvement of business confidence and conditions will support credit growth and ultimately economic activity. Increased competition in the banking sector will continue to support lower lending rates; however, banks have indicated significant declines are unlikely.

The NRBT is forecasting lending to grow by around 10 per cent over the 2013-14 financial year. This is on the basis of imminent drawdowns of some large loan commitments; the expected fall in interest rates; and an anticipated improvement in economic conditions more broadly. Growth is expected to increase slightly in 2014-15.

The NRBT will continue to encourage lending through its monthly liaison with the banks.

If an anticipated increase in lending and a forecast increase in foreign reserves come to fruition, further rises in broad money liabilities can be expected.

Interest Rates
Weighted average of all banks

| | Month ended | | | 3 months ended | | | Year ended | | | Share of loans/deposits % |
|----------------|-------------|-------------|-------------|----------------|-------------|-------------|-------------|-------------|---------------|---------------------------------|
| | May 14 % | Apr 14 % | Mar 14 % | May 14 % | Feb 14 % | Nov 13 % | May 14 % | May 13 % | Growth bps | |
| Deposits all | 2.09 | 2.09 | 2.04 | 2.09 | 2.01 | 1.86 | 2.09 | 2.00 | 9 | 100 |
| Demand | 0.49 | 0.52 | 0.51 | 0.49 | 0.54 | 0.47 | 0.49 | 0.46 | 3 | 41 |
| Savings | 1.97 | 2.00 | 1.91 | 1.97 | 1.91 | 1.89 | 1.97 | 2.11 | -14 | 16 |
| Term | 3.63 | 3.56 | 3.55 | 3.63 | 3.47 | 3.27 | 3.63 | 3.20 | 43 | 44 |
| Loans all | 8.95 | 9.00 | 8.95 | 8.95 | 8.98 | 9.27 | 8.95 | 9.84 | -89 | 100 |
| Housing | 8.69 | 8.70 | 8.64 | 8.69 | 8.65 | 8.75 | 8.69 | 9.07 | -38 | 35 |
| Other personal | 12.93 | 13.10 | 12.81 | 12.93 | 12.83 | 13.16 | 12.93 | 13.29 | -37 | 17 |
| Business | 9.03 | 9.29 | 9.09 | 9.03 | 9.10 | 9.22 | 9.03 | 9.79 | -76 | 27 |
| Other | 5.96 | 5.76 | 5.99 | 5.96 | 5.97 | 6.20 | 5.96 | 6.87 | -90 | 21 |

Sources: Banks; NRBT

Lending Balances

| | Month ended | | | 3 months ended | | | Year ended | | | Shares of totals % |
|--------------------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|-------------|--------------------------|
| | May 14 TOPm | Apr 14 TOPm | Mar 14 TOPm | May 14 TOPm | Feb 14 TOPm | Nov 13 TOPm | May 14 TOPm | May 13 TOPm | Growth % | |
| Lending, banks | 275.1 | 274.9 | 274.5 | 275.1 | 271.9 | 263.5 | 275.1 | 248.1 | 10.9 | 100 |
| Household | 137.0 | 137.5 | 138.0 | 137.0 | 135.2 | 134.1 | 137.0 | 132.4 | 3.5 | 50 |
| Business | 82.5 | 81.9 | 81.5 | 82.5 | 83.4 | 86.7 | 82.5 | 90.1 | -8.4 | 30 |
| Other | 55.5 | 55.5 | 55.0 | 55.5 | 53.4 | 42.6 | 55.5 | 25.6 | 117.0 | 20 |
| Lending, banks and other | 382.4 | 381.5 | 379.6 | 382.4 | 376.2 | 366.0 | 382.4 | 340.1 | 12.4 | 100 |
| Household | 181.7 | 181.5 | 180.5 | 181.7 | 176.4 | 173.5 | 181.7 | 161.3 | 12.7 | 48 |
| Business | 145.2 | 144.5 | 144.1 | 145.2 | 146.5 | 149.9 | 145.2 | 153.3 | -5.3 | 38 |
| Other | 55.5 | 55.5 | 55.0 | 55.5 | 53.4 | 42.6 | 55.5 | 25.6 | 117.0 | 15 |
| New comm'ts, banks | 7.9 | 7.5 | 10.6 | 7.9 | 6.1 | 6.5 | 7.9 | 7.1 | 11.5 | N/A |
| Undrawn comm'ts, banks | 9.3 | 9.4 | 9.3 | 9.3 | 11.1 | 21.5 | 9.3 | 14.7 | -36.8 | N/A |
| Implied repay'ts, banks | 7.8 | 7.1 | 9.8 | 7.8 | 4.4 | 5.2 | 7.8 | 6.3 | 24.5 | N/A |

Sources: SPBD; RFB; Government of Tonga; banking system

Consolidated Balance Sheet of Depository Corporations

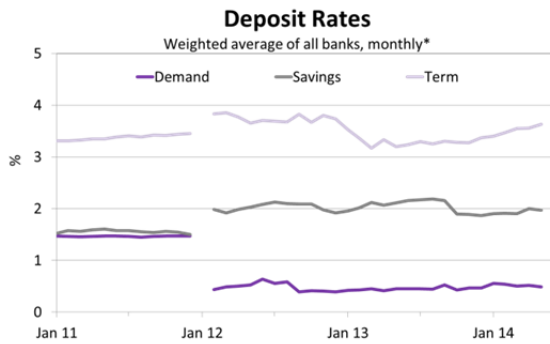
| | Month ended | | | 3 months ended | | | Year ended | | |
|--------------------------------|------------------|------------------|-----------------|------------------|------------------|------------------|------------------|------------------|-------------|
| | May-14 \$TOPm | Apr-14 \$TOPm | Mar-14 \$Tom | May-14 \$TOPm | Feb-14 \$TOPm | Nov-13 \$TOPm | May-14 \$TOPm | May-13 \$TOPm | % growth |
| Broad money liabilities | 357.7 | 357.5 | 354.5 | 357.7 | 353.2 | 356.3 | 357.7 | 341.7 | 4.7 |
| Currency in circulation | 38.6 | 36.0 | 34.3 | 38.6 | 33.8 | 34.5 | 38.6 | 29.3 | 31.8 |
| Demand deposits | 128.5 | 131.5 | 134.1 | 128.5 | 132.7 | 133.4 | 128.5 | 119.2 | 7.8 |
| Savings and term deposits* | 190.6 | 189.9 | 186.0 | 190.6 | 186.7 | 188.4 | 190.6 | 193.3 | -1.4 |
| <i>equals</i> | | | | | | | | | |
| Net foreign assets | 259.1 | 258.4 | 265.0 | 259.1 | 270.3 | 261.7 | 259.1 | 254.6 | 1.8 |
| <i>plus</i> | | | | | | | | | |
| Net domestic assets | 98.7 | 99.1 | 89.5 | 98.7 | 82.9 | 94.6 | 98.7 | 87.2 | 13.2 |
| Gross bank lending** | 282.6 | 282.1 | 281.7 | 282.6 | 279.0 | 270.5 | 282.6 | 254.5 | 11.0 |
| Other*** | -184.0 | -183.0 | -192.2 | -184.0 | -196.1 | -175.9 | -184.0 | -167.4 | 9.9 |

* Also includes very minor amounts for securities other than shares.

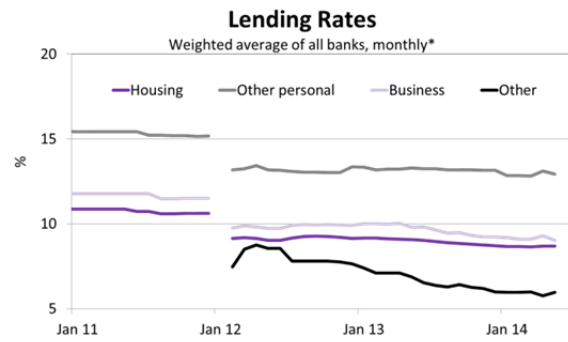
** Differs slightly from standard measures of bank lending by amounts classified as accrued interest.

*** Includes mostly capital accounts of the banks and NRBT, and their net claims on the central government.

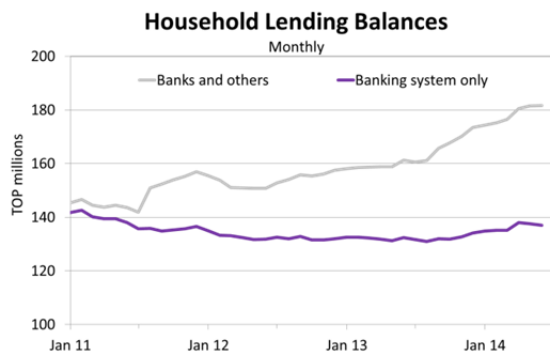
Sources: banking system; NRBT



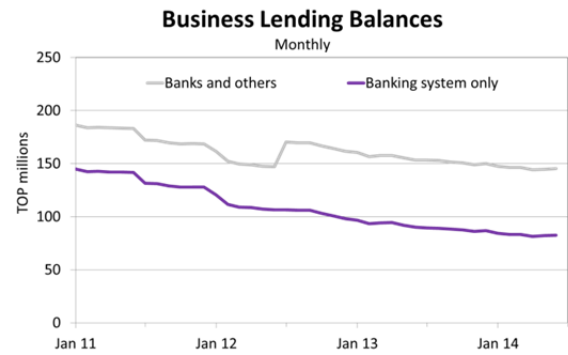
* Changes in bank reporting have occasionally caused series breaks.



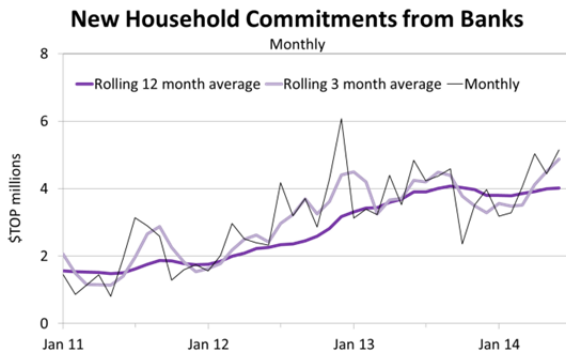
* Changes in bank reporting have caused a series break in January 2012; excludes overdrafts.



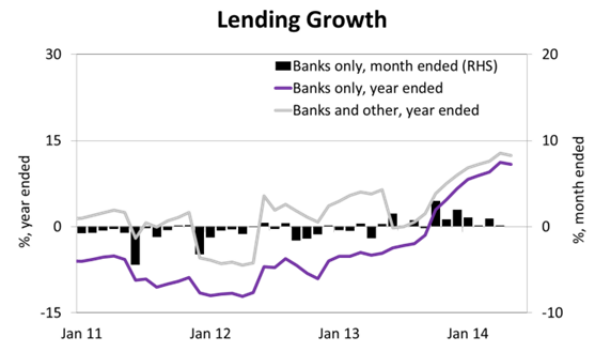
Sources: Banking System; SPBD; RFB



Sources: Banking System; Government of Tonga



Source: Banking system



Sources: Banking System; SPBD; RFB; Government of Tonga