NATIONAL RESERVE BANK OF TONGA

Private Bag No. 25
Post Office, Nuku'alofa, Tonga

NRBT Building
Salote Road
Nuku'alofa,

OFFICIAL PRESS RELEASE

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Monetary Policy Decision

The National Reserve Bank of Tonga's board of directors at its meeting on the 11th April 2018 approved to maintain its current monetary policy measures outlined below. This is to encourage utilisation of the excess liquidity in the banking system, through further lending, particularly to the growth sectors, in order to support economic growth and the recovery from Tropical Cyclone Gita, and strengthen the monetary policy transmission mechanism.

a. maintain the monetary policy rate at 0% (zero interest rate policy);
b. maintain the minimum loans/deposit ratio of 80%;
c. maintain the Statutory Reserve Deposit ratio at 10%; and
d. maintain the inflation reference rate at 5%.

The Governor of the Reserve Bank, Sione Ngongo Kioa, reported that the domestic economic activities in February 2018 were affected due to the devastation by tropical cyclone (TC) Gita, which would also be reflected in the economic activities of upcoming months. However, partial economic indicators were mixed over the month. The total agricultural exports declined mainly driven by the decrease in exported volume of root crops such as cassava and giant taro. Exported marine products (excluding aquarium products) however rose as more tuna was exported during the month. Activities in the secondary sector remained positive which were supported by the growth in individual housing and business construction loans despite the decline in business manufacturing loans. In the tertiary sector, total loans slightly rose over the month. Nonetheless, container registrations decreased as both business and private containers declined. Vehicle registrations also fell mainly lower registrations for cars and other light vehicles. This was followed by a decline in air arrivals.

The banking system remained sound maintaining strong capital position, supported by comfortable profitability, and non-performing loans continued to remain low. Liquidity in the banking system (reserve money) increased over February, driven by an increase in currency in circulation as the commercial banks withdrew cash from the Reserve Bank vault to meet the public's high demand for cash. The banks' total loan to deposit ratio (including Government Development Loan (GDL) scheme) remained relatively stable in February, reflecting a proportionate growth in both total deposits and total loans. Total loans to deposit ratio (excluding GDL) slightly decreased in February. It continues to remain below the minimum 80% loan to deposit ratio which indicates excess liquidity in the banking system remains and that there is capacity for further lending by banks. The weighted average interest rate spread widened over February, which resulted from a rise in the weighted average lending rate outweighing the decline in the weighted average deposit rate.

The foreign reserves increased to $448.0 million in February 2018 driven by higher receipts of Government grants and cyclone relief funds from development partners and insurance payouts. This is equivalent to 8.1 months[1] of import cover, which is still above the Reserve Bank's minimum range of 3 – 4 months.

The official inflation rate is yet to be released by the Statistics Department. However, inflationary pressure is expected to remain in the near term partially due to the impact of TC Gita on the domestic food supply. The rise in fruit and vegetable prices is expected to push up domestic inflation. Over the year, the headline inflation is anticipated to be around 5.0% compared to 6.0% last month. The anticipated annual headline inflation is due to higher expectations in the prices of food, transportation, alcohol and kava-Tonga.

The growth outlook for Tonga remains positive in the years ahead as projected by the Reserve Bank in its August 2017 MPS. Growth for 2017/18 will be reduced due to the impact of TC Gita but anticipated to be higher in 2018/19. The level of foreign reserves is expected to remain at comfortable levels well above the minimum range of 3-4 months of import cover supported by expected higher receipts of remittances and foreign aid. This will be partially offset by the projected rise in imports and the commencement of the Government's principal loan repayment to the EXIM Bank of China. Upward inflationary pressure remains in the near term and is expected to remain above the Reserve Bank's inflation reference rate of 5% per annum in 2018.The adverse weather conditions and higher import prices pose a risk to these favorable projections.

The Governor concluded that the Reserve Bank will continue to closely monitor developments in the domestic and global economy and update its monetary policy setting, to maintain internal and external monetary stability, and to promote a sound and efficient financial system in order to support macroeconomic stability and economic growth. The Reserve Bank will also remain vigilant and continue to closely monitor developments for early signs of vulnerabilities which may indicate overheating of the economy.

For further details please contact:
Economics Department
Telephone: (676) 24 057
Fax: (676) 24201
Email: nrbt@reservebank.to

[1] Methodology used for this calculation has changed to include both imports of goods and services whilst the calculation used in previous reports used import of goods only