

**OFFICIAL PRESS RELEASE****3 August 2018****Monetary Policy Decision**

The National Reserve Bank of Tonga's board of directors at its meeting on the 31st July 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, stated that the partial domestic economic indicators were mixed but broadly positive overall. The performance of all sectors of the domestic economy was favorable. Despite the lower exported agricultural produce during the month, there was abundant supply of local food due to its harvesting season, which was reflected in the lower domestic prices recorded for food. The on-going construction activities continued to boost the performance of the secondary sector supported by growth in individual housing loans, banks' lending to manufacturing businesses and electricity production also increased. Several events that took place during the month including annual church conferences and special Sundays for the family improved performance in the tertiary sector. Banks' total lending rose and total air arrivals increased which coincided with a rise in travel receipts. In addition, the total number of container registrations increased which indicates a vibrant trade sector.

The banking system remained sound and maintained strong capital position, supported by comfortable profitability, and non-performing loans continued to remain low. Liquidity in the banking system (reserve money) increased over May, driven solely by higher currency in circulation to meet public demands. The banks' total loans to deposit ratio slightly decreased in May from last month and continued to remain below the 80% minimum loan to deposit ratio. This indicates excess liquidity in the banking system and that there is capacity for further lending by the banks. Annually, both deposits and loans grew indicating the active financial inclusion policies of the banks. Total access points in the banking system rose over the year making financial services more widely accessible. The weighted average interest rate spread widened over May due mainly to an increase in the weighted average lending rate.

The foreign reserves fell to \$441.9 million in May 2018 due mainly to the return of funds to head offices and increase in total import payments mainly for wholesale & retail goods. This is equivalent to 7.8 months¹ of import cover.

Monthly headline inflation slowed to 0.1% in May 2018 from 0.4% last month. This was due mainly to domestic prices declining despite the imported prices rising over the month. The lower domestic prices was due to a decline in the prices of local produce mainly root crops and vegetables. Imported prices however rose by 0.3% as the respective monthly average price for petrol and diesel rose over the month by 3 cents and 5 cents per litre. Over the year to May 2018, the headline inflation remained high at 9.4%, although slowing from 9.6% in April 2018, due mainly to domestic prices rising from a low level in May 2017. Domestic prices contributed 5.6 percentage points to the overall inflation mainly attributed to higher local food prices as a result of seasonality and damages to fruits and vegetables caused by Tropical Cyclone Gita. The prices of local fruits and vegetables rose over the year by 44.5% due to higher prices of tomatoes, capsicum, coconuts, watermelon, banana ripe and pawpaw. Other local prices that contributed to the overall headline inflation included kava-Tonga and coral aggregates. The imported component of inflation contributed 3.8 percentage points to the overall headline inflation, due to higher prices of imported food, tobacco and fuel.

The 2017/18 financial year is coming to an end and the Reserve Bank still expects Tonga's economic growth to remain above 3% for 2017/18. The level of foreign reserves is expected to remain at comfortable level and inflation is anticipated to fall below the Reserve Bank's inflation reference rate of 5% per annum at the end of 2018. The banking system is expected to continue to remain strong.

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

Given the above developments and the outlook on the monetary policy targets, the current monetary policy stance is considered appropriate in the medium term. The Reserve Bank will continue to remain vigilant, closely monitor developments in the domestic and global economies and may change its monetary policy setting to support its monetary policy objectives.

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