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Monetary Policy Decision

The National Reserve Bank of Tonga's Board of Directors at its board meeting on the 21st January 2020, approved to maintain its current monetary policy measures outlined below. This is to encourage utilization of the excess liquidity in the banking system, through further lending in order to support economic growth 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 domestic economic activities slowed towards the end of 2019. This was reflected in lower agricultural exports which decreased in November 2019 by 411.3 tonnes (12.5%) coinciding with lower export proceeds as well as the ending of the squash season. Meanwhile, the industry and tertiary sectors showed mixed growth. Loans for the utility sector and housing purposes increased, whilst lending to the manufacturing sector declined. Container registrations increased by 238 (26.7%) in November 2019, whilst total air arrivals declined by 446 passengers (4.9%) and reflected the lower number of international flights during the month. This aligned with a \$1.7 million (13.6%) decrease in travel receipts. Vehicle registrations continued to fall by 47 vehicles (15.9%). The measles outbreak which continued over November 2019 also restricted scheduled functions as they were either cancelled or limited to some extent may have contributed to the domestic slowdown.

The banking system continues to be sound supported by strong capital and adequate profits. The banks' total loans to deposit ratio rose from 79.1% to 81.2% over November 2019, reflecting loans growing while deposits fell. This is above the 80% minimum loan to deposit ratio. However, the liquidity in the banking system still remains relatively high, indicating that existing capacity is still available for further lending. The weighted average interest rate spread continued to narrow and did so over the month and the year by 1.9 basis points and 9.6 basis points respectively to 6.02%. This was due to lower weighted average lending rates and weighted average deposit rates.

The official foreign reserves rose slightly by \$0.2 million to \$489.5 million (equivalent to 7.8 months of imports cover), whilst annually, foreign reserves increased by \$20.9 million due to higher receipts of budget support, grants, and project funds from development partners.

Inflation during November 2019 declined by 0.5% as a result of lower domestic and imported prices. Both the fall in domestic and imported prices was driven mainly by declining food prices. Annual headline inflation remained low in November 2019 at 0.1% compared to 0.2% in October 2019 and the 6.5% inflation rate in November 2018. This was mostly due to lower domestic prices, offsetting the rise in import prices over the year.

The medium-term outlook on Tonga's economic performance is now expected to grow at a slower pace, considering the recent economic indicators. However, weather uncertainty and global uncertainties continue to pose a risk to this expectation. The level of foreign reserves is projected to remain at a comfortable level, and inflation is expected to remain below the reference rate of 5%. The banking system is also anticipated to continue to remain sound.

Given the above developments and outlook, the current monetary policy stance is considered appropriate in the medium term. The Reserve Bank continues to adopt measures to encourage the utilization of the excess liquidity in the banking system to increase lending, support domestic economic activities, and strengthen the monetary policy transmission mechanism. Meanwhile, the Reserve Bank will continue to remain vigilant and closely monitor external and domestic developments and may change its monetary policy setting to support its monetary policy objectives.

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