NATIONAL RESERVE BANK OF TONGA

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

NRBT Building
Salote Road
Nuku'alofa,

OFFICIAL PRESS RELEASE

31 August 2022

Monetary Policy Decision

The National Reserve Bank of Tonga's Board of Directors, at its board meeting on the 24 August 2022, approved to retain its current accommodative monetary policy stance, while working in tandem with the Government to support economic recovery and macroeconomic stability. The following monetary policy measures are adopted:

To stimulate economic growth and support macroeconomic recovery while continuing to closely monitor developments in inflation, the Reserve Bank will:

a. Maintain the monetary policy rate at 0% (zero interest rate policy).
b. Maintain the current weights in the Exchange rate basket.
c. Maintain the minimum loans/deposit ratio at 70%.
d. Maintain the Statutory Reserve Deposit ratio at 10%.
e. Maintain the inflation reference rate at 5%.
f. Develop an enabling financial infrastructure to support prudent credit growth (credit registry, bankruptcy laws, land administration).
g. Explore other tools to encourage higher credit growth (loan guarantee, interest rate subsidy)
h. Collaborate with MOF to foster compatibility of fiscal and monetary policy objectives supporting inclusive and sustainable growth.
i. Explore ways to strengthen the monetary policy transmission mechanism.

In addition, to maintain a stable sound, and efficient financial system, conducive to macroeconomic stability and growth the Reserve Bank will:

j. Enhance financial sector supervision.
k. Maintain clear channels of effective communications with the financial institutions to ensure delivery of essential financial services to the public, especially during pandemic-related lockdown periods.
l. Modernise and improve the efficiency of the payments system, through monitoring the rollout of the Domestic Electronic Payment System (DEPS) for increased automation of the settlement/clearing system. This was live in July 2022.
m. Continue to implement measures to combat de-risking by global and local banks in order to retain banks' correspondent bank accounts and foreign exchange dealers' bank accounts.

The Governor of the Reserve Bank, Sione Ngongo Kioa reported that in May 2022, high inflation rate still remains a global issue triggering further tightening of monetary policies by many central banks. As a result, interest rate hikes have been observed in most of our major trading partner countries.

Without any further lockdowns and a gradual easing of Covid-19 restrictions in May, domestic activities have slowly gained momentum. The agricultural sector showed some recovery from the Hunga Tonga – Hunga Ha'apai (HTHH) disaster earlier in the year, with consistent rises in agricultural export volumes over the past few months. Marine activities, on the other hand, remains minimal. The reconstruction projects from the HTHH disaster funded by the Government, and private construction projects continue to support growth in the industrial sector. The active construction sector will have positive spillover effects to the mining & quarrying sector activities. The indicators of the service sector also demonstrate positive performance over the month. Higher consumption and demand from households and firms, celebrations of the family month, and the resumption of the majority of service businesses support the sectoral growth. Given the gradual reduction in the quarantine period for incoming passengers, and the anticipated reopening of the borders, travel activities are expected to pick up strongly thereby supporting the tourism industry in the near term.

Inflation rose by 1.5% over the month, driven by the prices of fuel, and both imported and domestic food prices. Over the year, headline inflation rose to a new high record of 11.3% driven by both imported and domestic inflation. Import prices rose by 11.9% on the back of higher prices of fuels, food items, construction materials, and liquefied petroleum gas. These movements are supply driven, and are beyond the control of the Reserve Bank. Domestic prices also rose by 10.4% due to higher local food items and electricity prices, reflecting the impact of the HTHH disaster on local food supply and the pass-through of imported fuel prices to domestic energy prices. Core inflation (excluding energy and imported food) was 7.5%, lower than the headline indicating that the elevated inflationary pressure is mostly driven by energy prices. At the same time, core inflation is now higher than the 5.6% in the previous month, implying broadening price pressures across non-oil commodities and domestic food items.

Official foreign reserves declined by $3.6 million in May to $880.4 million, which is equivalent to 12.4 months of import cover. This is well above the Reserve Banks' minimum threshold of 3 months, and the IMF's optimal level of 7.3 months of import cover. In the year to May 2022, foreign reserves continued to increase substantially by $190.9 million, attributing to inflows of budget support, relief funds, official grants, capital inflows, and remittances.

The financial system is still sound, supported by strong capital positions, high liquidity, and adequate profitability. Reserve money continued to expand over the month and year by 2.2% and 34.2%, respectively, owing mostly to the increase in the Exchange Settlement Account balance. Broad money declined over the month by 0.2%, however, still expanded over the year by 16.3%. Meanwhile, positive credit growth was recorded in May reflecting higher loans for both businesses and households. Nevertheless, annual credit growth is still negative, falling by 3.4%, while total deposits increased by 17.5%. As a result loans to deposit ratio dipped further to 53.6%, still remaining well below the new minimum threshold of 70%. Non-performing loans slightly improved from 4.8% to 4.7% of total loans over the month, due to household loan upgrades. This is still higher than the 4.0% recorded in May of last year. The weighted average interest rate spread narrowed slightly over the month by 1.46 basis points to 6.16%, reflecting a decrease in the weighted average lending rates which more than offset the decline in the weighted average deposit rates. However, the weighted average interest rate spread widened over the year by 43.24 basis points, underpinned by the continuous drop in the weighted average deposit rates coupled with the increase in weighted average lending rates.

Following a sharp contraction of 2.7% in GDP growth for FY2020/21, the Reserve Bank projects the Tongan economy to contract again in FY2021/22 as a result of the HTHH disaster and the Omicron outbreak. Spillover effects from the war in Ukraine, the China lockdowns, and the supply-demand mismatches will keep inflation elevated until 2023. At the same time, our major trading partner countries continue to fight inflation with contractionary monetary policies, which will flow on to Tonga's inflation through imports. Foreign reserves are anticipated to remain comfortable with adequate capacity to sustain high probability shocks. The financial system remains stable with excess liquidity, and adequate capital to absorb any shocks to the system.

In light of the projected economic contraction and the current expansionary fiscal policies, the Reserve Bank is maintaining its accommodative monetary policy stance while working in tandem with the fiscal policies to revive the economy and prevent any further contraction in growth. The Reserve Bank is concerned about the rising inflation and it continues to engage in discussions and exploring other measures that can curb inflation without offsetting the fiscal policy initiatives. At the same time, the Reserve Bank stands ready to realign its monetary policy settings should inflation continue to increase unsustainably.

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