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Lower Inflation Remains Priority for the Reserve Bank August 2023 MPS

The Board of Directors of the Reserve Bank of Tonga (NRBT) has decided to focus on two main goals in its August 2023 Monetary Policy Statement (MPS): first, to keep inflation below the 5% reference rate, including through seeking Government's assistance in controlling domestic and wage inflation; and second, to provide targeted support towards economic recovery of vulnerable sectors to address supply shortages and promote business investments.

Tonga's economy is showing signs of improvement. It is estimated to have grown by 2.4% in FY2023 and is expected to continue growing at a rate of 2.6% in FY2024. This growth is driven by reconstruction efforts, Government's new construction projects, an anticipated recovery in the agriculture sector, and improvements in tourism-related sectors due to the resumption of international travel. However, challenges such as labour shortages and skill gaps are hindering economic activities and contributing to inflationary pressures.

While inflation has decreased to 4.8% in July 2023 in line with forecasts, Governor Tatafu Moeaki stated "he is concerned that it may rise above the 5% reference rate in the next two quarters due to domestic factors and rising petroleum prices. Imported inflation has eased to 1.9%, but high domestic inflation at 8.8% remains a concern, leading to core inflation hovering around 10%. Supply-side issues are pushing up domestic food prices, affecting other related prices and potentially keeping inflation above 5% in the next two quarters." These factors are beyond the NRBT's control and Moeaki therefore emphasizes "the importance of close coordination with the Government fiscal policy measures and government-wide actions that can alleviate the cost of living and reduce inflation".

In terms of external stability, foreign reserves are healthy at \$945.2 million (equivalent to 13.3 months of import cover) as of July 2023. This is attributed to increasing inflows from development partners to support Government recovery effort, remittances, and travel receipts. The outlook is positive, with foreign reserves expected to remain above the recommended level of 7.5 months of import cover.

The banking system is supportive of economic growth, with annual credit growth gaining momentum at 8.4% in June 2023. However, an increase in non-performing loans as part of the economic recovery is monitored closely. Enhanced supervision of banks and non-bank financial institutions is crucial to mitigate risks to financial stability. The monetary policy stance since February 2023 of reducing excess liquidity in the banking system would also improve the effectiveness of monetary policy transmissions.

The NRBT will closely monitor both global and domestic economic developments and make necessary adjustments to its monetary policy.

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