NATIONAL RESERVE BANK OF TONGA

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OFFICIAL PRESS RELEASE

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Monetary Policy Statement for February 2017

At its meeting on the 31st July 2017, the National Reserve Bank of Tonga's board of directors approved to release its Monetary Policy Statement (MPS) for February 2017. This Statement reviews Tonga's economic growth and the Reserve Bank's conduct of monetary policy in the six months to February 2017 and its outlook.

The Reserve Bank maintained its monetary policy stance which supported the monetary policy objectives of maintaining internal and external monetary stability, promoting financial stability and a sound and efficient financial system and conducting its activities in a manner that supports macroeconomic stability and economic growth.

The Reserve Bank's outlook for a robust domestic economic growth remains for 2016/17 at 3.7%, an upward revision from the estimated 3.6% growth released in the August 2016 MPS. This followed a stronger growth of 3.7% and 3.4% for 2014/15 and 2015/16 respectively, as indicated by the Statistics Department's official estimate. The projected growth for 2016/17 was mainly driven by anticipated stronger growths in construction, utilities, fisheries and mining & quarry. Moreover, the number of events scheduled for 2016/17 supported the growth in tourism and trade sectors. Higher real GDP growth of 4.8% is projected by the Reserve Bank for 2017/18, an upward revision from the August 2016 MPS estimate of 4.7%. This growth is expected to be driven by construction, as Government continues the construction of sports facilities. Additionally, the financial intermediation, transport & communication, trade, fishing and tourism sectors are also expected to contribute to the anticipated growth.

Inflationary pressures continued to rise in February 2017. The annual headline inflation rate increased significantly by 8.9% in February 2017 compared to a 5.1% rise in August 2016, and remained above the Reserve Bank's reference rate of 5% per annum. The Reserve Bank expects the upward inflationary pressure to remain in the near term due to the impact of the increased custom duty and excise tax effective in July 2016. However, the annual headline inflation is forecasted to gradually decline below the reference rate of 5% per annum after August 2017.

The overall balance of Overseas Exchange Transactions (OET) over the past six months to February 2017 was a surplus of $11.4 million, contributed to an increase in the gross official foreign reserves to $377.7 million in February 2017, compared to $366.3 million in August 2016. This was sufficient to cover imports of merchandise goods and services for 7.1 months[1], well above the Reserve Bank's minimum range of 3-4 months of imports. The level of foreign reserves is expected to remain at comfortable levels supported by expected higher receipts of remittances, higher export receipts, anticipated government receipt of budget support and grant funds from development partners and this will be partially offset by the projected rise in import payments.

Tonga's financial system remained sound over the 6 months to February 2017 as the banking system maintained strong capital and liquidity position, supported by comfortable profitability, and non-performing loans continuing to remain low. Broad money and banking system liquidity continued to rise as total banks' lending increased to a new level in February 2017 and deposits also rose over the 6 months to February 2017. Total loans to deposits ratios slightly fell in February 2017 to 73.3% from 73.7% in August 2016. The loans to deposit ratio of banks remained below the 80% loan to deposit ratio target which indicate that excess liquidity in the banking system remains and the capacity for further lending by the banks exists. Despite the strong growth in the banks' loan books, this was outweighed by the continuous growth in deposits, which coincided with the higher foreign reserves.

Net credit to Government declined over the six months to February 2017 and anticipated to decline in the near term, as a result of expected Government budgetary support and grants receipts. The Reserve Bank will closely monitor the implication of the fiscal policy measures on the monetary policy objectives.

Given the recent developments and the outlook on the monetary policy targets, the current monetary policy stance is considered appropriate in the medium term. Therefore, the Reserve Bank will continue to adopt measures to encourage the utilisation of the excess liquidity in the banking system to increase lending in order to support domestic economic growth, and strengthen the monetary policy transmission mechanism in the medium term. The Reserve Bank will remain vigilant and continue to closely monitor early signs of vulnerability, developments in the domestic and global economy, and update its monetary policy setting to maintain internal and external monetary

[1] Method of calculation has changed in February 2017 to include both imports of goods & services (previous method used imports of goods only)

stability, and to promote a sound and efficient financial system in order to support macroeconomic stability and economic growth.

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