NATIONAL RESERVE BANK OF TONGA

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

NRBT Building
Salote Road
Nuku'alofa,

OFFICIAL PRESS RELEASE

6 October 2017

Monetary Policy Decision

The National Reserve Bank of Tonga's board of directors at its meeting on the 3rd October 2017 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 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, stated that the activities in the domestic economy were mixed. Despite the decline in the agricultural exports decreased in July, stakeholders in the domestic agricultural market indicated that the supply during the month was relatively more favourable compared to June. Furthermore, the growth in lending to the agricultural sector continues to support the sector. The secondary sector continued to show positive activities with growth in both individual housing loans and business construction loans over the month supporting the construction sector. In the tertiary sector, international air arrivals declined by 3.0% followed by vehicle registrations with 21 vehicles (7.0%). Container registrations on the other hand, increased by 12.3% as a result of higher number business container registrations which rose by 297 containers reflecting a vibrant trade sector during the month and spill over effects to the transportation sector.

The banking system remained sound maintaining strong capital position, supported by comfortable profitability, and continued low non-performing loans. Liquidity in the banking system (reserve money) continued to fall over July to $278.4 million. This largely reflected the issuing of the new notes to the banks during the King's birthday and other events in July which is also in line with the Reserve Bank's initiative to improve the quality of the notes in circulation. The total loans to deposit ratio increased slightly from 75.4% last month to 76.3% in July reflecting the 0.6% growth in total loans outweighing the 0.5% growth in total deposits. Nevertheless, this ratio continued to remain below the 80% loan to deposit ratio target which indicates excess liquidity in the banking system remains. The weighted average interest rate spread narrowed slightly to 5.7%. This resulted from widening in the weighted average deposit rate outweighing the increase in the weighted average lending rate.

The foreign reserves rose by $1.1 million to $408.9 million in July 2017 due to a surplus in the overall overseas exchange transaction balance. This is equivalent to 7.4 months[1] of import cover, which is still above the Reserve Bank's minimum range of 3 – 4 months.

The annual headline inflation slowed to 7.1% in July 2017 from a high of 10.3% in the previous month, the highest level since September 2013. The decline over the month largely reflected the wind down of the hike in prices last year when the new excise tax became effective in July 2016. Imported prices rose by 7.4% over the year contributing 4.2 percentage points to the annual headline inflation. Similarly, the domestic annual inflation rate rose by 6.7% largely driven by the seasonality of local food, rise in electricity price, and the continued short supply of kava-Tonga.

The Reserve Bank's expectation for strong economic activity remains in the near term. The level of foreign reserves is also projected to remain adequate supported by estimated higher receipts of remittances and foreign aid and this will be partially offset by the expected increase in imports. Upward inflationary pressure remains in the near term due mainly to the impact of the new customs duty and excise tax effective in July 2016 and 2017, although it is expected to fall below the Reserve Bank's inflation reference rate of 5% per annum in August 2017. However, adverse weather conditions and higher import prices poses a risk to these favorable projections.

The Governor concluded that the Reserve Bank will continue to closely monitor developments in the domestic and global economy and update its monetary policy setting, to maintain internal and external monetary stability, and to

[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

promote a sound and efficient financial system in order to support macroeconomic stability and economic growth. The Reserve Bank will also remain vigilant and continue to closely monitor developments for early signs of vulnerabilities which may indicate overheating of the economy.

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