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Monetary Policy Statement for August 2015

The National Reserve Bank of Tonga (NRBT) today released its Monetary Policy Statement for August 2015. This Statement reviews Tonga's economic growth and the NRBT's conduct of monetary policy in the six months to August 2015. It also provides the NRBT's outlook for the next six months.

The NRBT's monetary policy target is to maintain adequate level of foreign reserves above 3-4 months of import cover and to promote low and stable inflation below 6% annually. Against the background of low inflation and high level of foreign reserves in the six months to August 2015, the NRBT maintained its accommodative monetary policy stance to continue supporting macroeconomic stability and economic growth.

The NRBT estimates Real Gross Domestic Product growth of 2.5% in 2014/15 compared to the growth of 2.0% over 2013/14 as recorded by the Department of Statistics. The NRBT growth estimate was revised upwards from the forecasted growth of 2.2% released in the February 2015 MPS, which was mainly driven by improved growth in the secondary and tertiary sectors due to major events in mid-2015 such as the coronation, school reunions and church conferences; outweighing the continued negative growth in the primary sector. The growth estimate is supported by positive spillover effects from the declining global oil prices and low inflation.

Looking forward, the NRBT anticipates strong growth of 3.3% for 2015/16, an upward revision from the estimated growth of 3.2% in the February 2015 MPS driven by a rebound in primary production, particularly the agricultural and fisheries sectors.

Consumer prices decreased over the year to August 2015 by 1.1%, which is similar to the deflation rate recorded in the February 2015 MPS. The lower global energy and food prices contributed to the fourth month of deflation since February 2015. Headline inflation will continue to remain relatively low until the end of this calendar year supported by the declining global oil prices and low imported food prices.

Gross official foreign reserves increased significantly over the past six months, reaching a record high of \$310.9 million at the end of August 2015. This is in line with a surplus of \$26.9 million in the balance of Overseas Exchange Transactions (OET) over the year to August 2015. The NRBT expects the high level of foreign reserves to be maintained in the near term.

Monetary conditions improved as total credit and deposits continued to grow, and the banks maintained narrow weighted average interest rate spreads. Broad money increased to its highest level, consistent with the high banking system liquidity. Tonga's banking system remains sound as non-performing loans improved and the banking system continued to be profitable with strong liquidity and capital positions.

It is anticipated that government receipts will increase in the near term from budget support, issuance of government bonds and other new revenue streams. These are to finance the overall net borrowing requirement of \$20.7 million for the 2015/16 fiscal year, as reflected in the Ministry of Finance and

National Planning's 2015/16 Budget Statement. The NRBT will closely monitor the implication of fiscal policy measures on the monetary policy objectives.

With inflation remaining low; foreign reserves maintained at high levels; exchange rates being stable and competitive; monetary conditions improving as reflected in the high banking system liquidity, improvement in credit and deposit growth, interest rates trending lower coupled with the banking system remaining sound; and the positive outlook for the domestic economy, the NRBT Board of Directors approved to maintain the current accommodative Monetary Policy stance.

National Reserve Bank of Tonga