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# National Reserve Bank of Tonga

Annual Report for the Year Ended 30 June 2002



**PANGIKE PULE FAKAFONUA  
‘O TONGA**

**NATIONAL RESERVE BANK  
OF TONGA**

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

30 September, 2002

Hon S T T 'Utoikamanu  
Minister of Finance  
Ministry of Finance  
Nuku'alofa

Dear Mr Minister

In terms of section 54(1) of the National Reserve Bank of Tonga Act, Cap 102, I have the honour to transmit to you on behalf of the National Reserve Bank of Tonga the following:

- a) copy of the annual accounts for the year ended 30 June 2002, certified by the Auditors;
- b) report of the operation of the National Reserve Bank of Tonga for the year ended 30 June 2002.

Yours faithfully



HRH Prince 'Ulukalala Lavaka Ata  
Chairman

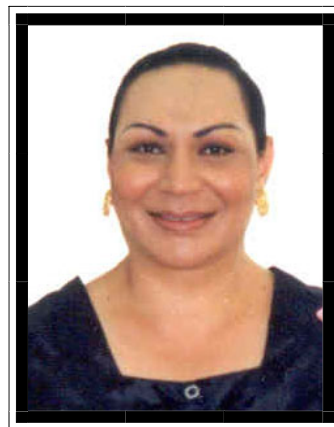
Telephone: 24-057 Facsimile: 24-201 Email: [nrbt@kalianet.to](mailto:nrbt@kalianet.to) Telex: 94079763 NRBT G

## Board of Directors of the National Reserve Bank of Tonga

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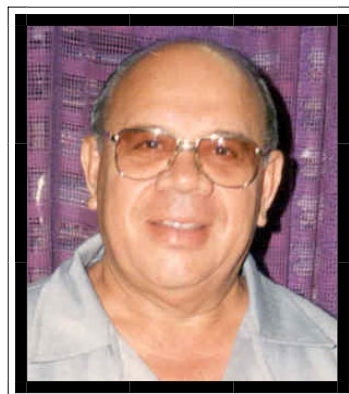
HRH Prince 'Ulukalala Lavaka Ata  
*Chairman*



HRH Princess Salote Pilolevu Tuita



Siosiua T. T. 'Utoikamanu  
*Governor (Acting)*



R. Albin Johansson

## **Principal purposes of the National Reserve Bank of Tonga**

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"The principal purposes of the National Reserve Bank of Tonga shall be:

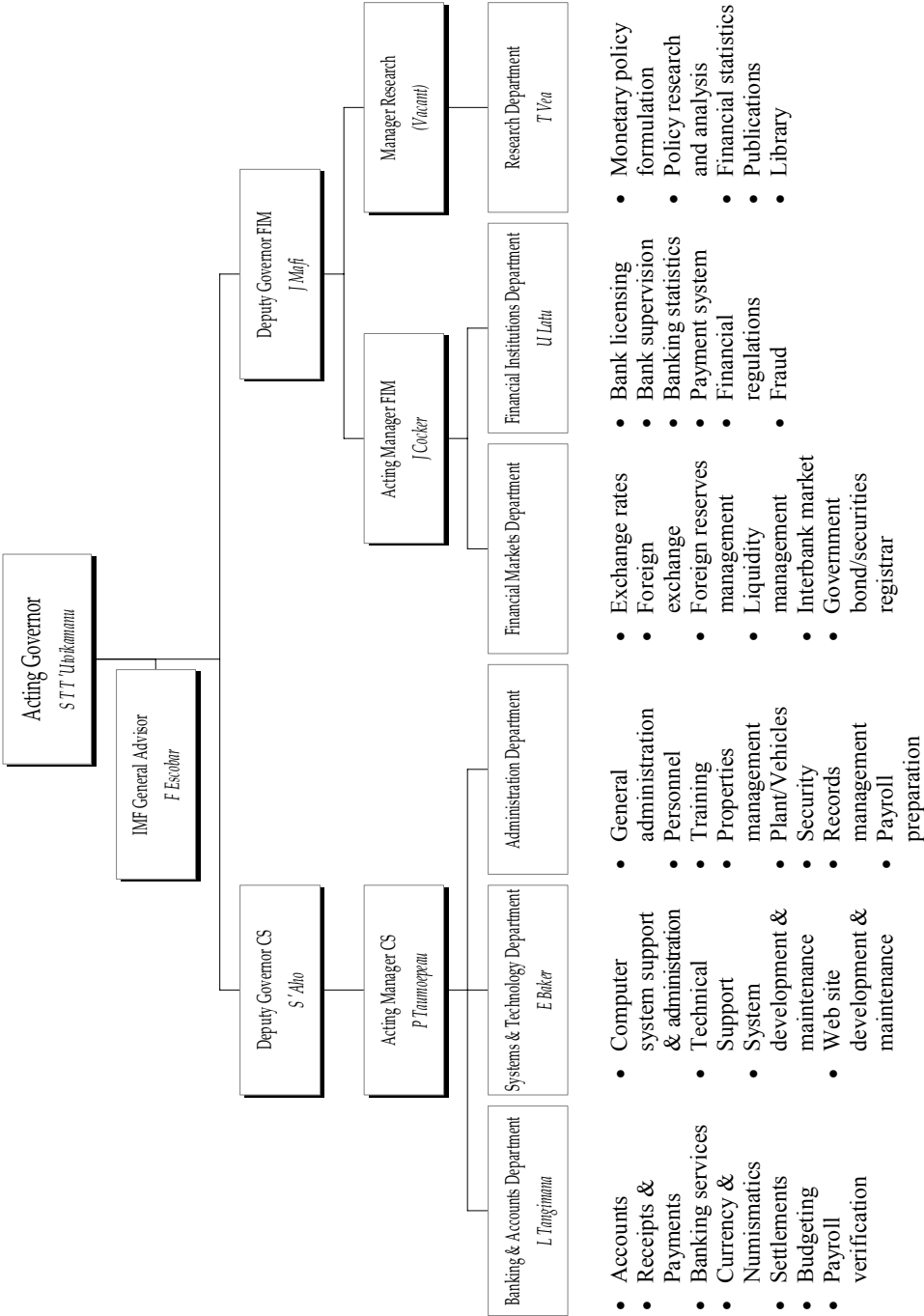
- (a) to regulate the issue of currency, and the supply, availability and international exchange of money;
- (b) to manage the external reserves of the Kingdom;
- (c) to promote monetary stability;
- (d) to promote a sound financial structure;
- (e) to foster credit and exchange conditions conducive to the orderly and balanced economic development of the Kingdom;
- (f) to provide advisory services to the Minister on banking and monetary matters;
- (g) to be the principal banker and fiscal agent of the Government;
- (h) to undertake banking business, in Tonga or elsewhere, subject to the provisions of this Act;
- (i) to undertake the licensing and supervision of financial institutions."

Section 4

National Reserve Bank of Tonga Act, Cap 102



National Reserve Bank of Tonga  
June 2002







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## The Economy and Monetary Policy in 2001/02

### International Economy

The International Monetary Fund, in its World Economic Outlook report of September 2002, estimated world output to have grown by 2.2 percent in 2001. The report stated that a global recovery had been underway in the first half of the year, and projected global output growth at 2.8 percent in 2002.

The report considered that since late 2001, a global recovery was underway, with trade and industrial production picking up across the globe. Global growth was projected at 2.8 percent in 2002, rising to 3.7 percent in 2003, underpinned by the turn in inventory cycle and continued accommodative policies, with interest rate increases in the United States and the euro area now expected to be deferred to 2003.

**Table 1. INTERNATIONAL ECONOMIC INDICATORS**

Country	<i>Percentage change year on year</i>								
	Real GDP % change			Inflation % change			Current Account Balance % of GDP		
	2000	2001	2002 <sup>1</sup>	2000	2001	2002 <sup>1</sup>	2000	2001	2002 <sup>1</sup>
United States	3.8	0.3	2.2	3.4	2.8	1.5	-4.2	-3.9	-4.6
Japan	2.4	-0.3	-0.5	-0.8	-0.7	-1.0	2.5	2.1	3.0
Germany	2.9	0.6	0.5	2.1	2.4	1.4	-1.1	0.1	1.9
United Kingdom	3.1	1.9	1.7	2.1	2.1	1.9	-2.0	-2.1	-2.1
Australia	3.1	2.6	4.0	4.5	4.4	2.8	-4.0	-2.6	-3.6
New Zealand	3.8	2.5	3.0	2.7	2.7	2.6	-5.5	-2.9	-3.5

<sup>1</sup> Forecasts

Source: IMF, World Economic Outlook, September 2002

The report stated that despite the expected global growth, there were still a few risks that might undermine the global recovery. First, the recovery depended heavily on the outlook for the United States, especially the pickup in western Europe was not yet self sustaining and domestic demand growth in Japan was likely to remain constrained by banking and corporate sector difficulties for some time. Second, oil prices could spike sharply if the security situation in the Middle East was to deteriorate further. Depending on its extent and duration, this increase could have a significant negative effect on global growth both directly and indirectly through its effects on confidence. Third, equity markets remained very volatile, and could fall further. Although a considerable portion of the irrational exuberance that characterized stock valuation in the 1990s might now have been eliminated, recent accounting and auditing scandals had seriously weakened confidence. Fourth, risks in emerging markets, in particular South America and Turkey, have increased. The tightening in the emerging market financing conditions had resulted in a serious deterioration in the outlook for a number of countries in South America, and had begun to affect a number of those elsewhere. Fifth, while the fall in the dollar had so far been orderly, the U.S. current account deficit remained very high, and a more abrupt and disruptive adjustment could not be ruled out.

In the **United States**, economic growth decelerated from 3.8 percent in 2000, to 0.3 percent in 2001, and was projected to reach 2.2 percent in 2002 and 2.6 percent in 2003. The recovery had been led by strong productivity growth, which supported higher real wages and prevented a further decline in profits. There had been a marked upturn in the inventory cycle and in household spending, particularly on automobiles and housing.

In **Japan**, real GDP was projected to increase by 0.5 percent in 2002 and by 1.0 percent in 2003. Japan's economic recovery was expected to be slower than earlier anticipated. Capital spending fell, consistent with a decline in business confidence. The projected growth would be driven by exports and increased consumer spending.

In the **euro-area**, recovery seemed to be lagging behind that of other regions. In 2001, the economy grew by 1.5 percent, a fall from 3.5 percent in 2000, and it was projected to further fall to 0.9 percent in 2002, before picking up to 2.3 percent in 2003. The modest pickup in growth since late 2001 had been led by the external sector, as domestic demand had remained sluggish. The outlook for 2003 appeared to hinge on a number of factors; first, the inventory cycle, which had yet to turn substantially, should boost activity later this year. Second, consumption was expected to pick up, underpinned by recent increases in real income, falling inflation and a robust labor market performance. Third, investment was expected to strengthen as corporate profits and capacity utilisation picked up. Inflation was expected to remain subdued at 2.1 percent then decline to 1.6 percent in 2003.

Growth in **Australia** and **New Zealand** in 2001 was among the highest in industrial countries, underpinned by supportive macroeconomic policies and highly competitive exchange rates. Both the Reserve Bank of Australia and the Reserve Bank of New Zealand had kept interest rates steady, as the global outlook had weakened. The fiscal situation in both countries remained sound. In Australia, additional measures might be required to finance major structural reforms that were needed over the medium term, while ensuring the objective of balancing the budget on average over the business cycle. In New Zealand, where productivity growth had been disappointing in recent years, the authorities' focus on innovation and skill development was appropriate, and was expected to be accompanied by additional efforts to reduce disincentives to work, to save, and invest.

## Domestic Economy

Provisional data provided by the Ministry of Finance in May 2002 projected that the economy would expand by 1.6 percent in real terms during the financial year 2001/02. This was attributed mainly to growth in Construction, Mining and Quarrying, Electricity & Water, Manufacturing, Transportation and Communication, and Finance and Business Services. Commerce, Hotels and Restaurants were expected to decline.

The favourable weather conditions and abundance of rainfall during the first half of the financial year had a favourable impact on agricultural production. The supply of agricultural produce (mostly root crops and fruit and vegetables) at the Talamahu market increased by 53.4 percent during the first half of the financial year. However, the volume supplied to the market fell by 18.2 percent during the second half of the year. This decline reflected the impact of the agricultural products that were sent to Vava'u and the Niua groups to assist with the devastation caused by cyclone Waka and a seasonal decline in the supplies of fruits and vegetables. Over the year, the supplies of agricultural produce to Talamahu Market increased by 22.8 percent compared to the previous financial year.

**Table 2. Main economic indicators**

		Estimates 3/			
		1998/99	1999/2000	2000/01	2001/02
<b>Economic Activity (1995/96 base)</b>					
Real GDP 1/	% change	4.6	6.1	3.0	1.6
Nominal GDP	% change	9.6	3.5	6.1	n.a.
Tourist arrivals (numbers)	thousands	27.7	33.9	33.7	34.9
<b>Money, Prices &amp; Interest Rates</b>					
CPI	% change	4.4	6.0	6.6	10.7
Money Supply (M2 - year end)	\$m pa'anga	86.5	97.8	116.3	132.7
Domestic Credit (year end)	\$m pa'anga	125.0	123.6	142.7	164.4
Short Term Deposit Interest Rate	% per annum	5.1	5.0	5.1	5.1
<b>External Sector</b>					
Merchandise exports fob 2/	\$m pa'anga	19.1	17.9	23.3	38.8
Merchandise imports fob 2/	\$m pa'anga	87.8	102.6	120.0	133.7
Official Foreign Reserves (year end)	\$m pa'anga	34.1	26.2	25.8	39.6
Import Coverage (year end)	months	3.9	2.6	2.3	2.5
Exchange Rate (period end)	US\$/T\$	0.6278	0.5920	0.4644	0.4651

1/ Department of Statistics estimate

2/ OET-basis

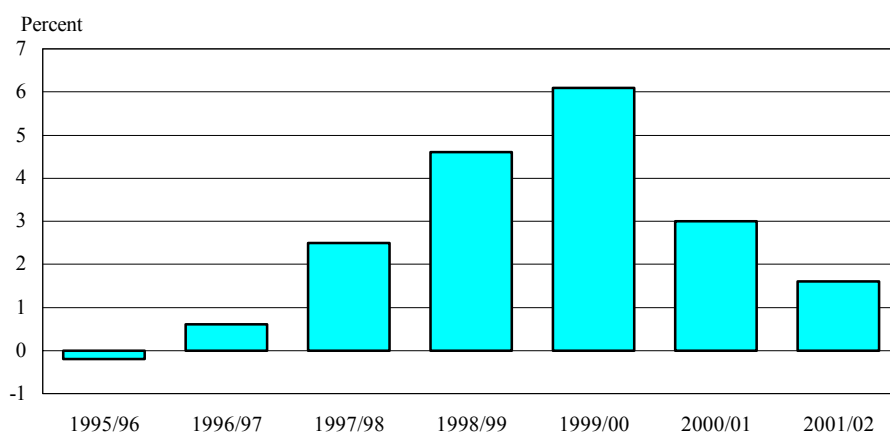
3/ Ministry of Finance estimate

Agricultural exports were led by squash with over 16,000 tonnes (Quarantine and Management Division) exported during the financial year 2001/02. This was 13.0 percent higher than the previous year, with average prices reported to be higher compared to the previous year. Based on the Overseas Exchange Transactions recorded by the commercial

banks, squash exports receipts amounted to \$14.7 million in the 2001/02 season, compared with \$7.6 million in the previous season. Higher market prices and favourable weather conditions contributed to the higher return on squash during the year.

Exports of root crops (which comprise Kape, Cassava, Swamp Taro, Taro Taruas, Yams and Sweet Potatoes) amounted to \$1.8 million during the financial year 2001/02, a decline of 8.7 percent compared with the \$2.0 million during the previous financial year. Taro Taruas accounted for 45.7 percent of total root crop exports, a pick up from 34.3 percent during the previous year while yams and sweet potatoes represented 25.9 percent, an increase from 10.2 percent last year.

The exports of kava during the financial year 2001/02 amounted to \$0.5 million. This was an increase of 91.2 percent compared with the 45.1 percent declined during the previous financial year. Market prices grew steadily while volumes increased by 51.8 percent compared to the previous year. The kava industry appears to increase growth despite the effects of cyclone Waka and the alleged side effects of kava.



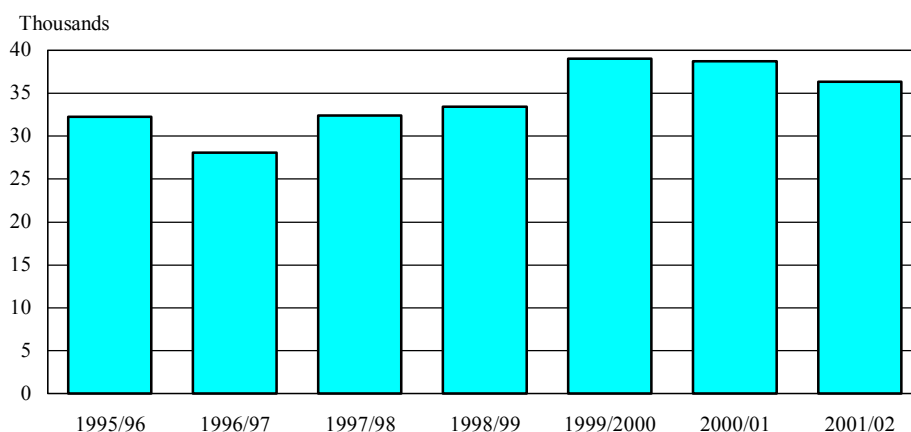
**Figure 1. Real GDP (annual percentage change)**  
(2001/02 - Ministry of Finance estimate)

Vanilla production continued to decline significantly during the year, with only 2.7 tonnes exported during 2001/02, compared with 14.6 tonnes during the year 2000/01. The low vanilla prices between 1997 and 2000, discouraged farmers and most of the vanilla plantations were destroyed to make room for other higher priced agricultural produce. However, due to recent significant rises in the price of vanilla, growers have been encouraged to grow more and to revive existing vanilla plantations.

Base on the data collected from a survey conducted by the Reserve Bank, fish exports during the year 2001/02 amounted to \$10.9 million, a 5.5 percent decline compared with \$11.5 million during the previous financial year. The decline in the value of fish exports, reflected the 9.0 percent decline in the volume of exported fish. The following were quoted as the major factors that contributed to the reduction in the volume of fish export; lower

catch due to warm weather, less airfreight space available for fish export and a major fishing export company concentrated on the domestic market. Local sales recorded a total of \$1.5 million during the year 2001/02, a 19.4 percent decline compared with \$1.9 million during the previous year.

The total number of visitors that arrived into the Kingdom during the financial year 2001/02 was 36,252, of which 96.0 percent arrived by air. This is a decline of 6.1 percent compared with 2000/01. It is believed that some tourists cancelled their visit to Vava'u after cyclone Waka devastated the group in January 2002. Receipts from tourists were reported to have declined by 2.5 percent to \$12.4 million from \$12.7 million during 2000/01.



**Figure 2. Tourist Arrivals**

According to a survey conducted by the Reserve Bank (covering vehicle, supermarket and household goods), wholesale and retail sales amounted to \$63.2 million during the financial year 2001/02, a pick up of 22.9 percent compared with \$51.5 million during the previous year. Vehicle sales declined by 20.3 percent to \$5.5 million while supermarket sales picked up by 26.7 percent to \$53.1 million during 2001/02. The opening of the new Si'i Kae Ola supermarket contributed to the rise in supermarket sales.

Construction activities increased significantly during the year with various large projects coming to completion and the commencing of others. Major projects that had been completed during the year included Si'i Kae Ola Shopping Center, Water Board Project and Ha'apai High School. Large projects in progress included projects for the Fund Management, International Dateline Hotel, 'Alatini Fisheries Store, Narottam's Warehouse and Church of Later Day Saints schools and chapels. The sales of construction materials by major wholesale and retail construction companies increased by 23.0 percent to \$24.6 million in 2001/02.

### **Electricity**

Electricity consumption increased by 6.9 percent during the year. Tongatapu continued to be the largest consumer of electricity, accounting for 75.8 percent of the total consumption,

followed by Vava'u with 14.7 percent, Ha'apai with 5.2 percent and 'Eua with 4.2 percent of overall consumption. However, the number of active consumers declined by 1.1 percent during the year. Price of electricity charged at outer islands fell by 8.0 percent while Tongatapu prices remained unchanged.

### Prices

The average annual headline inflation rate (measured by CPI) for the financial year 2001/02 was 10.7 percent, compared with 6.6 percent in 2000/01. The increase in the rate of inflation was due to increases in both domestic prices (which account for 44.8 percent of the total) and imported prices (which account for 54.2 percent of the total). Domestic prices rose by 11.8 percent compared with 5.0 percent increase in 2000/01, while import prices increased by 9.8 percent compared with 8.0 percent rise during the previous financial year.

The domestic rate of inflation increased by 11.8 percent in 2001/02, higher than the 5.0 percent increase recorded in 2000/01. The increase in domestic prices reflected a rise of 20.6 percent in domestic food prices. This reflected the seasonal increases in prices of fruits and vegetables and higher demand for meat, fish and poultry due to church conferences. Other categories that contributed to the rise in domestic prices during the year 2001/02 included: miscellaneous goods and services (6.9 percent); household goods (6.2 percent); tobacco and alcohol (3.1 percent); housing (2.8 percent) and transportation (2.8 percent).

Import prices increased by 9.8 percent during the year 2001/02, higher than the 8.0 percent increase in 2000/01. The categories that contributed to the rise in import prices were household goods (14.1 percent); miscellaneous goods and services (4.0 percent); clothing and footwear (4.0 percent) and transportation (2.9 percent).

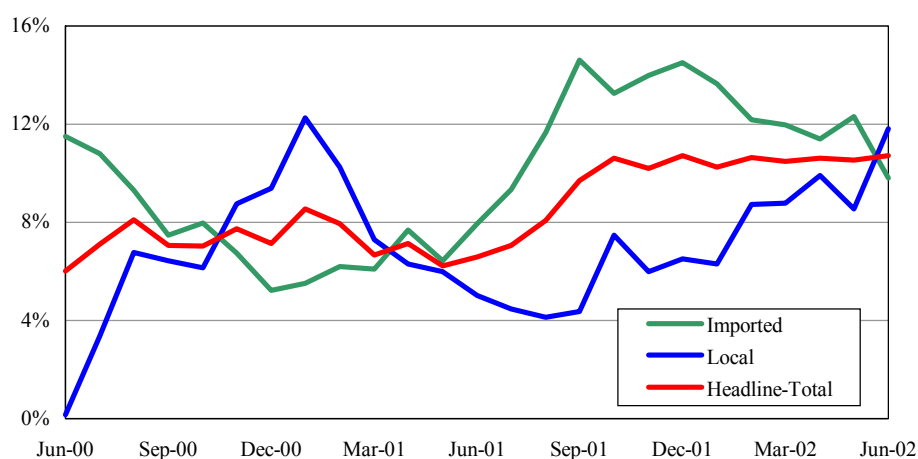


Figure 3. CPI (percentage change on same period previous year)



## Monetary Developments

### *Money Supply*

During 2001/02, broad money M2 increased to \$132.7 million compared to \$123.0 million in 2000/01. This represented a growth rate of 7.8 percent, lower than the 26.5 percent growth rate recorded in the previous year.

The strong growth in money supply during the year was reflected by an increase in M1, of \$9.4 million. The two components of M1, currency in circulation and demand deposits, both increased by \$1.6 million and \$7.8 million, respectively. The quasi-money was relatively unchanged as the increases in savings and term deposits were nearly offset by the decline in foreign currency deposits.

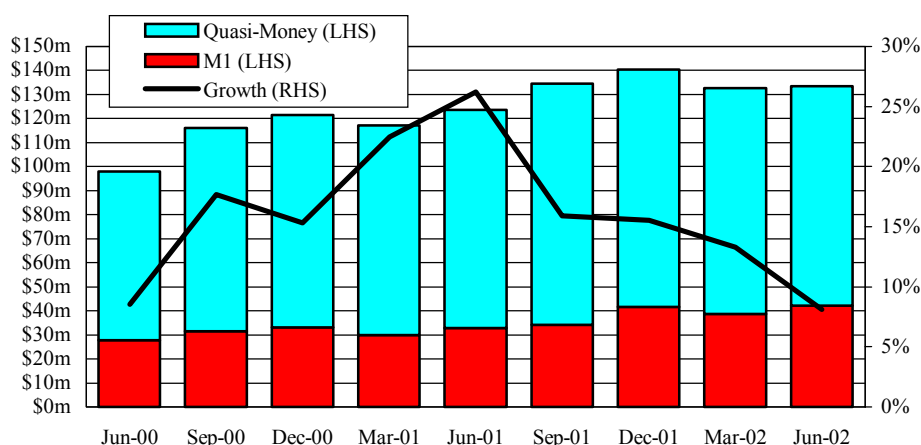


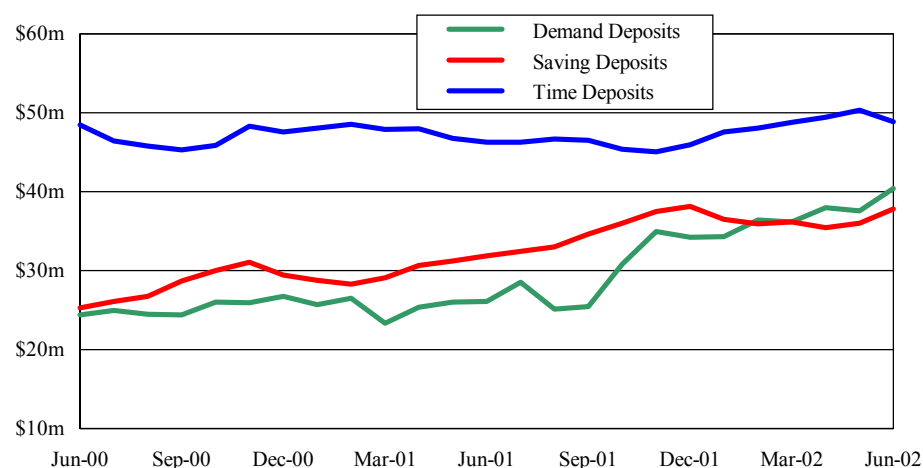
Figure 4. Money Supply (M2): Components

### *Deposits with the Banking System*

During 2001/02, the total deposits with the commercial banks increased by \$12.7 million to \$134.2 million. The increase in total deposits during the year reflected increases in deposits by the private sector, government and others. Deposits by the private sector increased by \$5.3 million to \$114.6 million. This reflected increases in demand deposits of \$6.0 million, savings deposits of \$6.0 million and time of \$2.9 million, which more than offset the decline of \$9.5 million in foreign currency deposits. Total government deposits with the commercial banks also increased by \$4.9 million to \$11.7 million.

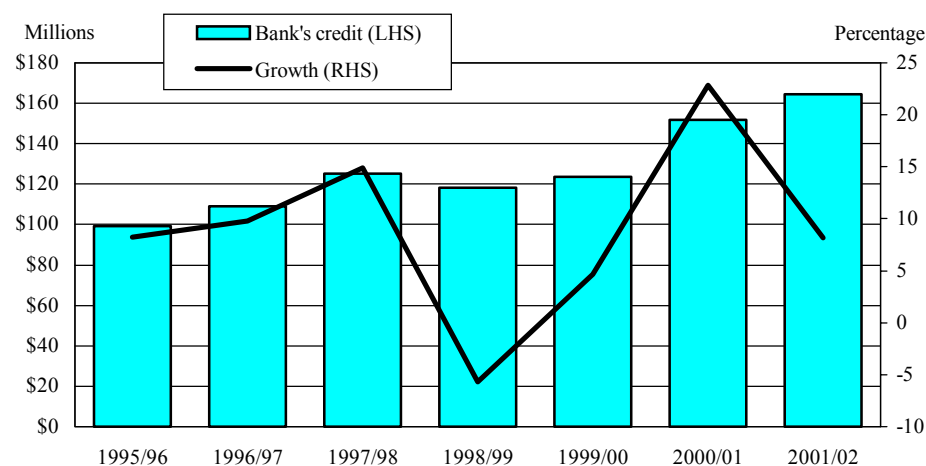
### *Domestic Credit*

During the year ended June 2002, the domestic credit extended by the banking system rose by \$12.4 million to \$164.4 million. This represented an annual growth of 8.2 percent compared with the 22.9 percent increase in 2000/01. The higher level of domestic credit was the result of an increase in credit extended to the private sector and non-financial public



**Figure 5. Deposits with the Banking System**

enterprises. Private sector credit increased by \$20.8 million to \$162.6 million and credit to the non-financial public enterprises rose by \$3.8 million to \$10.2 million. Credit to the private sector was mainly directed to the industrial and business sector.



**Figure 6. Banks' Credit**

### *Interest Rates*

With the exception of 24 months term deposit interest rates, which was revised upward from 6.17 percent to 6.33 percent in June 2002, all other term deposits below \$50,000 remained unchanged during 2001/02. For example, the average published interest rates on 3 months term deposits below \$50,000 remained unchanged at 5.13 percent in June 2002. Similarly,

the interest rates for term deposits over \$50,000 remained unchanged for all categories, except for 24 months term deposits interest rates. For example, the 3 and 6 months term deposit rates remained unchanged at 5.13 percent and 5.47 percent respectively. The interest rates paid on saving deposits also remained unchanged at 3.58 percent in June 2002.

Published interest rates on the non-monetary financial institution's securities were revised upward for most categories. The published interest rate on three-month securities below \$50,000 increased from 4.65 percent in June 2001 to 5.25 percent in June 2002.

The commercial banks' published lending rates remained unchanged during 2001/02. The lending rates for owner occupied housing loans remained unchanged at a minimum of 10.50 percent and a maximum of 12.0 percent and transportation at a minimum of 12.33 percent and a maximum of 14.17 percent per annum. The interest rates on business and personal overdraft also remained unchanged in June 2002. The published lending rates on Non-Monetary Financial Institutions term borrowing remained unchanged during the year while interest rates on business overdraft decreased from a minimum of 11.5 percent to 10.0 percent and the maximum rate of 11.5 percent was raised to 12.0 percent in March 2002.

The real deposit interest rate (based on a weighted average terms and savings deposit rate) at the end of the year 2001/02 declined from negative 0.86 percent to negative 4.97 percent. This was mainly due to the higher rate of inflation during the year. The negative real deposit interest rate means that customers are paying positive real rate of interest on borrowing but commercial banks on the other hand are paying a negative real rate of interest on deposits. This leads to a distortion of the allocation of resources.

## **External Developments**

### ***Overseas Exchange Transactions***

According to estimates based on the overseas exchange transactions data (oet), on a cash basis, collected by the Reserve Bank and the commercial banks, the overall balance recorded a surplus of \$13.8 million in 2001/02, compared with a deficit of \$0.4 million in 2000/01.

The balance of trade recorded a deficit of \$94.9 million, compared with \$96.7 million last year. The total import payments reached \$133.7 million in 2001/02, 11.4 percent higher than the \$120.0 million in the previous year. Total exports rose by \$15.5 million, reflecting the higher level of exports receipts led by squash, fish and other marine products. Higher net transfer inflows of \$116.0 million were more than enough to offset the small deficits in the services and investment income accounts. The services balance improved from a deficit of \$17.2 million to a deficit of \$4.1 million largely due to higher transportation and other services inflows combined with lower transportation and travel payments. Consequently, the current account recorded a surplus of \$15.8 million, a significant change from the \$26.2 million deficit of last year.

The capital account recorded a surplus of \$15.7 million, a significant improvement from the \$6.2 million surplus recorded last year. This increase was attributed to the disbursement of

**Table 3. Overseas Exchange Transactions (OET): Annual Summary**

	1998/99	1999/2000	2000/01	2001/02
<b>A. Merchandise trade balance</b>	-68.8	-84.7	-96.7	-94.9
Exports, f.o.b.	19.1	17.9	23.3	38.8
Imports, f.o.b.	87.8	102.6	120.0	133.7
<b>B. Services balance</b>	6.8	3.2	-17.2	-4.1
Receipts	29.6	30.0	23.0	36.2
Payments	22.8	26.9	40.2	40.3
<b>C. Investment income balance</b>	4.6	-0.8	-2.2	-1.2
Receipts	6.3	3.6	3.2	5.0
Payments	1.7	4.3	5.4	6.2
<b>D. Transfers balance</b>	55.8	66.3	89.9	116.0
Receipts	67.0	79.4	107.0	143.7
<i>Private</i>	63.6	78.6	105.7	142.1
<i>Official</i>	3.4	0.7	1.3	1.6
Payments	11.1	13.1	17.1	27.7
<i>Private</i>	9.9	12.5	16.4	26.9
<i>Official</i>	1.2	0.6	0.7	0.8
<b>E. Current account balance (A+B+C+D)</b>	-1.5	-16.0	-26.2	15.8
<b>F. Capital account balance</b>	14.2	4.2	6.2	15.7
Official capital	6.7	5.1	5.2	11.2
<i>Inflows</i>	11.1	8.3	8.7	27.0
<i>Outflows</i>	4.4	3.1	3.5	15.8
Private capital	7.5	-1.0	1.0	4.5
<i>Inflows</i>	10.9	7.4	19.9	14.0
<i>Outflows</i>	3.3	8.4	18.9	9.5
<b>G. Other items, net</b>	0.2	3.9	19.5	-17.7
<b>H. Overall balance (E+F+G) 1/</b>	12.8	-7.9	-0.4	13.8

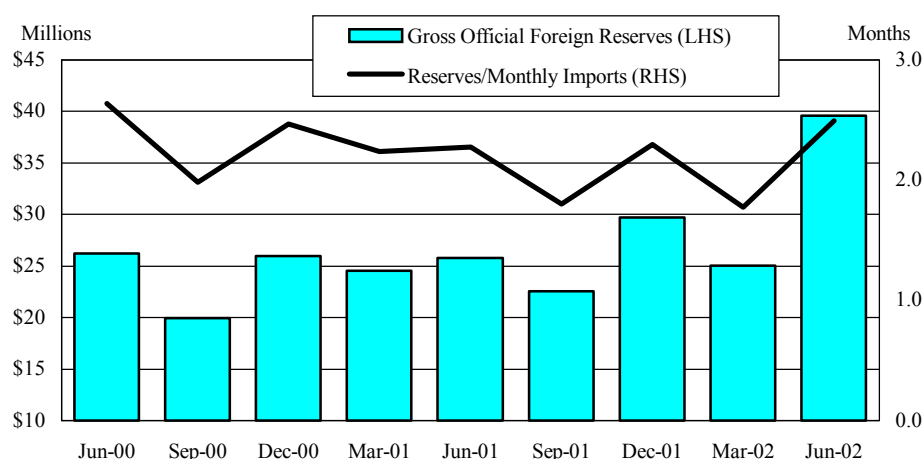
1/ Corresponds to changes in gross official foreign reserves.

the first tranche (\$10.7 million, equivalent to US\$5.0 million) of the loan from the Asian Development Bank (ADB), in support of the Economic and Public Sector Reform Program, receipt of foreign aid assistance and private capital inflow. Overall, a balance of payments surplus of \$13.8 million was recorded showing a marked improvement from the \$0.4 million deficit last year.

### ***Gross Official Foreign Reserves***

The gross official foreign reserves reached \$39.6 million at the end of June 2002, compared with \$25.8 million in the previous year. At the end of June 2002, the level of official foreign

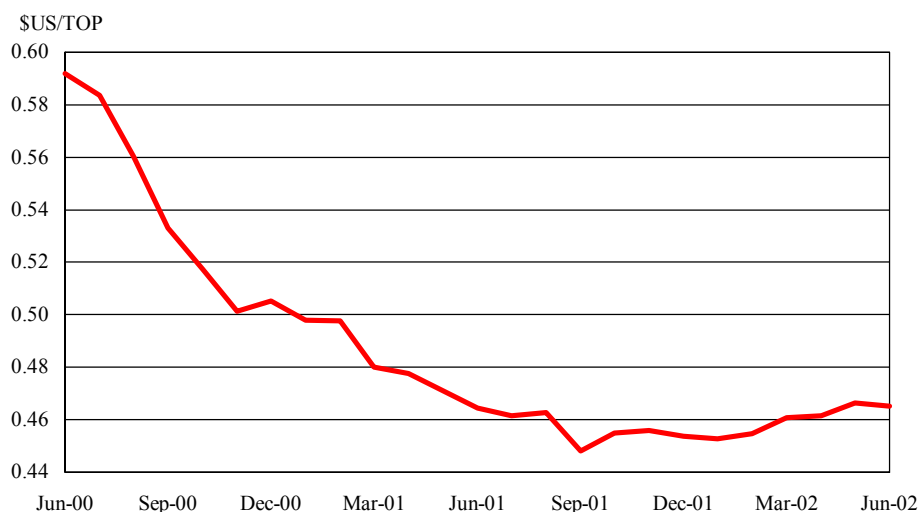
reserves was equivalent to 2.5 months of imports. The increase in the gross official reserves in the last quarter reflected the disbursement of the first tranche of the Government's loan from the ADB.



**Figure 7. Gross Official Foreign Reserves and Import Coverage**

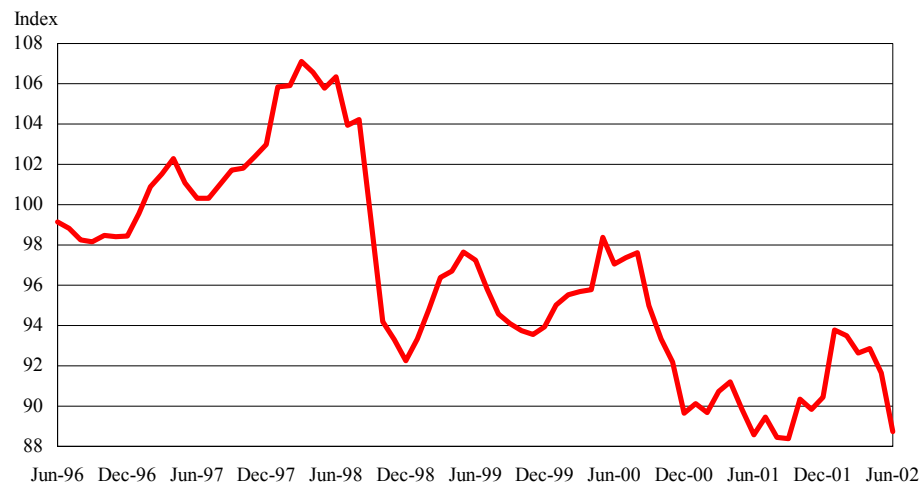
### *Exchange Rates*

During the year, the pa'anga weakened against all the currencies of Tonga's major trading partners. The pa'anga depreciated against the New Zealand dollar by 16.6 percent, Fijian dollar by 10.1 percent, Australian dollar by 9.8 percent and the Japanese Yen by 4.4 percent. On the other hand, it appreciated against the US dollar by 0.1 percent.



**Figure 8. US Dollar to Pa'anga Exchange Rate**

The nominal effective exchange rate (neer; which represents movements in the average of bilateral exchange rates with the pa'anga, weighted by trade) depreciated by 9.2 percent during the year, compared with a depreciation of 11.4 percent during the 2000/01 financial year. The real effective exchange rate (reer; a measure of external competitiveness of the Tongan economy against major trading partners weighted by their shares in Tonga's trade in goods and services) depreciated slightly by 0.2 percent during the year, compared with a depreciation of 8.6 percent during the previous financial year.



**Figure 9. Real Effective Exchange Rate (1991=100)**

## Monetary Policy Issues during 2001/02

The monetary policy objectives of the National Reserve Bank continued to be: to maintain an adequate level of foreign exchange reserves and a low inflation rate.

The official gross foreign reserves continued to be under pressure during the year until June 2002 when the first tranche of the government's loan from the Asian Development Bank was received (\$10.7 equivalent of USD5 million). At the end of June 2002, total official foreign reserves reached \$39.6 million (2.5 months of imports cover) compared with \$25.8 million (1.7 months of import cover) at the end May 2002 and \$25.8 million in June 2001 (2.3 months of import cover).

- In the wake of cyclone Waka, the Reserve Bank with the approval of Privy Council withdrew the credit ceiling on loans for housing, personal transport and personal loans that was imposed in June 2000. This decision was made to allow Banks to consider lending to those that were affected by cyclone Waka. However, the withdrawal of credit ceiling on loans for housing, personal transport and personal loans was replaced by an overall private sector credit ceiling for each individual bank. This overall credit ceiling was in line with the recommendations made by the IMF Article IV mission in May 2001.
- The Reserve Bank's minimum lending rate remained unchanged at 12 percent.
- The Statutory Reserves Deposit ratio remained unchanged at 15 percent.

These measures continued to reflect the constraints faced by the Reserve Bank. Given its financial position, the Reserve Bank was not able to manage the liquidity of the banking system by engaging in appropriate open market operations, the most preferred indirect monetary policy instrument. As such, the effectiveness of the Bank's policy instruments continues to be of concern. The main policy instrument available to the Bank for open market operations is its Reserve Bank Notes. Due to its balance sheet constraint, the Bank refrained from issuing Reserve Bank Notes after March 2001. However, the Bank has been encouraged by the indication received from the Ministry of Finance that it was considering sharing the cost of the Reserve Bank's monetary policy operations.

During the year the government continued resorting to monetary financing from the Reserve Bank to assist with the funding of its operations which makes the Bank's task of maintaining the foreign reserves at a sustainable level less easy. However, the Reserve Bank and the Ministry of Finance are working together to reduce the Ministry's resorting to such financing which is in line with the recommendations made by the IMF Article IV mission in May 2001. The Reserve Bank and the Ministry of Finance are also cooperating to promote complimentary fiscal and monetary policies for the overall economic development of the country.

## The Financial System

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The financial system in Tonga consists of three commercial banks, a development bank and the central bank. The total assets of the financial system, excluding the central bank, reached \$235.1 million at the end of June 2002, an increase of 3.9 percent from the previous year. The market share of the commercial banks dropped to 81.4 percent while that of the development bank rose to 18.6 percent in 2001/02 compared with 82.0 percent and 18.0 percent, respectively, for the previous year.

### Commercial Banks: Facilities and Operations

The three commercial banks in operation in 2001/02 included two locally incorporated banks and a foreign bank branch.

#### *Commercial Banks in Tonga*

<u>Bank</u>	<u>Headquarters</u>
Westpac Bank of Tonga	Nuku'alofa, Tonga
MBf Bank Limited	Nuku'alofa, Tonga
Australia and New Zealand Banking Group Limited	Melbourne, Australia

The Westpac Bank of Tonga maintains its head office and a branch on Tongatapu as well as branches on the islands of Vava'u, Ha'apai, and 'Eua. The MBf Bank Limited maintains its head office on Tongatapu and a branch on the island of Vava'u. The ANZ Bank has its main branch on Tongatapu and operates a branch on Vava'u.

In December 2000, Westpac Banking Corporation acquired Bank of Hawaii's 30 percent shareholding in Bank of Tonga, making it the major shareholder of Bank of Tonga with a total shareholding of 60 percent. The Bank of Tonga Act was then amended in July 2002 to reflect this change in shareholding and also allowed the change of name from Bank of Tonga to Westpac Bank of Tonga.

The total assets of the commercial banks reached \$191.45 million in 2001/02, an increase of \$5.8 million (3.1 percent) over the previous year. Total loans by the commercial banks to the non-financial sector increased by 18.8 percent to \$134.6 million in 2001/02 compared with 27.1 percent growth recorded in 2000/01. At the end of the 2001/02 financial year, the commercial banks' outstanding loans portfolio comprised: 40.2 percent for private individuals (of which 25.2 percent was for housing); 52.6 percent for industries and businesses including agriculture; and the remaining 7.2 percent was for other types of loans.

The total deposits by non-financial sector with the commercial banks grew by 10 percent to \$132.8 million in 2001/02 compared with a 21 percent growth recorded in 2000/01. The total number of accounts however declined by 15 percent to 68,194 compared with a 22 percent rise in the previous year. The number of demand deposit accounts increased by 121 percent, savings accounts decreased by 22 percent and those of time deposits accounts rose by 32 percent. In terms of value, the total demand deposits increased by 15 percent, savings deposits increased by 18 percent and time deposits increased by 2 percent.



**Table 4. Commercial Banks' Accounts**

	1998/99	1999/2000	2000/01	2001/02
<b>Demand Deposits</b>				
Number of Accounts	2,252	2,047	3,035	6,711
Value of Deposits (\$m)	23.6	27.4	40.4	46.5
<b>Saving Deposits</b>				
Number of Accounts	55,532	61,269	73,502	56,978
Value of Deposits (\$m)	24.0	24.6	31.2	36.8
<b>Time Deposits</b>				
Number of Accounts	1,246	2,357	3,413	4,505
Value of Deposits (\$m)	45.0	47.5	48.5	49.5
<b>Total Number of Accounts</b>	<b>59,030</b>	<b>65,673</b>	<b>79,950</b>	<b>68,194</b>
<b>Total Value of Deposits (\$m)</b>	<b>92.5</b>	<b>99.4</b>	<b>120.2</b>	<b>132.8</b>

## Financial Performance

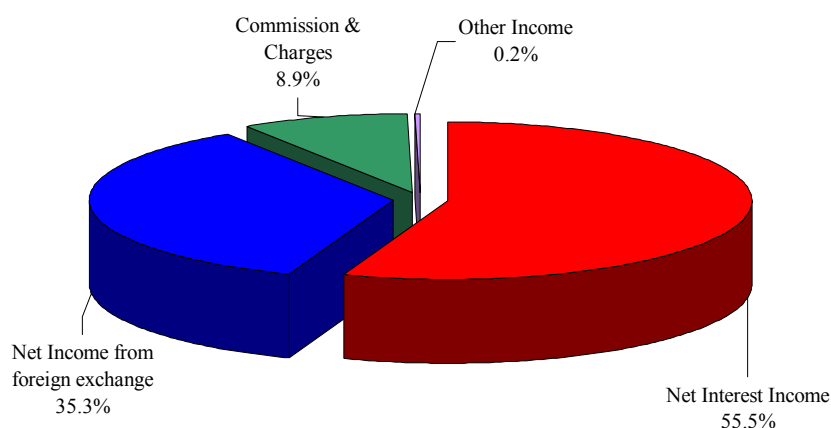
The commercial banks as a group showed a pre-tax profit (as a percentage of average assets) of 6.4 percent in 2001/02, compared with 5.4 percent in 2000/01. This increase was due to an improvement in the banks' profitability over the year. This, however, masks wide disparities in the performance of individual banks, which ranged from a strong profit position to a weak profit position.

**Table 5. Financial Performance**

	1998/99	1999/2000	2000/01	2001/02
Pre-tax Net Profit (% average total assets)	4.3	5.2	5.4	6.4
Total Operating Income (% average total assets)	9.3	9.9	10.4	11.5
Net Interest Income (% average total assets)	5.3	5.5	5.8	6.4
Non-interest Income (% average total assets)	4.0	4.4	4.6	5.1
Average Net Interest Margin (%)	6.4	6.7	7.0	7.8
Total Operating Expenses (% average total assets)	4.4	4.6	4.4	4.9
Consolidated Risk-weighted Capital Ratio (%)	33.4	25.0	23.6 <sup>1</sup>	24.3

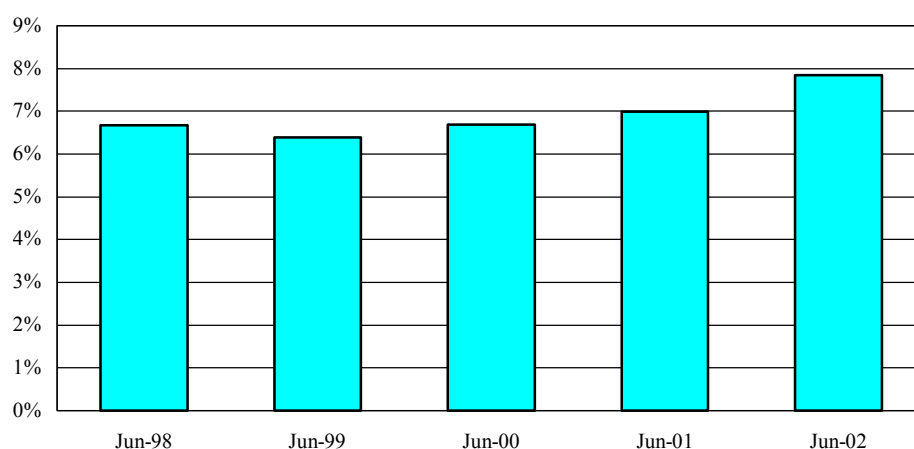
<sup>1</sup> Revised

Total operating income was 11.5 percent of average assets, an increase from 10.4 percent in 2000/01. Net interest income was 6.4 percent of average assets. The bulk of commercial banks' operating income was derived from the extension of loans. Net interest income comprised 55.5 percent of total operating income in 2001/02 compared with 55.8 percent in 2000/01. Foreign exchange business made up 35.3 percent of total income compared with 36.1 percent in the previous year and the balance of 9.2 percent came from commission and charges plus other income sources. Total non-interest income, as a percentage of average assets increased slightly to 5.1 percent compared with 4.6 percent in the previous year.



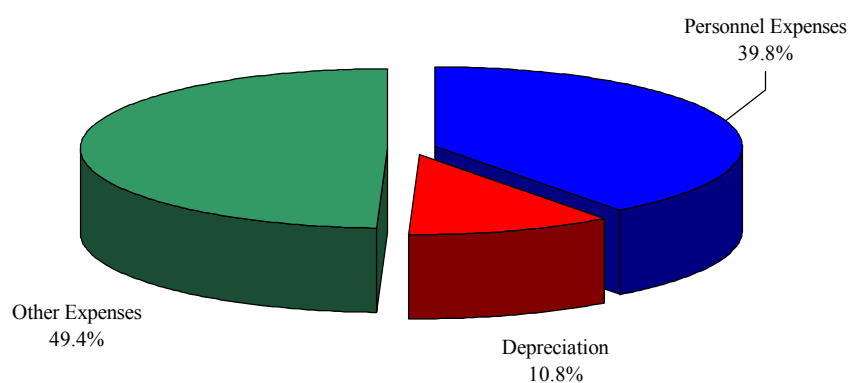
**Figure 10. Commercial Banks - Components of Total Operating Income**

The average net interest margin (net interest income as a percentage of average earning assets) for the commercial banks increased to 7.8 percent in 2001/02 compared with 7.0 percent in 2000/01.



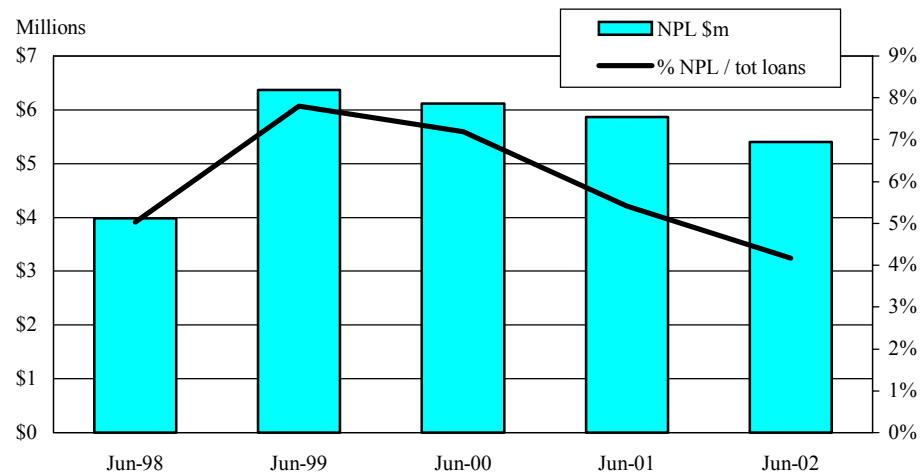
**Figure 11. Commercial Banks - Annual Net Interest Margin**

The operating expenses of the commercial banks rose to 4.9 percent of average assets in 2001/02 compared to 4.4 percent in 2000/01. About 39.8 percent of administrative expenses of the banks were taken up by employees' remuneration compared with 40.3 percent for the previous year. Depreciation and amortisation accounted for 10.8 percent of total administrative expenses and the balance of 49.4 percent was made up of the purchase of various goods and services necessary for the operations of the banks.



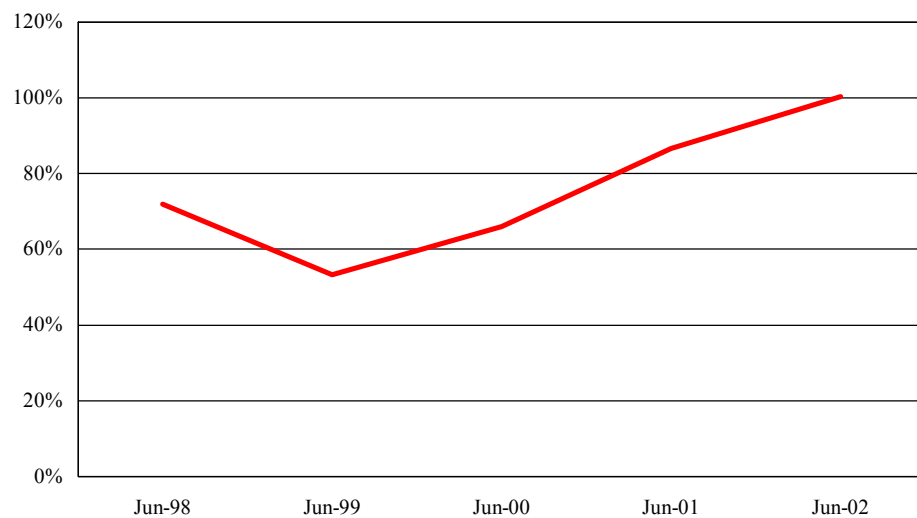
**Figure 12. Commercial Banks - Components of Total Operating Expenses**

The consolidated risk weighted capital ratio for all the commercial banks slightly improved to 24.3 percent at the end of 2002 compared with 23.6 percent at the end of June 2001.



**Figure 13. Commercial Banks - Non-Performing Loans**

The overall quality of the commercial banks' assets improved as total non-performing loans declined to 4.2 percent of total loans compared with 5.4 percent at the end of June 2001. In addition, coverage of the non-performing loans by total loan loss reserves improved to 100.4 percent compared with 86.6 percent at the end of June 2001.



**Figure 14. Commercial Banks - Coverage Ratio**

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### **Non Monetary Financial Institutions: Tonga Development Bank**

The Tonga Development Bank (TDB) was established in 1977 to provide short and long term finance to the private sector. Its main sources of funds were mainly provided by aid donors, particularly the Australian and New Zealand governments, and credit lines from multilateral lending agencies. However, TDB has been resorting more to domestic financing through the sale of TDB bonds and promissory notes.

The TDB maintains its head office on Tongatapu, as well as branches on the islands of Vava'u, Ha'apai, 'Eua, Niuatoputapu and Niuafu'ou.

The TDB's total assets reached \$43.7 million at the end of June 2002, a \$2.9 million (7.3 percent) growth over the previous year. The outstanding loans to the non-financial sector increased by 9.3 percent to \$38.1 million at the end of June 2002 compared with a 1.4 percent decline in 2000/01. Again these figures do not reflect seasonal lending for squash exports by the TDB, which peaks in October before declining over the November to January period.

The TDB's outstanding loans portfolio at the end of June 2002 comprised: 28.9 percent for agriculture; 23.0 percent for industries and manufacturing; 38.6 percent for private individuals; 2.0 percent for public enterprises; and 5.9 percent for fishing.

## **Operations of the Bank during the year ended 30 June 2002**

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### **Circulation Currency**

At the 30<sup>th</sup> of June 2002, the face value of currency notes in circulation, both new and reissuable, totalled \$13,707,805. This was an increase of 17.4 percent over the previous year and it was associated with events such as church conferences. Currency notes issued during the year totalled \$51,009,361 and currency notes withdrawn totalled \$49,890,600 of which \$3,815,850 (404,394 pieces) were classified as unfit for reissue and were destroyed; the balance was retained for reissue.

### **Circulation Coins**

At the end of June 2002 the face value of ordinary coins in circulation totalled \$1,453,910. During the year coins to a face value of \$217,692 (1,143,397 pieces) were issued. The Bank's coins are minted by the Royal Mint in the United Kingdom.

### **Numismatic Coins**

During the year numismatic coins were issued to collectors throughout the world under the agreements between the Bank and various producers for the production and marketing of a series of copper/nickel, silver and gold of various denominations.

### **External Reserves**

The Bank is required to maintain, within the limit of its powers, an external reserve at a level, which it considers adequate. The Bank considers an external reserve level equivalent to at least 3 to 4 months of imports to be adequate. During the year the gross official external reserves ranged between 2.0 months and 3.6 months of import cover. The level of gross external reserves ranged from \$22.4 million to a peak of \$39.6 million at the end of June 2002. At 30<sup>th</sup> June 2002 the total external reserves were \$39.6 million, equivalent to 2.5 months of imports. This compares with the level of \$25.8 million at 30 June 2001, equivalent to 2.3 months of imports.

The Bank holds the external reserves mainly in Australian dollars, New Zealand dollars, US dollars, pounds sterling, euro and special drawing rights. The strategy adopted for the investment of the external reserves is to obtain the maximum income commensurate with safety, liquidity and the maintenance of overall value.

### **External Value of the Pa'anga**

Section 34 of the Reserve Bank Act requires the Bank to determine the rate at which the pa'anga may be exchanged for the currency of another country. Since February 1991, the Bank has established the external value of the pa'anga daily by reference to a weighted basket of currencies of Tonga's most important partners in foreign trade and payments transactions. In June 2000, the Bank revised the composition and weights of the currencies in the basket. During 2001/02 the external value of the pa'anga ranged between US\$0.45 and US\$0.47.

The Bank monitors the movement of the rate of exchange of the pa'anga against other currencies with a view to ensuring that the Kingdom's export competitiveness and balance of payments position are maintained at levels, which are consistent with the achievement of the government's economic objectives. Since March 1998, the Bank, with the approval of His Majesty in Council, began to make technical adjustments to the external value of the pa'anga with a view to maintaining the external competitiveness of the economy in light of volatile external conditions as well as domestic developments. In June 2000, His Majesty in Council also approved that the limits within which the Bank might make adjustments should be extended to enable the Bank to react in a flexible manner to external shocks and to maintain the exchange rate at a level, which is consistent with the external competitiveness of the Kingdom's exports and services sectors. These adjustments continued during 2001/02.

### **Foreign Exchange Operations**

The Bank conducts foreign exchange operations with the domestic banks in the intervention currency only, the US dollar. The Bank quotes daily buying and selling rates for the US dollar against the pa'anga. These rates generally form the basis of the commercial banks' publicly quoted foreign exchange dealing rates. The Bank also conducts foreign exchange operations for its other customers, and for its own account, in a range of currencies. The total foreign exchange turnover for the year was \$104.4 million.

### **Domestic Market Operations**

The Bank had been using open market operations as the preferred monetary policy instrument for managing the liquidity of the banking system. The main policy instrument available to the Bank for open market operations is its Reserve Bank Notes. Due to its balance sheet constraint, the Bank refrained from issuing Reserve Bank Notes after March 2001. Therefore, at the end of 30 June 2002 there were no outstanding Reserve Bank Notes. However, the Bank has been encouraged by the indication received from the Ministry of Finance that it was considering sharing the cost of the Reserve Bank's monetary policy operations.

The Bank acts, as registrar for several of the Government of Tonga's bond issues, the total value of which was \$20.9 million at 30 June 2002. The Bank also seeks to develop the domestic capital market in Tonga.

### **Export Finance Liquidity Facility**

The Bank established the export finance liquidity facility in 1990 to ensure that any liquidity constraints in the banking system would not impede the financing of merchandise exports. There were no advances under the export finance liquidity facility during the year.

### **Operations with Licensed Financial Institutions**

The required reserve deposit remained unchanged at 15 percent of deposits and other similar liabilities during the year. No interest is payable on these deposits. The Bank

presently pays interest on excess reserves held with it by the domestic banks. The interest payable is 1.5 percent per annum for balances held in excess of a minimum level of \$1 million.

The Bank's minimum lending rate remained unchanged at 12 percent during the year.

The Bank continued to provide temporary liquidity to the banking system through the use of repurchase agreements with the domestic banks.

In 2001/02 \$4.1 million of repurchase agreement transactions were conducted with the banks. The interest rate on the transactions ranged from 17 percent to 19.5 percent per annum.

During the year, the domestic inter-bank market continued to develop. Total loans of \$3.21 million were made during the year for maturities ranging from overnight to over six months. The interest rate charged by the banks was 6 percent per annum for overnight loans.

### **External Relations**

During the year the Bank prepared regular briefing papers for the government on the level of the foreign reserves, interest rates and exchange rates. The Bank also conducted meetings with the domestic banks in order to review activities in the banking sector as well as to discuss policy issues. The Bank also met with representatives of international aid agencies and bilateral aid donors to discuss matters of mutual interest.

### **Supervision of Financial Institutions**

The National Reserve Bank of Tonga Act and the Financial Institutions Act authorise the Bank to undertake the prudential supervision of the licensed financial institutions. The primary concerns of the Bank are the stability of the financial system and the security of depositors' funds with the commercial banks.

During the year the Financial Institutions Department, which is responsible for administering the supervisory functions of the Bank, continued its supervisory activities. The Bank continued to monitor and evaluate the overall strategies, policies and performance of the financial institutions – where appropriate with reference to specific legal or prudential criteria – and formed a view as to the soundness of the institution and the competence of those running it. The Bank continued to administer its activities through the system of regular reports received from the financial institutions throughout the year. The reports were analysed to ensure that the activities of the financial institutions complied with the terms of their licences and other specified prudential standards such as capital adequacy and limits on credit exposures. The reports were also analysed for any significant changes in their financial conditions. During the year the Bank also continued to hold regular meetings with licensed financial institutions in order to discuss their operations and compliance with the regulations.



**Financial Results 2001/02**

Gross income from operations for the year ended 30 June 2002 amounted to \$2.46 million (2001, \$2.64 million); cost of maintaining the currency issue was \$0.22 million (2001, \$0.31 million), and administration and other costs were \$1.52 million (2001, \$1.29 million). The net operating profit for the year was \$0.404 million (2001, \$0.279 million).

The greater portion of the Bank's income is the interest received from the investment of the external reserves and the investment on Tongan asset. The decline in the overseas interest rates reduced the Bank's interest income from investment of the external reserves during the year. However, the decline in interest expenses more than offset the reduction in interest income which resulted in an improvement in the gross income of the Bank for 2001/02.

The Ministry of Finance has accepted the Bank's proposal to consider sharing the costs of operation through increasing the Bank's paid up capital and making resources available to meet the costs of liquidity management. The Minister of Finance has also approved that the net profit for the year ended June 2002 be transferred to the Bank's General Reserve account. This would improve the capital position of the Bank.

**Board of Directors**

During the year the Board of Directors met regularly to formulate the policies of the Bank and to monitor its operations. The Governor was appointed by His Majesty in Council to the position of the Minister of Finance on 24 January 2001. He is presently acting as Governor until a new appointment is made by the Privy Council. Mr. Tevita P. Tupou's membership in the Board of Directors was terminated when he resigned as Minister of Justice and Attorney General in September 2001. Furthermore, the Ex-officio membership of the Secretary for Finance was replaced by the Minister of Finance in January 2002.

**Staff**

Staff numbers increased during the year to 55 from 44 the previous year. This reflected the filling of some of the vacant positions. During the year, the Bank received advisory services provided by the International Monetary Fund and the Pacific Financial Technical Assistance Centre based in Suva. In July 2001, the IMF contracted a General Advisor to the Bank for six months. This contract was extended for another six months.

**Training**

The staff of the Bank attended various courses in the region in specialised areas relevant to their functions. The courses attended included IMF courses held at the Singapore Training Institute. A member of the staff also received a long term training award by AusAid to undertake a post graduate study in Western Australia. Four Security Guards participated in a short-term security training course held in Nuku'alofa that was organised by NZODA. The Bank continued to support staff development through financial assistance to staff undertaking approved part time and correspondence courses.

**Attendance at Meetings**

In March 2002 the Deputy Governor Financial Institutions and Markets attended the Conference on Financial Sector Regulations and Supervision for Pacific Island Countries organised by the IMF – Singapore Regional Training Institute and the Pacific Financial Technical Assistance Centre. She also attended the annual meeting of the Asia Pacific Group on Money Laundering in Brisbane. The Deputy Governor Corporate Services attended the ADB Annual Meeting in Shanghai in May 2002. She also attended the annual meeting of the South East Asian Central Bank Governors held in Mongolia.

Senior officers of the Bank also visited various overseas financial institutions with which the Bank maintains a business relationship.

**Acknowledgement**

The directors and management of the Bank take this opportunity to record their appreciation of the services rendered by the staff during the year. The assistance from the International Monetary Fund, the Reserve Bank of Australia, the Reserve Bank of New Zealand, Reserve Bank of Fiji, other regional central banks, Australian Prudential Regulation Authority, Pacific Technical Assistance Centre and the governments of New Zealand and Australia, is also gratefully acknowledged.

## Senior Officers

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### Senior Officers as at 30 June 2002

<b>Governor (Acting)</b>	Siosiu T T 'Utoikamanu
<b>Deputy Governor, Corporate Services</b>	Seneti 'Aho
<b>Deputy Governor, Financial Institutions &amp; Markets</b>	Siosi Koka Mafi
<b>Acting Manager, Financial Institutions &amp; Markets</b>	Jessie Cocker
<b>Acting Manager, Corporate Services</b>	Paula Taumoepeau



**NATIONAL RESERVE BANK OF TONGA**

**ACCOUNTS -  
30 JUNE 2002**

**APPROVAL OF ACCOUNTS**

In the opinion of the directors, the accounts set out on pages 29 to 38 are drawn up so as to give a true and fair view of the state of affairs of the Bank as at 30 June 2002 and of its results for the year ended on that date.

The accounts are approved in accordance with a resolution of the Board of Directors of the National Reserve Bank of Tonga.

Signed on this **6th** day of **September 2002**.

HRH Prince 'Ulukalala Lavaka Ata

CHAIRMAN

Hon. Siosuia T. T. 'Utoikamanu

ACTING GOVERNOR

Nuku'alofa  
Tonga

**NATIONAL RESERVE BANK OF TONGA****ACCOUNTS -  
30 JUNE 2002****INDEPENDENT AUDIT REPORT**

To the shareholder of the National Reserve Bank of Tonga.

**Scope**

We have audited the accounts of the National Reserve Bank of Tonga for the year ended 30 June 2002 as set out on pages 29 to 38. The Bank's directors are responsible for the preparation and presentation of the accounts and the information they contain. We have conducted an independent audit of these accounts in order to express an opinion on them to the Board of Directors of the Bank.

Our audit has been conducted to provide reasonable assurance as to whether the accounts are free of material misstatement. Our procedures included examination on a test basis, of evidence supporting the amounts and other disclosures in the accounts and the evaluation of accounting policies and significant accounting estimates. These procedures have been undertaken to form an opinion as to whether in all material respects, the accounts are presented fairly in accordance with the provisions of the National Reserve Bank of Tonga Act, 1988 so as to present a view which is consistent with our understanding of the Bank's financial position and the results of its operations.

The audit opinion expressed in this report has been formed on the above basis.

**Audit Opinion**

In our opinion

- a) proper books of account have been kept by the Bank, so far as it appears from our examination of those books, and
- b) the accompanying accounts:
  - (i) are in agreement with the books of account;
  - (ii) to the best of our information and according to the explanations given to us:
    - (a) give a true and fair view of the state of affairs of the Bank as at 30 June 2002 and of the results of the Bank for the year ended on that date;
    - (b) are in accordance with the provisions of the National Reserve Bank of Tonga Act, 1988.

We have obtained all the information and explanations, which, to the best of our knowledge and belief, were necessary for the purposes of our audit.

LAUTOKA, FIJI  
6 September 2002

PricewaterhouseCoopers  
Chartered Accountants

<b><u>NATIONAL RESERVE BANK OF TONGA</u></b>	<b><u>PROFIT &amp; LOSS STATEMENT FOR THE YEAR ENDED 30 JUNE 2002</u></b>
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2001 \$	Notes	2002 \$
<u>1,877,282</u>		<u>2,139,532</u>
	<b>INCOME FROM OPERATIONS:</b>	
	Net of Interest Paid \$321,922 (2001: \$766,213)	
	Less:	
	<b>OPERATING EXPENSES:</b>	
310,133	Currency Issue	218,406
945,596	Administration	1,153,737
14,480	Audit Fees	25,586
<u>327,877</u>	Depreciation	<u>337,790</u>
<u>1,598,086</u>		<u>1,735,519</u>
279,196	<b>OPERATING PROFIT</b> for the year	404,013
<u>279,196</u>	<b>TRANSFER TO GENERAL RESERVE</b>	<u>404,013</u>
	<b>BALANCE PAYABLE TO GOVERNMENT OF TONGA</b>	
	In accordance with section 8(1)(b) of the National Reserve Bank of Tonga Act, 1988	
<u>\$ -</u>		<u>\$ -</u>

## **NATIONAL RESERVE BANK OF TONGA**

2001		Notes	2002
\$			\$
	<b>CAPITAL &amp; RESERVES</b>		
<u>\$2,000,000</u>	Authorised Capital		<u>\$2,000,000</u>
1,000,000	Paid up capital		1,000,000
<u>303,981</u>	General Reserve	2	<u>707,994</u>
1,303,981			1,707,994
<u>492,262</u>	<b>REVALUATION RESERVE</b>	3	<u>1,147,958</u>
	<b>CURRENCY ISSUE</b>		
11,679,045	Notes		13,707,805
<u>1,415,353</u>	Coins		<u>1,453,910</u>
13,094,398			15,161,715
	<b>DEMAND DEPOSITS</b>		
950,928	Banks		4,964,035
8,394,284	Government		14,306,617
13,770,281	International Agencies		14,278,319
<u>15,099,244</u>	Other foreign currency liabilities	7	<u>7,836,651</u>
38,214,737			41,385,622
<u>18,347,000</u>	<b>STATUTORY RESERVE DEPOSITS</b>		<u>20,509,000</u>
<u>698,571</u>	<b>OTHER LIABILITIES</b>		<u>816,147</u>
<u>\$72,150,949</u>			<u>\$80,728,436</u>



		<b>BALANCE SHEET</b>	
		<b>30 JUNE 2002</b>	
2001		Notes	2002
\$			\$
<b>EXTERNAL RESERVES</b>			
International Monetary Fund			
4,588,425	- Reserve Tranche	4	4,862,400
343,096	- Special Drawing Rights		483,909
20,874,688	Short term bills and current accounts	1(ii)	34,218,190
<u>25,806,209</u>			<u>39,564,499</u>
<b>INTERNATIONAL MONETARY FUND</b>			
<u>13,770,281</u>	Currency Subscription	4	<u>14,278,318</u>
<b>CLAIMS ON GOVERNMENT OF TONGA</b>			
5,335,832	Deposit with Treasury	5	5,335,832
8,865,000	Investment - Government of Tonga Bonds		8,759,000
<u>14,200,832</u>			<u>14,094,832</u>
<u>8,816,523</u>	<b>ADVANCE BANKS</b>		<u>3,631,082</u>
<u>7,921,230</u>	<b>FIXED ASSETS</b>	6	<u>7,758,190</u>
<u>1,635,874</u>	<b>OTHER ASSETS</b>		<u>1,401,514</u>
<u>\$72,150,949</u>			<u>\$80,728,436</u>

**NATIONAL RESERVE BANK OF TONGA****STATEMENT OF CASH FLOWS  
YEAR ENDED 30 JUNE 2002**

2001		Notes	2002
<b>CASH FLOWS FROM OPERATING</b>			
285,291	Rental Income		270,008
27,020	Numismatic Sales		28,827
340,601	Other Income		584,212
2,252,815	Interest Receipts		1,634,581
( 106,465)	Interest paid on NRBT Notes		-
( 585,207)	Other Interest Payments		( 461,231)
( 726)	Currency expenditures		( 8,720)
( 970,791)	Administrative expenditures		( 1,167,995)
<b>1,242,539</b>	<b>Net cash inflows from operating activities</b>	<b>9</b>	<b>879,683</b>
<b>CASH FLOWS FROM INVESTING</b>			
( 182,149)	Purchase of Fixed Assets		( 145,891)
-	Proceeds from sale of Fixed Assets		450
( 630,000)	Purchase of currency stock		-
( 8,817,000)	Net movement in repurchase advance		5,185,441
( 946,840)	Net movement in IMF accounts		( 414,788)
145,794	Net movement in staff loans		( 23,768)
( 8,797,000)	Net movement in Government of Tonga Bonds		106,000
<b>19,227,195</b>	<b>Net cash inflows from investing activities</b>		<b>4,707,444</b>

<b>NATIONAL RESERVE BANK OF TONGA</b>		<b>CON'T STATEMENT OF CASH FLOWS YEAR ENDED 30 JUNE 2002</b>	
2001			2002
		Notes	
	<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
2,926,000	Net movement in currency in circulation		2,067,888
15,709,758	Net movement in demand deposits		2,828,628
5,808,000	Net movement in statutory deposits		2,162,000
( 9,270,000)	Net movement in NRBT notes		-
( 167,729)	Net movement in other liabilities	(	241,999)
( 4,000)	Net movement in other assets	(	3,881)
<b>15,002,029</b>	<b>Net cash inflows from financing activities</b>		<b>6,812,636</b>
<b>( 2,982,626)</b>	<b>NET INCREASE/(DECREASE) IN CASH</b>		<b>12,399,762</b>
<b>22,256,469</b>	<b>CASH AT BEGINNING OF FINANCIAL YEAR</b>		<b>20,878,037</b>
<b>1,604,194</b>	<b>REVALUATION RESERVE</b>	<b>3</b>	<b>942,685</b>
<b>\$ 20,878,037</b>	<b>CASH AT END OF FINANCIAL YEAR</b>	<b>9</b>	<b>\$ 34,220,484</b>

**NATIONAL RESERVE BANK OF TONGA****NOTES TO AND FORMING  
PART OF THE ACCOUNTS  
YEAR ENDED 30 JUNE 2002****1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND  
STATUTORY REQUIREMENTS**

The financial statements of the National Reserve Bank of Tonga have been prepared based on accounting principles approved by the Board of Directors in compliance with the National Reserve Bank of Tonga Act 1988.

The financial statements are prepared on the basis of historical cost convention, which has no regard to changes in the level of prices.

**ACCOUNTING POLICIES****(i) Foreign Currencies**

Foreign currencies have been translated to Tongan currency at rates of exchange ruling at the year end. Realised and unrealised gains and losses arising during the year from changes in the valuation of foreign currencies are taken to the revaluation reserve account in accordance with the provisions of Section 33 of the National Reserve Bank of Tonga Act, 1988 and are not included in the computation of annual profits and losses of the Bank. Losses arising from such changes are set off against any credit balance in the revaluation reserve account; if such balance is insufficient to cover such losses, His Majesty in Council shall cause to be transferred to the ownership of the Bank non-negotiable non-interest bearing securities issued by the Government to the extent of the deficiency. Any credit balance in the revaluation reserve account at the end of each year is applied first, on behalf of the Government, to the redemption of any non-negotiable non-interest bearing notes previously transferred to the Bank by the Government to cover losses. Thereafter, one fifth of the remaining balance is paid to the Government, except that if the remaining balance does not exceed \$100,000 it shall be paid in full to the Government.

**(ii) Securities**

Short term bills are valued at cost.

Where foreign currency assets are the subject of a sale and repurchase agreement the asset is shown net of the repurchase liability.

**(iii) Currency Issue**

The face value of notes and coins on issue is taken up as a liability in the accounts. Where notes and coins on issue are no longer considered to be in circulation, either through their age or their numismatic value, they are written back to income.

**NATIONAL RESERVE BANK OF TONGA****NOTES TO AND FORMING  
PART OF THE ACCOUNTS  
YEAR ENDED 30 JUNE 2002****(iv) Coins sold as numismatic items**

The Bank sells, or receives royalties on, coins which are specially minted or packaged as numismatic items. These coins have not been accounted for as currency issued for circulation as they are not issued for monetary purposes. In terms of Section 53(2) of the National Reserve Bank of Tonga Act, 1988, His Majesty in Council has specified by notice in the Gazette that the Bank shall not be required to include in its accounts the face value of these coins in circulation.

**(v) Income Tax**

The Bank is exempted from all Government taxes in accordance with Section 55 of the National Reserve Bank of Tonga Act, 1988.

**(vi) Depreciation**

Fixed assets are depreciated on a straight line basis so as to write off the cost of each fixed asset over its estimated useful life. The principal annual rates in use are:

Leasehold buildings	1.1%
Plant & equipment	6.7%
Carpets, drapes and security system	10.0%
Furniture & fittings, computer equipment and motor vehicles	25.0%

**(vii) Cash Flows**

Cash is defined as notes and coins held by National Reserve Bank of Tonga tellers cash, short term loans with maturity of twelve months or less in Tongan Pa'anga, and foreign currency cash and short term loans held by National Reserve Bank of Tonga in foreign currency.

**2. GENERAL RESERVE**

2001		2002
\$		\$
24,785	Balance - 1 July 2001	303,981
279,196	Transfer to/(from) Net Operating Profit for the year (as provided for under Section 8(1)(a) of the NRBT Act, 1988, and approved by the Minister of Finance)	404,013
<u>\$ 303,981</u>	Balance - 30 June 2002	<u>\$ 707,994</u>

**NATIONAL RESERVE BANK OF TONGA****NOTES TO AND FORMING  
PART OF THE ACCOUNTS  
YEAR ENDED 30 JUNE 2002****3. REVALUATION RESERVE ACCOUNT (Refer note 1 (i) )**

2001		2002
\$		\$
( 988,866)	Balance - 1 July 2001	492,262
	Net gains/(losses) arising during the year from translation of foreign currency assets to Tongan currency	
1,604,194		942,685
<u>615,328</u>		<u>1,434,947</u>
	Payable to the Government of Tonga in accordance with Section 33(3) of the National Reserve Bank of Tonga Act, 1988	
123,066		286,989
<u>\$ 492,262</u>	Balance - 30 June 2002	<u>\$ 1,147,958</u>

**4. INTERNATIONAL MONETARY FUND**

- (i) The Bank was designated to serve with effect from 1 July 1989 as the fiscal agent of Tonga for the purposes of the International Monetary Fund by virtue of Section 51(1) of the National Reserve Bank of Tonga Act, 1988, and assumed the financial obligations of the membership of the Kingdom of Tonga as from that date by virtue of Section 36(1)(c) of the National Reserve Bank of Tonga Act, 1988.
- (ii) As at 30 June 2002, Tonga's membership subscription to the International Monetary Fund was SDR 6,900,000 (2001: SDR 6,900,000). Of the total amount SDR 1,710,106 (2001: SDR 1,710,106) had been paid in foreign currencies, shown in the Balance Sheet as Reserve Tranche, and the balance representing the Currency Subscription portion was satisfied by crediting the demand deposit accounts of the International Monetary Fund with the Bank.

**5. DEPOSIT WITH TREASURY**

Part of the assets of the Board of Commissioners of Currency, taken over by the Bank on 1 July 1989, comprised a deposit with the Treasury of \$5,906,215. An amount of \$570,383 was repaid by the Treasury on 14 July 1989 and the balance of \$5,335,832 remains outstanding. The deposit is non-interest bearing. The deposit arose through the method of accounting for notes and coins issued and redeemed by the Board of Commissioners of Currency through the Treasury.

**NATIONAL RESERVE BANK OF TONGA****NOTES TO AND FORMING  
PART OF THE ACCOUNTS  
YEAR ENDED 30 JUNE 2002****6. FIXED ASSETS**

2001		2002
\$		\$
9,905,582	Leasehold land & buildings - at cost	9,983,506
<u>2,166,389</u>	Less : accumulated depreciation	<u>2,429,748</u>
<u>7,739,193</u>		<u>7,553,758</u>
755,176	Other fixed assets - at cost	845,502
<u>573,139</u>	Less : accumulated depreciation	<u>641,070</u>
<u>182,037</u>		<u>204,432</u>
10,660,758	Total - at cost	10,829,008
<u>2,739,528</u>	Less : accumulated depreciation	<u>3,070,818</u>
<u><u>\$ 7,921,230</u></u>		<u><u>\$ 7,758,190</u></u>

**7. OTHER FOREIGN CURRENCY LIABILITIES**

2001		2002
\$		\$
598,313	Accounts of International Organisations	465,159
4,328,528	Accounts of Domestic Organisations	3,064,860
10,172,403	Repurchase Agreements	4,306,632
<u>\$15,099,244</u>		<u>\$7,836,651</u>

**8. COMMITMENTS AND CONTINGENCIES**

Commitments and contingencies not otherwise provided for in the accounts and which existed at 30 June 2002 comprise:

(i) Contracts for foreign exchange transactions - \$1,383,365 (2001: \$1,304,428)

(ii) In accordance with the accounting policy in Note 1

(iii) Numismatic coins are not brought to account in the determination of the Bank's liabilities but a liability may arise if such coins are encashed for their face value. The Bank is of the opinion that in the unlikely event of encashment as legal tender, no significant loss is expected to arise.

**NATIONAL RESERVE BANK OF TONGA****NOTES TO AND FORMING  
PART OF THE ACCOUNTS  
YEAR ENDED 30 JUNE 2002****9. CASH BALANCES**

2001		2002
\$		\$
3,349	Cash on hand	2,295
<u>20,874,688</u>	Short term bill and current accounts	<u>34,218,189</u>
<u><u>\$ 20,878,037</u></u>		<u><u>\$ 34,220,484</u></u>

**RECONCILIATION OF NET CASH PROVIDED  
BY OPERATING ACTIVITIES TO NET PROFIT**

2001		2002
\$		\$
279,197	Net Profit	404,013
325,709	Increase in interest receivable	60
( 63,477)	Increase (Decrease) in income accrued	56,115
( 9,995)	(Decrease) in interest accrued on NRBT Notes	-
84,536	Increase (Decrease) in other interest accrued	( 139,309)
( 4,083)	Increase (Decrease) in expenses accrued	19,584
( 6,632)	Increase (Decrease) in expenses prepaid	( 8,256)
327,877	Depreciation	337,790
309,407	Amortisation of currency stock	209,685
<u><u>\$ 1,242,539</u></u>	<b>Net cash from operating activities</b>	<u><u>\$ 879,683</u></u>