

National Reserve Bank of Tonga

Annual Report 2008-09

Pangike Pule Fakafonua ‘o Tonga

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National Reserve Bank of Tonga

Annual Report for the Year Ended 30 June 2009

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Discrepancies between the sum of the constituent items and the total, as shown in some tables, are due to rounding.
Revisions to previously published statistics are included as they occur.

Governor's Forward

The 2008/09 financial year was another challenging year for the Tongan economy. The global financial crisis intensified, the world economy slipped into recession and the spillover effects started to affect the Pacific region including Tonga. The Ministry of Finance estimated the Tongan economy to have contracted by 0.4 percent in 2008/09, a downward revision from the 0.4 percent growth released in the Budget Statement in May 2009. The slowdown in economic activity largely reflected the impact of the global crisis which led to falling remittances, declining tourism receipts and lower imports.

To counter the adverse impact of the global crisis on the Tongan economy, the National Reserve Bank of Tonga (NRBT) played its part, ensuring that the stability of the Tongan economy and financial system was sound throughout the financial year. I am pleased to report that despite the many challenges to the Tongan economy, the internal and external stability of the country was maintained. The level of official foreign exchange reserves continued to rise reaching 5.3 months of imports at the end of the financial year and inflation continued to fall and stood at 1.2 percent in the year ended June 2009. It is anticipated that the foreign reserves would remain at adequate levels, above 4.0 months of import cover in the next financial year. Inflation is projected to rise in the next financial year in line with the rebound in oil prices and the movement in the exchange rate but will remain in single digit.

Monetary policy was adjusted throughout 2008/09 to safeguard the foreign reserves position at an adequate level and curb inflation. In October 2008 the Reserve Bank issued NRBT notes to mop up excess liquidity in the system following the large foreign exchange receipt by government and a private company and the capital injection by the commercial banks in September. In June 2009 the monetary policy stance was eased to enable further reductions in interest rates in order to support credit growth and stimulate sustainable economic activity. The Reserve Bank ceased the issue of NRBT notes and reduced the Statutory Reserve Deposit (SRD) from 10 percent to 5 percent in August 2009. The Reserve Bank also reduced the interest rate on its repurchase facility for banks from 10 percent in March to 4.5 percent in May 2009. The basis of the policy decisions of the Reserve Bank was, as usual, published on the September 2009 Monetary Policy Statement together with the state of the Tongan economy and financial system.

The Reserve Bank issued six new prudential statements to further strengthen the licensed financial institutions' understanding of the Reserve Bank's requirements and to comply with the requirements of the Financial Institutions Act. The major challenge for the financial sector was the notable deterioration in asset quality of banks as non-performing loans increased significantly. This was largely attributed to inadequate risk management and oversight, weak lending procedures, and the impact of the slowdown in remittances and economic activity.

Correspondingly, a significant amount of provisioning was raised and banks injected additional capital to meet the Reserve Bank's minimum capital requirements.

To combat money laundering and terrorist financing, the Reserve Bank continued to work together with the Sub-Committee on Money Laundering and Terrorist Financing in the preparation for Tonga's mutual evaluation by the Asia Pacific Group on Money Laundering (APG) in November 2009.

The Reserve Bank successfully completed all the projects planned as part of the milestones to mark the coronation of His Majesty King George Tupou V. These projects included the production of the royal scepter, the launch of the new \$100 pa'anga note, the unveiling of the new design family of notes, and the minting of the coronation numismatic coin. Another major achievement by the Reserve Bank during the year was the completion of the Staff Job Evaluation Exercise by Price Waterhouse Coopers Ltd (Fiji) which resulted in a salary increase for the Reserve Bank Staff effective from July 2009. The Reserve Bank also successfully completed the National Reserve Bank of Tonga Staff Provident Fund Scheme Rules and set up a Board of Trustee to manage the staffs' provident fund scheme.

The Reserve Bank responded to the increased demand for its services by the public, the banks and the government during the year. The currency notes on issue to the public increased by \$4 million, an increase of 18 percent from the previous year. The total turnover of foreign exchange transactions increased by 80 percent mainly due to large one off transactions carried out by the Bank during the year. The Reserve Bank continued to host the daily settlement of inter-bank transactions. The Reserve Bank carried out its function as the registrar of government bonds and sold all its \$9.7 million holdings of government bonds during the year which enhanced the activity in the secondary market for government bonds.

The Reserve Bank continued developing the skills of its staff, through overseas, local and in-house training. Staff participated in courses across a range of central banking functions, including monetary policy formulation and forecasting, bank supervision, anti-money laundering, accounting, human resource management and information technology.

The Reserve Bank's balance sheet expanded to T\$167 million, an increase of 31.3 percent from the previous year attributed mainly to the increase in the level of official foreign reserves over the year. However, the Reserve Bank's operating profit fell by 34.9 percent from the previous year to T\$2.5 million attributed to the global economic and financial crisis and the significant decline in global interest rates throughout the year.

I thank the staff of the Reserve Bank for their efforts during another challenging year for the Reserve Bank and the Tongan economy. I also thank the government and members of the financial sector for their part in ensuring that confidence and stability in the system were

maintained. Appreciation is also extended to the members of the Bank's Board for their continuing support during the year. The assistance from the International Monetary Fund, Pacific Technical Assistance Centre, the Reserve Banks of Australia, New Zealand and Fiji, other regional central banks, the Bank of England Centre for Central Banking Studies, AusAID, NZAid, AUSTRAC, AMLAT and the Pacific Anti-Money Laundering Project is also gratefully acknowledged.

A handwritten signature in black ink, appearing to read 'Mafi'.

Siosi C. Mafi

Governor

Board of Directors of the National Reserve Bank of Tonga **during the year ended 30 June 2009**



Mrs. Siosi Cocker Mafi
Chairperson & Governor



HRH Princess Salote Pilolevu Tuita
Director



Mr. Richard Prema
Director



Mr. 'Aisake Eke
Director



Mr. Henry Cocker
Director

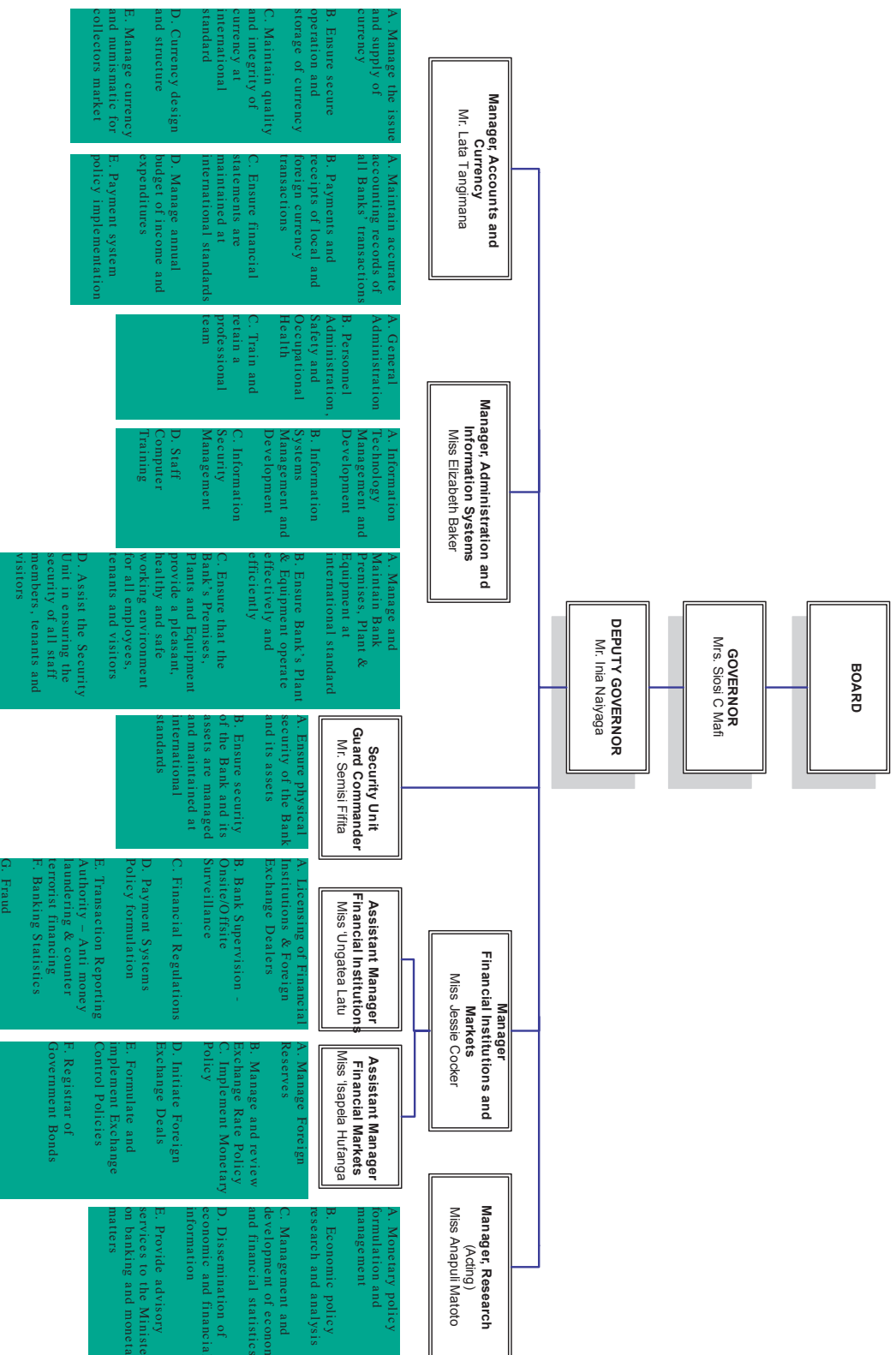
Principal objectives and functions of the National Reserve Bank of Tonga

- i) The principal objectives of the National Reserve Bank of Tonga shall be, to:
- (a) maintain internal and external monetary stability; and
 - (b) promote a sound and efficient financial system.
- ii) The principal functions of the National Reserve Bank of Tonga shall be, to:
- (a) issue currency;
 - (b) formulate and implement monetary policy;
 - (c) regulate as required the supply, availability and international exchange of money;
 - (d) hold and manage the external reserves of the Kingdom;
 - (e) provide advisory services to the Minister on banking and monetary matters;
 - (f) be the principal banker, fiscal agent and depository of the Government;
 - (g) undertake banking business, in Tonga or elsewhere, subject to the provisions of this Act;
 - (h) regulate and supervise financial institutions; and
 - (i) oversee and promote the efficient, sound and safe functioning of the payment system.

Section 4 and Section 4A

National Reserve Bank of Tonga (Ammendment) Act, 2007

NATIONAL RESERVE BANK OF TONGA JUNE 2009



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Economic Overview

Overseas Economic Developments

The global economy experienced a deep downturn in 2008/09 in the wake of the housing market and credit crises in the United States which unfolded rapidly with the collapse of several major financial institutions. Consequently, private consumption and investment contracted which led to a sharp decline in world trade. This pushed the major advanced economies into recession with high unemployment and falling inflation. In response to the adverse impact of the global financial crisis, some of the major advanced and Asian economies introduced aggressive monetary and fiscal policy stimulus to support the global economic recovery. In mid 2009, the global economy began to show some signs of recovery from the global financial crisis although the pace of recovery is expected to be sluggish.

The United States economy contracted sharply in the December 2008 and the March 2009 quarters with large falls in business investment and inventories. Household spending has shown signs of stabilizing but remains constrained by ongoing job losses. The large fiscal and monetary stimulus packages introduced by the Federal Reserve and the government have helped the economy to weather the financial turmoil. In the June quarter 2009, the economy contracted by 1.0 percent, better than the 6.4 percent contraction in the March quarter, indicating that the economy is in the early stages of recovery from the worst slowdown since the great depression.

Table 1. INTERNATIONAL ECONOMIC INDICATORS									
Country	Real GDP			Consumer Prices			Current Account Balances		
	Annual percent change			Annual percent change			Percent of GDP		
	2008	2009	2010	2008	2009	2010	2008	2009	2010
United States	0.4	-2.7	1.5	0.7	1.6	1.5	-4.9	-2.6	-2.2
Japan	-0.7	-5.4	1.7	0.4	-1.5	-0.7	3.2	1.9	2.0
Euro area	0.7	-4.1	0.3	1.6	0.9	0.6	-0.7	-0.7	-0.3
China	9.0	8.5	9.0	2.8	0.8	0.6	9.8	7.8	8.6
Australia	2.4	0.7	2.0	3.7	1.6	1.2	-4.6	-3.2	-5.6
New Zealand	0.2	-2.2	2.2	3.4	0.9	1.4	-8.9	-7.1	-6.7
IMF World Economic Outlook, October 2009									

The Australian economy shows considerable resilience in the face of what has been a very difficult international environment. Economic conditions in Australia have been stronger than in some advanced economies with positive growth in the March and June quarters indicating that the economy has managed to stay clear of recession. Despite the fall in business investment, exports had been remarkably strong especially in light of the large decline in global trade. The positive outcomes in Australia have been maintained by the large fiscal and monetary stimulus. The Reserve Bank of Australia aggressively cut the official interest rates by a total of 4.25 percent. The Australian government issued a fiscal stimulus package which included more than A\$12 billion in cash bonuses for low-to-middle income earners, designed to boost the economy and avert a recession.

The New Zealand economy began shrinking in the first quarter of 2008, curbing company profits and increasing the cost of welfare and unemployment payments. New Zealand's budget cash deficit was wider than expected in the year to June as the worst recession in three decades curbed tax revenue and the global slowdown slashed returns on government investments. The government issued a stimulus package in December 2008 to boost the economy and the Reserve Bank of New Zealand cut the official interest rates aggressively by a total of 5.75 percent. The economy expanded 0.1 percent in the June quarter, the first expansion in six quarters.

The Asian economies have experienced relatively strong growth for most of 2008. However, at the end of 2008 and in early 2009 the Asian economies contracted sharply, as global confidence collapsed and financial and trade flows dried up. Only China appears to have escaped recession. Growth projections in emerging Asia have been revised upward due to improved prospects in China and India, partly reflecting substantial macroeconomic stimulus, and a faster than expected turnaround in capital flows. In Japan, the economy rebounded strongly on the back of better exports and government stimulus.

The euro area economy slipped into recession in 2008. Conditions in the United Kingdom had been weak with another decline in output in the June quarter 2009. Britain's banks have been among the worst affected in the financial crisis as a result of unsound financing practices and insufficient capital to support over-extended lending. The European economy eased to 0.1 percent in the June quarter with improvement in consumer and business sentiment.

Over the year to June 2009, the impact of the global financial crisis on the Pacific island economies has begun to affect economic activity across the region, which resulted in slower economic growth than in previous years. Falls in demand and increases in unemployment in developed economies have resulted in lower remittance inflows into the Pacific and less tourism demand. While many economies have benefited from the plunge in commodity prices which helped to reduce external and inflationary pressures, the main commodity exporters in the Pacific such as Papua New Guinea, Solomon Islands and Fiji were affected.

Domestic Economic Conditions

Economic growth was estimated by the Ministry of Finance to contract 0.4 percent in 2008/09, a downward revision from 0.4 percent growth estimated in the Budget Statement 2009/10. The impact of the global financial crisis on the Tongan economy is evident from the slowdown in economic activity. The contraction in the economy was mainly due to a decline in the agriculture and fishing sector. The production and export of squash, Tonga's primary export commodity, experienced a further decline in 2008/09. Exports of vanilla also recorded a decline throughout the financial year due to price volatility and increased competition in the international market. Total fish exports were also subdued for the year ending June 2009. Nevertheless, the entrance of sea cucumber into the export market has contributed to the development of the export sector.

Construction activity in the Kingdom continued to rise in 2008/09 underpinned by the rebuilding of Nuku'alofa. According to surveys by the Reserve Bank, the increase in the construction activity is reflected by the increase in the sales of imported construction materials. The construction works for some of the major businesses in the central business district are

financed by the China reconstruction loan and the AusAID and NZAID Private Sector Relief Fund (PSRF).

The tourism sector has been affected by the global crisis. While the total visitor arrivals into the Kingdom, including returning nationals, rose by 4.1 percent in the year ended June 2009, tourist receipts reported by commercial banks' overseas exchange transactions fell by 6 percent over the same period. The rise in the total arrivals with increases in both air and cruise ship arrivals was mainly due to the coronation of His Majesty King George Tupou V, the Heilala festivities, and church and regional conferences.

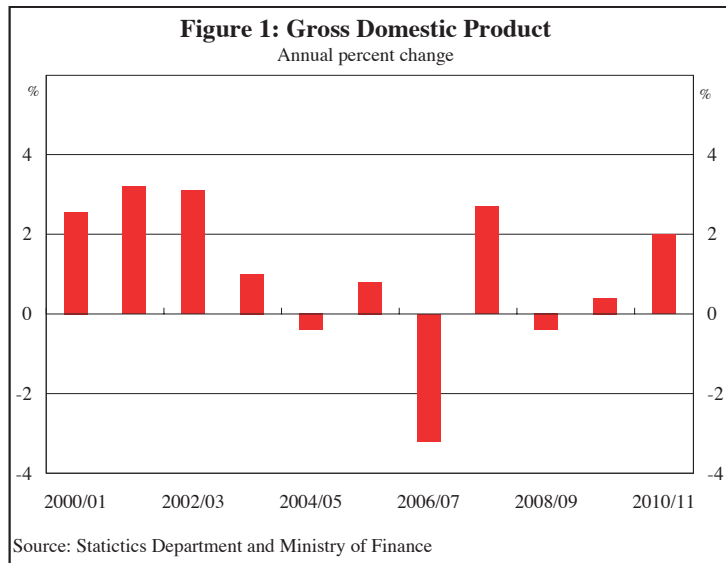
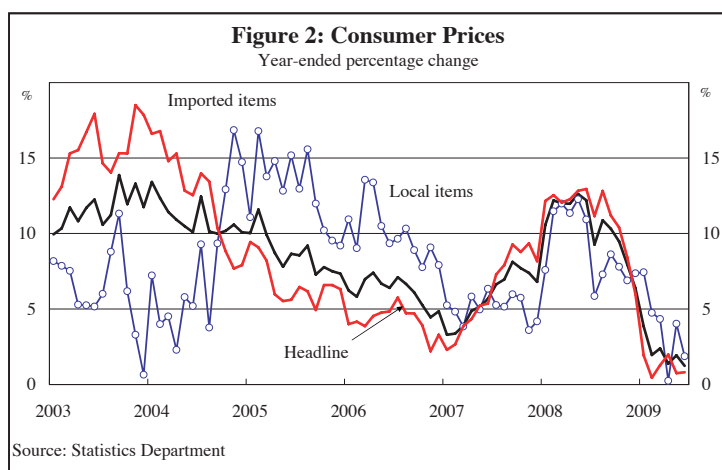


Table 2. TONGA MAIN ECONOMIC INDICATORS ^{1/}

		2005/06	2006/07	2007/08	2008/09
Economic Activity					
Real GDP	% change	0.8	-3.2	2.7	-0.4
Tourist Arrivals	Thousands	53.3	52.8	67.1	71.7
Money, Prices & Interest Rates					
CPI (average)	% change	7.2	5.1	9.6	5.6
CPI (year-end)	% change	6.4	5.7	12.2	1.2
Money Supply (M3 - year end)	\$m pa'anga	253.2	286.9	306.0	302.6
Domestic Credit (year end)	\$m pa'anga	264.5	295.2	332.9	318.7
Weighted term deposit interest rate (year end)	% per annum	6.8	6.6	6.4	5.8
Weighted lending rate (year end)	% per annum	12.3	12.4	12.7	12.5
External Sector					
Merchandise exports fob (OET basis)	\$m pa'anga	31.0	26.7	23.5	11.5
Merchandise imports fob (OET basis)	\$m pa'anga	245.4	217.5	262.4	271.4
Official foreign reserves (year end)	\$m pa'anga	83.2	91.6	89.1	136.3
Import coverage (year end)	Months	4.3	4.4	3.5	5.3
Exchange rate (period end)	US\$/T\$	0.4848	0.5131	0.5407	0.4967
^{1/} Sources: Ministry of Finance, Tonga Visitors Bureau, Department of Statistics and National Reserve Bank of Tonga					

Prices

The Consumer Price Index measured headline inflation to be 1.2 percent in the year ended June 2009, a significant fall from 12.2 percent in the year ended June 2008. This is the lowest inflation rate since the 1.1 percent in February 1997. The average annual inflation rate was 5.6 percent compared to 9.6 percent recorded in the same period a year earlier. The fall in the rate of inflation was mainly due to the substantial decline in the international oil prices from an average of around US\$133 per barrel in June 2008 to US\$69 per barrel in June 2009.



Imported inflation increased by 0.9 percent in the year ended June 2009, down from the 12.9 percent increase recorded in the year ended June 2008. The major contributions to the fall in imported inflation were from transportation and household operations. The fall in imported transportation prices, reflected the decline in the world oil prices throughout 2008/09 which led to the

fall in petrol and diesel prices by 88.36 seniti and 124.90 seniti per litre respectively. The weakening of the New Zealand dollar against the Tongan pa'anga also contributed to the fall in imported food prices from New Zealand, the main source of imported food for Tonga.

Domestic prices rose 1.8 percent in the year ended June 2009, compared to 10.9 percent rise in the year ended June 2008. The fall in domestic inflation largely reflected the decline in the price of electricity by 24.5 percent in the year ended June 2009.

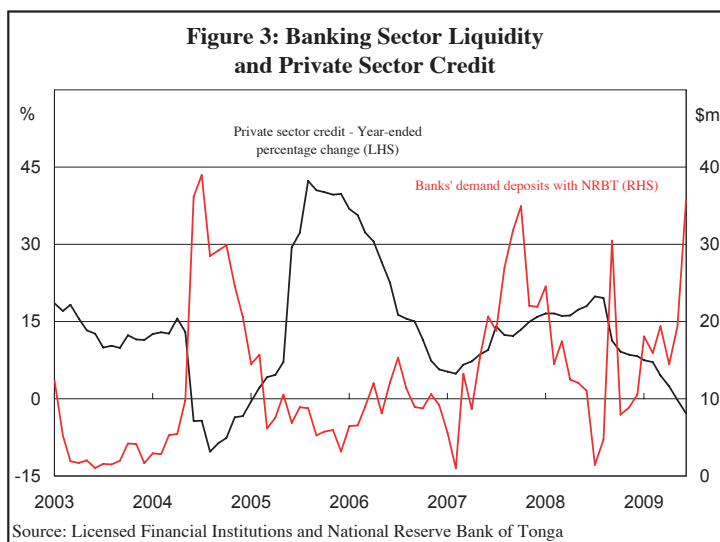
Financial Intermediation

Total broad money (M3), a broad measure of money supply, decreased by 1.1 percent in the year ended June 2009, compared to 6.7 percent increase in the previous year. The decrease reflected the impact of the decline in remittances which led to Tongans having to drawdown on their savings and term deposits in the banking system.

Demand for credit was strong at the beginning of the financial year, however, the tightened credit criteria by commercial banks in response to the rapid increase in non-performing loans, contributed to the slow down in credit growth. Hence, total private sector credit growth contracted by 2.9 percent year on year to June 2009.

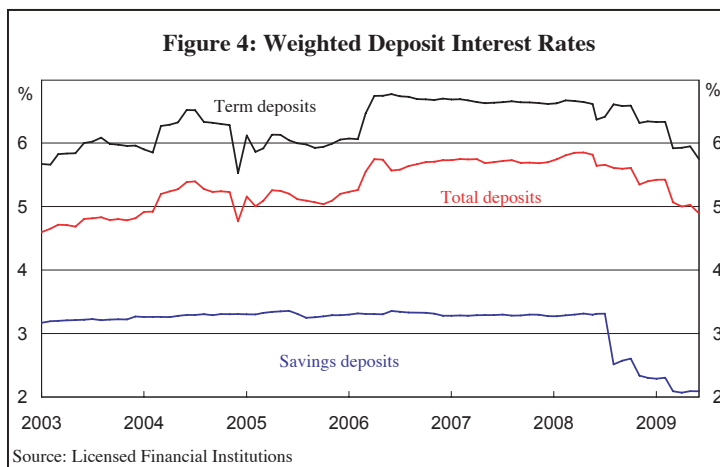
Throughout the financial year 2008/09, lending by the banking system was mostly towards the business sector. Business credit rose by 3.9 percent and household credit fell significantly by 9.7 percent in the year to June 2009.

The impact of the global financial crisis on domestic economic activity is reflected in lower receipts from remittances and tourism which have resulted in businesses and individuals in Tonga facing financial difficulties and has affected their ability to repay their debts. In June 2009, the Reserve Bank ceased the issue of NRBT notes and reduced the SRD by 5 percent from 10 percent in August 2009 to enable the domestic banks to reduce their lending rates to ease the financial difficulties of borrowers and encourage lending to support economic activity.



Interest Rates

Real interest rates have been generally declining in the past financial year. However, the decrease in nominal interest rates was offset by the fall in inflation and resulted in the real deposit interest rates moving to positive territory, rising as high as positive 3.6 percent in June 2009. Positive real interest rates are a welcomed situation as it is supportive of financial intermediation.



At the end of June 2009, the Reserve Bank's term deposit indicator rate, a weighted average of interest rates paid by commercial banks for deposits less than \$50,000 fell to 5.8 percent from 6.4 percent a year earlier as domestic liquidity increased towards the end of the financial year.

However, the lending indicator rate, a weighted average of interest rates across household and business lending, fell slightly to 12.5 percent from 12.7 percent a year earlier.

External Developments

According to the Overseas Exchange Transactions (OET) reported by the commercial banks for the year 2008/09, the current account deficit was more than offset by the capital account surplus and the net unrecorded inflows resulting in a rise in the level of official foreign exchange reserves by \$47.1 million to \$136.3 million, an equivalent of 5.3 months of imports (Table 3).

Table 3. OVERSEAS EXCHANGE TRANSACTIONS (OET): Annual Summary				
	2005/06	2006/07	2007/08	2008/09
A. Merchandise trade balance	-214.4	-186.6	-238.9	-259.9
Exports, f.o.b.	31.0	26.3	23.5	11.4
Imports, f.o.b.	245.4	212.9	262.4	271.4
B. Services balance	-16.2	-35.8	-6.2	-5.4
Receipts	50.9	38.8	70.1	83.7
Payments	67.1	74.7	76.3	89.1
C. Investment income balance	5.7	7.1	6.4	57.5
Receipts	9.9	12.9	13.0	60.8
Payments	4.2	5.8	6.6	3.4
D. Transfers balance	178.4	168.6	180.2	158.0
Receipts	205.5	187.3	203.6	177.9
<i>Private</i>	205.0	186.8	202.8	175.2
<i>Official</i>	0.5	0.5	0.8	2.6
Payments	27.1	18.7	23.4	19.9
<i>Private</i>	26.5	18.1	23.1	18.5
<i>Official</i>	0.5	0.6	0.3	1.3
E. Current account balance (A+B+C+D)	-46.6	-46.7	-58.6	-49.8
F. Capital account balance	45.0	53.8	69.0	68.0
Official capital	16.8	19.7	22.7	-11.0
<i>Inflows</i>	22.8	24.7	26.5	18.4
<i>Outflows</i>	6.0	5.0	3.7	29.4
Private capital	28.1	34.2	46.2	79.0
<i>Inflows</i>	37.5	39.9	50.5	88.9
<i>Outflows</i>	9.3	5.7	4.3	9.9
G. Other items, net	2.7	1.3	-12.9	29.0
H. Overall balance (E+F+G) ^{1/}	1.1	8.4	-2.5	47.1
1/ Corresponds to changes in gross official foreign reserves.				
Totals may not add up due to rounding.				
Source: National Reserve Bank of Tonga				

The widening in the trade deficit by \$21.0 million to \$259.9 million for year ended June 2009 was largely due to low export proceeds and high import payments especially for fuel. Exports fell to a very low level of \$11.4 million compared to \$23.5 million a year earlier due to lower export earnings from agriculture especially squash and fish.

The decrease in the services deficit from \$6.2 million to \$5.2 million in 2008/09 reflected higher receipts from tourism. Net investment income recorded a large surplus due to large one-off receipts from one of the private companies. Private remittance receipts fell by 14 percent to \$175.2 million in year ending June 2009, reflecting the impact of the global economic downturn. The high unemployment rate in the major remittance source countries contributed to the reduction in the amount sent to families and friends in Tonga.

The improvement in the net investment income and the net services deficit more than offset the increase in the trade deficit and the fall in the net transfers, resulting in the decrease in the current account deficit to \$49.8 million in the year 2008/09.

The capital account surplus slightly fell by \$1.0 million to \$68.0 million, reflecting higher official capital outflows. The net unrecorded inflows plus the capital account surplus more than offset the current account deficit which resulted in an overall balance of payments surplus of \$47.1 million compared with a deficit of \$2.5 million recorded for the year 2007/08.

Economic Outlook

The outlook for the Tongan economy is still uncertain. While the global economy is getting out of recession, recovery will be slow and protracted with unemployment continuing to rise. This means that the negative impact on remittances and tourism in Tonga will continue in the next financial year and economic activity will continue to be slow. The Ministry of Finance revised estimate for 2009/10 projected a 0.4 percent economic growth attributed to expected improvement in the agriculture and fishery sector, transport and communication, and government services.

The level of foreign reserves is anticipated to remain at adequate level, above 4 months of import cover by the end of 2009/10. Despite the prospect of high import bill for the construction activity in the Kingdom especially with the rebuilding of Nuku'alofa, expected official foreign aid will ease the downward pressure on foreign reserves.

Private sector credit is expected to remain slow despite the high liquidity in the banking system as domestic demand continues to be slow and banks will continue to tighten their lending criteria. Nevertheless, large construction projects will continue to be financed by the China reconstruction loan through government, which is outside the banking system.

Given the current development in international oil prices and the stronger NZ dollar, headline inflation is projected to rise but still remain in single digit. The Reserve Bank will have to remain vigilant and continue to closely monitor Tonga's economic and financial conditions to maintain an adequate level of foreign reserves and promote price stability.

Financial Markets

External Reserves

During the year, the Reserve Bank maintained the gross foreign reserves above the required level of 3 to 4 months of imports and this has contributed to maintaining confidence and stability in the economy and financial system during the global crises. The gross official external foreign reserves ranged between 3.2 months and 5.1 months of import cover. The level of gross external reserves increased from a low of \$86.2 million to peak at \$136.3 million and 5.1 months of imports as at the 30th June 2009. This compares with \$89.1 million and 3.6 months of imports at 30 June 2008. The significant increase in the level of reserves was attributed mainly to receipts of large inflows for the government, private sector companies as well as capital injections by the commercial banks. At the same time, the level of imports fell since January 2009 reflecting the slowdown in the demand for imports and economic activity, as well as the global decline in oil and food prices.

The Bank's investment policy is to obtain the maximum income commensurate with safety, liquidity and the maintenance of overall value which was a challenge, given the great uncertainty in the global financial markets, the decline in international interest rates and the volatility in the exchange rate markets brought about by the global economic and financial crisis. Against this background, the Reserve Bank took precautionary measures to manage its credit and market risks by limiting its investments with some of the international banks. Furthermore, the Bank closely monitored the international banks credit ratings and continued to ensure that the Reserve Banks investments were held with international banks that were rated above the Board approved minimum "A" rating by international credit rating agencies. Investments were also held in government securities and deposits with central banks. The Reserve Bank holds the external reserves mainly in Australian dollars, New Zealand dollars, and the US dollars.

External Value of the Pa'anga

The Tongan pa'anga is calculated daily by reference to a weighted basket of currencies of Tonga's major partners in foreign trade and payments transactions.

The Reserve Bank monitors the movement of the rate of exchange of the pa'anga against other currencies with a view to ensuring that the country's balance of payments position, price stability and competitiveness are maintained at levels that are consistent with maintaining macroeconomic stability. The Reserve Bank may also make adjustments to the Tongan pa'anga exchange rate to enable the Reserve Bank to react in a flexible manner to external shocks and to maintain the exchange rate at a level, which is consistent with its principal objectives to maintain external and internal monetary and financial stability. These adjustments continued during 2008/09. During 2008/09 the external value of the pa'anga ranged between US\$0.45 and US\$0.54, compared with the range of US\$0.50 to US\$0.55 in 2007/08. The Nominal Effective Exchange Rate (NEER) increased by 1.5 percent over 2008/09 which reflected the strengthening of the Tongan pa'anga against the currencies of its major trading partners. The strengthening of the Tongan pa'anga was attributed mainly to the weakening of the Australian dollar and the New Zealand dollar. The Australian and New Zealand dollar

weakened on the impact of the global economic crisis and investors moving their funds out of high risk currencies such as the Australian dollar and the New Zealand dollar to perceived safe haven currencies such as the US dollar. The pa'anga fluctuated between AUD0.56 to AUD0.70 and NZD0.71 to NZD0.86 in 2008/09, reflecting increased volatility in the foreign exchange markets during the global economic crisis, compared with a range of AUD0.56 to AUD0.60 and NZD0.65 to NZD0.70 respectively in 2007/08.

The Real Effective Exchange Rate (REER) rose by 0.6 percent over the same period as Tonga's inflation was higher than its trading partners during the year. Nevertheless, there is improvement in Tonga's inflation performance at the end of 2008/09 compared to the same period a year earlier. The significant fall in international oil prices and the weakening of the New Zealand dollar against the pa'anga contributed to Tonga's low inflation.

The Reserve Bank continued to respond to requests for exchange rates from government departments and other customers. The exchange rates of the banks and authorized foreign exchange dealers are published weekly on the Reserve Bank's website and local newspapers, an initiative to improve public access to exchange rate information, encourage competition and foster market discipline in setting of exchange rates. Following the implications on the Tongan economy from the global economic crisis, the Reserve Bank became more vigilant in its analysis and monitoring of commercial banks' and authorized foreign exchange dealers' exchange rate spread with a view to ensure competitive exchange rates are offered to the public and to reduce the exchange rate spread charged by the banks on their telegraphic transfers.

Foreign Exchange Operations

The Reserve Bank conducts foreign exchange operations with the domestic commercial banks in the intervention currency only, the US dollar. The Reserve 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 Reserve Bank also conducts foreign exchange operations for its other customers, and for its own account, in a range of currencies. The Reserve Bank was a net purchaser in the spot foreign exchange markets during the year. Foreign exchange purchases of T\$250.6 million exceeded sales of T\$203.8 million giving a total foreign exchange turnover for the year of T\$454.5 million. The total turnover of foreign exchange increased by 80 percent from the previous year mainly due to large one off transactions carried out by the Bank during the year.

Exchange Control Operations

During 2008/09, the Reserve Bank processed 878 exchange control applications for payments of amounts above the delegated limits stipulated in the Exchange Control guidelines. The approved exchange control applications amounted to T\$211.5 million in 2008/09 (of which 7 percent were classified as capital transactions) compared to the 895 exchange control applications processed in 2007/08 amounting to T\$194.6 million. The decrease in exchange control applications may be attributed to the reduction in demand for imports. Additionally, the Reserve Bank received 4 applications for the removal of cash over T\$10,000 across the border, of which 3 applications were approved totaling T\$0.3 million.

The Reserve Bank also held meetings with the banks, Revenue Services & Customs Department, and some large importers to clarify and improve the understanding of its Exchange Control policies and requirements. The Exchange Control data on foreign currency payments by large importers are key inputs to the Reserve Bank's foreign reserves forecast and monetary policy decisions.

Domestic Market Operations

The Domestic Market department implements the Reserve Bank's monetary policy that are formulated by the Monetary Policy Committee. The details of the Reserve Bank's monetary policy are outlined in the Reserve Bank's Monetary Policy Statements for March 2009 and September 2009. In October 2008, the Reserve Bank issued NRBT notes to mop up excess liquidity in the system following the large foreign exchange receipt by government and a private company and the capital injection by the commercial banks in September. The Reserve Bank concentrated on issuing 28 day Reserve Bank Notes by tender on a weekly basis at an average yield which ranged between 1.0 percent and 3.0 percent per annum. The Reserve Bank issued Reserve Bank notes totaling \$99 million. The holders of Reserve Bank notes were the commercial banks.

At the end of May 2009, the Reserve Bank decided to cease the issue of Reserve Bank notes following its decision to start easing its monetary policy stance, leaving excess liquidity in the system to enable further reductions in interest rates and to encourage credit growth and economic activity. Therefore, at the end of June 2009, there were no outstanding Reserve Bank Notes.

Registrar of Government Bonds

The Reserve Bank acts as the registrar for all of the Government of Tonga's bond issues. Over the course of the year, the Reserve Bank issued 3 new Government of Tonga Bonds during the financial year and processed 3 maturing bond issues. At the end of June 2009, the total value of Government of Tonga Bonds outstanding was \$21.45 million, which was unchanged from the previous year. The Reserve Bank sold all its holding of \$9.7 million holdings of government bonds during the year which enhanced the activity in the secondary market for government bonds. Moreover, this is in line with the requirement of the NRBT (Amendment) Act 2007.

Financial Sector

The Reserve Bank is responsible for the promotion of a sound and efficient financial system. This objective is pursued through the licensing, regulating and supervising of financial institutions (banks).

There are 4 banks licensed to operate in Tonga.

	Branches (including Head Office at Nuku'alofa, Tongatapu)	ATMs	Internet Banking	Other services
Australia and New Zealand Banking Group Limited (ANZ)	3	11	Yes	Rural Banking
Westpac Bank of Tonga (WBOT)	5	8	Yes	Financial First Steps Program
MBf Bank Limited	2	-	-	-
Tonga Development Bank (TDB)	6	-	-	Microfinance

In 2008/2009, the banks provided additional services mainly through the increase in internet banking services. A total of 19 ATMs are currently operating in Tongatapu and Vava'u.

The Westpac Bank of Tonga and the Tonga Development Bank maintained their head office and branches on Tongatapu as well as branches on the islands of Vava'u, Ha'apai, and 'Eua. The MBf Bank Limited maintained their head office on Tongatapu and a branch on the island of Vava'u. The ANZ Bank also maintained their head office on Tongatapu and a branch on Vava'u. Furthermore, the ANZ Bank completed and began operations from its new head office building and branch located at Ma'ufanga in March 2009 and opened its Nuku'alofa main branch in early July following the destruction of its head office in 2006.

Tonga Development Bank continued to be the only bank serving the outermost islands of Niuatoputapu and Niuafo'ou. At the same time, Tonga Development Bank is the only bank offering microfinance services to the rural areas in Tongatapu and the outer islands. Meanwhile, ANZ continued its rural banking services in Tongatapu. During the year, Westpac Bank of Tonga provided to many of its customers and other organizations in Tonga the "Financial First Steps Program", a financial education program on how to manage money.

Supervision and Regulation of Licensed Financial Institutions

During 2008/09, the Reserve Bank focused its supervisory activities on liquidity and credit risk management of the banks following the increasing non-performing loans in the banking system and the reported losses by two of the large financial institutions. The Reserve Bank with IMF technical assistance, conducted an on-site examination of one bank to review its risk management systems and their applications. The main focus of the risk management review was on credit and liquidity risk management systems. The Reserve Bank continued to hold regular meetings with banks in order to discuss their operations and compliance with the financial institutions regulations. Technical meetings were also conducted with each

bank to clarify the Reserve Bank's reporting requirements, improve the accuracy of reporting to the Reserve Bank and to discuss issues of mutual interest to both parties.

The Reserve Bank continued to implement the requirements of the Financial Institutions Act 2004, by issuing six new Prudential Statements in February 2009 which became effective on 1 June 2009. These were Prudential Statements No.6 to No.11 on Capital, Audit Arrangements, Fit & Proper, Governance, Lending Limits, and Foreign Exchange Risk Management. These new Prudential Statements explained the requirements under the Financial Institutions Act 2004. These prudential statements should further strengthen the licenced financial institutions' understanding of the Reserve Bank's requirements as well as comply with the requirements of the Financial Institutions Act. Prudential Statements 6 to 11 add to Prudential Statements 1 to 5, previously issued by the Reserve Bank.

Technical assistance was provided by the IMF during the year to strengthen the Reserve Bank's supervisory framework through revisions to/and additional Prudential Statements as well as reporting requirements, assistance with the onsite visit to one licenced financial institution, and training for the Financial Institution Department's bank examiners.

The Reserve Bank continued to meet with the Association of Banks in Tonga to discuss issues which would support the soundness and stability of the financial system. These issues included head office oversight, liquidity in the banking system, asset quality, credit growth, exchange rates, and interest rates.

The Financial Institutions Department of the Reserve Bank also hosted the Annual Meeting of the Association of Financial Supervisors in Pacific Countries (AFSPC) and a training workshop funded by Pacific Financial Technical Assistance Centre (PFTAC) on risk-based supervision in October 2008.

Financial Performance

The total assets of the financial system reached \$457.5 million in 2008/09, an increase of \$13.8 million (3.1 percent) over the year. The growth in assets was underpinned by the increase of \$23.8 million in the exchange settlement accounts of banks, investments in government of Tonga bonds which rose by \$10.2 million, and holdings with foreign banks increased by \$7.1 million, compared to the previous year. Meanwhile, total net loans by the banks to the non-financial sector fell by \$40.3 million (11.6 percent) compared with a \$55.7 million (19.2 percent) growth recorded in 2007/08. At the end of 2008/09, the banks' consolidated loans portfolio comprised mainly of loans to industries and businesses including agriculture (56.1 percent) and private individuals (42.6 percent of which 32.2 percent was for housing). The significant decline in net loans included a contraction of \$10.6 million in gross loans and an increase of \$29.7 million in total loan loss reserves as banks scaled back lending and tightened credit standards as they continued to clean up their loan portfolios and raise additional provisions against bad and doubtful loans.

Meanwhile, T\$9.6 million of the private sector reconstruction facility (PSRF) remain to be lent out, and T\$0.5 million of the business recovery facility remain to be utilized for interest payments. The delay in the drawdown of the PSRF may be attributed to the lingering uncertainty in the domestic and the international economic conditions. These facilities are

held with the Reserve Bank and were established by the New Zealand and Australian Governments to assist businesses affected by the civil riots of November 2006.

Total liabilities of banks increased by \$9.8 million (2.7 percent) due mainly to an increase in total borrowing by the banks from other financial institutions of \$14.0 million (40.7 percent) mainly attributed to the increase in deposits by foreign banks. Total deposits by non-financial sector, on the other hand, fell by \$5.6 million (2.0 percent) to \$280.3 million in 2008/09 and the total number of accounts reported to have decreased by 2.5 percent to 47,686 (Table 4). The fall in deposits was attributed to the repercussions of the global crisis, the fall in remittances, decline in tourism receipts, the slowdown in the domestic economy and the banks tightening credit standards, which resulted in the need for depositors to draw down on their savings deposits.

Table 4. FINANCIAL SECTOR ACCOUNTS					
	2004/05	2005/06	2006/07	2007/08	2008/09
Demand Deposits					
Number of Accounts	22,077	2,878	2,657	2,687	2,650
Value of Deposits (\$m)	68.3	56.1	67	66	70
Saving Deposits					
Number of Accounts	66,885	39,361	45,816	44,486	43,547
Value of Deposits (\$m)	41.9	62.4	54	54	49
Time Deposits					
Number of Accounts	2,428	2,318	1,710	1,747	1,489
Value of Deposits (\$m)	88.4	113.0	131	166	162
Total Number of Accounts	91,390	44,557	50,183	48,920	47,686
Total Value of Deposits (\$m)	198.6	231.5	251.2	286.0	280.3
Source: Licensed Financial Institutions					

Profitability

The total financial sector as a group showed a pre-tax loss of 6.1 percent in 2008/09, compared with a pre-tax profit of 4.9 percent in 2007/08 (Table 5). The notable deterioration in profitability was attributed to a significant increase in provisioning for non-performing loans reported by the 2 major banks.

Total operating income slightly decreased to 11.1 percent of average assets from 11.9 percent in 2007/08. Net interest income was 6.3 percent of average assets, unchanged from 2007/08. The bulk of banks' operating income was derived from the extension of loans, the composition of net interest income increased to 56.4 percent of total operating income in 2008/09 compared with 52.9 percent in 2007/08. Foreign exchange business made up 27.9 percent of total operating income, an increase from 25.3 percent in the previous year and the balance of 15.7 percent came from commission and charges plus other income sources. Total non-interest

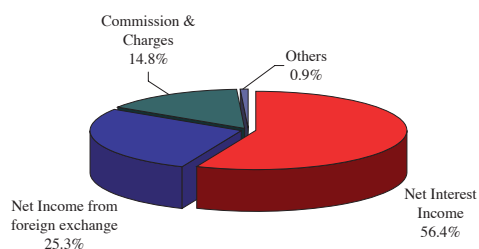
Table 5. FINANCIAL SECTOR - FINANCIAL PERFORMANCE

	2004/05	2005/06	2006/07	2007/08	2008/09
Pre-tax Net Profit (% average total assets)	6.5	6.4	2.9	4.9	-6.1
Total Operating Income (% average total assets)	12.6	11.5	11.2	11.9	11.1
Net Interest Income (% average total assets)	7.7	6.9	6.6	6.3	6.3
Non-interest Income (% average total assets)	4.9	4.7	4.6	5.6	4.9
Average Net Interest Margin (%)	9.8	8.3	7.9	7.6	7.2
Total Operating Expenses (% average total assets)	5.7	4.9	5.5	5.5	6.6
Consolidated Risk-weighted Capital Ratio (%)	22.4	21.2	20.7	22.4	26.5
Source: Licensed Financial Institutions					

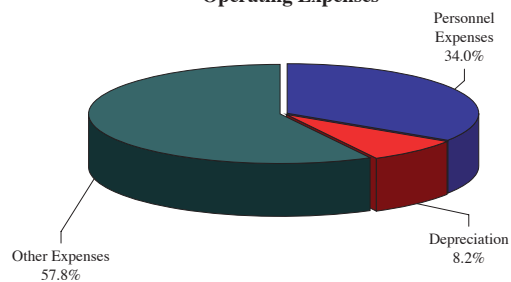
income, as a percentage of average assets decreased to 4.9 percent from 5.6 percent in the previous year. The average net interest margin (net interest income as a percentage of average earning assets) for the banks fell slightly to 7.2 percent in 2008/09 compared with 7.6 percent in 2007/08 which was due mainly to the higher growth in average earning assets during the year in particular investments in government bonds and holdings with other banks.

The operating expenses of the banks increased to 6.6 percent of average assets in 2008/09 compared to 5.5 percent in 2007/08.

This was mainly due to an increase in the banks' administrative expenses over the year. About 34 percent of administrative expenses of the banks were taken up by employees' remuneration, a decrease from 36.3 percent in the previous year. Depreciation and amortisation accounted for 8.2 percent of total administrative expenses and the balance of 57.8 percent was made up of the purchase of various goods and services necessary for the operations of the banks. Loan loss provision expenses increased significantly to 10.6 percent of average assets in 2008/09 compared to 1.5 percent in 2007/08. This reflected the weakening in the banks' asset quality which required raising of a significant amount of additional provisions.

Figure 5: Financial Sector - Components of Total Operating Income

Source: Licensed Financial Institutions

Figure 6: Financial Sector - Components of Total Operating Expenses

Source: Licensed Financial Institutions

Liquidity

Liquidity in the banking system had improved in 2008/09 underpinned by the capital injection by major banks, large inflows into government and the contraction in credit growth which outweighed the decline in deposits. Net loans as a proportion of deposits decreased to 86.7 percent from 101.2 percent in 2007/08. Furthermore, the Liquid Asset Ratio increased to 17.5 percent, which is above the minimum Reserve Bank 5% requirement, compared with 6.32 percent in 2007/08.

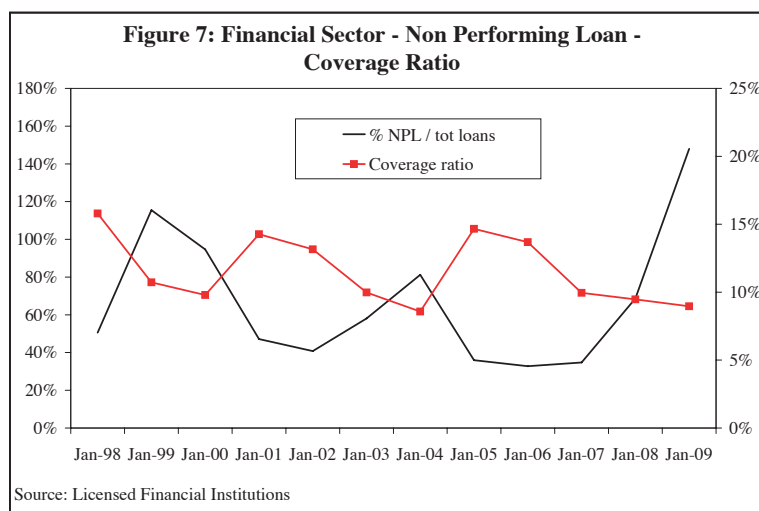
Capital

The capital position of the banking industry remained strong and above the minimum ratio required by the Reserve Bank, despite the weakening of profitability as a result of deteriorating asset quality. The consolidated risk weighted capital ratio for all the banks increased to 26.5 percent at the end of June 2009 compared with 22.4 percent at the end of June 2008. The increase in the capital adequacy ratio over the year was attributed mainly to the capital injection by the large commercial banks to replenish their capital position as they reported significant losses during the year. The risk-weighted assets also decreased as the banks scaled back lending in response to the increase in non-performing loans.

Asset Quality

The overall quality of the banks' assets deteriorated over the year as a sizeable proportion of the banks' loans were downgraded to non-accrual status. Total non-performing loans significantly rose to 20.4 percent of total loans compared with 9.5 percent at the end of June 2008. The total non-performing loans comprised of loans to

businesses (66.9 percent) mainly the tourism and retail and wholesale sector as well as the private individuals mostly for housing (14.7 percent). This reflected inadequate risk management and oversight, weak lending procedures, and the impact of the slowdown in economic activity and remittances. At the same time, provisions against loans increased by \$23.2 million (98.1 percent). The large increase in total non-performing loans outweighed the increase in provisions and resulted in the weakening of the coverage ratio of the non-performing loans by total loan loss reserves to 65.2 percent from 68.2 percent at the end of June 2008.



Transaction Reporting Authority

The Transaction Reporting Authority (TRA) is part of the Reserve Bank and performs a function similar to the functions of the Financial Intelligence Units (FIU) in other countries. These functions include combating money laundering and terrorist financing in Tonga by enhancing awareness and ensuring risk management systems are in place.

During the year, the Reserve Bank continued with its effort to improve its suspicious transaction reporting (STR) framework in cooperation with licensed foreign exchange dealers and the Transnational Crime Unit (TCU) of the Ministry of Police. The banks and authorized restricted foreign exchange dealers reported a total of 14 suspicious transactions to the TRA during the year, an increase from 9 reports in the previous year. Eight of the 14 were reported to the Police for further investigation. The increase in the number of STRs reflects an improvement in the banks awareness regarding money laundering and terrorist financing.

In February 2009, a follow up review of the TRA was conducted by an expert funded by the Pacific Anti-Money Laundering Program (PALP). This was a follow up to the 2007 review by PALP, and the focus was on strengthening the analytical process of the STR framework. The TRA continued to implement recommendations from these reviews.

The TRA conducted onsite visits to one bank and one foreign exchange dealer in February 2009 with the assistance of an expert funded by PALP. These visits reviewed the compliance of these institutions with the requirements of the Money Laundering and Proceeds of Crime Act 2000 and the TRA's Anti-Money Laundering Guidelines. The TRA also conducted regular meetings with the TCU to discuss updates on STRs and ways to improve the STR framework.

The members of the Sub-Committee on Money Laundering and Terrorist Financing continued to work together towards Tonga's preparation for its mutual evaluation by the APG which was scheduled for September 2009 and was subsequently deferred by the APG to November 2009. The preparation involved the completion of the mutual evaluation questionnaire for submission to the APG Secretariat prior to the onsite visit by the assessors in November. In June 2009, a pre-mutual evaluation visit was conducted by the APG Secretariat. The purpose of this visit was to raise awareness of the stakeholders on the upcoming mutual evaluation. Meetings were convened with the National Committee on Money Laundering and Terrorist Financing and other stakeholders such as representatives from the Crown Law, Customs and Inland Revenue Department, Ministry of Police, Ministry of Finance, and the Ministry of Labour, Commerce and Industries. Other private agencies that participated in this pre-mutual evaluation program included private agencies such as banks and foreign exchange dealers, lawyers, accountants, and insurance companies. Stakeholders were informed of the purpose of the mutual evaluation and the process involved. This was also the first opportunity for stakeholders from sectors that are not licenced/supervised by the Reserve Bank to participate in any AML/CFT awareness program. These private agencies would be required to comply with the requirements of the amendments to the Money Laundering and Proceeds of Crime Act 2000. The enactment of the amendments to the Money Laundering and Proceeds of Crime Act 2000 is a vital requirement of Tonga's membership in the APG and its compliance status under the mutual evaluation.

The Money Laundering and Proceeds of Crime Regulations which are to be issued under section 80 of the Money Laundering and Proceeds of Crime Act 2000, set out policies and practices for financial institutions to deter and prevent money laundering and terrorist financing. These Regulations await approval by Cabinet and Privy Council.

Operations of the Reserve Bank

Coronation of HM King George Tupou V

The Reserve Bank Board and staff participated in the historical event of the coronation of HM King George Tupou V. The Reserve Bank presented His Majesty with the gold and maroon royal scepter for the coronation ceremony. To mark the coronation of HM King George Tupou V, His Majesty launched the new T\$100 pa'anga note and unveiled the new family design of notes with his image on these new notes. The Reserve Bank also marked the King's coronation by issuing a gold coronation commemorative coin which the Bank presented to His Majesty together with the traditional Tongan presentation of Kava, fine mats and food. The Coronation commemorative coin was issued for sale to collectors in Tonga in August 2008.



Launching of the new \$100 pa'anga note by HM King George Tupou V

Currency Operations

Circulation Notes

During the year, the Reserve Bank continued to inspect, analyse and sort currency notes to ensure that the quality of notes and coins on issue to the public are maintained at a high standard. At the end of June 2009, the face value of currency notes on issue, both new and reissuable, totaled \$26.4 million. This was an increase of \$4 million (18 percent) over the year compared to \$1.9 million (9 percent) increase in the previous year. Currency notes issued during the year totaled \$54 million and currency deposited totaled \$49 million of which \$18.1 million were classified by the Reserve Bank as unfit for reissue and were destroyed. The currency notes of the Kingdom are printed by De La Rue Currency in the United Kingdom.

New Design Currency Notes

The work towards the introduction of the new \$100 pa'anga note featuring the portrait of HM King George Tupou V and the redesigning of all the existing denominations was completed in July 2008. This work was undertaken not only to commemorate His Majesty's coronation but also to update the themes on these notes and improve the security features to combat counterfeiting. HM King George Tupou V, on the 25th July 2008, launched the new \$100 pa'anga note together with the unveiling of the new design family of notes. The new \$100 pa'anga note was issued to the public on the 30th July 2008 to mark His Majesty's coronation. The other denominations (\$50, \$20, \$10, \$5, \$2, and \$1) of the new design family of notes were received in Tonga in December 2008 and issued to the general public in January 2009.

Prior to the issue of the new design family of notes, the Reserve Bank held awareness campaigns on Tongatapu and the outer islands, conducted a TV program, and issued to the public brochures both in English and Tongan, to familiarize the public with the new design family of notes.

The new \$100 pa'anga note was short listed among 8 other currency notes that were nominated by the International Bank Note Society to compete for the best designed currency note in 2009. The new \$100 pa'anga note has become the highest bank note sold by the Reserve Bank to overseas and local collectors since its launch.



Unveiling of the new design family of notes by HM King George Tupou V

Circulation Coins

At the end of June 2009, the face value of coins on issue totaled \$1.75 million, compared to \$1.70 million of the previous year. During the year, coins to a face value of \$0.08 million were issued for circulation. The total face value of coins redeemed during the period was \$0.03 million. During the year the Bank did not order new coins from the Mint.

Note Trust Depots

The Reserve Bank has Note Trust Depot (NTD) agreements with all commercial banks. The record shows that commercial banks increased their utilization of NTDs this year. During 2008/09 the commercial banks lodged a total of \$21.4 million (\$14.4 million in 2007/08) and withdrew \$21.2 million (\$14.3 million in 2007/08). Lodgements to and withdrawals from NTDs increased by 49 and 48 percent respectively over the previous year at the same time deposits to the Reserve Bank vault increased by 8 percent. The Bank conducted surprise checks of these NTDs during the year and all were in order.

Counterfeits

During the year, 53 counterfeit notes were reported to the Reserve Bank compared to 39 cases in the previous year. These included one \$1, two \$2, two \$20 and forty-eight \$50 pa'anga notes. These counterfeit notes were reported by the public and the banks. The 48 pieces of \$50 pa'anga counterfeit notes was part of the \$50 pa'anga counterfeit notes by two foreigners who were apprehended by police in May 2008. The Reserve Bank sent these counterfeit notes to De La Rue Currency for testing and verification. Examination of these notes by De La Rue Currency confirmed that they were indeed counterfeit. The counterfeiters were charged and imprisoned in September 2008. The Reserve Bank has produced and issued to the public brochures on identifying counterfeit notes both in English and Tongan. Prior to the issue of the new design family of notes, the Reserve Bank conducted a TV program, issued to the public brochures both in English and Tongan, and held awareness

campaigns on Tongatapu and the outer islands, not only to familiarize the public with the new design family of notes but also to assist the public in identifying counterfeit notes. The public has also been advised to report to both the Reserve Bank and the Police if they receive any suspicious looking currency notes.

Numismatic Coins and Notes

During the year, numismatic coins were issued to collectors throughout the world under agreements between the Reserve Bank and various producers for the production and marketing of coins of various denominations. Agreements were signed with the World Coin Association, for five new commemorative coins to be minted and issued in 2010 for sale to collectors outside of Tonga. The five new numismatic coins included the smallest gold coin of the world featuring the Ha'amonga Trilithon, the Olympic Games 2010 (gold), the Olympic Games 2012 (copper), Ships and Explorers Thor Heyerdahl (silver), Railways, DB Class V200 (silver). The obverse of these coins depicts the Effigy of HM King George Tupou V.

The total revenue collected from numismatic coins and notes was \$0.13 million, an increase of 39 percent from 2007/08. The increase in revenue was mainly due to demand for the coronation coins and the sale of the Food and Agriculture Organization coins to collectors. The publicity from the launch of the new family of notes and His Majesty's coronation contributed to the increase in revenue from the sales of numismatic notes and coins.

Financial Performance

Gross income from operations for the year ended 30 June 2009 amounted to \$6.832 million (2008, \$8.027 million). The fall in the Reserve Bank's gross income in 2008/09 was mainly due to lower income resulting from the decline in global interest rates to record low levels throughout the year caused by the global economic and financial crisis. However, this was partially offset by the higher than budgeted level of foreign reserves. Interest expense, currency, administration and other costs totaled \$4.366 million (2008, \$4.238 million), a 3 percent increase from the previous year. This increase was mainly due to the cost of issuing of the new design notes. The net operating profit for the year decreased by 35 percent to \$2.467 million (2008:\$3.789 million).

In accordance with section 8(1)(c) of the NRBT (Amendment) Act 2007, 25 percent (\$616,766) of the Net Profit is to be transferred to the General Reserves, and the remainder (\$1,850,296) is payable to Government.

In April 2009, the Reserve Bank set up a Board of Trustee to manage the staffs' provident fund scheme. As such, the staff provident fund records were separated from the Bank's financial statements and reported under its own set of accounts. The scheme is now managed by the Board of Trustees under the National Reserve Bank of Tonga Staff Provident Scheme Rules.

Information Systems and Technology

The Reserve Bank continued to improve its business continuity operations by establishing an offsite backup server, strengthening the storage capacity of its backup system and increasing the usage of uninterrupted power supply devices to computer machines performing high risk

operations of the Bank. With the technical assistance of Chubb Ltd (NZ) the Bank upgraded the recording and storage of its Security Control System to a new digital recording system. In addition, procedures were revised to improve postings to the Reserve Bank's Website and its maintenance were closely monitored to ensure accuracy and timeliness.

The importance of in-house data management systems to provide timely dissemination of information and to minimize duplication of works were given priority to the Financial Institutions and Markets and Administration Departments with the developments of a Domestic Market Database Management System, the Staff Attendance Management System, and the improvement to the Fixed Asset Management System.

The IT Department played a vital role in four major projects of the Bank, the launching of the \$100 Pa'anga note and the new design family of notes, the designing of the security features pamphlets that were used as the material for public awareness of the new family of notes, the designing of the Christmas card, and the upgrade of the Accounting System from Prophet to Attaché Pro.

General Administration

In addition to the normal services of administration of the Reserve Bank, the Administration Department strengthened the management of the Central Filing Storage by constructing a File Archive Storage Area, and secured staff life insurance cover with Willis (NZ). Other achievements were the continued updates to the master job descriptions, improvements to the checklists for loan applications and security pledge inspections, staff recruitment and termination, strengthened the induction program for new recruits and the continuous staff backup inter-departmental training and multi-skilling of staff. The Administration Department continued the staff occupational health program with the Health Promotion Unit of the Ministry of Health by conducting staff monthly weight measurements.

Staff

The Reserve Bank's staff complement as at the end of June 2009, was 68 staff compared with 64 staff, a year earlier. Of the 68 staff, 66 were local staff and 2 were expatriates. Mr. Inia Naiyaga's term as Deputy Governor was completed on the 30th June, 2009 and became a General Advisor until the end of August 2009. Mr Richard Sullivan, the Manager Research Department, also completed his contract in May 2009. Miss 'Anapuli Matoto, Acting Manager of Research Department returned in May 2009 after serving as Advisor for one year at the Office of the Executive Director of the South East Asia Group, International Monetary Fund, Washington D.C., United States of America.

In June 2009, an important milestone for the Reserve Bank was achieved with the completion of the Staff Job Evaluation Exercise by Pricewaterhouse Coopers Ltd (Fiji) which resulted in a salary increase for the Reserve Bank Staff with effect from the 1st July 2009. To complement the salary remuneration review, the Reserve Bank reviewed the Job descriptions of the staff, strengthened the performance based annual staff assessment, and reviewed the Administration and Personnel Policies and Procedures. Another major achievement was the completion of the National Reserve Bank of Tonga Staff Provident Fund Scheme Rules and the certification by the Commissioner of Revenue as an approved retirement fund scheme

for the purposes of the Income Tax Act 2007 and Income Regulation 2008 effective from the 1st July, 2008. The Reserve Bank also participated in a remuneration survey with Hays (NZ).

Training

Throughout the year, the Reserve Bank continued to invest in the training of its Human Resources, through overseas training, local training and in-house training programs. The overseas training programs included the Regional Workshop on the Compilation of Financial



Soundness Indicators (FSIs), Mutual Evaluation on Anti-Money Laundering Training Workshop, Central Bank Operations on Settlement & Monetary Policy Issues for Pacific Islands. IT staff attended the Datec Limited course on Web Development such as Macromedia Dreamweaver, Flash and Fireworks Application and an exam on Microsoft Certified Exam on Windows 2003 Server Environment.

Staff in-house training

The Bank arranged for 3 of the senior management staff to attend the new manager program hosted by the Reserve Bank of Australia in Sydney. In addition, two senior staff attended short attachments at the Human Resource Department of the Reserve Bank of Australia and the Training Department and Knowledge Services Group (KSG) of the Reserve Bank of New Zealand. One of the senior staff successfully completed her post graduate degree under the AUSAID Fund in June 2009. Local training for staff at the Reserve Bank included the Customer Service Training, Bank supervisors training Workshop hosted by PFTAC, Time Management Training by the S&K Performance Solutions (Tonga), Human Resource Skills Training by a Senior Staff from the Reserve Bank of Fiji, online teleconference training on Attaché and Prophet from Neurogen, NZ. Staff from the Accounts and Administration Departments were also trained by Consultants from Neurogen, NZ during their visit to upgrade the accounting system from Prophet Platform to Attaché Pro. Other local trainings included the National Training Needs Analysis Workshop hosted by the Ministry of Education, and Quick Pay Review and Training by Westpac.

The Reserve Bank provided inter-departmental trainings on Microsoft applications and the security staff sat a Security Exam on the Guard Standing Orders. The Reserve Bank continued to support staff development through financial assistance to those undertaking approved part time and correspondence courses aligned to the Training Policy of the Bank. This included Distance Flexible Learning courses to Pennfoster, USA in the areas of Electricity, Plumbing

and Electronics for 2 Building Staff, Economic and Accounting courses with the University of the South Pacific for 2 Research and 1 Financial Markets Staff, CISCO courses on CISCO Certified Network Associate (CCNA) for 1 IT Staff with Tupou Tertiary Institute plus the support for 2 senior staff to undertake Overseas Postgraduate courses online to Australia. One of the Building staff completed a Diploma in Plumbing and Electronics under the Distance Flexible Learning courses to Pennfoster, USA funded by the Bank.



Presentation of Certificates to Staff by the Deputy Governor, Mr. Inia Naiyaga

During the year, the Reserve Bank continued to receive advisory and technical services provided by the International Monetary Fund (IMF), Asian Development Bank (ADB), AusAID, the Pacific Financial Technical Assistance Centre (PFTAC) based in Suva, Asia Pacific Group on Money Laundering (APG), Neurogen (NZ), PowerGen (NZ), Otis Ltd (NZ), Reserve Bank of Fiji, Reserve Bank of Australia and Reserve Bank of New Zealand. These advisory and technical services were mainly in the areas of the Global Financial Crisis and its economic impact to Tonga, Human Resource development and management, Banking Supervision and Anti-money laundering. Other assistance was received from private service providers in the areas of information systems and technology and building management.



AFSPC hosted by NRBT

Attendance at Meetings

In July 2008, the Governor attended the APG Annual Meeting held in Indonesia. In August 2008, the Governor attended the PFTAC/Multi Donor Regional Conference held in Sydney. In October, 2008, the Manager of Financial Markets and Institutions, the Bank Examiner and Transaction Reporting Officer attended the AFSPC Annual Meeting which was hosted by the Reserve Bank. Some staff from the Research, IT, Administration and Accounts Department participated as observers at this meeting. In December 2008, the Governor and Assistant Manager, Financial Markets attended the South Pacific Central Bank Governors' Annual Meeting held at the Reserve Bank of Australia. In February, 2009, the Deputy Governor attended the Symposium on Commemorative Coins Conference held in New Zealand. In April 2009, the Governor, the Manager of Research and Manager of Financial Institutions and Markets attended the South Pacific Central Banks Governors' special meeting in Nadi, Fiji. In June, 2009, the Governor and Manager of Administration and Information Technology attended the PFTAC Tripartite Review Multi-donors meeting held in Nadi, Fiji.

Security

The Reserve Bank's security unit continued to carry out its responsibilities of ensuring that the security and safety of the Bank's staff and premises were maintained at all times. Major achievements during the year included the upgrade of the Security Recording system and the installation of high equipped cameras to enhance the Security Units ability to monitor all boundaries of the Bank. The Security Unit with the assistance of the Tonga Defense Services and the Currency Department ensured the safe and secure delivery and storage of the new currency consignments. To ensure the safety of the staff and premises, the fire fighting equipment at the Reserve Bank was upgraded to meet the Tonga Fire Brigade and the new fire engine requirements.

Building, Plants and Equipment

The Building Unit continued to maintain the Bank's property, plant and equipment at a high standard despite the reduction in the number of senior staff in this unit. The major achievements included the refurbishment project of Level 5 arranged between the Reserve Bank, the Embassy of Japan and Jaimi Architect Associates (Tonga) and the commencement of the tenancy agreement with the Embassy of Japan. Other major works included the replacement of the electrical transformer, the establishment of a maintenance contract agreement with PowerGen(NZ) on the standby generator, the renovation works to the new File Archive Room at Level 1, and the additional car parks to the front area of the Bank.

External Relations

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

Board of Directors

During the year, the Board of Directors met regularly to formulate the policies of the Reserve Bank and to monitor its operations. The Governor became the Chairperson of the Board in July 2008 in accordance with the National Reserve Bank (Amendment) Act, 2007. In January 2009, Mr. 'Aisake Eke, Secretary for Finance replaced Mr Henry Cocker as a Director of the Board.

Senior Officers during the year ended 30 June 2009

Governor	Siosi C. Mafi
Deputy Governor	Inia R. Naiyaga
Manager, Financial Institutions & Markets	Jessie Cocker
Manager, Research Department	Richard Sullivan
Manager, Accounts & Currency	Lata Tangimana
Manager Information System & Technology and Administration	Elizabeth Baker
Assistant Manager, Research Department	‘Anapuli Matoto
Assistant Manager, Financial Markets	‘Isapela Hufanga
Guard Commander	Semisi Fifita

National Reserve Bank of Tonga

Financial Statements Year Ended 30 June 2009

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NATIONAL RESERVE BANK OF TONGA**FINANCIAL STATEMENTS**
30 JUNE 2009**DIRECTORS' REPORT**

In accordance with a resolution of the Board of Directors, the directors herewith submit the Balance Sheet of the Bank as at 30 June 2009, and the related Income Statement, Statement of Distribution, Statement of Changes in Equity, and Cash Flow Statement for the year ended on that date and report as follows:

1. DIRECTORS

The following were directors of the Bank at any time during the financial year and up to the date of this report:

HRH Princess Salote Pilolevu Tuita
Mr Richard Prema
Mrs Siosi C Mafi
Mr Henry Cocker (up to December 2008)
Mr 'Aisake Eke (from January 2009)

2. PRINCIPAL ACTIVITIES

The National Reserve Bank of Tonga's (the Bank) principal objectives as a central bank, as defined in Section 4 of the National Reserve Bank of Tonga (NRBT) (Amendment) Act 2007, shall be, to -

- a) maintain internal and external monetary stability; and
- b) promote a sound and efficient financial system

The principal functions of the Bank shall be, to -

- a) issue currency;
- b) formulate and implement monetary policy;
- c) regulate as required the supply, availability and international exchange of money;
- d) hold and manage the external reserves of the Kingdom;
- e) provide advisory services to the Minister on banking and monetary matters;
- f) be the principal banker, fiscal agent and depository of the Government;
- g) undertake banking business, in Tonga or elsewhere;
- h) regulate and supervise financial institutions; and
- i) oversee and promote the efficient, sound and safe functioning of the payment system.

3. TRADING RESULTS

The operating profit of the Bank for the year ended 30 June 2009 was \$2,467,062 (2008: \$3,789,005).

NATIONAL RESERVE BANK OF TONGA**FINANCIAL STATEMENTS**
30 JUNE 2009**4. GENERAL RESERVES**

In accordance with Section 8(1)(c) of the National Reserve Bank of Tonga (Amendment) Act, 2007, the Minister and the Board of Directors have agreed to transfer \$616,766 (2008: \$947,251) to the General Reserve at year end.

5. PAYABLE TO GOVERNMENT

In accordance with Section 8(3) of the National Reserve Bank of Tonga (Amendment) Act, 2007, subject to Section 8(1) and Section 8(2), the amount of \$1,850,296 (2008: \$2,841,754) is payable to the Government of the Kingdom of Tonga.

6. BAD AND DOUBTFUL DEBTS

The directors took reasonable steps before the Bank's financial statements were made out to ascertain that all known bad debts were written off and adequate provision was made for doubtful debts.

At the date of this report, the directors are not aware of any circumstances which would render the amount written off for bad debts, or the amount of the provision for doubtful debts, inadequate to any substantial extent.

7. PROVISIONS

There were no material movements in provisions during the year apart from the normal amounts set aside for such items as doubtful debts, depreciation and employee entitlements.

8. ASSETS

The directors took reasonable steps before the Bank's financial statements were made out to ascertain that the assets of the Bank were shown in the accounting records at a value equal to or below the value that would be expected to be realised in the ordinary course of business.

At the date of this report, the directors are not aware of any circumstances which would render the values attributable to the assets in the financial statements misleading.

9. DIRECTORS BENEFIT

No director of the Bank has, since the end of the previous financial year, received or become entitled to receive a benefit by reason of contract made by the Bank with the director or with a firm of which the director is a member, or with a company in which the director has substantial financial interest.

NATIONAL RESERVE BANK OF TONGA**FINANCIAL STATEMENTS
30 JUNE 2009****10. EVENTS SUBSEQUENT TO BALANCE DATE**

Since the end of the financial year the directors are not aware of any matter or circumstances not otherwise dealt with in the report that has significantly affected the operations of the Bank, the results of those operations or the state of affairs of the Bank in subsequent financial years.

11. BASIS OF ACCOUNTING

The directors believe the basis of the preparation of financial statements is appropriate and the Bank will be able to continue in operation for at least 12 months from the date of this statement. Accordingly the directors believe the classification and carrying amounts of assets and liabilities as stated in these financial statements to be appropriate.

12. OTHER CIRCUMSTANCES

At the date of this report, the directors are not aware of any circumstances not otherwise dealt with in this report or financial statements which render any amounts stated in the financial statements misleading.

13. UNUSUAL TRANSACTIONS

The results of the Bank's operations during the financial year have not in the opinion of the directors been substantially affected by any item, transaction or event of a material and unusual nature other than those disclosed in the financial statements.

For and on behalf of the Board of Directors in accordance with a resolution of the Directors this 28th day of September, 2009.



Mrs Siosi C Mafi
CHAIRPERSON



Mr Richard Prema
DIRECTOR

NATIONAL RESERVE BANK OF TONGA**FINANCIAL STATEMENTS**
30 JUNE 2009**STATEMENT BY DIRECTORS**

In the opinion of the Directors:

- (a) the accompanying balance sheet is drawn up so as to give a true and fair view of the state of affairs of the Bank as at 30 June 2009,
- (b) the accompanying income statement is drawn up so as to give a true and fair view of the results of the Bank for the year ended 30 June 2009,
- (c) the accompanying statement of distribution is drawn up so as to give a true and fair view of the results of the Bank for the year ended 30 June 2009,
- (d) the accompanying statement of changes in equity is drawn up so as to give a true and fair view of the movement in equity for the year ended 30 June 2009, and
- (e) the accompanying cash flow statement is drawn up so as to give a true and fair view of the cash flows of the Bank for the year ended 30 June 2009.

For and on behalf of the Board of Directors by authority of a resolution of the Directors this 28th day of September, 2009.



Mrs Siosi C Mafi
CHAIRPERSON



Mr Richard Prema
DIRECTOR

NATIONAL RESERVE BANK OF TONGA**FINANCIAL STATEMENTS
30 JUNE 2009****INDEPENDENT AUDIT REPORT**

To the Shareholder of the National Reserve Bank of Tonga

Scope

We have audited the accompanying financial statements of the National Reserve Bank of Tonga which comprise the balance sheet as at 30 June 2009 and the income statement, statement of distribution, statement of changes in equity and cash flow statement for the year then ended and a summary of significant accounting policies and other explanatory notes as set out on pages 36 to 58.

Directors' and Management's Responsibility for the Financial Statements

Directors and Management are responsible for the preparation and fair presentation of these financial statements in accordance with the basis of accounting described in note 2 of the financial statements and in the manner required by the National Reserve Bank of Tonga Act, 1988, and the National Reserve Bank of Tonga (Amendment) Act, 2007. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

This report is made solely to the Reserve Bank's shareholder. Our audit work has been undertaken so that we might state to the Reserve Bank and its shareholder those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Reserve Bank and the Reserve Bank's shareholder, for our audit work, for this report, or for the opinions we have formed. Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

NATIONAL RESERVE BANK OF TONGA**FINANCIAL STATEMENTS
30 JUNE 2009****INDEPENDENT AUDIT REPORT**

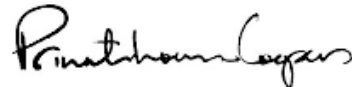
We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the accompanying financial statements have been prepared, in all material respects, in accordance with the basis of preparation and the accounting policies described in note 2 of the financial statements and in the manner required by the National Reserve Bank of Tonga Act, 1988, and the National Reserve Bank of Tonga (Amendment) Act, 2007.

Without qualifying our opinion, we emphasise that the accounting policies used and disclosures made are not intended to, and do not, comply with certain requirements of International Financial Reporting Standards.

28 September 2009
Suva, Fiji



PricewaterhouseCoopers
Chartered Accountants

NATIONAL RESERVE BANK OF TONGA**BALANCE SHEET
AS AT 30 JUNE 2009**

	Notes	<u>2009</u> \$	<u>2008</u> \$
ASSETS			
Foreign Currency Assets			
Short Term Investments and Current Accounts	9	129,396,341	82,614,896
Accrued Interest		1,415,399	1,314,405
International Monetary Fund	10		
- Reserve Tranche Position		5,335,514	5,152,417
- Special Drawing Rights		1,520,468	1,367,495
- Currency Subscription		16,550,132	15,588,292
Local Currency Assets			
Cash on Hand		127,900	64,089
Accrued Interest		9,466	239,050
Domestic Securities	11	-	9,677,000
Other Assets	12	4,464,707	4,113,120
Property, Plant and Equipment	13	8,171,276	7,049,400
Total Assets		166,991,203	127,180,164
LIABILITIES			
Foreign Currency Liabilities			
Demand Deposits	14(a)	10,345,958	3,104,425
Accrued Interest		-	3,959
Local Currency Liabilities			
Demand Deposits	14(b)	61,285,894	34,846,364
Accrued Interest		29,110	327,449
Currency in Circulation	15	28,175,399	24,121,575
Statutory Reserve Deposits	16	29,470,000	29,554,000
International Monetary Fund - Currency Subscription	10	16,550,132	15,588,292
Other Liabilities	17	2,935,824	3,562,389
Total Liabilities		148,792,317	111,108,453
NET ASSETS		18,198,886	16,071,711
CAPITAL AND RESERVES			
Authorised Capital		5,000,000	5,000,000
Paid up Capital		5,000,000	5,000,000
General Reserves		9,368,140	8,751,374
Revaluation Reserve Account		3,830,746	2,320,337
TOTAL CAPITAL AND RESERVES		\$18,198,886	\$16,071,711

The above balance sheet should be read in conjunction with the accompanying notes.

NATIONAL RESERVE BANK OF TONGA**INCOME STATEMENT
YEAR ENDED 30 JUNE 2009**

Income	Notes	<u>2009</u>	<u>2008</u>
		\$	\$
Interest Income	5	4,409,499	6,952,962
Other Income	6	2,423,244	1,073,655
Total Operating Income		6,832,743	8,026,617
Expenses			
Interest expense	7	424,443	918,312
Administration and other expenses	8	3,941,238	3,319,300
Total Operating Expenses		4,365,681	4,237,612
Operating Profit		\$2,467,062	\$3,789,005

The above income statement should be read in conjunction with the accompanying notes.

NATIONAL RESERVE BANK OF TONGA**STATEMENT OF DISTRIBUTION
YEAR ENDED 30 JUNE 2009**

	Notes	<u>2009</u>	<u>2008</u>
Operating Profit		<u>\$2,467,062</u>	<u>\$3,789,005</u>
Distribution as follows:	2(m)		
Transfer to General Reserves as required under:			
- Section 8(1)(a) of the National Reserve Bank of Tonga Act, 1988		-	-
-Section 8(1)(c) of the National Reserve Bank of Tonga (Amendment) Act, 2007		616,766	947,251
Balance Payable to Government of Tonga as required under Section 8(3) of the National Reserve of Tonga (Amendment) Act, 2007		<u>1,850,296</u>	<u>2,841,754</u>
		<u>\$2,467,062</u>	<u>\$3,789,005</u>

The above statement of distribution should be read in conjunction with the accompanying notes.

NATIONAL RESERVE BANK OF TONGA**STATEMENT OF CHANGES IN EQUITY
YEAR ENDED 30 JUNE 2009**

	Paid up Capital \$	General Reserves \$	Revaluation Reserve Account \$	Total \$
Balance - 30 June 2007	2,000,000	10,804,123	4,924,317	17,728,440
Transfer out of General Reserves (as provided for under section 6(2) of the National Reserve Bank of Tonga (Amendment) Act, 2007 and approved by the Minister of Finance.	-	(3,000,000)	-	(3,000,000)
Net losses arising during the year from translation of foreign currencies to Tongan currency.	-	-	(2,603,980)	(2,603,980)
Transfer from Income Statement (as provided for under Section 8 (1) (c) of the National Reserve Bank Tonga (Amendment) Act, 2007, and approved by the Minister of Finance	-	947,251	-	947,251
Increase in Paid up Capital as provided for under Section 6(1) of the National Reserve Bank of Tonga (Amendment) Act, 2007 and approved by the Minister of Finance	3,000,000	-	-	3,000,000
Balance 30 June 2008	5,000,000	8,751,374	2,320,337	16,071,711
Net gains arising during the year from translation of foreign currencies to Tongan currency	-	-	1,510,409	1,510,409
Transfer from Income Statement (as provided for under Section 8(1)(c) of the National Reserve Bank of Tonga (Amendment) Act, 2007, and approved by the Minister of Finance	-	616,766	-	616,766
Balance 30 June 2009	\$5,000,000	\$9,368,140	\$3,830,746	\$18,198,886

The above statement of changes in equity should be read in conjunction with the accompanying notes.

NATIONAL RESERVE BANK OF TONGA**STATEMENTS OF CASH FLOWS
YEAR ENDED 30 JUNE 2009**

	<u>Note</u>	<u>2009</u>	<u>2008</u>
CASH FLOWS FROM OPERATING ACTIVITIES		\$	\$
Rental income		497,748	199,812
Numismatic sales		127,893	53,506
Other income		1,899,594	681,657
Interest received		4,525,890	6,635,518
Purchase of currency		(72,919)	(2,541,508)
Other Interest paid		(726,742)	(1,035,619)
Administrative expenses		(4,204,557)	(962,529)
Net cash inflow from operating activities		2,046,907	3,030,837
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchase of fixed assets		(1,558,481)	(591,192)
Net movement in IMF accounts		(336,070)	(349,562)
Net movement in staff loans		(295,099)	275,486
Net movement in Government of Tonga bonds		9,677,000	6,331,832
Net cash inflow from investing activities		7,487,350	5,666,564
CASH FLOWS FROM FINANCING ACTIVITIES			
Net movement in currency in circulation		4,053,824	1,899,077
Net movement in demand deposits		32,013,143	11,257,512
Net movement in statutory deposits		(84,000)	4,010,000
Net movement in NRBT notes		-	-
Net movement in Government of Tonga accounts		(182,377)	(3,550,200)
Net cash inflow/(outflow) from financing activities		35,800,590	(8,898,635)
NET EFFECT OF CHANGE IN EXCHANGE RATE		1,510,409	(2,603,980)
NET INCREASE/(DECREASE) IN CASH		46,845,256	(2,805,214)
CASH AT BEGINNING OF FINANCIAL YEAR		82,678,985	85,484,199
CASH AT END OF FINANCIAL YEAR	18	\$ 129,524,241	\$ 82,678,985

The above cash flow statement is to be read in conjunction with the accompanying notes.

NATIONAL RESERVE BANK OF TONGA**NOTES TO AND FORMING PART OF
THE FINANCIAL STATEMENTS
YEAR ENDED 30 JUNE 2009****1. GENERAL INFORMATION**

The National Reserve Bank of Tonga's principal objectives as a central bank, as defined in Section 4 of the NRBT (Amendment) Act 2007, shall be, to -

- a) maintain internal and external monetary stability; and
- b) promote a sound and efficient financial system.

The principal functions of the Bank shall be, to -

- a) issue currency;
- b) formulate and implement monetary policy;
- c) regulate as required the supply, availability and international exchange of money;
- d) hold and manage the external reserves of the Kingdom;
- e) provide advisory services to the Minister on banking and monetary matters;
- f) be the principal banker, fiscal agent and depository of the Government;
- g) undertake banking business, in Tonga or elsewhere;
- h) regulate and supervise financial institutions; and
- i) oversee and promote the efficient, sound and safe functioning of the payment system.

These financial statements have been approved for issue by the Board of Directors on 28th September 2009.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND STATUTORY REQUIREMENTS**a) Basis of accounting**

The financial statements of the Bank have been prepared in accordance with the National Reserve Bank of Tonga Act, 1988 and the National Reserve Bank of Tonga (Amendment) Act, 2007. The Bank's accounting policies are based on International Financial Reporting Standards ("IFRS") except where the Act requires a different treatment, as noted in Note 2 (b), in which the Act takes precedence.

The financial statements are prepared on the basis of the historical cost convention, which has no regard to changes in the levels of prices. Unless otherwise stated the accounting policies adopted are consistent with those of the previous year.

NATIONAL RESERVE BANK OF TONGA**NOTES TO AND FORMING PART OF
THE FINANCIAL STATEMENTS
YEAR ENDED 30 JUNE 2009****2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND
STATUTORY REQUIREMENTS - Continued****b) Foreign currencies**

Foreign currencies have been translated to Tongan currency at rates of exchange ruling at year end.

Exchange 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 the NRBT (Amendment) Act, 2007 and are not included in the computation of annual profits and losses of the Bank as required under International Accounting Standard 21, "The effects of changes in foreign exchange rates" (IAS 21).

Net 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. According to the National Reserve Bank of Tonga (Amendment) Act 2007, any balance remaining in the revaluation reserves account shall be carried forward to the next financial year.

c) Financial Assets and Liabilities*Investment Securities*

The Reserve Bank only invests in securities with the intention to hold to maturity. The Reserve Bank does not invest in securities for trading purposes.

Held-to-maturity investments are carried at amortised cost. Any premium or discount on purchase is capitalised and amortised over the term of the maturity on a constant yield to maturity basis.

NATIONAL RESERVE BANK OF TONGA**NOTES TO AND FORMING PART OF
THE FINANCIAL STATEMENTS
YEAR ENDED 30 JUNE 2009****2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND
STATUTORY REQUIREMENTS - Continued**

All purchases and sale of investment securities are recognised at settlement date, which is the date that the asset is transferred to the Reserve Bank.

Other Financial Assets and Liabilities

Local and foreign cash, deposits and short-term advances are valued at transaction date value.

d) Currency in Circulation

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.

e) 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 financial statements the face value of these coins in circulation.

f) Income tax

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

g) 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	1.01%
Plant and equipment	10.0%
Carpets, drapes and security system	10.0%
Furniture, fittings, computer equipment and motor vehicles	25.0%

NATIONAL RESERVE BANK OF TONGA

**NOTES TO AND FORMING PART OF
THE FINANCIAL STATEMENTS
YEAR ENDED 30 JUNE 2009**

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND
STATUTORY REQUIREMENTS - Continued****h) Employee Entitlements**

The Bank and staff make contributions to a staff provident scheme based on the years of service. The liability recognised in the balance sheet in respect of the staff retirement fund is on an accrual basis. Other employee related liabilities are recognised and measured as the amount unpaid at year end, at the current pay rate in respect of employee services up to date.

i) Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents includes notes and coins held by National Reserve Bank of Tonga, tellers cash, short term bills and current accounts.

j) Revenue Recognition

Interest income is brought to account on an accrual basis.

k) Staff Loans

Loans are carried in the balance sheet at historical cost net of impairment provisions.

A provision for impairment is based on an appraisal carried out at the end of the financial year. The amounts of potential losses that have been identified are either written off against provisions in the year in which they are recognized or recognized as an expense in the income statement.

l) Provisions

Provisions are recognised when the Bank has a present legal or constructive obligation as a result of past events; it is more likely than not that an outflow of resources will be required to settle the obligation, and the amount has been reliably estimated.

NATIONAL RESERVE BANK OF TONGA**NOTES TO AND FORMING PART OF
THE FINANCIAL STATEMENTS
YEAR ENDED 30 JUNE 2009****2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND
STATUTORY REQUIREMENTS - Continued****m) General Reserve and Distribution of Profits**

- Section 8(1) of the National Reserve Bank of Tonga (Amendment) Act 2007 states that:
 - a) where the General Reserve does not exceed 50% of the authorised capital of the Bank, 100% of the net profit be transferred to the General Reserve;
 - b) where the General Reserve exceeds 50 percent of the authorised capital of the Bank, 50 percent until the General Reserve is equal to the authorised capital of the Bank; and
 - c) where the General Reserve exceeds 100 percent but does not exceed 200 percent of the authorised capital of the Bank, 25 percent or such lesser sum to increase the General Reserve to twice the authorised capital of the Bank; Provided that upon agreement between the Minister and the Bank, the General Reserve may be increased.
- Section 8(2) states that subject to Section 8(1), the remainder of the net profits for the financial year shall be applied to the redemption of any securities issued under Section 6 held by the Bank.
- Section 8(3) states that the balance of the net profit for the financial year remaining after all deductions as above be paid to the Government of the Kingdom of Tonga.

n) Revaluation Reserve

Unrealised exchange gains and losses arising from revaluation of foreign currencies are transferred to the Revaluation Reserve (refer Note 2(b)) and are not included in the computation of annual profits and losses of the Bank.

o) Segment Reporting

The Bank presents financial assets and financial liabilities, and their associated income and expense streams, by distinguishing between foreign currency and local currency activities. The Bank considers that these reporting approaches provide appropriate segmental reporting of the Bank's activities.

NATIONAL RESERVE BANK OF TONGA

**NOTES TO AND FORMING PART OF
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**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND
STATUTORY REQUIREMENTS - Continued****p) Leases**

Where the Bank is the lessee, the lease rentals payable on operating leases are recognised in the Income Statement over the term of the lease.

Where the Bank is the lessor, the assets leased out are retained in Property, Plant & Equipment.

q) Currency of Presentation

All amounts are expressed in Tongan Pa'anga.

3. FINANCIAL RISK MANAGEMENT

The Bank identifies risks and implements controls in its operation and management of foreign reserves holdings. The main financial risks that the Bank faces are exchange rate risk, interest rate risk, credit risk and liquidity risk.

(a) Exchange Rate Risk Management

Exchange rate risk relates to the risk of loss arising from changes in the exchange rates against the Tongan Pa'anga. The Bank has adopted a currency risk management policy, which maintains the Tongan Pa'anga value of foreign reserves and minimizes the fluctuations in the Revaluation Reserve Account.

The value of the Tongan Pa'anga is determined by a basket of currencies. To minimize the exchange rate risk, the weights of the currencies in the exchange rate basket is the benchmark for the composition of the Bank's foreign currency assets.

(b) Interest Rate Risk Management

Interest rate risk refers to the risk of loss arising from changes in interest rates. The Bank limits interest rate risk by investing in short term investments of up to 12 months.

NATIONAL RESERVE BANK OF TONGA**NOTES TO AND FORMING PART OF
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Credit risk relates to the risk of loss arising from the failure of counterparty to a transaction to perform according to the terms and conditions of the financial contract.

Credit risk or safety is a key criterion in the determination of the composition of the Bank's foreign currency assets.

To manage this credit risk, the Bank prescribes minimum credit ratings acceptable for investment and specifies the maximum permissible credit exposure to individual banks and countries. In addition, the number of commercial banks, with whom the Bank may deal with in foreign exchange must have minimum credit ratings of **A**.

The NRBT uses Standard and Poors credit ratings of assessing the credit risk of foreign counterparties. The credit ratings of counterparties are on "watch" all the time and are updated as new market information is available.

The concentration of credit risk in the Bank's investment portfolio is as follows.

	<u>2009</u>	<u>2008</u>
	\$	\$
Public Sector Securities – Local	-	9,677,000
Financial Institutions – Foreign	129,396,341	82,614,896
Total financial investments	<u>\$129,396,341</u>	<u>\$92,291,896</u>

3. FINANCIAL RISK MANAGEMENT - Continued

(d) Liquidity Risk Management

Liquidity risk relates to the difficulty in raising funds at short notice to meet commitments.

Liquidity is a key criterion in the determination of composition of the Bank's foreign currency assets.

To minimize the liquidity risk, the Bank maintains an adequate level of reserves and taking into consideration the transaction demand on foreign exchange, ensures that an appropriate amount is maintained in current accounts at all times. The balances of the investible reserves are placed on term investments of up to 12 months. The composition of foreign currency assets is monitored daily.

The note below analyses the Bank's assets and liabilities into relevant maturity groupings based on the remaining period at balance sheet date to the contractual maturity date.

NATIONAL RESERVE BANK OF TONGA**NOTES TO AND FORMING PART OF
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The table below analyses the Bank's assets and liabilities into relevant maturity groupings based on the remaining period at balance sheet date to the contractual maturity date.

MATURITY ANALYSIS- 30 June 2009

Maturity Analysis	0-3 months \$	3-12 months \$	1- 5 years \$	Over 5 Years \$	No Specific maturity \$	Total \$
Assets						
Foreign Currency Assets						
Short Term Commercial Paper and C/Accounts	19,158,519	110,237,822	-	-	-	129,396,341
Accrued Interest	1,415,399	-	-	-	-	1,415,399
International Monetary Fund						
- Reserve Tranche Position	5,335,514	-	-	-	-	5,335,514
- Special Drawing Rights	1,520,468	-	-	-	-	1,520,468
- Currency Subscription	16,550,132	-	-	-	-	16,550,132
Local Currency Assets						
Cash on hand	127,900	-	-	-	-	127,900
Accrued Interest	9,466	-	-	-	-	9,466
Domestic Securities	-	-	-	-	-	-
Other Assets	-	96,034	-	-	4,368,673	4,464,707
Property, Plant and Equipment	-	-	-	-	8,171,276	8,171,276
Total Assets	44,117,398	110,333,856	-	-	12,539,949	166,991,203
Liabilities						
Foreign Currency Liabilities						
Demand Deposits	10,345,958	-	-	-	-	10,345,958
Accrued Interest	-	-	-	-	-	-
Local Currency Liabilities						
Demand Deposits	61,285,894	-	-	-	-	61,285,894
Accrued Interest	29,110	-	-	-	-	29,110
Currency in Circulation	-	-	-	-	28,175,399	28,175,399
Statutory Reserve Deposits	-	-	-	-	29,470,000	29,470,000
IMF - Notes Currency Subscription	-	-	-	-	16,550,132	16,550,132
Other Liabilities	1,901,160	-	-	-	1,034,664	2,935,824
Total Liabilities	73,562,122	-	-	-	75,230,195	148,792,317
Liquidity Gap	(29,444,724)	110,333,856	-	-	(62,690,246)	18,198,886

NATIONAL RESERVE BANK OF TONGA**NOTES TO AND FORMING PART OF
THE FINANCIAL STATEMENTS
YEAR ENDED 30 JUNE 2009****4. MATURITY ANALYSIS - Continued****MATURITY ANALYSIS- 30 June 2008**

Maturity Analysis	0-3 months \$	3-12 months \$	1- 5 years \$	Over 5 Years \$	No Specific maturity \$	Total \$
Assets						
Foreign Currency Assets						
Short Term Commercial Paper and C/Accounts	21,036,493	61,578,403	-	-	-	82,614,896
Accrued Interest	1,314,405	-	-	-	-	1,314,405
International Monetary Fund						
- Reserve Tranche Position	5,152,417	-	-	-	-	5,152,417
- Special Drawing Rights	1,367,495	-	-	-	-	1,367,495
- Currency Subscription	15,588,292	-	-	-	-	15,588,292
Local Currency Assets						
Cash on hand	64,089	-	-	-	-	64,089
Accrued Interest	239,050	-	-	-	-	239,050
Domestic Securities	-	4,188,000	5,489,000	-	-	9,677,000
Other Assets	-	43,449	-	-	4,069,671	4,113,120
Property, Plant and Equipment	-	-	-	-	7,049,400	7,049,400
Total Assets	44,762,241	65,809,852	5,489,000	-	11,119,071	127,180,164
Liabilities						
Foreign Currency Liabilities						
Demand Deposits	3,104,425	-	-	-	-	3,104,425
Accrued Interest	3,959	-	-	-	-	3,959
Local Currency Liabilities						
Demand Deposits	34,846,364	-	-	-	-	34,846,364
Accrued Interest	327,449	-	-	-	-	327,449
Currency in Circulation	-	-	-	-	24,121,575	24,121,575
Statutory Reserve Deposits	-	-	-	-	29,554,000	29,554,000
IMF - Notes Currency Subscription	-	-	-	-	15,588,292	15,588,292
Other Liabilities	2,841,755	-	-	-	720,634	3,562,389
Total Liabilities	41,123,952	-	-	-	69,984,501	111,108,453
Liquidity Gap	3,638,289	65,809,852	5,489,000	-	(58,865,430)	16,071,711

NATIONAL RESERVE BANK OF TONGA**NOTES TO AND FORMING PART OF
THE FINANCIAL STATEMENTS
YEAR ENDED 30 JUNE 2009****5. INTEREST INCOME**

	<u>2009</u>	<u>2008</u>
	\$	\$
Overseas investments	4,237,986	5,853,379
Domestic investments	159,315	1,072,415
Staff Loans	12,198	27,168
	<u>\$4,409,499</u>	<u>\$6,952,962</u>

6. OTHER INCOME

	<u>2009</u>	<u>2008</u>
	\$	\$
Numismatic Coins	127,893	53,506
Rental Income	430,706	338,492
Gain on sale of Assets	3,755	677
Forex sales/ purchases	1,832,466	656,251
Bank user fees	16,558	23,960
Information services - publications	200	769
Miscellaneous	11,666	0
	<u>\$2,423,244</u>	<u>\$1,073,655</u>

7. INTEREST EXPENSE

	<u>2009</u>	<u>2008</u>
	\$	\$
Foreign Currency Accounts	11,623	40,840
Domestic Currency Accounts	412,820	877,472
	<u>\$424,443</u>	<u>\$918,312</u>

8. ADMINISTRATION AND OTHER EXPENSES

	<u>2009</u>	<u>2008</u>
	\$	\$
Administration	1,309,048	1,410,171
Staff Costs	1,291,822	1,114,122
Audit Fees	21,500	20,100
Currency Issue (refer note 12)	882,263	355,544
Depreciation	436,605	419,363
	<u>\$3,941,238</u>	<u>\$3,319,300</u>

NATIONAL RESERVE BANK OF TONGA**NOTES TO AND FORMING PART OF
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YEAR ENDED 30 JUNE 2009****9. SHORT TERM INVESTMENTS AND CURRENT ACCOUNTS**

	<u>2009</u>	<u>2008</u>
	\$	\$
Current Account	19,158,519	12,702,168
Short term Investments	110,237,822	69,912,728
	<u>\$129,396,341</u>	<u>\$82,614,896</u>

10. INTERNATIONAL MONETARY FUND

- (i) The Bank was designated to serve with effect from 1 July 1989 as the fiscal agent of the Kingdom 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 2009, Tonga's membership subscription to the International Monetary Fund was SDR6,900,000 (2008: SDR6,900,000). Of the total amount SDR 1,711,633 (2008: SDR1,711,633) had been paid in foreign currencies, shown in the Balance Sheet as Reserve Tranche, and the remaining balance representing the Currency Subscription portion was satisfied by crediting the demand deposit accounts of the International Monetary Fund with the Bank.

11. DOMESTIC SECURITIES

	<u>2009</u>	<u>2008</u>
	\$	\$
Government of Tonga Bonds	\$ -	<u>\$9,677,000</u>

The Bank can no longer deal in notes, bills, stocks, securities or other evidence of indebtedness issued or guaranteed by his Majesty's Government under the National Reserve Bank of Tonga (Amendment) Act, 2007.

NATIONAL RESERVE BANK OF TONGA**NOTES TO AND FORMING PART OF
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YEAR ENDED 30 JUNE 2009****12. OTHER ASSETS**

	<u>2009</u>	<u>2008</u>
	\$	\$
Staff loans and advances	451,561	156,462
Currency and numismatics	3,771,503	3,698,585
Other assets	241,643	258,073
	4,464,707	4,113,120
Less: Provision for doubtful debts on staff loans and advance	-	-
	<u>\$4,464,707</u>	<u>\$4,113,120</u>

The amount charged to the income statement for currency expense is based on the cost of notes and coins issued for circulation.

13. PROPERTY, PLANT & EQUIPMENT

(a) Property, Plant & Equipment include:

	<u>2009</u>	<u>2008</u>
	\$	\$
Leasehold land & buildings – at cost	11,657,801	10,384,475
Less: accumulated depreciation	3,930,386	3,638,209
	7,727,415	6,746,266
Other fixed assets – at cost	1,881,045	1,729,241
Less: accumulated depreciation	1,437,184	1,426,107
	443,861	303,134
Total – at cost	13,538,846	12,113,716
Less: accumulated depreciation	5,367,570	5,064,316
	<u>\$8,171,276</u>	<u>\$7,049,400</u>

NATIONAL RESERVE BANK OF TONGA**NOTES TO AND FORMING PART OF
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YEAR ENDED 30 JUNE 2009****(b) Reconciliation of Property, Plant & Equipment**

FIXED ASSETS	Land, Bldg & Improvement	Other Fixed Assets	Work in Progress	Total
	\$	\$	\$	\$
At 30th June 2009				
Opening net book amount	6,746,266	303,134	-	7,049,400
Additions	1,293,538	264,943	-	1,558,481
Depreciations	(312,389)	(124,216)	-	(436,605)
Closing net book amount	7,727,415	443,861	-	8,171,276

14. (a) FOREIGN CURRENCY DEMAND DEPOSITS

	<u>2009</u>	<u>2008</u>
	\$	\$
Government of Tonga	\$10,345,958	\$2,477,079

(b) LOCAL CURRENCY DEMAND DEPOSITS

	<u>2009</u>	<u>2008</u>
	\$	\$
International Banks	26,184	627,346
Domestic banks	35,788,787	11,043,360
Government of Tonga	25,470,923	23,803,004
	\$61,285,894	\$35,473,710

15. CURRENCY IN CIRCULATION

The exclusive rights of national currency issue are vested with the Bank. Currency in Circulation comprises bank notes and coins issued by the Bank.

	<u>2009</u>	<u>2008</u>
	\$	\$
Notes	26,429,375	22,436,666
Coins	1,746,024	1,684,909
	\$28,175,399	\$24,121,575

NATIONAL RESERVE BANK OF TONGA**NOTES TO AND FORMING PART OF
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YEAR ENDED 30 JUNE 2009****16. STATUTORY RESERVE DEPOSITS**

The deposit represents the reserves required to be maintained by each financial institution under Section 39 of the NRBT Act 1988.

17. OTHER LIABILITIES

	<u>2009</u>	<u>2008</u>
	\$	\$
Other creditors and accruals	2,459,690	3,477,246
Provision for annual leave	57,990	50,022
Payable to the National Reserve Bank of Tonga Staff Provident Scheme	418,144	35,121
	<u>\$2,935,824</u>	<u>\$3,562,389</u>

The National Reserve Bank of Tonga Staff Provident Scheme was administered by the Bank till 31 March 2009. The Scheme is now managed by Trustees and the amount is payable to the National Reserve Bank of Tonga Staff Provident Scheme. The fund is reconciled as follows:

Total of Provident Fund	977,144	739,121
Less: investment in domestic securities	(559,000)	(704,000)
	<u>\$418,144</u>	<u>\$35,121</u>

18. CASH AND CASH EQUIVALENTS

Cash and cash equivalents included in the cash flow statement comprise the following items in the balance sheet:

	<u>2009</u>	<u>2008</u>
	\$	\$
Cash on hand	127,900	64,089
Short term investments and current accounts	129,396,341	82,614,896
	<u>\$129,524,241</u>	<u>\$82,678,985</u>

NATIONAL RESERVE BANK OF TONGA**NOTES TO AND FORMING PART OF
THE FINANCIAL STATEMENTS
YEAR ENDED 30 JUNE 2009****19. RELATED PARTIES***Identity of related parties*

The Bank's ultimate parent entity is the Government of the Kingdom of Tonga.

The Board of Directors during the financial year ended 30 June 2009 were Siosi Mafi (Chairperson and Governor), HRH Princess Salote Pilolevu Tuita, Richard Prema, Henry Cocker and 'Aisake Eke.

During the year, the following executives were identified as key management personnel of the Bank: Siosi C Mafi (Governor), Inia Naiyaga (Deputy Governor), Lata Tangimana (Manager Accounts and Currency), Elizabeth Baker (Manager Administration and Information Systems), Jessie Cocker (Manager Financial Institutions and Markets) and 'Anapuli Matoto (Acting Manager Research).

Transactions with related parties

In the normal course of operations, the Bank enters into transactions with related parties identified above.

The transactions with the Government of the Kingdom of Tonga include banking services, foreign exchange transactions and registry transactions.

The funds of the Provident Scheme are invested within the Bank at the rate of 5.92% per annum. The total interest payable by the Bank for the financial year amounted to \$1,447. The Trustees of the Provident Scheme are indemnified by the Bank against all losses, damages or other costs which may be sustained or suffered by or made against a trustee as a result of any act or omission committed by the Trustee or Trustees which is not a breach of trust on the part of the Trustee.

Transactions with a director related entity includes purchases of goods and services as follow:

	<u>2009</u>	<u>2008</u>
	\$	\$
Purchase of goods	<u>1,969</u>	<u>2,249</u>

The Directors are paid fees and sitting allowances for services rendered. The Directors are also entitled to a retirement fund which at year end amounted to \$120,512. The Bank also provides non-cash benefits to the Executive Directors and executive officers in addition to their salaries.

NATIONAL RESERVE BANK OF TONGA**NOTES TO AND FORMING PART OF
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YEAR ENDED 30 JUNE 2009****19. RELATED PARTIES - Continued**

Total remuneration is included in 'staff costs' as follows:

	<u>2009</u>	<u>2008</u>
	\$	\$
Executive officers	176,396	191,672
Director's fees and remuneration	30,554	33,450
	<u>\$206,950</u>	<u>\$225,122</u>

20. COMMITMENTS AND CONTINGENCIES

Commitments and contingencies not otherwise provided for in the accounts and which existed at 30 June 2009 comprise:

- (i) Contracts for foreign exchange transactions was nil (2008: \$nil)
- (ii) In accordance with the accounting policy in Note 2 (e) 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.

21. FAIR VALUES OF FINANCIAL ASSETS AND LIABILITIES

The fair value of an instrument is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arms length transaction.

Quoted market values represent fair value when a financial instrument is traded in an organised and liquid market that is able to absorb a significant transaction without moving the price against the trader.

Financial Assets and Liabilities

The valuation of the Bank's financial assets and liabilities are discussed below:

Domestic Securities

The Bank can no longer buy, sell or deal in notes, bills, stocks, securities or other evidence of indebtedness issued or guaranteed by his Majesty's Government under the National Reserve Bank of Tonga (Amendment) Act, 2007.

NATIONAL RESERVE BANK OF TONGA

**NOTES TO AND FORMING PART OF
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**21. FAIR VALUES OF FINANCIAL ASSETS AND LIABILITIES -
Continued*****Statutory Reserve Deposits***

The carrying value of statutory reserve deposits are considered to approximate their fair value as they are denominated in cash.

Demand Deposits

The carrying value of deposits are considered to approximate their fair value as they are payable on demand.

Currency in Circulation

The carrying value of Currency in Circulation is considered to be its fair value as reported in the accounts.

Other Financial Assets and Liabilities

The reported values of other financial assets and liabilities are considered to be its fair value.

