



# National Reserve Bank of Tonga

*28*  
*Years of Service*

## ANNUAL REPORT

2018 for the Year Ended 30 June 2018

N R B T

# **ANNUAL REPORT**

**2018**

for the Year Ended 30 June 2018

*Issued by:* National Reserve Bank of Tonga  
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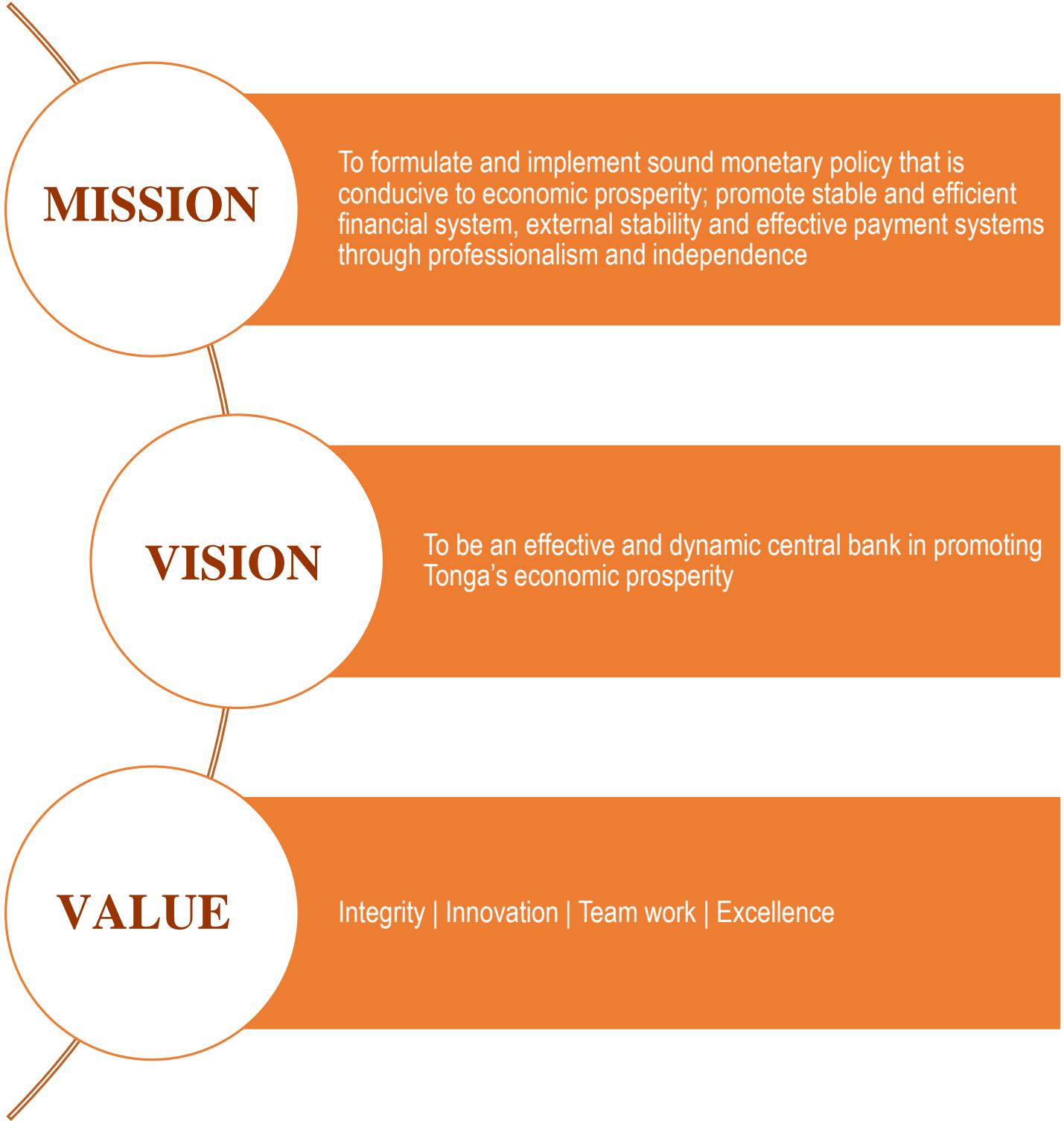
*Subscription:* Economics Department  
National Reserve Bank of Tonga  
Private Mail Bag No. 25  
Post Office  
Nuku'alofa  
Kingdom of Tonga

*Enquiries:* Phone: (676) 24-057  
Facsimile: (676) 24-201  
Email: nrbt@reservebank.to



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## MISSION

To formulate and implement sound monetary policy that is conducive to economic prosperity; promote stable and efficient financial system, external stability and effective payment systems through professionalism and independence

## VISION

To be an effective and dynamic central bank in promoting Tonga's economic prosperity

## VALUE

Integrity | Innovation | Team work | Excellence



## Governor's Foreword

I am pleased to present the 28th annual report for the financial year 2017/18. This report outlines the analysis of the economic and financial conditions, the policies adopted by the Reserve Bank, the activities of the departments as well as the audited accounts of the Reserve Bank for the year ended 30th June 2018. This is in accordance with the Principal objectives and functions outlined in the NRBT Act.

During the year, global economic activity was favorable in 2018 with the International Monetary Fund (IMF) revising up the global economic growth to 3.9%, commodity prices and oil prices have picked up compared to the previous year. However, these developments in the global economy had no notable adverse impact on the domestic economy. The domestic economy remains solid, despite the impact of Tropical Cyclone Gita, and is expected to record another year of growth for the 5th consecutive year. This growth is supported by improved performance in the construction, manufacturing, financial intermediation, trade, and transport and communication sectors.

Inflation spiked to a high of 9.8% in March 2018 reflecting the impact of Tropical Cyclone Gita and then declined to remain slightly above Reserve Bank's 5% reference rate at the end of June 2018. This supported the positive economic sentiment. During the year, the slowdown in the rate of inflation is attributed to the wind down of the

Government excise tax that was introduced in the previous year, the favorable harvest season of agricultural produce and the Government decision to hold any tariff increases in electricity prices.

Partial indicators also supported economic growth as well as positive consumer and business sentiment. This was evident in the continued increase in bank loans to private individuals for housing and personal loans as well as business loans to the retail, wholesale, manufacturing and construction sectors. This increase in lending was despite the slight increase in lending interest rates and a corresponding decline in deposit interest rates.

Furthermore, similar to other currencies in the region, the Tongan pa'anga strengthened against the Australian and New Zealand dollar but was lower against the US dollar and other trading partner currencies. This development in the exchange rates benefited those who receive remittances from the United States, our main remittance country, and supported an overall increase in private individual's disposable income. The increase in individual's disposable income also supported the demand and payment of imports from New Zealand, our main source country for imports.

Domestic economic growth was also evident in the increase in overseas payments for imports of goods and services. Businesses also transferred profits overseas

to their head offices. These payments were offset by inflows of remittances, as well as official and travel receipts. Given these overseas transaction flows, at the end of June 2018, Tonga's transactions with the rest of the world improved with a current account surplus of T\$7.0 million. Consequently, the official foreign reserves rose to a record high of T\$468 million, equivalent to 7.8 months of imports. The Reserve Bank is conscious of the vulnerabilities to natural disasters and the economy's heavy reliance on imports such as oil and consumption goods and continued to ensure that the foreign reserves are at sufficient levels to withstand any external shocks. More importantly a sufficient level of foreign reserves supports the fixed basket exchange rate regime and the value of the Tongan Pa'anga exchange rate to maintain internal and external monetary stability.

On financial stability, the banks remained sound and well capitalized. During the year the banks continued to improve their balance sheets, credit continued to grow but at a slower rate of 10.6% with non-performing loans falling to 3.7% of total loans.

Although the risk weighted capital ratio of the banks fell due to the increase in loans and the repatriation of banks' profits to their head offices, the banks' profits continued to improve, and capital remains adequate and acts as a safeguard against any shock to the financial system.

Liquidity in the banking system continued to increase as a consequence of the high foreign reserves despite the increase in the statutory reserve deposit requirement in July 2017. The Reserve Bank continued to focus on maintaining financial stability and ensuring the depositors' interest are protected. The Reserve Bank during the year ensured depositors were paid following the revocation of a bank license, onsite bank examinations were undertaken, a credit bureau guideline was issued and an application for a license to provide credit bureau services was processed, as well as 2 license applications for foreign exchange dealers.

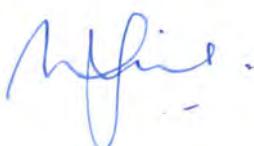
The banks and foreign exchange dealers also reacted positively to support their customers in the aftermath of the Tropical Cyclone Gita by providing relief packages such as concessional loans and reduced fees on foreign exchange transfer services.

Against this background, the Reserve Bank continued its accommodative monetary policy stance and at the same time remained vigilant in monitoring the developments in the economy and the banking system for early signs of vulnerabilities. To enhance its role in promoting macroeconomic and financial stability, policy actions were implemented by the Reserve Bank during the 2017/18 such as the increase in the statutory reserve deposits requirement, reviewing the basket exchange rates and amendments to the exchange control policy guidelines.

On the financial performance, the Reserve bank is reporting a net profit of T\$3 million for 2017/18 financial year, an increase from T\$2.85 million in the previous year. The increase in net profit is attributed to investment income from the foreign reserves, numismatic sales and the receipt of the cyclone insurance claim. At the end of the financial year, the net profit available for distribution was T\$2.1 million.

Throughout the year there was no change to the governance composition of the Bank. The Directors continued to carry out their functions outlined in the NRBT Act and reviewed and approved the achievement of 73% of the corporate plan targets for 2017/18 and the corporate plan targets for 2018/19.

At the end of the financial year 2017/18, the Bank has achieved its principal objectives and functions outlined in the NRBT Act of monetary and financial stability. The results outlined in this annual report would not have been possible without the support of the Board of Directors and the Staff. In this regard, I would like to thank the Chairman and the Board of Directors for their support and the staff for their commitment and dedication in delivering the mandate of the NRBT. The support of the Ministry of Finance, Government Ministries and financial institutions during the year is appreciated as well as the assistance from the international organizations, development partners and the central banks in the region.



Dr. Sione Ngongo Kioa  
Governor

# Functions and Objectives

The National Reserve Bank of Tonga (Amendment) Act, 2014, Section 4 sets out the principal objectives of the Bank. It states:

## Objectives of the Bank

- (1) The principal objectives of the Bank shall be to maintain internal and external monetary stability.
- (2) Without prejudice to its principal objective, the Bank shall-
  - (a) promote financial stability; and
  - (b) promote a sound and efficient financial system.
- (3) Subject to subsections (1) and (2), the Bank shall conduct its activities in a manner that supports macroeconomic stability and economic growth.

Maintaining internal monetary stability is pursued by the Reserve Bank through promoting low and stable inflation over the medium term. The Reserve Bank's inflation reference rate is 5% per annum.

Maintenance of external monetary stability is pursued through maintaining adequate amount of foreign currencies (foreign reserves) to meet the country's foreign currency demands to pay for imports, etc. As such, the Reserve Bank's monetary policies aim to ensure that Tonga always has foreign reserve holdings of at least three to four months of import cover.

The National Reserve Bank Act, Section 4A also sets out the Reserve Bank's functions:

*"The principal functions of the Bank shall be, to:*

- (a) issue currency;
- (b) formulate and implement monetary policy;
- (c) prescribe the regime for the determination of the external value of the Tongan currency in consultation with the Minister;
- (d) determine the foreign exchange rate and implement foreign exchange policy;
- (e) determine and implement financial stability policy, and oversee the maintenance of the stability of the financial system as a whole;
- (f) regulate as required the supply, availability and international exchange of money;
- (g) exclusively hold and manage the external reserves of the Kingdom;
- (h) provide advisory services to the Minister on banking and monetary matters;
- (i) be the principal banker, fiscal agent and depository of the Government;
- (j) undertake banking business, in Tonga or elsewhere, subject to the provisions of this Act;
- (k) regulate and supervise financial institutions, including non-bank financial institutions;
- (l) oversee and promote the efficient, sound and safe functioning of the payment system;
- (m) collect and produce statistics;
- (n) cooperate with and participate in international councils and organisations, including public international financial institutions, and cooperate with domestic and foreign public entities, concerning matters related to its objectives and functions;
- (o) regulate and supervise capital markets in Tonga;
- (p) to manage and promote financial inclusion initiatives and related activities; and
- (q) carry out any other function or any ancillary activities incidental to the exercise of its functions under this Act or any other Act;

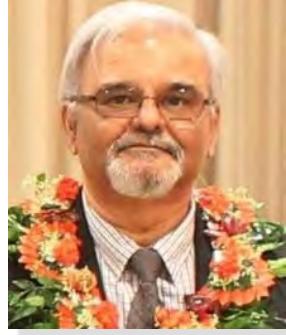
Details on how the Reserve Bank applied its functions to meet its objectives are outlined in this report and other publications.

# Governance

## Board of Directors



*Chairman*  
Mr. Steve Edwards



*Director*  
Mr. Richard Prema



*Director*  
Mrs. Sinaitakala Tu'itahi



*Governor*  
Dr. Sione Ngongo Kioa



*Director (Secretary for Finance)*  
Mrs. Balwyn Fa'otusia

## Key Decision Makers

The Board of Directors comprises of the Chairman (non-executive Director), the Governor, Secretary for Finance, and 4 other non-executive Directors. The Governor, who is the Chief Executive Officer of the Bank, is responsible to the Board for the management and execution of the Bank's policy. Under the NRBT Act and the Amendment Acts, the Directors are appointed for terms of up to five years by the Minister of Finance and may be reappointed. During the year, there were no changes to the members of the Board of Directors. As at the end of June 2018 two director positions remained vacant.

In accordance with the Act, the Board must meet at least 10 times during the calendar year to discuss and formulate the policies of the Bank and to monitor its operations. The Board Sub-Committee also met regularly to discuss and vet all Board matters well before every Board meeting and fulfil any requirements for further consideration at the Board. While the Board Sub-Committee met 11 times during the financial year, the Board met 11 times to formulate the policy of the Bank, monitor the Bank's operations and provide strategic direction and advice to the Governor. In line with Section 54D, the Board Audit Committee met to support the Board on External Audit matters. The Audit Committee in their responsibility to oversee the internal audit function directed that, at this time, the Risk Management Office would undertake some internal audit functions and report directly to the Board.

The Board of Directors are responsible for the Reserve Bank's policy and affairs. This involves constantly reviewing the performance of the Reserve Bank in the conduct of its functions and its use of resources, and may give advice to the Governor not only to sustain the efficient and effective management of the Bank's operations but also to ensure that the Reserve Bank delivers its core functions in compliance with the NRBT Act and related Acts.

Section 9A of the NRBT Amendment Act 2014 specifies the powers and functions of the Board which may not

be delegated. During the year, the Board of Directors diligently carried out these powers and functions and defined and adopted the accommodative monetary policy stance which was published in the bi-annual Monetary Policy Statements. The Directors also approved the monthly economic review, data flashes and issued a press release on the Monetary Policy decisions and its implementation. The management of the foreign reserves and implications of the exchange rate policies of the Bank was reported through the management monthly updates at Board and Board sub-committee meetings.

Throughout the year, the Directors also defined and adopted financial stability policies, foreign exchange policies and other policies of the Bank regarding the execution of its supervisory functions.

During the year, to ensure financial stability was maintained and that depositors' funds are protected at all times, the Directors discussed the commercial banks' liquidity, capital, credit growth and profitability as well as their exchange rates, interest rates and fees & charges. The Directors supervised the implementation of the policies and the exercise of the functions of the Bank through management monthly updates at Board meetings. The implementation of the Bank's functions by management was also discussed at the sub-committee meetings.

To ensure the operations of the Bank are carried out efficiently and effectively during the year, the Directors approved the review and changes to general staff policies and internal rules applicable to the administration and operations of the Bank. These changes contributed to strengthening the Bank's Corporate Plan strategic priority of positioning the Bank as the employer of choice while maintaining a high staff retention rate.

The Directors also endorsed the 2018/19 annual budget and the organization chart of the Bank as well as the Annual Report for 2016/17. Monthly financial statements comparing the actual financial outcomes against the budget were also approved by the Directors and transmitted to the Minister of Finance and the Prime Minister's Office to be published in the Government Gazette.

## Organisational Chart

### National Reserve Bank of Tonga Organisational Structure – 30<sup>th</sup> June 2018

#### BOARD OF DIRECTORS

—

**Governor**  
Dr. Sione Ngongo Kioa

**Deputy Governor**  
Ms. Jessie Coker

**Assistant Governor - Operation**  
Mr. Lala Tangimana

**Assistant Governor - Policy**  
Ms. 'Ungatea Latu

**Snr Manager Finance**  
Mrs. Teisla Tongia

**Snr Manager Corporate Services**  
Ms. Kasoline Lohieea

**Snr Manager Financial Systems**  
Ms. Ara Takai

**Snr Manager Financial Markets & Research**  
Mr. Taniela Tauapepeu

**General Counsel**  
Ms. Mele Mangisi (Study Leave)

**Head of Security**  
Mr. Teau 'Itiolo

**Snr Manager Economics**  
Mr. Tevita Vainai (Study Leave)

# Corporate Plan

In June 2017, the Board of Directors approved the revised Reserve Bank's Corporate Plan for 2017/18. This review resulted in an increase in the number of measurable targets from 215 to 400. This was to better reflect the core functions of each Unit/Department and break them down to the number of activities that are being carried out. This also included breaking down of large projects to phases and broken down further in details to enable better measurement of the targets.

The mid-term review of the Corporate Plan 2017/18 was based on performance up to the end of December 2017. This was conducted by each department's manager and was then presented to all staff on the 1st and 2nd March 2018 in the presence of members of the Board of Directors. This review showed that overall the Bank has achieved 73% of the 400 Corporate Plan targets for 2017/18. This is an improvement from the 69% achieved in the previous year, considering the significant increase in the number of measurable targets. Some of the tar-

gets that were not achieved were attributed to other work priorities, capacity constraints and matters that were out of the Reserve Bank's control such as targets that were awaiting the enactment of draft legislations and awaiting responses from external stakeholders. Of the 27% unachieved targets, 14% are currently work in progress or delayed due to reasons beyond their control and/or targeted to be completed within the next 3 months from the end of the year. These unachieved/work in progress targets were either re-prioritised and scheduled for the Bank's Corporate Plan for 2018/19, removed or replaced by other more practical and achievable targets.

Management will continue to align staff behaviours with the Bank's values. This is not only in maintaining a culture of high performance that supports achieving the strategic priorities set out in the Corporate Plan but also in positioning the National Reserve Bank of Tonga as an effective and dynamic central bank in promoting Tonga's economic prosperity.

# CORPORATE PLAN STRATEGIC PRIORITIES

## STRATEGIC PRIORITY 1

- Set a Platform for Tonga Becoming a High-Growth Economy

## STRATEGIC PRIORITY 2

- Develop Tonga's Financial Markets

## STRATEGIC PRIORITY 3

- Become the Employer of Choice

## STRATEGIC PRIORITY 4

- Modernize the Operations of the Bank

# Economic Overview

## Overseas Economies

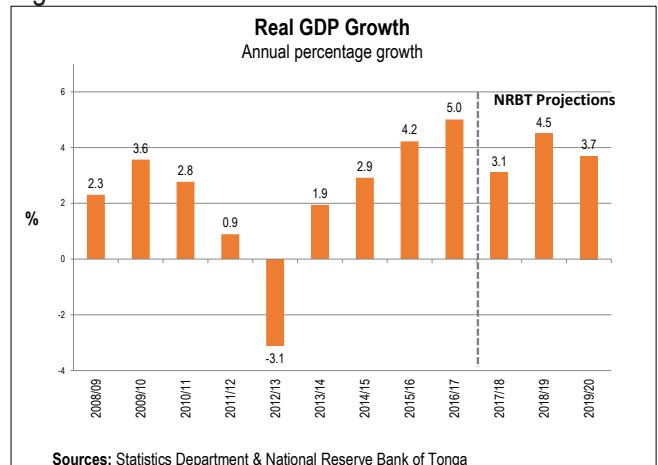
Global economic activity were favourable in 2018, supported by a rebound in global investment and trade. Also, the favourable market sentiment, accommodative financial conditions, and the domestic and international impacts of the expansionary fiscal policy in the United States (US), all contributed to the improved economic activity in 2018. Furthermore, advanced economies experienced an investment recovery while strong growth continued in emerging Asia. As such, the International Monetary Fund (IMF) in its April 2018 World Economic Outlook (WEO) anticipated a global economic growth of 3.9% (revised upwards from 3.7%) for 2018 and 2019 compared to a growth of 3.8% in 2017. Generally, rising commodity prices boosted recovery in commodity exporting countries. According to Reuters, world oil prices averaged around US\$65.58 per barrel in the year to June 2018 rising from US\$50.46 in the year to June 2017. Moreover, in June 2018 oil prices averaged around US\$75.78 per barrel, higher than an average of US\$47.64 in June 2017. Oil prices are at its highest since 2015 resulting mainly from a reduction in supply production. This stems from the extension of the production agreement by the Organization of the Petroleum Exporting Countries (OPEC) in November 2017. The agreement entails a limit on the barrels produced per day and is extended to the end of 2018.

## Developments in the Domestic Economy

The Tongan economy is expected to achieve its fifth year of consecutive growth in 2017/18. Despite the devastation caused by Tropical Cyclone (TC) Gita to Tongatapu and 'Eua in the latter half of the financial year, the Reserve Bank had projected the economy to grow by 3.1%, revised downward from 4.0%. This downward revision was due to lowering of the projected growth in the trade,

agricultural, utility, fisheries, transport & communication and ownership of dwellings sectors. This is due to the effect of Tropical Cyclone Gita and revenue loss from respective sectors. However, growth is expected to remain strong in 2017/18, reinforced particularly by the implementation of infrastructure projects and ongoing housing construction projects, improved power supply, and improved performance in the above mentioned sectors despite the impact of Tropical Cyclone Gita.

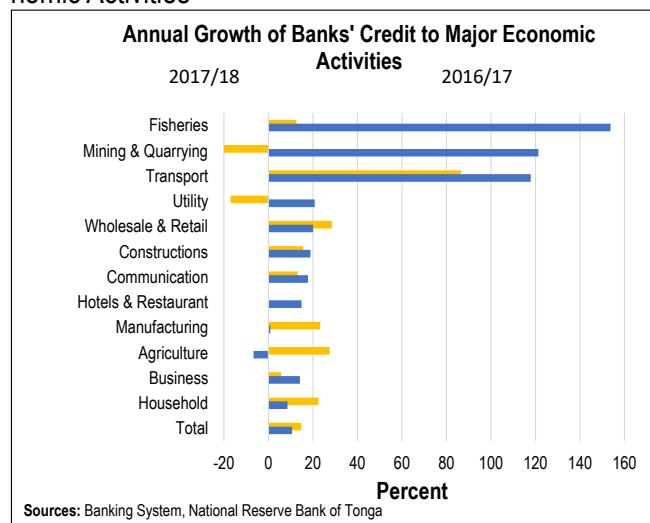
Figure 1: Real GDP Growth



Partial indicators for primary production revealed positive growth in 2017/18 which supported the growth estimates of 1.2% (revised downward from the earlier forecast of 2.6%). The agricultural production further improved over the year attributed mainly to the favourable weather conditions which resulted in better yields for squash, taro, yam and watermelon before Tropical Cyclone Gita struck Tonga. According to the Domestic Market Survey Report for the first 3 quarters of 2017/18, the total agricultural produce available for sale at the domestic market increased by 525 tonnes (17.1%) when compared to the four quarters of 2016/17. This is lower than the 21.4% growth recorded in 2016/17 compared with the previous year. The total agricultural exports volume also rose over the year to June 2018 by 1,362.9 tonnes (11.8%) compared to a growth of 33.0% in year ended June 2017.

Growth was driven mainly by higher exported volumes of squash which rose by 1,575.6 tonnes (38.3%), followed by the exports of taro and yam which increased by 803.7 tonnes (172.1%) and 208.4 tonnes (12.2%) respectively. These outweighed a decline in the export of cassava, breadfruit, vanilla, sweet potatoes and green coconut. Exported Kava Tonga increased by 11.3 tonnes (13.4%) as returns were much higher overseas despite its shortage of supply locally.

Figure 2: Annual Growth of Bank's Credit to Major Economic Activities



The construction activities continued to boost performance in the industry sector which was estimated to have grown by 7.5% (revised downward from the earlier forecast of 7.7%). This was supported by an 11.8% growth in individuals' housing loans. Banks' lending to utilities, construction and manufacturing businesses also grew by 20.8%, 18.9% and 1.0% respectively. The num-



Tropical Cyclone GITA

ber of construction permit approvals also increased over the year by 16.1%. Electricity production and consumption however, decreased over the year ended June 2018 by 1.4% and 2.4% respectively indicating the damages caused by TC Gita and restoration works needed after the cyclone. The developments in the industry sector are expected to have spill over effects on other sectors of the economy.

Several events that took place during the year improved performance in the tertiary sector. The higher import payments and business repatriation of funds to their head offices reflected the lively domestic economic activity during the year. Banks' total lending rose by 10.6% reflecting activities in the banking sector. In addition, the total number of container registrations increased by 857 (7.9%) due to a 8.5% increase in business containers and 7.2% increase in private containers indicating a rise in the informal distribution sector and a vibrant trade sector. Activities in the trade sector also indicated growth in the transportation sector. The number of cargo ships arriving during the year to June 2018 was lower by 23 however, much higher when compared to previous years. 15 cruise ships arrived during the year supported performance in the tourism sector though lower compared to 16 in 2016/17. The lower number of ships arriving during the year was due to disruptions caused by Tropical Cyclone Gita. Meanwhile, the number of scheduled flights increased over the year by 162 flights which was in line with a 5.7% rise in the total air arrivals and coincided with a 2.3% rise in travel receipts.



Damage from Tropical Cyclone GITA

According to the Reserve Bank's survey on job advertisements, the total number of vacant positions that was advertised in the local newspapers and the Matangi Tonga website grew over the year by 80 vacancies. Recruitment intentions were mainly for non-government organisations largely reflecting plans for the implementation of donor funded projects. Looking ahead, the number of persons in employment is expected to increase, though growth may be slow, in line with the domestic economic outlook.

## Monetary Policy Formulation

### Monetary Policy Actions

The Reserve Bank's monetary policy objectives are to maintain internal and external monetary stability, promote financial stability and a sound and efficient financial system and conduct its activities in a manner that supports macroeconomic stability and economic growth.

Given Tonga's vulnerability to external shocks, such as oil price increases, adverse weather conditions, and high dependence on remittances and imports, the Reserve Bank closely monitored the developments in the external and domestic markets to ensure that foreign reserves are maintained at an adequate level to meet individuals' needs for basic essentials and support economic growth.

The domestic economy experienced favourable growth in 2017/18 and the foreign reserves continued to remain comfortably above the minimum range of 3-4 months of imports cover. The annual headline inflation remained above the reference rate of 5% annually in most parts of 2017/18 partially due to the new custom duties and excise tax introduced in July 2017 and also the effects of Tropical Cyclone Gita on local food supplies. The banking system remained sound with strong capital position was maintained, supported by strong profitability and low non-performing loans. Excess liquidity in the banking system still remained, due to continuous growth in deposits, supported by the higher foreign reserves, despite the strong credit growth in the year to June 2018.

In light of the above developments and the outlook on the monetary policy targets, the Reserve Bank maintained an accommodative monetary policy stance in 2017/18. Nonetheless, in order to improve the Reserve

Bank's monetary policy transmission mechanism and objectives, few changes were made to its policy actions during the 2017/18 financial year. The Reserve Bank:

- Revised its statutory reserve deposits requirement from 5% to 10% effective in July 2017;
- Amended its Exchange Control Policy Guidelines in July 2017 to remove all requirements to provide tax clearance certificates for foreign exchange payments and lifted the delegated limits for capital payments, thereby provided an accommodative business environment;
- Reviewed the exchange rate basket during the year which became effective in November 2017.

In addition, the following policy actions were implemented by the Reserve Bank during 2017/18 to enhance its role in promoting macroeconomic and financial stability:

- Maintained the monetary policy rate (interest rate on banks' exchange settlement accounts or excess reserves) at 0% (zero interest rate policy);
- Maintained the minimum loans/deposit ratio at 80%;
- Maintained the inflation reference rate at 5%;
- Continued to explore other avenues and mechanisms to develop the domestic market operations to be more market oriented;
- Continued the financial inclusion initiatives to improve access to financial services and provide further protection to the consumers through regulating the non-bank financial institutions. Three legislations were passed by Parliament during the year for the regulation of microfinance institutions, money lend-



*Presentation to Parliamentarians - May 2018.*

ers and foreign exchange dealers, and await royal assent.

- Continued to closely monitor the effects of the eased Foreign Exchange Control requirements and economic development on the foreign reserves;
- Continued to communicate the monetary policy by announcing policy decisions approved by the Reserve Bank Board of Directors shortly after the monthly Board meetings to enhance transparency.

The Reserve Bank during the year also continued to publish its Monetary Policy Statement (MPS) every six months, as required by the National Reserve Bank of Tonga Act. The Reserve Bank also published Quarterly Bulletins, Monthly Economic Reviews and monthly data flashes on economic indicators. The Reserve Bank also conducted presentations to the Minister of Finance and Members of Parliament and other stakeholders upon request during the year to inform them of economic updates. Furthermore, the Reserve Bank remained vigilant and continued to closely monitor developments for early signs of vulnerabilities which may indicate overheating of the economy.

## Monetary Policy Outcomes

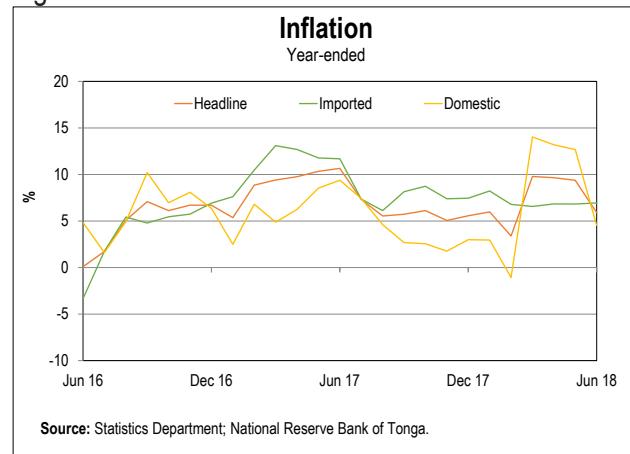
The Reserve Bank's monetary policy objectives were observed during the 2017/18 financial year.

### Inflation

The annual headline Inflation rate remained above the 5% reference rate during most part of 2017/18 and peaked at 9.8% in March 2018 before declining to 5.9% in June 2018. This is lower when compared to 2016/17, as the annual headline inflation reached 10.7% in June 2017. The slowdown in the annual headline inflation rate reflected the wind down of the hike in prices when new excise taxes became effective in July 2016. There were further new amendments to the Excise Tax and Customs Duty that was effective in July 2017 which again contributed to the increase in imported prices of 6.9% (3.9 percentage points) over the year to June 2018. The prices of all imported food categories rose, except for imported fruits and vegetables and cereal products. The price for meat, fish & poultry rose by 10.3% (1.6 percentage points) reflecting a rise in the price of mutton flaps and chicken pieces by 8.9% and 11.5% respectively over the year. The price of dairy farm & vegetable products also

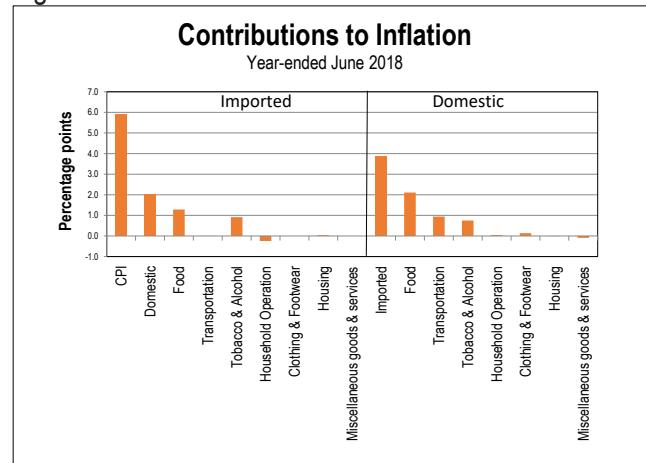
increased by 7.7% (0.2 percentage points). In addition, the price of other food also increased by 6.2% (0.3 percentage points).

Figure 3: Inflation



The increase in prices of Winfield (20.1%) and alcohol (6.5%) contributed 0.8 percentage point to the overall headline inflation. Additionally, the increase in world oil prices drove the price of fuel higher by 9.5% (0.9 percentage point). The price of petrol and diesel also increased over the year by 12.3% and 16.6% respectively which accounted for the increase in the annual imported inflation.

Figure 4: Contributions to Inflation



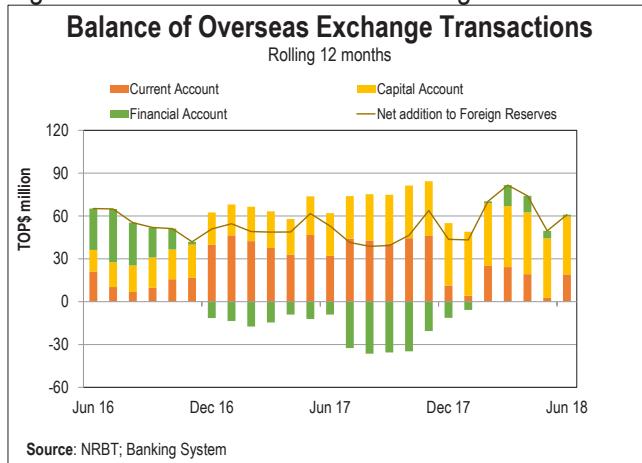
The domestic prices however, helped to bring down the annual headline inflation in the first 8 months of the financial year before the Tropical Cyclone Gita hit Tonga. The prices of local fruits and vegetables had declined during this period which drove the aggregate food prices lower reflecting an excess supply of food and better har-

vests. Following the aftermath of Tropical Cyclone Gita, the domestic prices increased significantly by 14.0% in March 2018. However, the annual domestic inflation rate has slowed to 4.5% in June 2018 compared to 12.7% in May 2018. The favourable local food season over the months contributed to this slowed growth although the food category remained the highest contributor to the annual domestic inflation rate with 1.3 percentage points. These are due to higher prices of agricultural crops, fish, and pastries. The second highest contributor to the annual domestic inflation rate was the price of kava-Tonga with a 45.4% increase over the year and a 0.9 percentage point contribution. The price of other local goods which also increased over the year included house maintenance goods and household furniture, furnishing & textiles. These outweighed the annual decline in prices of electricity, public transportation and communication services. The price of electricity declined over the year by 5.4% reflecting the Government's decision to hold any tariff increase up to June 2018 following the aftermath of Tropical Cyclone Gita.

### *Balance of OET*

In the year ended June 2018, the total Overseas Exchange Transaction (OET) receipts rose by \$62.2 million (8.0%) to \$835.2 million driven by higher inflows of private remittances, official receipts and travel receipts. The annual growth in remittances continued to indicate the willingness of Tongans abroad to support families in Tonga due to events that had happened during the year. Similarly, the total OET payments rose over the year ended June 2018 by \$78.6 million (12.3%) to \$715.7 million which was attributed to higher import and services payments, particularly for wholesale & retail goods, freight and professional services. The overall OET balance for the year ended June 2018 was therefore a surplus of \$60.9 million, which was \$7.9 million higher when compared to over a year ago.

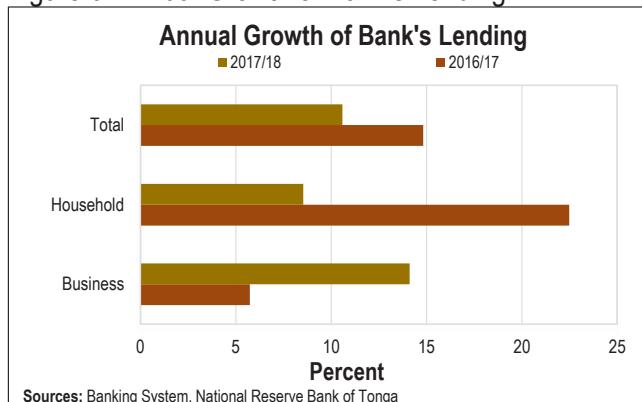
Figure 5: Balance of Overseas Exchange Transactions



### *Official Foreign Reserves*

The level of foreign reserves has remained at a very comfortable level during 2017/18 maintaining the months of import coverage above the Reserve Bank's minimum range of 3 – 4 months. The level of foreign reserves at the end of June 2018 was equivalent to US\$206.1 and was above the IMF's projection of US\$185.2 million by the end of 2017/18, but with lower months of import coverage of 5.9 months. The Reserve Bank continued to issue its monthly press release on the level of foreign reserves and is posted on to the website for the awareness of the public.

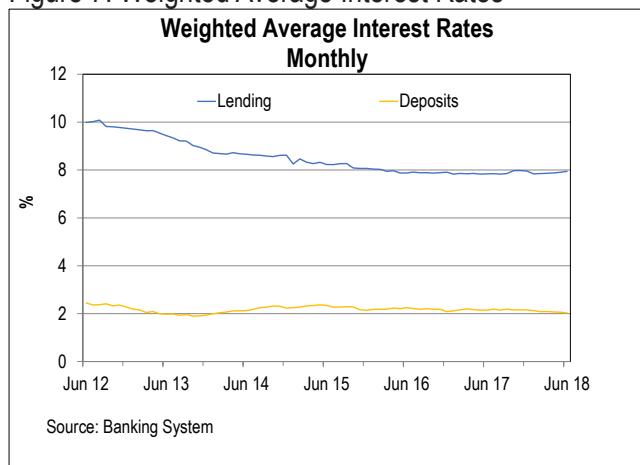
Figure 6: Annual Growth of Bank's Lending



## Exchange Rates

Majority of Tonga's major trading currencies appreciated against the Tongan Pa'anga over the year to June 2018, namely the United States Dollar, Fijian Dollar, Euro, British Pound, Japanese Yen and the Chinese Yuan while the Australian Dollar and New Zealand Dollar depreciated against the Tongan Pa'anga. As a result, the Nominal Effective Exchange Rate (NEER) declined slightly over the year by 0.4%. The Real Effective Exchange Rate (REER) increased which reflected Tonga's higher headline inflation rate relative to its trading partners.

Figure 7: Weighted Average Interest Rates



## Lending Balances

Total banks' lending grew over the year to June 2018 by 10.6% to \$447.3 million, which was lower than a credit growth of 14.8% recorded in year ended June 2017. This was also lower than the Reserve Bank's anticipated 16% credit growth for 2017/18 largely reflecting delays and cancellation in implementing of projects which the loans were to fund, as well as households' ability and capacity to access loans. Growth in loans during the year to June 2018 resulted from a 14.1% increase in business lending (wholesale & retail, transport, tourism, construction, fisheries) and a 8.5% rise in household lending (housing loans). Lending activities of the non-bank financial institutions also increased over the year to June 2018 by 15.3%. This supported domestic economic activities throughout the year.

## Deposit Balances

Total deposits with the banking system grew over the year by \$59.4 million (10.8%) to \$550.8 million. This stemmed largely from foreign investments and higher deposits of retirement funds and the private sector. In addition, saving deposits increased as a result of higher deposits by individuals and churches. Receipt of Government's budget support funds and improved government revenue collection throughout the year also contributed to the overall rise in deposits.

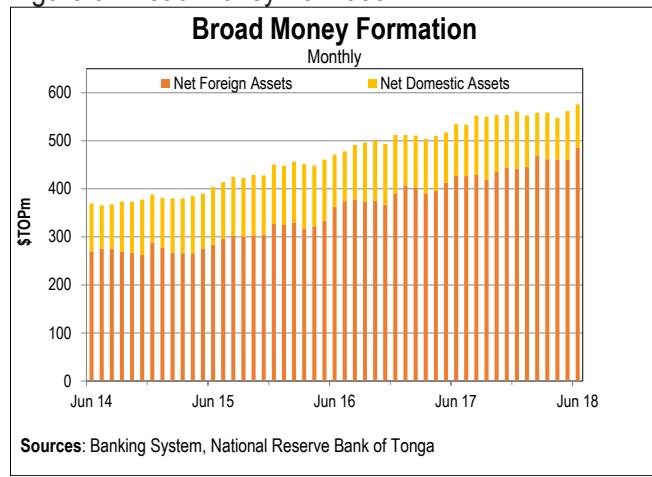
## Interest Rates

The excess liquidity in the banking system remained high during 2017/18. This resulted in continued active competition amongst banks which contributed to the lower weighted average lending rate since June 2012, despite the 10.8 basis points increase to 7.944% over the year to June 2018. This increase was due mainly to a rise in business lending rates. The low weighted average deposit rate was also maintained over the year and declined by 6.5 basis points to 2.027% driven by lower deposit rates offered by the commercial banks particularly for demand and time deposit rates. This was largely contributed by the significant growth in the volume of deposits. The weighted average interest rate spread therefore widened over the year from 5.744% to 5.918%.

## Broad Money Balances

Broad money grew over the year ended June 2018 by 7.6% to \$575.5 million. The expansion in broad money continued to be supported by the continued rise in the net foreign assets as the foreign reserves continued to rise. On the contrary, net domestic credit contracted due to a decline in net credit to government as government deposits increased. This was mainly due to a rise in government receipts of cyclone relief funds, project grants and funding, budgetary support as well as improved government revenue collection during the year.

Figure 8: Broad Money Formation



## Economics Corporate Plan Targets

The Economics Department was allocated with 37 measurable targets for 2017/18. A review of the corporate plan was carried out in February 2018 which revealed that the Department achieved 27 targets, 2 targets were rolled over to the 2018 calendar year and 8 targets were not achieved. This was attributed to the delay in releasing of reports due to other work priorities during the year. Following the review in February 2018, the measurable targets for the Economics Department was reduced to 25 targets for 2018/19.

# Financial Stability

## Financial Sector

The Reserve Bank continued to be responsible for the promotion of a sound and efficient financial system. This is pursued through the effective licensing, regulation and supervision of financial institutions, both banks and non-bank financial institutions (NBFIs). Three legislations that were processed since 2016 were approved in July 2018, which are the Microfinance Institutions Act 2018, Money-lenders Act 2018, and the Foreign Exchange Control Act 2018. These are for the licencing and supervision of microfinance institutions and moneylenders, and amended legislation for the licencing of foreign exchange dealers. Separate legislations are still being processed for the licensing and supervision of Insurance Companies and Retirement Funds. The Reserve Bank issued the Credit Bureau Licensing Guidelines in July 2017 pursuant to its power under the NRBT (Amendment) Act 2014 to licence and regulate credit information systems that disseminate credit information amongst financial institutions. The main provider of credit information systems in Tonga is currently in the process of being licensed under the Reserve Bank's Credit Bureau Licensing Guidelines. The Reserve Bank is looking forward to enhancing the credit reporting system in terms of implementing the positive reporting, and inclusion of non-bank financial institutions in the credit reporting system.

As of the end of June 2018, there were 4 banks licensed to operate in Tonga.

The Bank of South Pacific Tonga Limited continued to build on its outreach programs with increased number of access points mainly for EFTPOS and agents/in-store banking. BSP's number of EFTPOS facilities increased by 48 to 382 from 334 last year, and an additional 4 agents/in-store banking from 2016/17.

Table 1: Banking Services in Tonga

Banks	ANZ	BSP	MBf	TDB
Branches (including Head Office at Nuku'alofa)	3	4	2	8
Sub-branches	-	-	-	-
Agents/Instore banking	-	22	-	-
ATMs	13	12	-	-
EFTPOS	200	382	-	-
Internet Banking	Yes	Yes	No	Yes
MoneyGram Agent	No	Yes	Yes	No
Money Transfer	Yes	Yes	No	No

All banks maintained their head offices in Tongatapu. MBf Bank Limited and ANZ Bank also maintained their branches and sub-branches in Vava'u. Similarly, BSP maintained branches and sub-branches in Vava'u, Ha'apai, and 'Eua, and has plans underway for a sub-branch in Hihifo, Tongatapu to be set up during the next financial year. Tonga Development Bank (TDB) continued to be the only bank serving all the outer islands of Ha'apai, Vava'u, 'Eua and the two Niuas (Niutoputapu and Niuafo'ou). TDB also continued to operate two other sub-branches in Tongatapu located in Tatakamotonga for the Hahake District and Nukunuku for the Hihifo District.

Following the Tropical Cyclone Gita in February 2018, the banks were successful at maintaining their current banking services, and were also able to provide relief packages (concessions on loans and reduced fees on foreign exchange transfer services) to assist their staff and customers' recovery effort from the aftermath of the cyclone.

## 32<sup>nd</sup> South Pacific Governors Meeting 14<sup>th</sup> - 17<sup>th</sup> November 2017 Nuku'alofa, Tonga



## Banking System Supervision and Regulation

During 2017/18 the Reserve Bank continued to prioritize its supervisory roles on ensuring maintenance of prudent credit lending standards by banks particularly with the ongoing monetary policy stance to encourage credit growth by banks to support ongoing economic development. In addition, much emphasis was placed on regular meetings and consultation with banks over the year to be updated on their performance and strategies. Legal and prudential requirements continued to be closely monitored through enhanced offsite and onsite supervision to promote an ongoing safe and sound financial system, and also ensure a level playing field in the banking system.

The Reserve Bank continued to closely monitor the implication of the increase in the Statutory Reserve Deposit (SRD) requirement from 5% to 10% in July 2017, on banks' liquidity. This is in addition to monitoring of banks' compliance with the minimum requirement on the loans to deposit ratio of 80%. As of June 2018, none of the banks achieved this target however the Reserve Bank considered relevant factors such as deposits growth outweighing credit growth, in line with the rising foreign reserves, and agreed to continue to monitor the banks' loans/deposit ratio.

During the year the Reserve Bank approved the temporary breach of the single borrower limit for two loans subject to conditions that provided sufficient assurance to the Reserve Bank of the regularisation of these temporary breaches.

As at the end of June 2018, the final judgement on the court proceedings between the Reserve Bank and the Pacific International Commercial Bank (PICB) was still pending. The Supreme Court issued its ruling on 5th July 2018 dismissing PICB's claim that its licence was unlawfully revoked. The Court ordered that the word "bank" is removed from the name of Pacific International Commercial Bank; and that the legal costs of the Reserve Bank are to be fixed by the Registrar if not agreed with PICB on how the costs will be covered.

Onsite examination of banks continued to be one of the core parts of the Reserve Bank's supervisory role. The Reserve Bank's examination team focused on conducting risk-based onsite visits to 2 banks in September 2017 and April 2018. The most recent onsite visit in April 2018 was assisted by the Australian Prudential Regulation Authority. Onsite examinations continue to aim at verifying the bank's ongoing compliance with the Reserve Bank's requirements. Furthermore, spot checks were conducted to verify banks' compliance with the requirements of Prudential Statement No. 4 on Disclosure of Interest rates and Fees & Charges, as these are common issues which directly affect the public.

The Reserve Bank continued to put much emphasis in improving the quality of banks' reports to assist with the Reserve Bank's policy decisions. Enhanced checking of banks' reports to the Reserve Bank and a new requirement was imposed for banks to provide the source data for their reports to allow verification of the accuracy of their reports.

During 2017/18, the Reserve Bank received enquiries for a bank license, and have arranged meetings to clarify the bank license requirements. However as of end of June, 2018 no formal bank license application has been submitted for review.

The amendment of the Financial Institutions Act to be renamed as the Banking Act is currently being processed. Following the consultation process, the Reserve Bank considered and addressed comments from the Association of Banks.

Further revision was made to 1 out of the 12 Prudential Statements which became effective in May 2018. This was a revision to the Prudential Statement No. 11 Foreign Exchange Risk Management to explicitly reflect the Reserve Bank's requirement on local transactions on the foreign currency accounts held with the banks. On Prudential Statement No. 4 Disclosure of Interest rates and Fees & Charges, the revised Annual Percentage Rate (APR) calculator was finalized and uploaded on the Reserve Bank website for the public to use for comparison of the cost of credit from different banks.

Monthly bilateral meetings with the banks and their external and internal auditors as well as bi-annual meeting with the Association of Banks in Tonga (ABT) were held during the year to obtain updates on the banks strategies in light of the market development to ensure that they continued to operate prudently and in compliance with the Reserve Bank's requirements. Furthermore, technical meetings were also carried out during the year on specific issues mainly on reporting requirements.

The Reserve Bank Board continues to be well informed of developments in the banking system through a monthly report on banking sector development as well as other updates in the Governor's update to the Board on a monthly basis.

In terms of unclaimed monies paid to the Reserve Bank by the banks, the Reserve Bank continued to publish those accounts that remained unclaimed totalling \$884,269.57 to give customers another opportunity to place their claims for their funds before they are forfeited to the Government if they remain unclaimed after 5 years of being paid to the Reserve Bank. During the year, an amount of \$130,170.45 was forfeited to the Government's account pursuant to the requirements of the Financial Institutions Act.

## Banking System Financial Performance Financial Position

The total assets of the banking system reached \$827.2 million at the end of June 2018, a growth of \$57.1 million (7.4%) over the year 2017/18. This resulted mainly from ongoing credit growth of \$33.3 million (8.2%) and a \$11.9 million (4.8%) growth in banks' deposits with depository institutions. This included banks' deposits with the Reserve Bank (Statutory Reserve Deposit) which rose significantly by \$30.2 million (122.4%) reflecting the increase in the SRD requirement in July 2017, which was partly offset by a \$13.1 million (7.1%) decrease on the Exchange Settlement Account over the year.

About 53% of credit growth over the year to June 2018 was attributed to banks' lending to individuals (\$246 million). This consisted of mainly housing loans (\$190.8 million) which reflected the high demand for housing loans

during the year, motivated by competitive low interest rates by 2 of the banks focusing on this market. In addition, loans to the business sector rose during 2017/18 by \$16.3 million (47%). Majority of loan beneficiaries were businesses involved in retail & wholesale, manufacturing and construction indicating ongoing build up in business confidence.

Government continued to offer its low interest rate loans through the Government Development Loan (GDL) scheme administered by TDB. The total outstanding loan under this scheme as of June 2018 was at \$9.5 million compared to \$9.1 million in June 2017. Of the total outstanding loan as of June 2018, 47.3% was lent to the agricultural sector followed by the fisheries and education sectors at 17.9% and 13.1% respectively. This is a similar trend from June 2017.

Table 2: Financial Sector Deposit Account

	2016/2017	2017/2018
Demand Deposits		
Number of Accounts	17,148	36,777
Value of Deposits (\$m)	242,289	244,488
Saving Deposits		
Number of Accounts	46,184	49,058
Value of Deposits (\$m)	84,020	95,037
Time Deposits		
Number of Accounts	2,284	2,266
Value of Deposits (\$m)	210,461	256,693
Total Number of Accounts	65,616	88,101
Total Value of Deposits (\$m)	536,770	596,218

Banks' total liabilities rose over the year by \$54.3 million (8.7%). Total deposits continued to rise with all deposit categories increasing with much of the growth in time deposits which increased by \$46.2 million (22.0%). This reflected the growth in statutory non-bank deposits by \$22 million (36%) and Government deposits of \$8.5 million (66.2%).

The total number of deposit accounts reported by banks significantly increased over the year by 34.3% to 88,101 in line with the total value of deposits increasing by \$59.4 million to \$596.2 million.

## Profitability

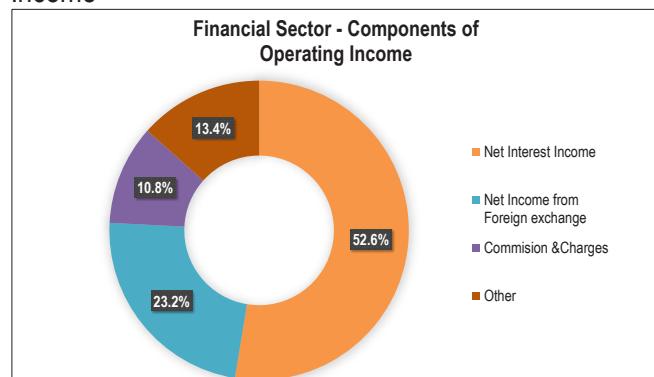
The profitability of the total banking system improved in 2017/18 compared to the previous year. An after-tax profit of \$20.561 million was recorded for the year ended June 2018, which is equivalent to 2.6% of average assets, compared to an after-tax profit of \$18.317 million for the previous year, which was equivalent to 3.4% of average assets. The improved profitability was attributed to a rise in net interest income and non-interest income of \$3.2 million and \$0.3 million respectively, as well as a decline in provision expenses of \$0.9 million which outweighed an increase in non-interest expenses of \$1.7 million.

Table 3: Financial Performance

	2016/2017	2017/2018
Pre-tax Net Profit (% average total assets)	3.3%	3.4%
After-tax Net Profit (% average total assets)	2.5%	2.6%
Total Operating Income (% average total assets)	7.2%	7.0%
Net Interest Income (% average total assets)	3.6%	3.7%
Non-interest income (% average total assets)	3.6%	3.3%
Average Net Interest Margin (%)	3.2%	3.4%
Total Operating Expenses (% average total assets)	3.8%	3.7%
Consolidated Risk-weighted Capital Ratio (%)	29.4%	28.2%

Total operating income of the banks was comprised mainly of net interest income at 52.6% followed by net income from foreign exchange at 23.2% compared with 50.9% and 24.4% respectively in June 2017. The growing net interest income is in line with the strong credit growth over the year for all banks.

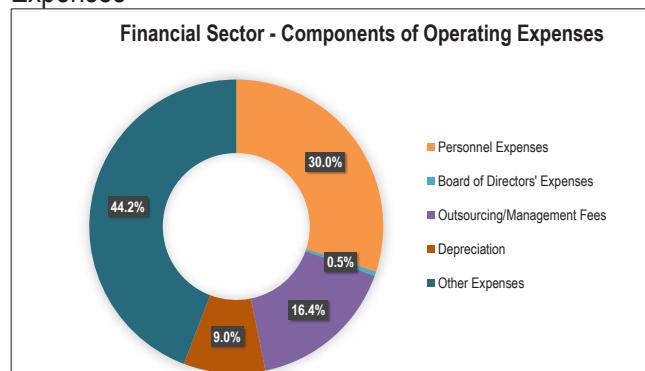
Figure 9: Financial Sector - Components of Operating Income



Total operating expenses of the banks largely comprised of Other Expenses at 44.2% followed by Personnel Expenses at 30.0% and outsourcing & management fees at 16.4% compared with 41.6%, 30.4% and 16.5% respectively in the previous year. The increase in other expenses largely reflected the higher administrative expenses in adjustment of one of the banks' audit results.

The Reserve Bank expects profitability of the banks to remain comfortable, supported by the outlook for positive economic activities and credit growth to continue subject to the risk of any further deterioration in the quality of the banks' loan books.

Figure 10: Financial Sector - Components of Operating Expenses

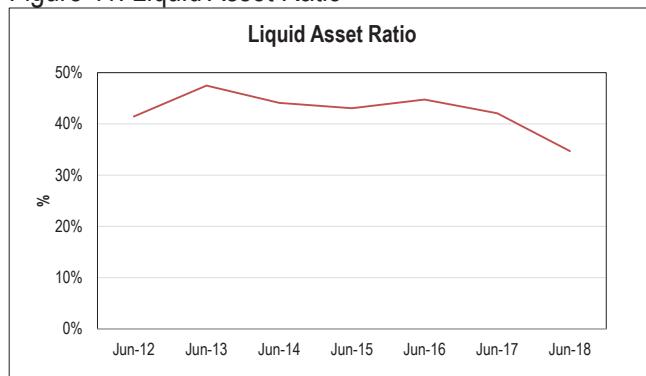


## Liquidity

The banking system's liquidity continued to remain high during 2017/18. Despite the decrease in eligible liquid assets by \$16.9 million over the year, which was mainly due to the lower Exchange Settlement Accounts and lower Government Bond holdings, the liquid asset ratio remained well above the 5% minimum requirement, at 34.7% compared with 42.1% in June 2017. Total loans as a proportion of deposits decreased to 73.4% in June 2018 from 75.4% that was recorded in June 2017. This was driven by the deposit build up over the year outweighing the credit growth.

The outlook on liquidity is that it will remain comfortable supported by the outlook for the foreign reserves to remain high.

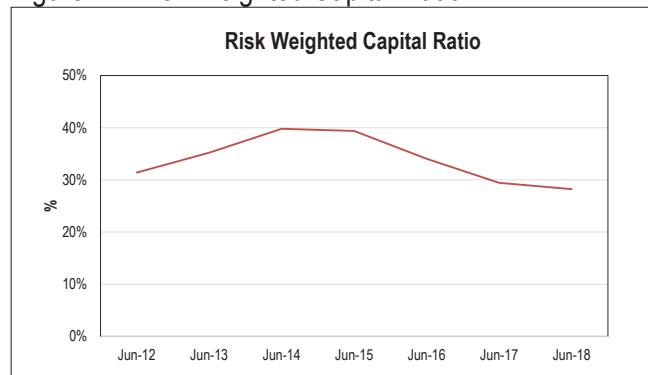
Figure 11: Liquid Asset Ratio



## Capital

The capital position of the banking system remained strong as the risk-weighted capital ratio remained well above the minimum ratio required by the Reserve Bank of 15%. The consolidated risk weighted capital ratio for the banks fell to 28.2% at the end of June 2018 from 29.4% in June 2017. This was mainly due to a \$27.6 million (6.3%) increase in risk-weighted assets reflecting the strong credit growth over the year offsetting the growth in eligible capital from the previous year's earnings. It is expected that the capital position will continue to remain strong largely supported by the outlook for profitability which can be offset by any further profit distribution by the banks and the growth in risk-weighted assets.

Figure 12: Risk Weighted Capital Ratio



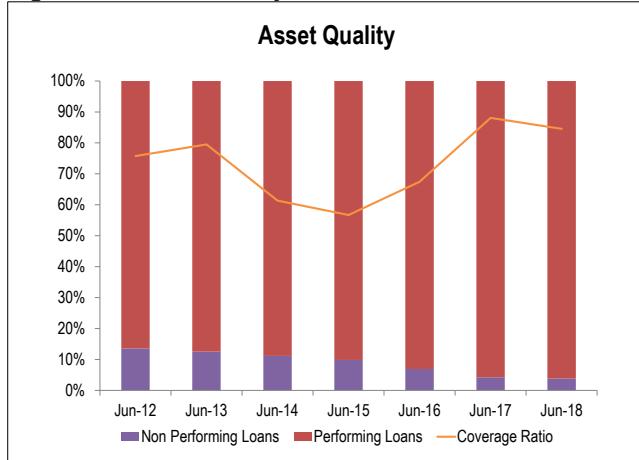
## Asset Quality

The overall quality of the banks' assets improved over the year to June 2018. Total non-performing loans decreased by \$0.6 million (3.4%) to \$16.4 million at the end of June 2018. This largely reflected some settlements and write-offs over the year. The ratio of non-performing loans to total loans therefore improved to 3.7% from 4.2% in June 2017.

Household non-performing loans accounted for 57% (\$9.6 million) of the total non-performing loans in June 2018 compared to 44% in June 2017 while the remaining 43% (\$7.2 million) was non-performing business loans. Housing loans accounted for 41% (\$6.8 million) of total non-performing loans followed by personal loans with 16% (\$2.7 million) and non-performing loans from the tourism sector with 15% (\$2.6 million).

Total provisions against loans fell by \$1.1 million (7.3%) to \$13.8 million which is in line with the decline in non-performing loans over the year. The coverage ratio of the non-performing loans by total loan loss reserves, therefore declined to 84.6% compared with 88.1% in June 2017. The Reserve Bank continued to work closely with banks to ensure adequate provisions are in place as well as the accurate reporting of security values is maintained.

Figure 13: Asset Quality



Given the outlook for positive economic growth, it is expected that asset quality will remain stable, however this is subject to the impact of Tropical Cyclone Gita on the banks' loan books should insurance claims do not adequately cover any losses.

## Non-Bank Financial Institutions Supervision

The supervision and oversight of all non-bank financial institutions remains work in progress. The Reserve Bank is in the process of implementing the requirements of the legislations that were recently approved for the supervision of microfinance institutions, money lenders, and foreign exchange dealers. Whilst work is underway for the legislations for the licensing and supervision of insurance and retirement funds, the Reserve Bank is developing reporting requirements to be imposed on all the NBFIs, to start gathering data on their operations. The Reserve Bank retains its position that the regulation of NBFIs is required to ensure the customers of these NBFIs are better protected and to minimize potential systemic risks posed by large NBFIs such as retirement funds and insurance companies, on the total financial system.

In terms of de-risking, the Reserve Bank continued to work together with the foreign exchange dealers to strengthen their Anti-Money Laundering/ Counter Terrorist Financing (AML/CFT) compliance status in order for the banks to retain their accounts. Furthermore, the Reserve Bank continued to liaise with the banks to encourage them to offer alternative products for de-risking



Nautilus Minerals Inc. presentation - July 2017

with the aim of maintaining and reducing the cost of remittances to Tonga.

Following the Tropical Cyclone Gita in February 2018, some of the foreign exchange dealers took some time to re-open for business, they also provided relief packages for their customers such as lower or waiving of foreign exchange transfer fees.

## Licencing and Supervision of Restricted Foreign Exchange Dealers

The licensing and supervision of foreign exchange dealers continued under the current Foreign Exchange Control Regulations, which was repealed and replaced by the Foreign Exchange Control Act 2018 that became effective in July 2018. During 2017/18, the Reserve Bank licensed two new authorized restricted foreign exchange dealers, while one foreign exchange dealer license was revoked in the beginning of 2018. This takes the total number of licensed authorized restricted foreign exchange dealers up to 14 from 12 in June 2017.

The annual compliance checks at the end of 2017 found that the majority of the foreign exchange dealers were generally compliant with the conditions of their license which formed the basis for the Reserve Bank's approval for these 14 authorized restricted foreign exchange dealers at the beginning of 2018 to continue their operations. Two of the commercial banks, namely BSP and MBf Bank continued to hold agency arrangements with

MoneyGram. All banks are licensed as authorized dealers under their banking license. An ongoing quarterly spot checks, training of the authorized restricted foreign exchange dealers, stakeholder and quarterly meetings when required contributed to the improvement in the understanding and compliance with the conditions of their license.

## Financial Institutions Corporate Plan Targets

The Financial Institutions department committed to 46 targets in the 2017/18 corporate plan in which 28 were successfully achieved. During the review of the 2017/18 corporate plan, targets were removed and revised, and new targets were added to guide the department in delivering its expected output. This resulted in a total 28 targets for 2018/19.

## Payment System

The Reserve Bank continued to explore ways to improve the efficiency and sound functioning of the payment system. Meanwhile, the manual settlement system, involving the inter-bank cheque clearance that is conducted by the Settlement Unit on a daily basis is operating well.

## Interbank Cheques Clearance

The Reserve Bank facilitates a daily cheque clearance service for the commercial banks to ensure a safe and efficient clearing system in Tonga. The commercial banks in Tonga signed an interbank clearing agreement to guide them in ensuring all cheques are cleared in a timely manner. A total of 152,837 cheques were presented for clearance at the Reserve Bank during the financial year 2017/2018 a decrease of 2.6% from the previous year. The decrease in the number of cheques presented for clearance was driven by the wider usage of electronic payment system such as internet banking and EFTPOS machine in Tonga. The clearance of cheques in the centre was running well and all participants were committed to settle their dues on time.

## Settlement Corporate Plan Targets

During the year, Settlement Unit participated in the review of the 2017 Corporate Plan. The Unit was assigned eighteen measurable targets for the calendar year 2017 which were all achieved. The measurable targets were related to promoting an efficient settlement and secured payments system and the modernization of the operations of the Reserve Bank.

## Financial Inclusion

The Reserve Bank's financial inclusion initiatives was reconsidered during the year which included an emphasis on building the data repository so that a base line could be established for the level of access to financial services. This baseline would provide the benchmark, which will be of assistance in measuring the effectiveness of any policies that will be developed later on. The financial inclusion strategy is to be developed after identifying the trends in financial access and challenges that is to be monitored closely from the data collection exercise. This therefore meant holding off of plans to develop the national financial inclusion strategy and the Working Group that was to be established as initially planned. However, the Reserve Bank distributed copies of the Demand Side Survey (DSS) in August 2017 to all relevant stakeholders and ministries as a token of appreciation for the concerted efforts and contribution made towards the report.

During 2017/18, the Reserve Bank revised the financial inclusion framework to endorse the three main focus areas of financial inclusion in order to accomplish the department's objective of improving access to finance for all Tongans, individuals and Micro, Small and Medium Enterprises (MSMEs). Digital Financial Services (DFS) is one of the catalysts for the promotion of financial inclusion, to every segment of societies including rural and remote areas, and the outer islands. DFS could be the solution to those that are dispersed among many islands given the rugged geography and low density of population in Tonga, which makes it a challenge for financial service providers such as banks to provide access to relevant and affordable formal financial services. As a result, the commitment of the Reserve Bank to the Alli-

Table 4: Sector Contribution for 2016 - 17

Type of Sectors	2016				2017			
	Number of MSMEs	Outstanding Balance (\$)	MSMEs	Out-standing Balance	Number of MSMEs	Outstanding Balance (\$)	MSMEs	Out-standing Balance
TOTAL	1,585	11,968,771	100%	100%	1,670	18,700,216	100%	100%
Agriculture	762	3,176,969	48.1%	26.6%	729	4,389,316	43.6%	23.5%
Construction	15	943,382	0.9%	7.9%	23	1,183,470	1.4%	6.3%
Fisheries	47	224,826	3.0%	1.9%	69	1,377,974	4.1%	7.4%
Forestry	-	4,589	0.0%	0.0%	6	46,030	0.4%	0.2%
Manufacturing	395	2,195,847	24.9%	18.3%	473	1,229,190	28.3%	6.6%
Other services	298	1,683,981	18.8%	14.1%	280	3,335,252	16.8%	17.8%
Tourism	29	1,437,144	1.8%	12.0%	28	2,319,880	1.7%	12.4%
Transport	6	230,363	0.4%	1.9%	3	294,571	0.2%	1.6%
Wholesale/Retail	33	2,071,670	2.1%	17.3%	59	4,524,533	3.5%	24.2%

Table 5: Summary of Access Points by Constituency

Constituency	Jun-17					Jun-16					2016 Census Report
	Total Access Points	No. of branches	No. of Agents	No. of EFT-POS	No. ATMs	Total Access Points	No. of branches	No. of Agents	No. of EFT-POS	No. ATMs	
Tongatapu 1	38	1	2	35	0	23	0	2	20	1	11,219
Tongatapu 2	186	2	1	169	14	347	6	2	323	16	11,874
Tongatapu 3	74	1	0	72	1	0	0	0	0	0	
Tongatapu 4	54	1	0	50	3	0	0	0	0	0	
Tongatapu 5	19	1	2	16	0	10	0	2	8	0	2,716
Tongatapu 6	11	0	3	7	1	5	1	2	1	1	4,975
Tongatapu 7	31	0	1	29	1	7	0	2	5	0	8,236
Tongatapu 8	14	0	2	11	1	0	0	0	0	0	
Tongatapu 9	23	2	1	18	2	11	1	1	8	1	4,362
Tongatapu 10	3	0	3	0	0	4	0	3	1	0	4,418
'Eua 11	6	2	0	3	1	4	1	1	2	0	3,020
Ha'apai 12	11	2	1	7	1	10	1	2	7	0	2,779
Ha'apai 13	0	0	0	0	0	0	0	0	0	0	1,102
Vava'u 14	11	0	0	11	0	0	0	0	0	0	2,514
Vava'u 15	44	3	3	35	3	85	4	3	75	3	3,374
Vava'u 16	11	1	0	10	0	0	0	0	0	0	2,683
0	2	2	0	0		2	2	0	0	0	804
<b>TOTAL</b>	<b>538</b>	<b>18</b>	<b>19</b>	<b>473</b>	<b>28</b>	<b>508</b>	<b>16</b>	<b>20</b>	<b>450</b>	<b>22</b>	<b>64,076</b>

Table 6: Gender Distribution Summary as of June 2017

	No. of MSMEs			MSMEs Outstanding Balance (T\$M)		
	Female	Male	Total	Female	Male	Total
<b>TOTAL</b>	<b>540</b>	<b>1,130</b>	<b>1,670</b>	<b>1,768,689</b>	<b>16,931,531</b>	<b>18,700,220</b>

ance for Financial Inclusion (AFI) as a member has also been amended. Firstly, the adjustment was made to its Maputo Commitment, in lieu of targeting to improve access to finance by 20% in 2020 for agriculture, fisheries, tourism, women and youth sectors, but to target all MSME sectors in Tonga. In addition, the Reserve Bank reprioritized its membership in AFI working groups from six working groups to only three related working groups (Financial Inclusion Data (FID) Working Group, Digital Financial Services (DFS) Working Group, and SME Finance (SMEF) Working Group) believing that the knowledge exchange and training materials retrieved from this networking will assist with the development and promotion of access to finance. Through its membership of the Alliance for Financial Inclusion (AFI), the Reserve Bank participated in the AFI Global Policy Forum (Egypt) in September 2017, the Joint Learning Program on MSMEs Finance in Malaysia in April 2018 and the Pacific Islands Regional Initiative (PIRI) meeting in Samoa in June 2018. These forums provided the platform where experience and knowledge are shared amongst its members, to assist with finding possible solutions to challenges in Tonga as well as developing policy in terms of access to finance to all levels of society.

The Reserve Bank recognized the importance of evidence-based policymaking and the critical role of data in the policymaking process. Thus, Reserve Bank collected data from all the licensed financial institutions including Banks and Non-Bank Financial Institutions in Tonga to establish a baseline for financial inclusion. Not only to identify the level of financial access and usage of financial services in Tonga but to be comparable across the countries in the pacific region as well.

During 2017/18, the Reserve Bank collected data for the first time on MSMEs for the financial year 2016/17 and was able to furnish a report on the access to finance of MSMEs in Tonga.

Over the year ended June 2017, the MSMEs outstanding loan rose by \$6.7 million (56%) to \$18.7 million reflecting an increase in the number of MSMEs that banks lend to by 85 MSMEs (5%) to a total of 1,670 MSMEs.

On a sectorial basis, the increase in total MSME outstanding loans was mainly due to increases in loan to the wholesale & retail, other services and fisheries sectors. A number of factors contributed to this positive growth in MSMEs outstanding loans such as the high liquidity in the banking system, continuation of the Government Development Loan (GDL)'s low interest rates and the launching of BSP's MSME products.

In addition, the Reserve Bank was able to collect data on the number of MSMEs owned by women here in Tonga. Approximately 32% of the total number of MSMEs is female owned, however this accounted to only 2% of the total working age female population in Tonga (refer to Table 5). On the other hand 68% whom are male owned MSMEs that have access to finance, is equivalent to around 4% of the total working male population. Promoting women owned MSMEs will not only assist in achieving the Reserve Bank's Maputo commitment but also the Tonga Strategic Development Framework II (TSDF) national outcome of a more inclusive, sustainable and empowering human development with gender equality.

There is a great improvement on the access points from the Supply Side Survey (SSS) update on individuals' access to finance.

The total access points in the banking system rose by 6% to 538 access points over the year ended June 2017 mainly due to an increase in the number of ATMs, bank branches and EFTPOS by 27%, 13% and 6% respectively. The re-opening of bank branches at Ha'apai and 'Eua also contributed to the overall improvement in total access points.

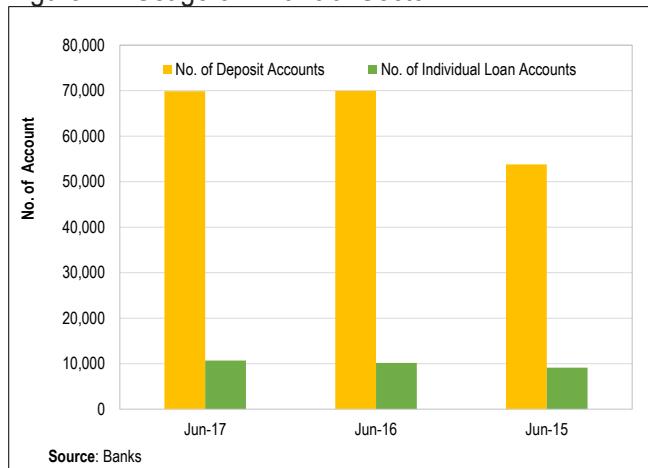
In terms of bank account ownership, according to the Demand Side Survey (DSS) conducted in 2016, both adult women and men showed similar levels of bank account ownership at 41%. However, more than one third of men (35%) and women (34%) are financially excluded.

Ha'apai has the highest number of unbanked adults which represents 60% of the adult population (2,329 people) in Tonga. The rugged geography, costly transportation, and the low density of population dispersed among many islands makes it challenging for banks to provide relevant and affordable formal banking services in the outer islands including Ha'apai.

## Usage of Financial Services

Usage of Financial Services is the frequency or how often a product or a service is being used by an individual. From the SSS, the usage of bank accounts rose over the year to June 2017 owing to an increase in the number of loan accounts outweighing the decline in the number of deposit accounts (refer to Figure 14).

Figure 14: Usage of Financial Sector



The fall in the number of deposit accounts was due to data cleansing by banks leading to closing of inactive accounts. In contrast, the increase in total number of individuals' loan accounts is due to the lower lending rates for housing loans, the banks housing loans campaigns, the continuous excess liquidity in the banking system and the Reserve Bank's accommodative monetary policy stance to encourage the utilization of the excess liquidity and the positive economic growth which has supported further lending by the banks.

## Peer Comparison

According to reports from the Alliance for Financial Inclusion (AFI), Tonga leads in financial access points, particularly in bank branches, when compared to the rest of the Pacific Island countries. For every 10,000 adults, Tongan adults can access 3 bank branches compared to 1 bank branch in Fiji and 2 bank branches in Samoa per 10,000 adults. Tonga's lower population size compared to other Pacific countries may have contributed to its higher access points particularly branches in the Pacific region.

The Reserve Bank is planning on collecting data on digital financial services; a reporting form has been developed to start collecting data on digital financial products and services that are currently offered in Tonga including mobile financial services such as the Digicel Mobile Money. The data collected will assist in setting the baseline for access to finance through digital financial services. Furthermore, the Reserve Bank conducted an informal stock take of financial literacy programs to capture all programs that are currently available in Tonga and to assist with empowering Tongans to be financially literate. It is noted that the pursuit of financial knowledge is also a key economic imperative as it has the ability to transform lives. The ability and knowledge to save, invest and borrow are essential life skills for both individuals and MSMEs as financial knowledge is particularly important in generating income as well as securing finance.

Despite all these initiatives, a number of challenges have been identified with regards to data collection which includes lack of sex-disaggregated data on both MSMEs and individuals in terms of distortion of data, access to finance and the timeliness of data submission. The Reserve Bank is currently liaising with the banks to agree on the most cost efficient way of addressing these challenges. The Reserve Bank will continue collecting quality data in order to draw a comprehensive and outcome based strategy over the state of Tonga's access to financial services. This will in turn promote economic prosperity but at the same time, maintain the stability of the financial system.

## Financial Inclusion Corporate Plan Targets

The Financial Inclusion department committed to 31 targets in the 2017/18 corporate plan in which 13 were successfully achieved and 10 were work in progress. However the corporate plan was then reviewed, targets were revised and removed while new targets were added to better guide the department in delivering its expected output. A total of 22 targets were approved in the 2018/19 corporate plan. The comprehensive corporate plan for 2018/19 was developed to supplement the department's objective of improving access to finance and also, to address the challenges identified from the Demand Side Survey Report 2016 and other informal surveys undertaken by the Financial Inclusion team over the years. This corporate plan was based on the revision made towards the financial inclusion framework, to enable all Tongans to have access to a range of affordable and appropriate financial products and services. Also, quantitative targets have been established to clearly define policy objectives to maintain commitment in support of financial inclusion efforts as listed below:

- i. Reducing 34% of unbanked Tongan by 10% in 2020;
- ii. Increasing number of MSMEs access to finance by 20% in 2020 and;
- iii. To increase 10% of Tongan adults using mobile money accounts by 20% in 2020

## Financial Intelligence Unit

During the year, the Financial Intelligent Unit (FIU) continued to carry out the function of the Transaction Reporting Authority as stipulated under the Money Laundering & Proceeds of Crime Act and Regulations through continued supervision of its reporting entities as well as continued analysis and sharing of financial intelligence.

## Supervision & Compliance

The FIU completed its second bi-annual training for the banks and the authorized foreign exchange dealers in August 2017. The training focused on enhancing the understanding of all reporting institutions on their obligations to adopt a risk based approach on customer due diligence. This was also an opportunity to provide feedback on the reports that have been submitted to the

FIU. The FIU also conducted initial AML/CFT training to a newly established authorized foreign exchange dealer SAV Money Transfer Ltd, whose license was granted in August 2017.

Compliance checks were conducted on all foreign exchange dealers throughout the year to verify the compliance of these entities with their licensing conditions which includes AML/CFT related requirements. Visits were conducted to all foreign exchange dealers in November to December 2017 as part of the annual compliance check process and were followed up by quarterly visits to those foreign exchange dealers which were identified to have compliance issues. The results of these checks were generally compliant.

The FIU has initiated communications with its counterparts in New Zealand and China in an attempt to explore opportunities to expand its information source and to formalize exchanges of information with these two countries. This will enable the FIU to exchange information with the FIUs of China and New Zealand to assist in due diligence checks of companies and individuals from these countries. The FIU has received draft Memorandum of Agreements/ Understandings from these two FIUs which are being processed for approval and sign off.

In January 2018, the FIU conducted a review of the compliance of the reporting entities with the requirements of the Money Laundering and Proceeds of Crime (MLPC) Regulation 23 that subjects them to report currency transactions reports (CTR) for transactions with value greater than T\$10,000, subject to exemptions. All reporting entities were required to submit their CTR Exemption Register for review by the FIU pursuant to Regulation 23(16) which also reserves the right at any time for the FIU, through appropriate order, to direct deletion of any exemption. Following the review of the CTR exemption registers, the FIU instructed all reporting entities, pursuant to relevant provision, to remove from the CTR exemption register the customers whom have been reported in suspicious transaction reports (STRs). The FIU continued to work closely with its reporting entities in ensuring that they meet all regulatory reporting requirements.

The FIU was visited by the Asia Pacific Group on Money Laundering (APG) in May 2018 as part of scoping exercise which was to raise awareness in Tonga of the New Zealand-funded technical assistance program for the Pacific and how it can assist the FIU specifically in areas of needs through AML/CFT technical assistance and training. This assistance program of the New Zealand Government pledged \$3.5M to the APG to provide individual technical assistance to Pacific Island jurisdictions including Tonga. The New Zealand Government engages this program to ensure transparency of the international financial system and to ensure compliance of its neighbouring countries with the FATF Standards.

During May 2018, the FIU joined in meetings with the Taskforce of law enforcement agencies such as Ministry of Revenue & Customs, Ministry of Police, Ministry of Commerce, Consumer, Trade, Innovation and Labour, Attorney General's Office as well as Immigration Department of the Ministry of Foreign Affairs. Meetings were relating to matters pertaining to commission of serious offences by several suspects and how information can be shared amongst these relevant agencies to maximize the result on these cases. The FIU continued to work closely with the Ministry of Revenue & Customs relating to reports previously disseminated for their further investigations and have had two meetings during the year to discuss update on investigations.

Following Tonga's participation in a Pre-Mutual Evaluation workshop conducted by the APG in February 2018, the FIU commenced with the preparation works for Tonga's APG Mutual Evaluation scheduled for 2019. The APG Mutual Evaluation will put Tonga under a peer-assessment process where the country's AML/CFT regime is being assessed for compliance with the FATF Standards. The focus of this coming evaluation will be on the effectiveness of Tonga's system according to what the FATF Standards has called 'Immediate Outcomes'. Tonga will have to demonstrate how its system is robust and effective across the 11 Immediate Outcomes laid out by the Standards. The FIU continues with its preparation works which has on work plan for the next coming months plans to conduct outreach to cash dealers not currently covered under its supervision, implement risk based approach supervision and to enhance its information sharing mechanisms.

## Reports & Statistics

Table 7: Number of reports received

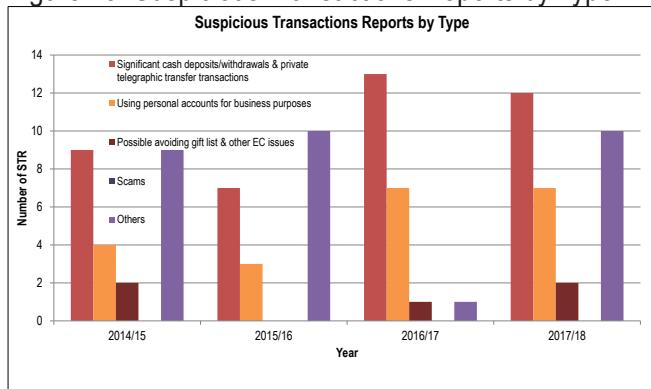
Types of reports filed	2015/16	2016/17	2017/18
Suspicious Transaction Reports (STRs)	20	22	31
Currency Transaction Reports (CTR)s	7,087	8,668	10,892
Border Currency Reports (BCRs)	52	80	108

The FIU received 31 STRs from the banks and foreign exchange dealers during the year, increasing by 9 reports from the previous year. The FIU has seen an increasing trend in the filing of STRs consistently in the past years and this might be attributed to reporting entities becoming more aware of the indicators for reporting as well paying more attention to trends of customer's activities through transaction monitoring.

The number of CTRs also increased from the previous year by 25% totalling to 10,892 reports filed this year. Continuing the trend, total BCRs also increased this year by 35% totalling to 108 reports filed by the Ministry of Revenue & Customs. The FIU retains the information obtained in these reports to assist in its analysis function.

## Reports analysis & Information sharing

Figure 15: Suspicious Transactions Reports by Type



The dominant STR indicator continued to be significant transactions that were inconsistent with the customer's known background or the source of fund were undetermined followed by the use of personal accounts for conducting of business transactions. The remaining STRs were related to several indicators such as large and

rapid movement of funds and structured payment. Other transactions that did not match the type of transactions described above but were also reported included, mismatch of customer's information on ID, uneconomical transfer made to a foreign jurisdiction and possibility of misusing of identification documents.

Table 8: Number of STRs disseminated

Law Enforcement Agencies	2015/16	2016/17	2017/18
Ministry of Police	2	1	7
Ministry of Revenue & Customs	13	8	14
Ministry of Foreign Affairs (Immigration)	0	1	1
MCCTIL	0	1	3
Other			

Following the analysis of the 31 STRs received, 14 STRs were disseminated to the Ministry of Revenue & Customs for possible contravention of tax related requirements. 11 of those reports were passed to other law enforcement agencies as follows, 7 reports passed to Police for further investigation of possible serious offence, 1 report was referred to the Immigration Department given some issues relating to visa issues and 1 report was referred to the Ministry Commerce, Consumer, Trade, Innovation & Labour in relation to business licensing concerns.

Table 9: CTR data analysis

	2016/17 (TOP\$ million)	2017/18 (TOP\$ million)
Movement of transactions		
Inwards	132.6	183.4
Outwards	68.7	84.8
Purpose of transactions		
Business	91.6	144.4
Personal	109.7	123.8
Transaction type		
TT	25.2	28.9
Cash	103.6	132.8
Cheque	40.9	54.9
Other	25.6	38.2
Cash/ Cheque	6.0	13.4

From the 10,892 reports received this year, majority of the report volume were for inward transactions which are classified into cash, cheque, telegraphic transfers and other deposits. Cash continued to be the dominant type of transaction reported over the year followed by the use of cheques and telegraphic transfers.

Table 10: BCR data analysis

	2016/17 (TOP\$M)	2017/18 (TOP\$M)
Movement of funds		
Inbound	0.6	0.8
Outbound	36.5	42.3
Purpose of funds		
Business	36.4	42.0
Personal	0.7	1.1

The FIU received 108 BCRs this year from the Ministry of Revenue & Customs. Majority of the reports were for outbound funds across the border. Shipments of currencies for currency conversion companies and commercial banks are mostly the outbound funds being reported. Very few reports were received for outbound individual travellers. Outbound funds for commercial banks and currency conversion companies have received prior approval of the Reserve Bank before transporting across the border. A fewer number of the outbound individual travellers funds were seized from travellers at the border given no proper approval in place. Inbound funds carried across the border were mostly for individual travellers returning or visiting Tonga.

During the year, the FIU continued to conduct analysis on individuals converting notes/ buying Tongan Pa'anga with amounts exceeding the BCR declaration threshold of TOP\$10,000 but were not reported from Customs as they may have not been declared at the border. These information were passed on to Customs to assist with the profiling of travellers. With the Inter-agency MOU in place, the FIU was able to share 10 monthly reports during the year.

Under the same Inter-agency MOU, the FIU have been able to respond to 6 requests for information submitted by the Ministry of Revenue & Customs in relation to subjects previously referred for further investigation also subjects that are under investigations for possible Tax and Customs related offences.

The FIU continued to disseminate the terrorist list from the Office of Foreign Assets Control's (OFAC) of the United States Department of the Treasury of Specifically Designated Nationals (SDN) and the dissemination list of the Non-Cooperative Countries and Territories and countries that are subject to the Financial Action Task Force's public statements.

## FIU Corporate Plan Targets

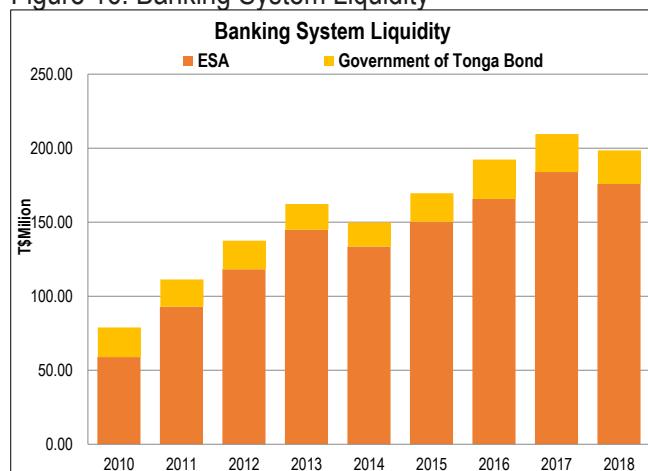
In February 2018, the FIU contributed to the review of the NRBT's Corporate Plan for 2018/19. The FIU contributes to the first strategic priority of the bank in setting a platform for Tonga becoming a high growth economy through the prevention of money laundering. For 2017/18, the FIU had a total of 17 targets to achieve. This review resulted in an increase in the FIU's targets to 20. The FIU's targets are aimed at effective supervision of reporting entities, ensuring a well-informed regime and to comply with global AML/CFT related requirements.

# Financial Markets Operations

## Domestic Market Operations

As of the 30 June 2018, the banking system liquidity fell to \$198.5 million from \$209.5 million at the end of June 2017 largely reflecting the impact of the increase in the statutory reserve deposit requirement from 5% to 10% effective in July 2017. The banking system liquidity comprised mainly of \$175.9 million in the banks' Exchange Settlement Accounts (ESA) held with the Reserve Bank and \$22.6 million of Government of Tonga's Bonds held by the banks.

Figure 16: Banking System Liquidity



In order to better measure the excess liquidity in the banking system, the Reserve Bank reviewed its current estimate of the banks' precautionary demand. This resulted in a higher estimated level of excess liquidity in the banking system.

The Reserve Bank therefore did not issue any Reserve Bank notes during the year as it continued to encourage banks to use the excess liquidity in the banking system for lending to support economic growth as well as improve the monetary policy transmission mechanism.

Furthermore, there was no activity in the inter-bank market and similarly there were no applications for repurchase agreements during the year.

The Reserve Bank continued to publish financial information, such as comparisons of financial institutions' daily and weekly exchange rates and fees related to foreign exchange transactions, in its efforts to improve the public's understanding of financial indicators in order to make better financial decisions.

The Reserve Bank is also exploring other avenues and mechanisms in order to develop the domestic market operations in the near future to be more market oriented. Amendments to the NRBT Act approved in February 2017 allows the utilization of the excess balance in the Revaluation Reserve Account, above \$10 million, to cover the Reserve Bank's monetary policy costs. This enhances the Reserve Bank's ability to issue NRBT notes to implement the monetary policy and thereby develop the domestic market. This amendment also allowed the excess balance in the Revaluation Reserve Account to be paid to the Government upon the request of the Minister of Finance and as approved by the Reserve Bank Board.

## Foreign Exchange Operations

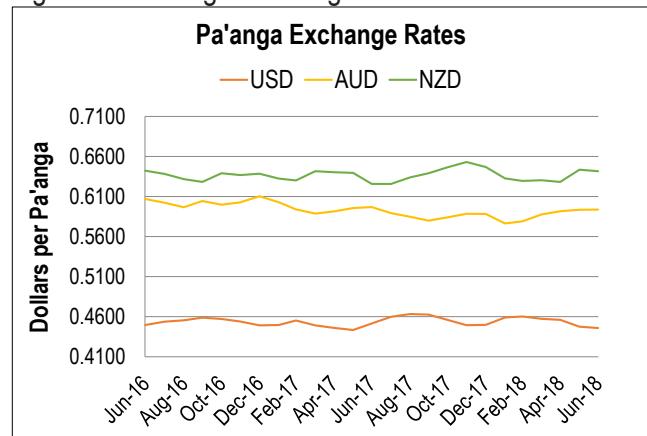
The Reserve Bank determines the rate at which the Tongan pa'anga is exchanged for foreign currencies on a daily basis by reference to a weighted basket of currencies of Tonga's major partners in foreign trade and foreign receipts and payments transactions. The exchange rates set on a daily basis generally form the basis of the commercial banks' publicly quoted foreign exchange dealing rates.

The Reserve Bank reviewed the basket of currencies during the year in accordance with the latest trend in bilateral trades with our major trading partners. As a result, the weights of the currencies in the basket were revised effective on the 1st November 2017. The review resulted in the Tongan Pa'anga being stronger against the other major trading currencies.

The Reserve Bank continued to closely monitor the movement of the rate of exchange of the pa'anga against other currencies with a view to ensure that the country's balance of payments position and price stability are maintained at levels that are consistent with the achievement of macroeconomic stability. However, should pressure on the foreign reserves emerge, the Reserve Bank stands ready to reevaluate the pa'anga against the basket of currencies in order to safeguard external stability.

Over the year ended June 2018, the Tongan pa'anga fluctuated against the US dollar (USD) & New Zealand dollar (NZD) in wider bands, compared to last year reflecting increased volatility in the USD and NZD while the TOP fluctuated against the Australian dollar (AUD) in a narrower band compared to last year reflecting decreased volatility in the AUD during the year. The USD strengthened against the NZD and AUD mainly due to increased expectations of more US interest rate hikes by the Federal Reserve Bank after lifting interest rates by 0.75% during the year and as trade friction uncertainties between the US and China encouraged safe haven buying. The AUD and the NZD depreciated on the strong USD and also due to relatively weaker economic prospects in the respective countries. As such, the TOP depreciated against the USD while it appreciated against the AUD and NZD over 2017/18.

Figure 17: Pa'anga Exchange Rates



The Reserve Bank also continued to monitor the commercial banks' exchange rates spreads to ensure that they were in compliance with approved limits that were set by the Reserve Bank. Despite the introduction of the levy on foreign exchange transactions in June 2016, the

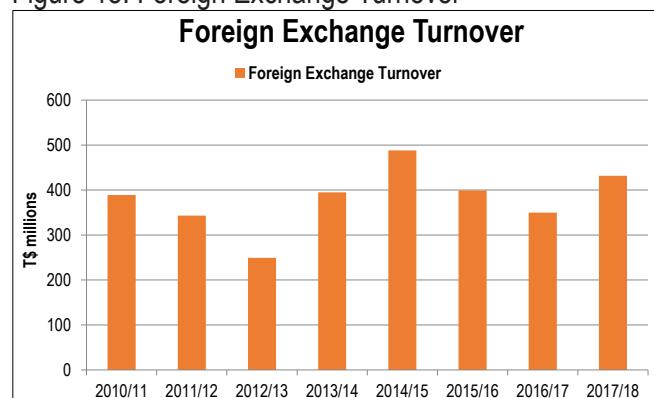
spread limits remained unchanged. The Reserve Bank also directed the banks not to pass on the levy burden to customers through an additional fee. This directive meant that the banks would absorb the levy burden within their own profit margin instead of passing it to the public. The Reserve Bank paid T\$0.6 million in levy to the Ministry of Finance during 2017/18.

## Foreign Reserves Management

### The Reserve Bank Portfolio

The gross official foreign reserves was maintained well above the minimum range of 3 to 4 months of import cover. The level of foreign reserves peaked at a record high of T\$468.7 million on 29th June 2018, equivalent to 7.8 months of import cover compared to T\$407.9 million (7.5 months of import cover) as at 30th June 2017. The significant increase in the level of foreign reserves was attributed mainly to receipts of remittances, government budget support and relief grants for Tropical Cyclone Gita. The Reserve Bank continued to monitor the banks' compliance with their respective nostro limits and that excess is sold to the Reserve bank as part of its foreign reserves management tools.

Figure 18: Foreign Exchange Turnover

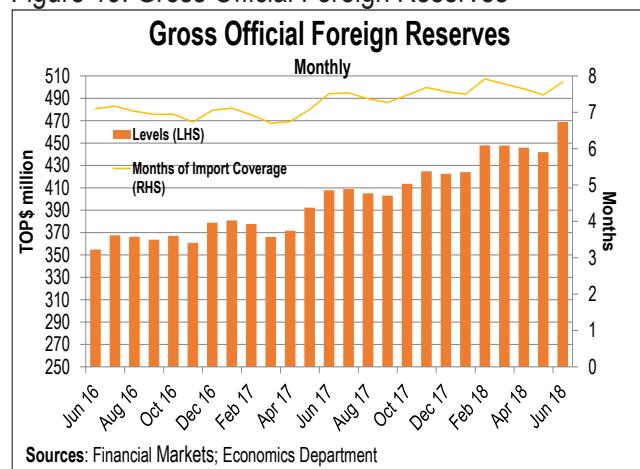


During the year, the Reserve Bank was a net purchaser in the spot foreign exchange markets. Foreign exchange purchases of T\$246.2 million exceeded sales of T\$185.4 million giving a total foreign exchange turnover for the year of T\$431.6 million. This is an increase from T\$349.8 million last year due mainly to an increase in volume of foreign exchange transfers by the Reserve Bank. The Reserve Bank conducted foreign exchange operations for its customers, mainly the Government, and for its own account in a range of currencies.

The management of the foreign reserves met the objectives of safety, liquidity and profitability. The currency composition of the foreign reserves was mainly in US dollars, Australian and the New Zealand dollars.

The Reserve Bank's investment policy is to obtain the maximum income commensurate with safety, liquidity and the maintenance of overall value which continued to be a challenge, given the uncertainty and volatility in the global financial markets and continued low interest rates in the trading partner countries. The currency composition therefore deviated from the benchmark portfolio but remained within the Board approved limit, in order to maximize income and maintain the value of the foreign reserves. The currency composition exposes the Bank to exchange rate risk however, the Reserve Bank continued to closely monitor the implications of the movements of the exchange rates on the value of the foreign reserves. Despite lower interest rates in the global markets, the income on the investment of the foreign reserves increased by \$0.64 million compared with the previous year, which is in line with the significant increase in the level of foreign reserves of \$61 million.

Figure 19: Gross Official Foreign Reserves



The Reserve Bank complied with all the Board approved risk parameters for the management of the foreign reserves during the year which included ensuring that investments were held with banks rated above the Board approved minimum "A" rating by international credit rating agencies and minimizing concentration of investments in one bank. In August 2017, technical assistance from the IMF reviewed the Reserve Bank's foreign reserves management practices and provided recommen-

dations that the Reserve Bank took into consideration for implementation. Reserve Bank staff also participated in an attachment program with the Reserve Bank of Fiji to further develop the department's capacity to better manage the foreign reserves.

## Exchange Control Operations

The Reserve Bank amended its Exchange Control Policy Guidelines in July 2017 to remove all requirements to provide tax clearance certificates for payments. This was to clarify to the banks, foreign exchange dealers and the general public that tax clearance requirements for outward payments are imposed and monitored by the Ministry of Revenue & Customs. Given the high level of foreign reserves, the comfortable levels of the outlook and the current monetary policy stance, the Reserve Bank did not make any further restrictions on the Exchange Control Requirements in 2017/18.

As such, the Reserve Bank processed 767 exchange control applications for current and capital payments. This included 255 applications of amounts below the delegated limit of \$100,000 for non-compliant customers who have been referred to the Reserve Bank for further monitoring. The approved exchange control applications amounted to T\$262.0 million in 2017/18 (of which 14% were classified as capital transactions) compared to the 776 exchange control applications (of which 14% capital transactions) processed in 2016/17 amounting to T\$223.5 million. The Exchange Control Unit mostly achieved its corporate plan target for a half day turnaround time for processing and approval of applications, provided that all the submitted documents met all the requirements. The exchange control data on foreign currency payments by large customers including the Government and large importers were key inputs to the Reserve Bank's foreign reserves forecast and monetary policy decisions.

The Reserve Bank also received 84 applications for the removal of cash (both Tongan pa'anga and foreign currency notes totaling T\$10,000 and above) across the border which were all approved and amounted to a total of T\$49.2 million. This compares with 65 applications that were approved last year totaling T\$49.0 million. The higher number of applications reflected the preference of banks and foreign exchange dealers to exchange

foreign currencies overseas due to the more favorable US dollar exchange rates offered by overseas banks. The Exchange Control Unit also notified the Ministry of Revenue and Customs of all approved applications for exports of cash, two (2) days before the date of travel, with some exceptions due to late submission of applications from banks, authorized restricted foreign exchange dealers, and individual applicants.

Quarterly and monthly spot checks were conducted during the year to ensure banks and foreign exchange dealers were compliant with the exchange control guidelines. Internal monitoring of compliance is also carried out through other reports such as the Overseas Exchange Transactions (OET), Foreign exchange transactions with value that is equivalent to T\$50,000 and above, Forward exchange contracts (FEC) and the Foreign currency accounts (FCA). Press releases were posted on the website, and trainings with the banks and authorized restricted foreign exchange dealers were conducted to keep them informed of the revision to the exchange control guidelines and to also raise issues identified from the spot checks. The Reserve Bank still continued to issue the Gift list for those who have reached their annual

delegated limit of T\$50,000 and a Caution list for those who had nearly exhausted their annual delegated limit for gift payments (T\$45,000 up to T\$50,000). In addition, a Travel list is also issued for those who have breached the delegated limit for Travel allowance of T\$20,000 per travel. In cases of breaches, customers will be referred to the Reserve Bank for approval and further monitoring to ensure they consistently comply with the exchange control requirements, and that payments made are bona-fide transactions to help with anti-money laundering initiatives.

## Financial Market Corporate Plan Targets

A review of the 2017 corporate plan and targets was also conducted during the financial year. The revision showed the Financial Markets Department had achieved 47 out of the 57 targets. Most of the unachieved targets were recommendations by an IMF technical assistance mission on domestic market development that were beyond the Reserve Bank's control as they had to be implemented in collaboration with other ministries and institutions. As such, these targets were either revised or removed going forward, therefore the targets were reduced to 39.

# Risk Management

The Reserve Bank continues its effort in integrating risk management to its daily operations. Risks are identified, controls are put in place to mitigate their effects with regular monitoring functions assigned to the Risk Management Unit and updated to Management and the Board of Directors.

The Risk Management Unit under the Governor's Office identifies and monitors the many risks the Reserve Bank faces – some general while others are unique to central banks. Such risks are related to operational and reputational risks in the Currency, Information Technology and Property Units. These risks are addressed in the various Management committees and monitored by the Risk Unit.

The Unit also receives incident reports and monitors these risks in its risk incident register to document events that occur and may adversely affect the achievement of the Reserve Bank's mandate as outlined in the Act. There were sixty-eight incidents reported over the year of which a half of these incidents were related to Currency and Information Technology issues with Property issues coming at a third.

These risk incidents are presented at the monthly meeting of the Risk Management Committee and presented also to the Board of Directors.

In addition, the Unit also performs the internal audit function related to monthly compliance spot checks to ensure that proper controls, governance and risk management processes are operating effectively for Currency Department, Financial Markets Department, Settlement and the Accounts Department. The unit also ensures the External Audit Management letter issues are fully addressed and completed in a timely manner. Adhoc

review of compliance with departmental procedures are conducted as and when an incident is reported that warrants an in-depth audit.

The Unit is also tasked with the review and updating of the delegation of authority. In October 2017, the Board of Directors approved the revised Delegated Authority. Changes made include the documentation of current practice as outlined in subsequent amendments in the NRBT Act, extending the delegation taking into account changes in job titles and the expansion of job description for Senior Officers.

## Risk Management Corporate Plan Targets

In the approved revised Reserve Bank's Corporate Plan for 2017/18, the Risk Management Unit was allocated with eighteen specific measurable targets. A review of the calendar year corporate plan was carried out in March 2018 which revealed that the Unit achieved twelve targets while six targets were unrealized. The unrealized measurable targets were related to reporting of incidents, compliance testing, risk assessments, complaints management and managing of legislative risk.

## Complaints Management

The Risk Management Unit is also tasked with receiving complaints from external parties, stakeholders or the general public, in relation to the performance of the Reserve Bank's services and/or functions, as well as the services of the financial institutions that are licenced by the Reserve Bank. The Complaints Unit of the Financial Institutions Department is responsible for handling complaints against the institutions licenced by the Reserve Bank.

# Currency Management

The National Reserve Bank of Tonga is responsible for regulating the issue of currency in the Kingdom of Tonga and maintaining an adequate supply of quality banknotes and coins in circulation to meet the public's currency needs.

The Reserve Bank also redeems any banknotes or coins that are mutilated or no longer fit for circulation and destroys them accordingly.

## Currency in Circulation

As at 30 June 2018, total currency in circulation was T\$86.9 million. The value of banknotes in circulation as at 30 June 2018 rose by 15.8% to T\$83.2 million from the end of June 2017 (T\$71.8 million). There were 33.5 million coins, worth T\$3.7 million, in circulation at the end of June 2018. The value of coins in circulation increased by 11.6% to T\$3.7 million from the end of June 2017 (T\$3.3 million). The increase in banknotes and coins in circulation was mainly attributed to the accelerated issuance of currency post Tropical Cyclone GITA.

## Note Processing Operation

The purpose of the note processing operation is to ensure that quality banknotes are in circulation to which the public can use with confidence knowing that they are genuine. As at 30 June 2018, T\$118 million returned banknotes were processed. Of this, T\$36.2 million were deemed fit for reissue while T\$81.8 were deemed unfit.

Table 11: Note Processing

	July 2017 – June 2018	
Details	Value (\$ Million)	Pieces (Million)
Notes saved for reissue	36.2	1.2
Notes destroyed	48.4	2.9
Notes to be destroyed	33.4	2.1
Total Processed	118.0	6.2

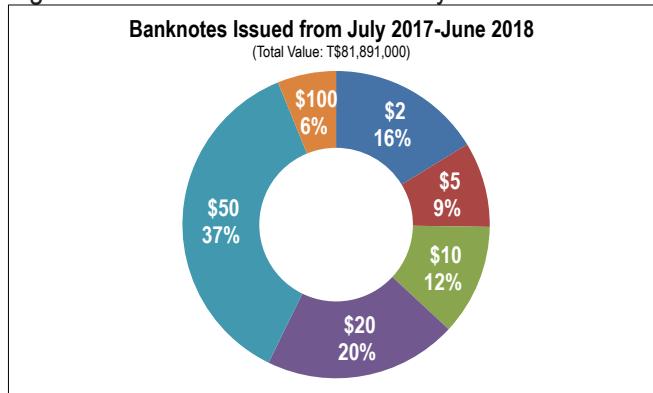


Currency Bank Notes Public Awareness - archway display.

## Banking Transactions

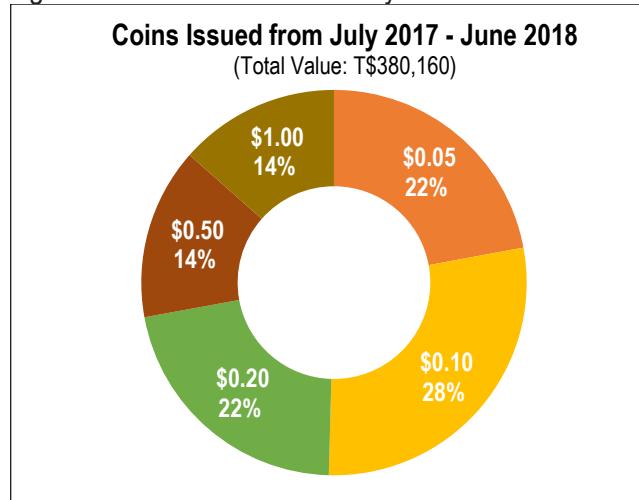
During the financial year 2017/18, the value of currency issued to the commercial banks and the general public was T\$82.3 million, of which T\$81.8 million was in banknotes and T\$0.38 million in coins.

Figure 20: Banknotes issued from July 2017 - June 2018



The high percentage of T\$20 and T\$50 banknote is mainly due to its increasing usage in ATMs and as a store of value.

Figure 21: Coins issued from July 2017 - June 2018



## Numismatics

Numismatic or “collector” currency income as of 30 June 2018 amounted to T\$249,606.99. This is an increase of 56% from the previous year.

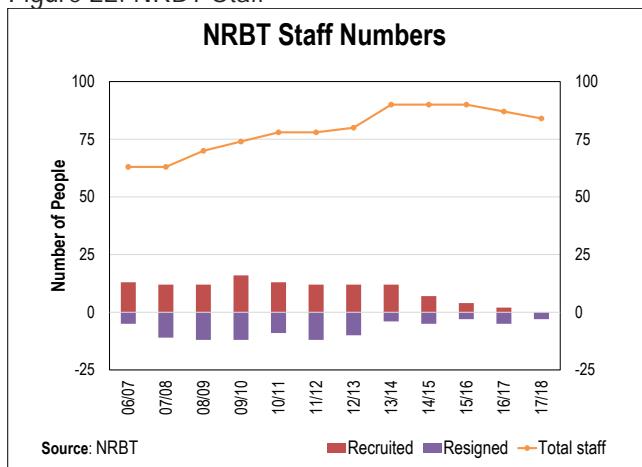
# Corporate Services

## Staffing

During the year, the Human Resource department continued to train and develop a team of committed and motivated employees.

At the end of June 2018, the Reserve Bank employed 84 staff consisting of 13 per cent on fixed term contract and 87 per cent permanent employees. Of the 84 staff, 55 per cent are women and 45 per cent are men. The staff turnover in 2017/18 financial year slightly declined to only 4% where only 3 employees exited the Bank due to overseas migration and various reason. During the year, the Bank did not recruit any Staff to replace the staff that had exited the Bank. Through the commitment and support facilitated by the 84 employees, the Reserve Bank was able to deliver its core responsibilities to achieve the Bank's objective and Strategic priorities.

Figure 22: NRBT Staff



To promote the Reserve Bank as the Employer of Choice and foster a work environment that retains and attracts high quality employees, the Bank reviewed and established new Human Resource policies such as Rewards and Recognition, Staff benefits, Study Leave policy and Redundancy policy. The Bank continued to encourage staff continuous improvements of performance through

carrying out annual performance evaluations, succession planning, and the Rewards and Recognition initiative such as Employee of the Month Awards and Governors Awards at the end of the year. The Bank enhanced staff work experience and overall understanding of the Bank's function by undertaking staff rotation and lateral transfers across within Departments. The staff job descriptions and the organizational structure were reviewed and updated during the year to facilitate the emerging changes in the organization.

## Training and Development

During the year, the Reserve Bank encouraged and supported its staff to upskill and develop their capabilities and competencies through short courses, self-training, online courses, part time correspondence study as well as professional further studies overseas. In 2017/18 financial year, the Bank continued to provide financial support to staff on part time study at the University of the South Pacific as well as online courses. The Bank had scholars graduating with postgraduate degrees from the Bangor University, United Kingdom and University of the South Pacific as well as undergraduate degree



Employee of the Month Awards - April 2018



NRBT Staff function.

holder. The Reserve Bank is again grateful to the New Zealand Aid Scholarship program, Australian Award Scholarship program, Chevening United Kingdom Government Scholarship Program and the Pacific Leaders Educational Assistance for Development of States for the continuous sponsoring of the Bank's employee's further studies overseas. The Bank also acknowledges the technical support and advisory services provided through the IMF, Pacific Financial Technical Assistance Centre (PFTAC) and Alliance for Financial Inclusions (AFI) throughout the year.

## Organizational Health and Safety

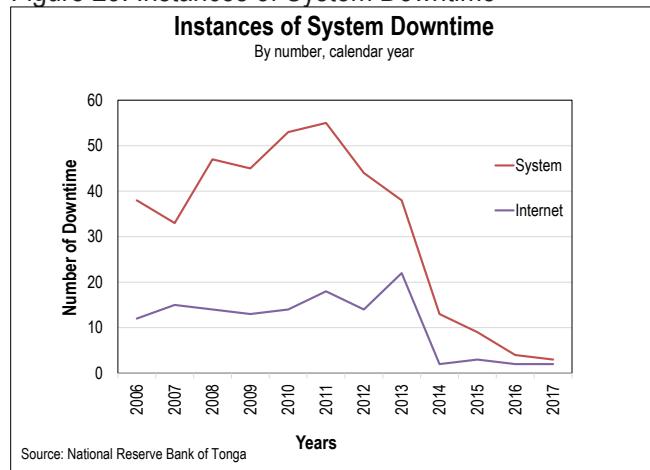
In 2017/18 financial year, the Bank continued to promote and encouraged a healthy working environment by supporting staff to participate in corporate netball tournaments, golf tournaments and various health activities during the year. The Reserve Bank believes that a healthy employee not only improves self-confidence and health but it will improve staff productivity and overall morale.

## Information Technology

The Information Technology (IT) Department continued to support the departments in achieving the core functions of the Bank, maintain a high level of uninterrupted Information and communication Technology services and provide a secure, reliable and robust system to support the Reserve Bank Strategic priorities. In the 2017/18 financial year, IT continued to enforce the alignment of its processes and project implementation to international

best practices with emphasis on preventing and managing cyber-risk. This includes implementing controls in order to comply with the SWIFT Customer Security Programme and actively participating in the local TongaCERT initiative and regional forum on cyber security. The Bank also coordinated and assisted in disseminating cyber security intelligence to local financial institutions and counterpart. Key Projects completed during the year includes: upgrade of the Domain Controller, re-layout the network infrastructure for the Backup system, upgrade of the network switch backbone infrastructure in preparation for fibre optic cabling and the ongoing developments of the Web Server and Proxy. Throughout the year, the IT Department continued to develop its staffs' technical skills through "on-the-job trainings", self-learning and professional training on IT Auditing and Cyber Security.

Figure 23: Instances of System Downtime



## IT Corporate Plan Targets

In 2017/18 financial year, the IT Department reviewed its level of implementation and achievement of the Department Corporate Plan targets and achieved 78% of the targets. The remaining 22% were rolled over to the 2018/19 financial year.

## Property, Security and General Administration

The Reserve Bank continues to invest in the maintenance of the building, property, plant and equipment to uphold its standards and enhance a safe and secure working environment. During the year, the corporate

services departments continued to provide support services to the other departments. The administration unit carried out its responsibilities for procurement of goods and, organising events as well as manage the transport services. Records management, electronic filing system, and corporate communications systems was also managed by the Administration unit. The Security department continued to provide security to the staff and tenants, buildings, property as well as the currency consignments to the outer islands.

The corporate services projects executed during the year included the upgrading of the Embassy of Japan air condition, completion of the new staff room construction, relocation of the Board meeting room to the 4th Floor due to Tropical Cyclone Gita. The Reserve Bank employs external contractors and third party to carry out specific task where the bank lacks specialist expertise or to investigate and diagnose an issue. During the year, the Bank engaged contractors to maintain and service the elevators, standby generator, physical security and the electronic security system. These services ensure that the Bank provides a high un-interrupted building services for its staff, tenants and to minimize risk to Bank's operation.



*NRBT Board Room damage from Tropical Cyclone GITA*

## **Property, Security and General Administration Corporate Plan Targets**

In 2017/18 financial year, the Property, Administration and Security Department reviewed its level of implementation and achievement of the Department Corporate Plan targets and achieved 80% of the targets and the remaining 20% were re-prioritized and rolled over to the 2018/19 financial year.

# Financial Performance



*Chairman of the NRBT Board of Directors with the Minister of Finance and National Planning during present of Divident Transfer*

The gross income from operations for the year ended 30 June 2018 amounted to \$11.4 million, compared to \$10.4 million of the previous year. This largely comprises of interest income from overseas investments as a result of higher than expected level of foreign reserves and the favorable foreign exchange rate against the New Zealand and the Australian dollar.

Other Income also increased by 17% due to the insurance claim proceeds from damages to the building caused by Tropical Cyclone Gita in February 2018.

Total Expenditures incurred during the year was \$8.368 million compared to \$7.548 in the previous year. The 11% increase is mainly attributed to the write off of Level 5 Fixed Assets damaged by Cyclone Gita, and the increase in legal fees from PICB court case. Furthermore, the administration cost, staff cost and interest expense

from foreign and domestic currency accounts increased during the year but was insignificant to offset the 12% drop in the cost of currency issue.

The net profit for the year ending 30 June 2018 was \$3.010 million, compared to \$2.853 million of the previous year. The financial result for 2017/2018 continued to overtake the corporate plan's annual target of \$1 million net profit per year, reflecting the effective strategies implemented during the year resulting in well managing and control of the bank's expenses. The National Reserve Bank of Tonga adhered with section 8(1) of the NRBT (Amendment) Act 2014, which indicates that 30 percent of the profit shall be transferred to the Bank's General Reserves and 70 percent of the profit for the year is payable to the Government. In this regard, T\$2.107 million will be transferred to the Ministry of Finance and National Planning account.

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National Reserve Bank of Tonga

# Financial Statements

YEAR ENDED 30 JUNE 2018

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## DIRECTORS' REPORT

In accordance with a resolution of the Board of Directors, the directors herewith submit the Balance Sheet of the National Reserve Bank of Tonga (the "Bank") as at 30 June 2018, and the related Statements of Comprehensive Income, Distribution, Changes in Equity and Cash Flows 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:

Mr Steve Edwards - Chairman

Mr Richard Prema

Dr Sione Ngongo Kioa - Governor

Mrs Sinaitakala Tu'itahi

Mrs Balwyn Fa'otusia

### 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 2014, shall be, to:

- 1) maintain internal and external monetary stability;
- 2) without prejudice to its principal objective, the Bank shall-
  - a) promote financial stability; and
  - b) promote a sound and efficient financial system.
- 3) subject to subsections (1) and (2), the Bank shall conduct its activities in a manner that supports macroeconomic stability and economic growth.

The principal functions of the Bank shall be, to:

- a) issue currency;
- b) formulate and implement monetary policy;
- c) prescribe the regime for the determination of the external value of the Tongan currency in consultation with the Minister;
- d) determine the foreign exchange rate and implement foreign exchange policy;
- e) determine and implement financial stability policy, and oversee the maintenance of the stability of the financial system as a whole;
- f) regulate as required the supply, availability and international exchange of money;
- g) exclusively hold and manage the external reserves of the Kingdom;
- h) provide advisory services to the Minister on banking and monetary matters;
- i) be the principal banker, fiscal agent and depository of the Government;
- j) undertake banking business, in Tonga or elsewhere, subject to the provisions of this Act;
- k) regulate and supervise financial institutions, including non-bank financial institutions;
- l) oversee and promote the efficient, sound and safe functioning of the payment system;
- m) collect and produce statistics;
- n) cooperate with and participate in international councils and organisations, including public international financial institutions, and cooperate with domestic and foreign public entities, concerning matters related to its objectives and functions;

- o) regulate and supervise capital markets in Tonga;
- p) to manage and promote financial inclusion initiatives and related activities; and
- q) carry out any other function or any ancillary activities incidental to the exercise of its functions under this Act or any other Act.

### **3. TRADING RESULTS**

The net profit of the Bank for the year ended 30 June 2018 was \$3,010,978 (2017: \$2,852,592).

### **4. GENERAL RESERVES**

In accordance with Section 8(1)(b) of the National Reserve Bank of Tonga (Amendment) Act, 2014, the amount of \$903,293 (2017: \$855,778) being 30% of the current year profit, is transferred to the General Reserve at year end.

### **5. PAYABLE TO GOVERNMENT**

In accordance with Section 8(1) of the National Reserve Bank of Tonga (Amendment) Act, 2014, the amount of \$2,107,685 (2017: \$1,996,814) 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 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. DIRECTOR'S 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 other than what is disclosed in the financial statements.

**10. BASIS OF ACCOUNTING**

The directors believe the basis of preparation of the 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.

**11. 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 dated this 18th day of September, 2018.



Mr Steve Edwards  
Chairperson



Sione Ngongo Kioa  
Governor

## STATEMENT BY DIRECTORS

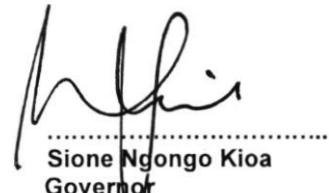
In the opinion of the Directors:

- (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 2018;
- (b) the accompanying statement of comprehensive income is drawn up so as to give a true and fair view of the results of the Bank for the year ended 30 June 2018;
- (c) the accompanying statement of distribution is drawn up so as to give a true and fair view of the distribution of operating profit of the Bank for the year ended 30 June 2018;
- (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 2018; and
- (e) the accompanying statement of cash flows 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 2018.

For and on behalf of the Board of Directors by authority of a resolution of the Directors dated this 18th day of September, 2018.



Mr Steve Edwards  
Chairperson



Sione Ngongo Kioa  
Governor

## Independent Auditor's Report

To the Board of Directors of National Reserve Bank of Tonga

### Report on the audit of the financial statements

#### *Opinion*

We have audited the accompanying financial statements of the National Reserve Bank of Tonga (the 'Bank'), which comprise the balance sheet of the Bank as at 30 June 2018, and the statement of comprehensive income, statement of distribution, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements are prepared, in all material respects, in accordance with 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, the National Reserve Bank of Tonga (Amendment) Act, 2007, the National Reserve Bank of Tonga (Amendment) Act, 2014 and the National Reserve Bank of Tonga (Amendment) Act, 2017.

#### *Basis for Opinion*

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report.

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

#### *Emphasis of Matter*

We draw attention to Note 2(a) and (b) to the financial statements, which refers to the reporting framework and the policy on the treatment of exchange gains and losses and its variance with IAS 21 "Effect of changes in Foreign Exchange Rates". Our opinion is not modified in respect of this matter.

#### *Independence*

We are independent of the Bank in accordance with the ethical requirements of the International Ethics Standards Board for Accountant's Code of Ethics for Professional Accountants (IESBA Code) that are relevant to our audit of the financial statements in Tonga, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code.

#### *Other Information*

Directors and Management are responsible for the other information. The other information comprises the information included in the Bank's Annual Report for the year ended 30 June 2018 (but does not include the financial statements and our auditor's report thereon).

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

*PricewaterhouseCoopers, Level 8 Civic Tower, 272 Victoria Parade, Suva, Fiji.  
GPO Box 200, Suva, Fiji.  
T: (679) 3313955 / 3315199, F: (679) 3300981 / 3300947*

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In connection with our audit of the financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

*Responsibilities of Directors and Management for the Financial Statements*

Directors and management are responsible for the preparation and fair presentation of the financial statements in accordance with International Financial Reporting Standards and with the requirements of the National Reserve Bank of Tonga Act, 1988, the National Reserve Bank of Tonga (Amendment) Act, 2007, the National Reserve Bank of Tonga (Amendment) Act, 2014 and the National Reserve Bank of Tonga (Amendment) Act, 2017 and for such internal control as the directors and management determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors and management are responsible for assessing the Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors and management either intend to liquidate the Bank or to cease operations, or have no realistic alternative but to do so.

The directors and management are responsible for overseeing the Bank's financial reporting process.

*Auditor's Responsibilities for the Audit of the Financial Statements*

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole is free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

As part of an audit in accordance with the ISAs, we exercise professional judgement and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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 Bank's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors and management.
- Conclude on the appropriateness of the directors and management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Bank to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with the directors and management regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

#### **Restriction on Use**

This report is made solely to the Board of Directors of the Bank, as a body. Our audit work has been undertaken so that we might state to the Board of Directors 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 Bank and the Board of Directors as a body, for our audit work, for this report, or for the opinions we have formed.

*PricewaterhouseCoopers*

**PricewaterhouseCoopers**  
Chartered Accountants

**18 September 2018**  
**Suva, Fiji**

## BALANCE SHEET AS AT 30 JUNE 2018

	Notes	2018	2017
<b>ASSETS</b>		\$	\$
<b>Foreign Currency Assets</b>			
Short Term Investments and Current Accounts	8	440,571,670	381,043,257
Accrued Interest		10,240,857	12,642,504
International Monetary Fund (IMF)	9		
- Reserve Tranche Position		10,972,647	10,464,778
- Special Drawing Rights		17,186,574	16,351,486
<b>Local Currency Assets</b>			
Cash on Hand	18	24,586	36,520
Accrued Interest		20,664	20,069
Other Assets	10	10,547,514	11,307,829
International Monetary Fund			
- Currency Subscription	9	33,060,789	32,089,040
Property, Plant and Equipment	11	9,213,978	9,067,277
<b>Total Assets</b>		<b>531,839,279</b>	<b>473,022,760</b>
<b>LIABILITIES</b>			
<b>Foreign Currency Liabilities</b>			
Accrued Interest		4,916	2,164
Demand Deposits	12(a)	55,606,074	47,411,769
IMF - Special Drawing Rights Allocation	9	21,011,485	20,038,963
<b>Local Currency Liabilities</b>			
Payable to Government	13	2,107,685	1,996,814
Demand Deposits	12(b)	228,859,354	223,780,936
Accrued Interest		22,671	41,468
Other Liabilities	16	1,454,941	1,274,723
Currency in Circulation	14	86,969,701	75,218,625
Statutory Reserve Deposits	15	54,868,000	24,670,000
International Monetary Fund			
- Currency Subscription	9	33,060,789	32,089,040
Employee Provisions	17	155,342	132,711
<b>Total Liabilities</b>		<b>484,120,958</b>	<b>426,657,213</b>
<b>NET ASSETS</b>		<b>47,718,321</b>	<b>46,365,547</b>

<b>CAPITAL AND RESERVES</b>			
Authorised Capital		5,000,000	5,000,000
Paid up Capital		5,000,000	5,000,000
General Reserves	2(n)	13,377,850	12,474,557
Revaluation Reserve Account		29,340,471	28,890,990
<b>TOTAL CAPITAL AND RESERVES</b>		<b>\$47,718,321</b>	<b>\$46,365,547</b>

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

**STATEMENT OF COMPREHENSIVE INCOME YEAR ENDED 30 JUNE 2018**

	Notes	2018	2017
<b>Income</b>		\$	\$
Interest Income	4	8,981,339	8,343,926
Other Income	5	2,397,831	2,056,338
<b>Total Operating Income</b>		<b>11,379,170</b>	<b>10,400,264</b>
<b>Expenses</b>			
Interest expense	6	226,516	123,428
Administration and other expenses	7	8,141,676	7,424,244
<b>Total Operating Expenses</b>		<b>8,368,192</b>	<b>7,547,672</b>
<b>Net profit for the period</b>		<b>3,010,978</b>	<b>2,852,592</b>
Other comprehensive income			
Net gains/(losses) arising from the translation of foreign currency balances to local currency		449,481	2,182,678
<b>Total other comprehensive income for the period</b>		<b>449,481</b>	<b>2,182,678</b>
<b>Total comprehensive income for the period</b>		<b>\$3,460,459</b>	<b>\$5,035,270</b>

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

**STATEMENT OF DISTRIBUTION YEAR ENDED 30 JUNE 2018**

	Notes	2018	2017
		\$	\$
<b>Net profit available for distribution</b>		<b>\$ 3,010,978</b>	<b>\$ 2,852,592</b>
<b>Distribution as follows:</b>			
Transfer to General Reserves as required under Section 8(1)(b) of the National Reserve Bank of Tonga (Amendment) Act, 2014	2(n)	903,293	855,778
Balance Payable to Government of Tonga as required under Section 8(1) of the National Reserve Bank of Tonga (Amendment) Act, 2014	13	2,107,685	1,996,814
		<b>\$ 3,010,978</b>	<b>\$ 2,852,592</b>

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

## STATEMENT OF CHANGES IN EQUITY YEAR ENDED 30 JUNE 2018

	Paid up Capital	General Reserves	Revaluation Reserve Account	Total
	\$	\$	\$	\$
Balance 30 June 2016	\$ 5,000,000	\$ 11,618,779	\$ 26,708,312	\$ 43,327,091
<i>Other comprehensive income</i>				
Net gains arising from the translation of foreign currency balances to Tongan currency	-	-	2,182,678	2,182,678
Transfer to General Reserves (as provided for under Section 8(1)(b) of the National Reserve Bank of Tonga (Amendment) Act 2014, and approved by the Minister of Finance	-	855,778	-	855,778
Balance 30 June 2017	\$ 5,000,000	\$ 12,474,557	\$ 28,890,990	\$ 46,365,547
Net gains arising from the translation of foreign currency balances to Tongan currency	-	-	449,481	449,481
Transfer to General Reserves (as provided for under Section 8(1)(b) of the National Reserve Bank of Tonga (Amendment) Act 2014, and approved by the Minister of Finance	-	903,293	-	903,293
Balance 30 June 2018	\$ 5,000,000	\$ 13,377,850	\$ 29,340,471	\$ 47,718,321

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

## STATEMENT OF CASH FLOWS YEAR ENDED 30 JUNE 2018

	Notes	2018	2017
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		\$	\$
Interest received		11,382,391	7,059,455
Rental income		628,083	777,140
Numismatic sales		205,454	73,758
Other income		1,564,294	1,205,440
Purchase of currency		-	24,183
Interest paid		(242,561)	(100,027)
Payments to suppliers and employees		(6,205,044)	(5,343,089)
Net cash (outflow)/ inflow from operating activities		7,332,617	3,696,860
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Purchase of fixed assets		(683,145)	(387,549)
Net movement in IMF accounts		(1,342,957)	228,808
Net movement in staff loans		(309,657)	(72,687)
Net cash used in investing activities		(2,335,759)	(231,428)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Increase in currency in circulation		11,751,076	7,874,089
Increase in demand deposits		13,272,723	39,624,058
Increase in statutory deposits		30,198,000	3,144,000
Net movement in Government of Tonga account		(1,996,814)	(2,894,639)
Net movement in funds held for clearance		(127,367)	(10,622)
Net movement in IMF SDR Allocation		972,522	(178,537)
Net cash inflow from financing activities		54,070,140	47,558,349
Net increase in cash and cash equivalents		59,066,998	51,023,781
<b>Cash and cash equivalents at the beginning of the financial year</b>		\$ 381,079,777	\$327,873,318
Net effect of change in exchange rates	2 (b)	449,481	2,182,678
<b>Cash and cash equivalents at the end of the financial year</b>	18	\$ 440,596,256	\$381,079,777

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

## 1. GENERAL INFORMATION

The National Reserve Bank of Tonga's ("Bank") principal objectives as a central bank, as defined in Section 4 of the NRBT (Amendment) Act 2014, shall be, to:

- 1) The principal objectives of the Bank shall be to maintain internal and external monetary stability
- 2) Without prejudice to its principal objective, the Bank shall-
  - a) promote financial stability; and
  - b) promote a sound and efficient financial system.
- 3) Subject to subsections (1) and (2), the Bank shall conduct its activities in a manner that supports macroeconomic stability and economic growth.

The principal functions of the Bank shall be, to:

- a) issue currency;
- b) formulate and implement monetary policy;
- c) prescribe the regime for the determination of the external value of the Tongan currency in consultation with the Minister;
- d) determine the foreign exchange rate and implement foreign exchange policy;
- e) determine and implement financial stability policy, and oversee the maintenance of the stability of the financial system as a whole;
- f) regulate as required the supply, availability and international exchange of money;
- g) exclusively hold and manage the external reserves of the Kingdom;
- h) provide advisory services to the Minister on banking and monetary matters;
- i) be the principal banker, fiscal agent and depository of the Government;
- j) undertake banking business, in Tonga or elsewhere, subject to the provisions of this Act;
- k) regulate and supervise financial institutions, including non-bank financial institutions;
- l) oversee and promote the efficient, sound and safe functioning of the payment system;
- m) collect and produce statistics;
- n) cooperate with and participate in international councils and organisations, including public international financial institutions, and cooperate with domestic and foreign public entities, concerning matters related to its objectives and functions;
- o) regulate and supervise capital markets in Tonga;
- p) to manage and promote financial inclusion initiatives and related activities; and
- q) carry out any other function or any ancillary activities incidental to the exercise of its functions under this Act or any other Act.

These financial statements have been approved for issue by the Board of Directors on 18th September 2018.

## 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, the National Reserve Bank of Tonga (Amendment) Act, 2007, and the National Reserve Bank of Tonga (Amendment) Act, 2014. 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. Unless otherwise stated, the accounting policies adopted are consistent with those of the previous year.

*New standards, amendments and interpretations issued but not yet effective and not early adopted*

A number of new standards and amendments to standards and interpretations are effective for accounting periods beginning on or after 1 July 2018. None of these is expected to be relevant to the Bank, except the following set out below:

Standard/Interpretation	Content	Applicable for financial years beginning on/after
IFRS 16: Leases	<p>IFRS 16, 'Leases', replaces the current guidance in IAS 17. Under IFRS 16, a contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. Under IAS 17, a lessee was required to make a distinction between a finance lease (on balance sheet) and an operating lease (off balance sheet). IFRS 16 now requires a lessee to recognise a lease liability reflecting future lease payments and a 'right-of-use asset' for virtually all lease contracts. Included is an optional exemption for certain short-term leases and leases of low-value assets; however, this exemption can only be applied by lessees.</p> <p>The standard is effective for accounting periods beginning on or after 1 January 2019. Early adoption is permitted but only in conjunction with IFRS 15, 'Revenue from Contracts with Customers. The Bank is in the process of evaluating the potential effect of this standard.</p>	Effective date: periods beginning on or after 1 January 2019
IFRS 9: Financial instruments	<p>IFRS 9 "Financial instruments", replaces the current guidance in IAS 39 that relates to the classification and measurement of financial instruments. IFRS 9 retains but simplifies the mixed measurement model and establishes three primary measurement categories for financial assets: amortised cost, fair value through other comprehensive income and fair value through profit or loss. The basis of classification depends on the entity's business model and the contractual cash flow characteristics of the financial asset. Investments in equity instruments are required to be measured at fair value through profit or loss with the irrevocable option at inception to present changes in fair value in other comprehensive income not recycling. There is now a new expected credit lossess model that replaces the incurred loss impairment model used in IAS 39.</p> <p>For financial liabilities there were no changes to classification and measurement except for the recognition of changes in own credit risk in other comprehensive income, for liabilities designated at fair value through profit or loss. IFRS 9 relaxes the requirements for hedge effectiveness by replacing the bright line hedge effectiveness tests. Contemporaneous documentation is still required but is different to that currently prepared under IAS 39.</p> <p>The standard is effective for accounting periods beginning on or after 1 January 2019. Early adoption is permitted. The Bank intends to adopt IFRS 9 on its effective date and has yet to assess its full impact.</p>	Effective date: periods beginning on or after 1 January 2019

## **b) Foreign currencies**

Transactions denominated in foreign currencies are translated to the Tongan Pa'anga using exchange rates applied on the trade dates of the transactions.

Foreign currencies have been translated to the Tongan Pa'anga 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 Act 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). The impact of this in the statement of comprehensive income would be an increase in net profit by \$449,481 (2017: \$2,182,678).

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, Cabinet shall cause to be transferred to the ownership of the Bank non-negotiable market 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 may be used by the Reserve Bank for the costs of implementing the monetary policy subject to the approval by the Board or be paid to the Government upon the request of the Minister in writing to the Reserve Bank subject to the market conditions and approval by the Board. According to the National Reserve Bank of Tonga (Amendment) Act 2017, the Revaluation Reserve Account is to be maintained at a minimum balance of \$10,000,000 and any balance remaining in the Revaluation Reserve Account shall be carried forward to the next financial year.

## **c) Critical accounting estimates and judgements**

The preparation of the financial statements requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an on-going basis. Revisions to accounting estimates are categorised in the period in which the estimates are revised and in any future periods affected.

In particular, information about significant areas of estimation, uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amounts categorised in the financial statements are included in the following notes:

- Note 2 (d) – Impairment of financial assets
- Note 2 (i) – Depreciation
- Note 2 (j) – Provisions for employee entitlements

## **d) Financial Assets and Liabilities**

### **i. Financial Assets**

The Bank classifies its financial assets in the following categories: Held to maturity investments and loans and receivables.

- Held to Maturity Investments**

Held to Maturity Investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Bank's management has the positive intention to hold to maturity.

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

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

- Loans and Receivables (Staff Loans)**

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market.

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

### **Impairment of Financial Assets**

For held to maturity investment, the Bank assesses as at each balance date whether there is objective evidence of impairment. This would include observable data that comes to the attention of the Bank such as significant financial difficulty of the issuer or counterparty; the disappearance of an active market for financial asset because of financial difficulties or a market downgrade in credit rating of the counterparty.

For loans and receivables an appraisal is carried out at the end of the financial year by management. The amounts of potential losses that have been identified are either written off against provisions in the year in which they are recognised or recognised as an expense in the income statement.

### **ii. Financial Liabilities**

Financial liabilities are recognised at amortised cost. They are recognised when an obligation arises and derecognised only when the obligation is discharged, cancelled or expired.

Financial liabilities are recorded at trade date, the date on which the Bank commits to borrow or repay the relevant funds.

- Demand Deposits**

Demand Deposits represent funds placed with the Bank by financial institutions and other organisations brought to account on a cost basis. These deposits are at call. Interest is paid on demand deposits of commercial banks held with the Bank.

**e) Currency and Numismatics Inventory**

Currency and numismatics on hand are recognised in the statement of financial position at cost. Cost includes the cost of bringing currency to the Bank's premises. Currency issuances are determined on a first-in-first-out basis. When currency is issued the value is reduced and amortisation expense is recognised in the income statement.

**f) Currency in Circulation**

The exclusive rights of national currency issue are vested with the Bank. Currency in circulation comprises notes and coins issued by the Bank and represent a claim on the Bank in favour of the holder. Currency in circulation relates to the issue of notes and coins and demonetised currency that have yet to be redeemed, less notes and coins redeemed. The liability for currency in circulation is recorded at face value.

**g) 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 and the Miscellaneous Amendments (Privy Council) Act 2010, Cabinet 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.

**h) Income tax**

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

**i) 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 and buildings	1.01% - 2%
Furniture and fittings, computer and office equipment	6.67% - 25%
Motor vehicles	25%

**j) Employee Entitlements**

The Bank has its own Staff Provident Fund and all staff contribute to this scheme. The bank and staff contributions are based on the years of service.

Liabilities for other employee entitlements which are not expected to be paid or settled within twelve months of the reporting date are accrued in respect of all employees at the present value of future amounts expected to be paid.

## **k) Cash and cash equivalents**

For the purposes of the statement of cash flow, cash and cash equivalents includes tellers cash, current accounts and short term deposits.

## **l) Revenue Recognition**

### *Interest income*

Interest income is brought to account on an accrual basis using the effective interest method.

### *Rental income*

Rental income is recorded over the term of the tenancy agreement on a straight line basis.

### *Other income*

Other income includes numismatic sales and fees income, and are recorded when the related services are rendered.

## **m) 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.

## **n) General Reserve and Distribution of Profits**

- Section 8(1) of the National Reserve Bank of Tonga (Amendment) Act 2014 states that:

The net profits of the Bank for any financial year, after meeting all current expenditure for that year and after making provision for bad and doubtful debts, depreciation in assets and any other purposes deemed necessary by the Board shall be allocated as follows:

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% of the authorised capital of the Bank, 30% to be transferred to the General Reserve until the sum of the General Reserve and the authorised capital of the Bank equal 10% of the total monetary liabilities 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 Board shall, with the approval of the Minister, subject to Section 8(1) and 8(2), allocate to the General Reserve and pay to Government's general revenue the remaining net profit.

**o) 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.

**p) Leases**

For operating leases, where the Bank is the lessee, the lease rentals payable 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.

The Bank has not entered into any finance leases, either as a lessee or lessor.

**q) Functional and Presentation Currency**

The Bank's financial statements are expressed in Tonga Pa'anga, which is the Bank's functional currency.

**r) Rounding**

Amounts in the financial statements are rounded to the nearest thousand dollars unless otherwise stated.

**3. FINANCIAL RISK MANAGEMENT**

The Bank carries out a wide range of activities, from operating monetary policy to monitoring, regulating and supervising the health of the financial system, managing foreign reserves and banking system liquidity, providing payment systems and settlement services, and issuing currency, supported by a range of corporate services. The activities expose the Bank to a variety of risks. The majority of the Bank's financial risks arise from the foreign reserves management unit of the Bank's Financial Markets Department. The main financial risks to which the Bank is exposed include credit risk, liquidity risk and market risks and policies for managing these risks are outlined below.

**(a) Credit Risk**

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 Bank uses Standard & Poor's 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.

	2018	2017
	\$	\$
<b>Foreign currency assets</b>		
Short Term Commercial Paper and current accounts	440,571,670	381,043,257
<b>Local currency assets</b>		
Staff loans	1,954,549	1,644,892
<b>Total financial investments</b>	<b>\$ 442,526,219</b>	<b>\$ 382,688,149</b>

The Bank's end of year concentration of credit exposure, based on Standard & Pools credit rating of the foreign counterparties based on the country in which the counterparty is resident. N/R indicates the entity has not been rated by Standard & Poor's and includes exposure to Supernational.

	Ratings	2018	2017
<b>Country in which issuer is resident</b>		\$	\$
Australia	AAA	201,012	868,334
	AA-	179,231,751	159,063,481
	A+	49,771,220	74,871,442
New Zealand	AA	292,646	844,346
	AA-	122,126,420	129,005,315
United States of America	AA+	10,940,496	10,046,431
Switzerland	AAA	77,736,476	6,048,046
United Kingdom	AA	250,549	216,970
Fiji	B+	21,100	78,892
		<b>\$ 440,571,670</b>	<b>\$ 381,034,257</b>
Tonga	N/R	1,954,549	1,644,892
<b>Total financial investments</b>		<b>\$ 442,526,219</b>	<b>\$ 382,688,149</b>

*(b) Liquidity Risk*

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 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 Bank manages liquidity on a contractual maturity basis, which is consistent with the expected maturities of financial instruments.

The maturity analysis noted below includes all financial and non-financial assets and liabilities as at 30 June 2018.

Maturity Analysis as at 30 June 2018

	0-3 Months	3-12 months	1-5 years	Over 5 Years	No Specific maturity	Total
<b>Foreign Currency Assets</b>						
Short Term Investments and current accounts	89,924,687	350,646,983	-	-	-	440,571,670
Accrued Interest	10,240,857	-	-	-	-	10,240,857
IMF - Reserve Tranche position	10,972,647	-	-	-	-	10,972,647
- Special drawing Rights	17,186,574	-	-	-	-	17,186,574
<b>Local Currency Assets</b>						
Cash on hand	24,586	-	-	-	-	24,586
Accrued Interest	20,664	-	-	-	-	20,664
Other Assets	10,547,514	-	-	-	-	10,547,514
IMF - Currency subscription	33,060,789	-	-	-	-	33,060,789
Property, Plant & Equipment	-	-	-	-	9,213,978	9,213,978
<b>Total Assets</b>	<b>171,978,318</b>	<b>350,646,983</b>	<b>-</b>	<b>-</b>	<b>9,213,978</b>	<b>531,839,279</b>
<b>Foreign Currency Liabilities</b>						
Accrued Interest	4,916	-	-	-	-	4,916
Demand Deposits	55,606,074	-	-	-	-	55,606,074
IMF Special Drawing Rights Allocation	-	-	-	-	21,011,485	21,011,485

Local Currency Liabilities							
Payable to Government	2,107,685		-	-	-	-	2,107,685
Demand Deposits	228,859,354		-	-	-	-	228,859,354
Accrued Interest	22,671		-	-	-	-	22,671
Other Liabilities	-	1,454,941		-	-	-	1,454,941
Currency in Circulation	-	-	-	-	-	86,969,701	86,969,701
Statutory Reserve Deposits	-	-	-	-	-	54,868,000	54,868,000
IMF - Currency Subscription	-	-	-	-	-	33,060,789	33,060,789
Employee Provisions	-	5,635	46,174	103,533		-	155,342
<b>Total Liabilities</b>	<b>286,600,700</b>	<b>1,460,575</b>	<b>46,174</b>	<b>103,533</b>	<b>195,909,975</b>	<b>484,120,958</b>	
<b>Net Assets</b>	<b>(114,622,382)</b>	<b>349,186,408</b>	<b>(46,174)</b>	<b>(103,533)</b>	<b>(186,695,997)</b>	<b>47,718,321</b>	

The maturity analysis noted below includes all financial and non-financial assets and liabilities as at 30 June 2017.

#### Maturity Analysis as at 30 June 2017

	0-3 Months	3-12 months	1-5 years	Over 5 Years	No Specific maturity	Total
<b>Foreign Currency Assets</b>						
Short Term Investments and current accounts	103,812,376	277,230,881	-	-	-	381,043,257
Accrued Interest	12,642,504	-	-	-	-	12,642,504
IMF - Reserve Tranche position	10,464,778	-	-	-	-	10,464,778
- Special drawing Rights	16,351,486	-	-	-	-	16,351,486
<b>Local Currency Assets</b>						
Cash on hand	36,520	-	-	-	-	36,520
Accrued Interest	20,069	-	-	-	-	20,069
Other Assets	11,307,829	-	-	-	-	11,307,829

IMF - Currency subscrip- tion	32,089,040	-	-	-	-	-	32,089,040
Property, Planet & Equipment	-	-	-	-	-	9,067,277	9,067,277
<b>Total Assets</b>	<b>186,724,602</b>	<b>277,230,881</b>				<b>9,067,277</b>	<b>473,022,760</b>
Foreign Currency Liabilities							
Accrued Interest	2,164	-	-	-	-	-	2,164
Demand Deposits	47,411,769	-	-	-	-	-	47,411,769
IMF Special Draw- ing Rights Allocat- tion	-	-	-	-	-	20,038,963	20,038,963
Local Currency Liabilities							
Payable to Govern- ment	1,996,769	-	-	-	-	-	1,996,769
Demand Deposits	223,780,936	-	-	-	-	-	223,780,936
Accrued Interest	41,468	-	-	-	-	-	41,468
Other Liabilities	-	1,274,723	-	-	-	-	1,274,723
Currency in Circu- lation	-	-	-	-	-	75,218,625	75,218,625
Statutory Reserve Deposits	-	-	-	-	-	24,670,000	24,670,000
IMF - Currency Subscription	-	-	-	-	-	32,089,040	32,089,040
Employee Provi- sions	-	69,365	4,503	58,843	-	-	132,711
<b>Total Liabilities</b>	<b>273,233,151</b>	<b>1,344,088</b>	<b>4,503</b>	<b>58,843</b>	<b>152,016,628</b>	<b>426,657,213</b>	
<b>Net Assets</b>	<b>(86,508,549)</b>	<b>275,886,793</b>	<b>(4,503)</b>	<b>(58,843)</b>	<b>(142,949,351)</b>	<b>46,365,547</b>	

**(c) Market Risk**

Market risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market prices. In respect of the Bank, market risk comprises interest rate risk and foreign currency risk.

**(i) Interest rate risk**

Interest rate risk refers to the risk of loss arising from changes in interest rates. The Bank limits interest rate risk by modified duration targets. The benchmark modified duration for the total portfolio is capped at 36 months. The duration of the portfolio is re-balanced regularly to maintain the target duration.

**(ii) Foreign exchange risk**

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

The value of the Tonga Pa'anga is determined by a basket of currencies. To minimise 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.

The following tables show the currency concentration of the Bank's net exposure to foreign currencies as at 30 June 2018 in Tonga Pa'anga equivalents.

	2018	2017
	\$	\$
United States Dollar	189,981,905	129,260,279
Australian Dollar	70,720,377	64,564,195
Great Britain Pound	255,454	221,656
New Zealand Dollar	134,210,294	152,141,457
Other	7,181,243	6,861,542
<b>Total Net Foreign Exchange Position</b>	<b>402,349,273</b>	<b>353,049,129</b>

***iii. Sensitivity to Foreign Currency Risk and Interest Rate Risk***

The sensitivity of the Bank's financial assets and liabilities to assumed across the board changes in exchange rate and the interest rates with all other variables held constant is shown below

Impact of:	2018	2017
	\$	\$
Change in equity due to a +/-5% appreciation / depreciation of the Tonga Pa'anga	20,117,474	17,652,456
Change in profit/loss due to a rise/drop of +/-1 percentage point in interest rate	102,361	3,530,491

	2018	2017
	\$	\$
<b>4. INTEREST INCOME</b>		
Overseas investments	8,901,300	8,256,547
Staff loans	80,039	87,379
	<b>\$ 8,981,339</b>	<b>\$ 8,343,926</b>

<b>5. OTHER INCOME</b>		
Numismatic coins	247,517	72,660
Rental income	628,083	777,140
Gain on sale of assets	-	65,250
Forex sales/ purchases	1,162,876	1,062,815
Bank user fees	55,441	77,375
Miscellaneous	303,914	1,098
	<b>\$ 2,397,831</b>	<b>\$ 2,056,338</b>
<b>6. INTEREST EXPENSE</b>		
Foreign currency accounts	143,840	43,888
Domestic currency accounts	82,676	79,540
	<b>\$ 226,516</b>	<b>\$ 123,428</b>
<b>7. ADMINISTRATION AND OTHER EXPENSES</b>		
Administration	2,776,686	2,079,444
Retirement fund	456,479	360,296
Staff costs	3,135,203	2,999,717
Audit fees	30,197	26,127
Currency issue	1,206,726	1,370,703
Depreciation	536,445	587,957
	<b>\$ 8,141,676</b>	<b>\$ 7,424,244</b>
<b>8. SHORT TERM INVESTMENTS AND CURRENT ACCOUNTS</b>		
Current accounts	12,300,196	12,630,507
Short term investments	428,271,474	368,412,750
	<b>\$ 440,571,670</b>	<b>\$ 381,043,257</b>

## 9. 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 (IMF) 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 2018, Tonga's membership subscription to the International Monetary Fund was SDR13,800,000 (2017: SDR13,800,000). Of this total amount, SDR3,436,633 (2017: SDR3,436,633) had been paid in foreign currencies, shown in the Balance Sheet as Reserve Tranche Position, 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.

(iii) Special Drawing Rights holdings is an interest bearing international reserve asset created by the IMF and is allocated to members on the basis of their quotas in the Fund. As at 30 June 2018, the Special Drawing Rights holdings had a balance of SDR5,382,835 (2017: SDR5,369,828).

## 10. OTHER ASSETS

	2018	2017
	\$	\$
Staff loans and advances	1,954,549	1,644,892
Currency and numismatics	4,862,182	3,555,381
Other assets	3,730,783	6,107,556
	<b>\$10,547,514</b>	<b>\$ 11,307,829</b>

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

**11. PROPERTY, PLANT & EQUIPMENT**

	Leasehold & Buildings	Computer and Office Equipment	Furniture and Fittings	Motor Vehicles	WIP	TOTAL
<b>At 30 June 2016</b>						
Cost	13,524,546	3,254,010	340,494	502,232	-	17,621,281
Accumulated Depreciation	(5,548,709)	(2,217,362)	(211,677)	(375,849)	-	(8,353,597)
Net Book Amount	7,975,836	1,036,648	128,817	126,383	-	9,267,684
<b>Year Ended 30 June 2017</b>						
Opening net book value	7,975,836	1,036,648	128,817	126,383	-	9,267,684
Additions	64,178	188,994	-	134,378	-	387,549
Net Transfer/Disposal	306,693	(263,585)	(48,275)	5,167	-	-
Depreciation	(260,612)	(194,858)	(57,375)	(75,111)	-	(587,957)
Closing net book value	8,086,095	767,199	23,167	190,816	-	9,067,277
<b>At 30 June 2017</b>						
Cost	10,716,790	1,492,069	142,219	364,249	-	12,715,326
Accumulated Depreciation	2,630,696	(724,870)	(119,052)	(173,433)	-	(3,648,050)
Net Book Amount	8,086,095	767,199	23,167	190,816	-	9,067,277
<b>Year Ended 30 June 2018</b>						
Opening net book value	8,086,095	767,199	23,167	190,816	-	9,067,277
Additions	10,830	414,535	9,388	-	537,354	972,107
Net Transfer/Disposal	(262,390)	(19,643)	(6,928)	-	-	(288,961)
Depreciation	(259,731)	(185,125)	(8,506)	(83,083)	-	(536,445)
Closing net book value	7,574,804	976,966	17,121	107,733	537,354	9,213,978
<b>At 30 June 2018</b>						
Cost	10,097,405	1,881,113	140,626	364,249	537,354	13,020,747
Accumulated Depreciation	(2,522,601)	(904,147)	(123,505)	(256,516)	-	(3,806,769)
Net Book Amount	7,574,804	976,966	17,121	107,733	537,354	9,213,978

	2018	2017
	\$	\$
<b>12. (a) FOREIGN CURRENCY DEMAND DEPOSITS</b>		
Government of Tonga	55,551,957	47,357,315
Other institutions	54,117	54,454
	<b>\$ 55,606,074</b>	<b>\$ 47,411,769</b>
 <b>(b) LOCAL CURRENCY DEMAND DEPOSITS</b>		
International banks	53,666	363,821
Domestic banks	175,855,128	183,892,722
Government of Tonga	52,950,560	39,524,393
	<b>\$ 228,859,354</b>	<b>\$ 223,780,936</b>
 <b>13. PAYABLE TO GOVERNMENT</b>		
Amount payable to government in accordance with Section 8(1) of the National Reserve Bank of Tonga (Amendment) Act 2014	\$ 2,107,685	\$ 1,996,814
 <b>14. CURRENCY IN CIRCULATION</b>		
Notes	83,212,153	71,852,269
Coins	3,757,548	3,366,356
	<b>\$ 86,969,701</b>	<b>\$ 75,218,625</b>

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

#### 15. STATUTORY RESERVE DEPOSITS

The deposits represent the reserves required to be maintained by each financial institution under Section 39 of the NRBT Act 1988. The Statutory Reserve Deposit (SRD) ratio increased from 5% to 10% effective 1 July 2017.

#### 16. OTHER LIABILITIES

	2018	2017
	\$	\$
Other creditors and accruals	1,080,289	947,112
Payable to the National Reserve Bank of Tonga Staff Provident Scheme – refer note below	374,652	327,611
	<b>\$ 1,454,941</b>	<b>\$ 1,274,723</b>

Funds belonging to the National Reserve Bank of Tonga Staff Provident Scheme are held with the Bank in this account.

## 17. PROVISION FOR EMPLOYEE ENTITLEMENTS

	2018	2017
	\$	\$
Opening balance	132,711	101,147
Entitlements during the year	277,101	264,635
Utilised/reversals	(254,470)	(233,071)
	<b>\$ 155,342</b>	<b>\$ 132,711</b>

## 18. CASH AND CASH EQUIVALENTS

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

	2018	2017
	\$	\$
Cash on hand	24,586	36,520
Short term investments and current accounts	440,571,670	381,043,257
	<b>\$ 440,596,256</b>	<b>\$ 381,079,777</b>

## 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 2018 were Steve Edwards (Chairperson), Richard Prema, Sinaitakala Tu'itahi, Balwyn Fa'otusia, Sione Ngongo Kioa (Governor).

During the year, the following executives were identified as key management personnel of the Bank: Sione Ngongo Kioa (Governor), Jessie Cocker (Deputy Governor), Lata Tangimana (Assistant Governor-Operation), 'Ungatea Latu (Assistant Governor-Policy).

### *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 total interest paid to Government on Deposits held amounted to \$81,784 (2017: \$41,249).

The Bank contributes to the National Reserve Bank of Tonga Staff Provident Fund in accordance with the Provident Scheme Rules. The contributions in the current financial year were as follows:

	2018	2017
	\$	\$
Provident Fund payments made by the Bank	456,479	360,296
	<b>\$ 456,479</b>	<b>\$ 360,296</b>

The funds of the National Reserve Bank of Tonga Staff Provident Fund are invested within the Bank at an average rate of 3.67% (2017: 3.80%) per annum. The total interest paid by the Bank for the financial year amounted to \$8,411 (2017: \$7,152). The Trustees of the Staff Provident Fund 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 director related entities include purchases of goods and services and receipt of rental and utilities income as follows:

	2018	2017
	\$	\$
Purchase of goods	NIL	1,928

The Directors are paid fees and sitting allowances for services rendered. The Directors' entitlements to the retirement fund at year end amounted to \$220,629 (2017: \$196,059). The Bank also provides non-cash benefits to the Executive officers in addition to their salaries.

Total remuneration below is included in 'administrative costs'

	2018	2017
	\$	\$
Executive officers	315,980	311,633
Director's fees and allowances	107,320	115,730
	<b>\$ 423,300</b>	<b>\$ 427,363</b>

## 20. COMMITMENTS

### (a) Operating lease commitments

#### Lessee Disclosure

Operating lease expenditure and commitments contracted for are payable as follows:

Detail of the major operating lease as at year end is as follows:

(i) On 28 July 1992 the bank entered into an agreement with His Majesty the King of Tonga to rent the property in Fasi Moe Afi for 100 years ending 27 July 2091. Under the agreement, rent is payable at \$3,000 per year.

Total commitments for future lease rentals which have not been provided for in the accounts are as follows:

	2018	2017
	\$	\$
Due not later than one year	3,000	3,000
Due later than one year but not later than five years	12,000	12,000
Due later than five years	207,370	210,370
	<b>\$ 222,370</b>	<b>\$ 225,370</b>

#### Lessor Disclosure

The Bank leases its building premises under operating leases to tenants for a term of 2 to 3 years. The minimum lease payments receivable at balance date are as follows:

	2018	2017
	\$	\$
Due not later than one year	238,203	404,621
Due later than one year but not later than five years	114,213	134,934
	<b>\$ 352,416</b>	<b>\$ 539,555</b>

#### (b) Capital and other commitments

	2018	2017
	\$	\$
Commitment not provided for in the financial statements are as follows:	\$ 537,354	NIL
Capital commitment: approved and contracted		

### 21. CONTINGENT LIABILITIES

Contingencies not otherwise provided for in the accounts and which existed at 30 June 2018 comprise:

- (i) Contracts for foreign exchange transactions was nil (2017: \$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 en-cashed 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.

### 22. 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 arm 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:

### *Short term investments and current accounts*

The reported value of short term investments and current accounts is considered to be its fair value due to the short term nature of the financial assets.

### *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.