National Reserve Bank of Tonga

Annual Report 2018 - 2019

NATIONAL RESERVE BANK OF TONGA

Celebrating 29 Years of Service

NRBT

ANNUAL 2019 REPORT

for the Year Ended 30 June 2019

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Governor's Foreword

I am pleased to present the annual report for the financial year 2018/19. This annual report marks the 29th year of service and 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 2019. This is in accordance with the Principal objectives and functions outlined in the NRBT Act.

During the year, according to the International Monetary Fund (IMF), global economic growth was further downgraded to 3.3%, commodity prices have been volatile, headline inflation was subdued, while average oil prices increased compared to the previous year. Slower growth was also observed amongst Tonga's major trading partners. On the domestic economy, the official statistics recorded growth of 0.2% in 2017/18. The Reserve Bank also revised its growth projections down to 3.4% in 2018/19 on the delays in the implementation of some projects, the Tropical Cyclone Gita reconstruction, new government infrastructure projects, and private house construction. This growth is also supported by improved performance in the fishing sector, construction, and the service sector. Agriculture is estimated to record lower growth this year as it recovers from the Tropical Cyclone Gita.

At the end of June 2019, the annual inflation rate was at 1.8%, although it peaked at a high of 6.5% in November 2018, reflecting the impact of Tropical Cyclone Gita on local food prices coupled with the new Customs excise tax on unhealthy food, beverages, and tobacco. Rising global oil prices also contributed to the increase in imported inflation. However, the annual inflation has declined and remains well below the Reserve Bank's 5% reference rate at the end of June 2019. The slowdown in the rate of inflation is attributed to the improvement in the supply of local food products and fall in kava tonga prices. Global food and fuel prices, as well as the stable exchange rates, contributed to keeping imported inflation low.

The financial sector continued to play a role in financing economic activity, with bank loans rising to a record high level in May 2019. Loans to individuals for house construction remained a sizeable portion of the loan portfolio Bank loans were mainly to private businesses in the transport, professional & other services, retail, wholesale, and tourism sectors as well as private individuals housing and personal loans, reflecting positive business confidence and active investment throughout the year. Loans by non-bank financial institutions also increased mainly reflecting an increase in lending to households. Over the year, bank loans continued to grow despite the slight rise in lending interest rates and a corresponding decline in deposit interest rates.

Furthermore, similar to other currencies in the region, the US dollar strengthened against Tongan pa'anga while the Australian and New Zealand dollar weakened against the Tongan pa'anga. 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 to finance imports. These remittance receipts, mostly personal transfers from friends and family abroad remained above $346.6 million at the end of June 2019.

Domestic economic growth was also evident in the increase in overseas payments for imports of goods and services, which outweighed the steady level of receipts. These payments were attributed to higher imports and service payments. These payments were offset by inflows of remittances, as well as travel and official receipts for budget support, grants, and cyclone relief funds. Consequently, at the end of June 2019, the Overseas Exchange Transactions (OET) balance recorded a lower surplus, and the official foreign reserves rose to T$484.3 million, equivalent to 8.1 months of imports. This is well above the Reserve Banks 3 months of import threshold. The Reserve Bank is conscious of the vulnerabilities to natural disasters and the economy's heavy reliance on imports and continued to ensure that the foreign reserves are at sufficient levels to meet the foreign exchange needs of the country as well as withstand any external shocks.

As a consequence of the high foreign reserves and the Reserve Bank's accommodative monetary policy to encourage banks to lend, liquidity in the banking system continued to remain at high levels.

During the year, the Reserve Bank continued to monitor developments in the domestic economy to asses any impact on financial stability, particularly after Tropical Cyclone Gita. Over the year, the overall performance of the banks was satisfactory, the banks remained sound and well-capitalized, supported by the capital injection by new shareholders to one of the banks. This increase in the risk-weighted capital ratio of the banks continued to increase and to act as a safeguard against any shock to the financial system. During the year the banks continued to improve their balance sheets, credit continued to grow but at a slower rate of 9.3% with non-performing loans falling to 3.2% of total loans. Banks also introduced new financial access points such as eftpos terminals and ATM's as well as agents in the 17 electoral constituencies, to better serve the people of Tonga. As such, financial inclusion indicators to promote inclusive economic growth showed a marked improvement. The financial intelligence unit (FIU) also contributed to the stability of the financial system by carrying out its functions under the Money Laundering and Proceeds of Crime Act. The FIU met with the members of the working group on serious financial crime to prepare for Tonga's upcoming Mutual Evaluation of its anti-money laundering and terrorist financing regime.

The Reserve Bank continued to focus on maintaining financial stability and ensuring the depositors' interest are protected through onsite bank examinations, spot checks on compliance, and technical meetings with the banks. A credit bureau license is being considered to provide credit bureau services and to further strengthen the credit environment. Besides, to also support financial development and growth in the economy, the Reserve Bank commenced work on developing a national payment system to better facilitate the circulation of money, and that is suitable for Tonga's financial system and the number of transactions to maintain low transaction costs.

Against this background, the Reserve Bank continued its accommodative monetary policy stance and at the same time, remaining vigilant in monitoring the developments in the economy and the banking system for early signs of vulnerabilities. The Reserve Bank to promote macroeconomic and financial stability, implemented policy actions such as the proclamation and implementation of the Microfinance and Foreign Exchange Act, the annual review of the basket exchange rates, and the implementing of the exchange control policy guidelines.

Furthermore, to address new risks to macroeconomic and financial stability such as de-risking of foreign exchange dealers accounts and correspondent banks, as well as climate change issues, cybersecurity and anti-money laundering, the reserve bank invested in building the capacity of its staff through the attendance at meetings and overseas training.

On the financial performance, the Reserve Bank is reporting a net profit of T$6 million for the 2018/19 financial year, the highest profit the Reserve Bank has recorded, and an increase from T$3 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$4.2 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 82% of the corporate plan targets for 2018/19 and the corporate plan targets for 2019/120.

At the end of the financial year 2018/19, the Bank has achieved its principal objectives and functions outlined in the NRBT Act of monetary and financial stability. In this regard, I take this opportunity to thank the Chairman and the Board of Directors for their support and the staff for their dedication and commitment and 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 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.

Corporate Plan

VISION

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

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.

VALUES

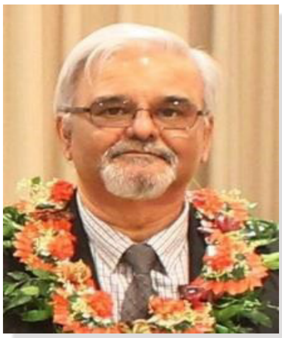
Integrity | Innovation | Team Work | Excellence

Corporate Plan Strategic Priorities

Governance

Board of Directors

Mr. Steve Edwards
Chairman



Mr. Richard Prema
Director

Mrs. Sinaitakala Tu'itahi
Director

Dr. Sione Ngongo Kioa
Governor

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

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. Over the year, one Director position was renewed, and at the end of June 2019, 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 fulfill any requirements for further consideration at the Board. While the Board Sub-Committee met 12 times during the financial year, the Board also met 15 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 was updated by the Risk Management Unit, which undertook some internal audit functions and reports 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.

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. These policies included the annual review of the exchange rate basket to determine the external value of the Tongan pa'anga, decisions relating to bank lending and the single borrower limit. On foreign reserves management, the Directors endorsed the exchange control directive and amendments to the Foreign Exchange Control (FEC) Act. To meet the public demand on currency banknotes and coins, the Directors endorsed the currency re-design of the 5 and 10 seniti circulating coins to enable the public to differentiate these coins as well as improvements to the banknote counting, sorting and authentication process. The development of an automated payment system that would suit the size and capacity of the financial system as well as, the Tropical Cyclone Gita repair works, the satellite redundancy connection, and the staff life insurance scheme was also approved by the Directors.

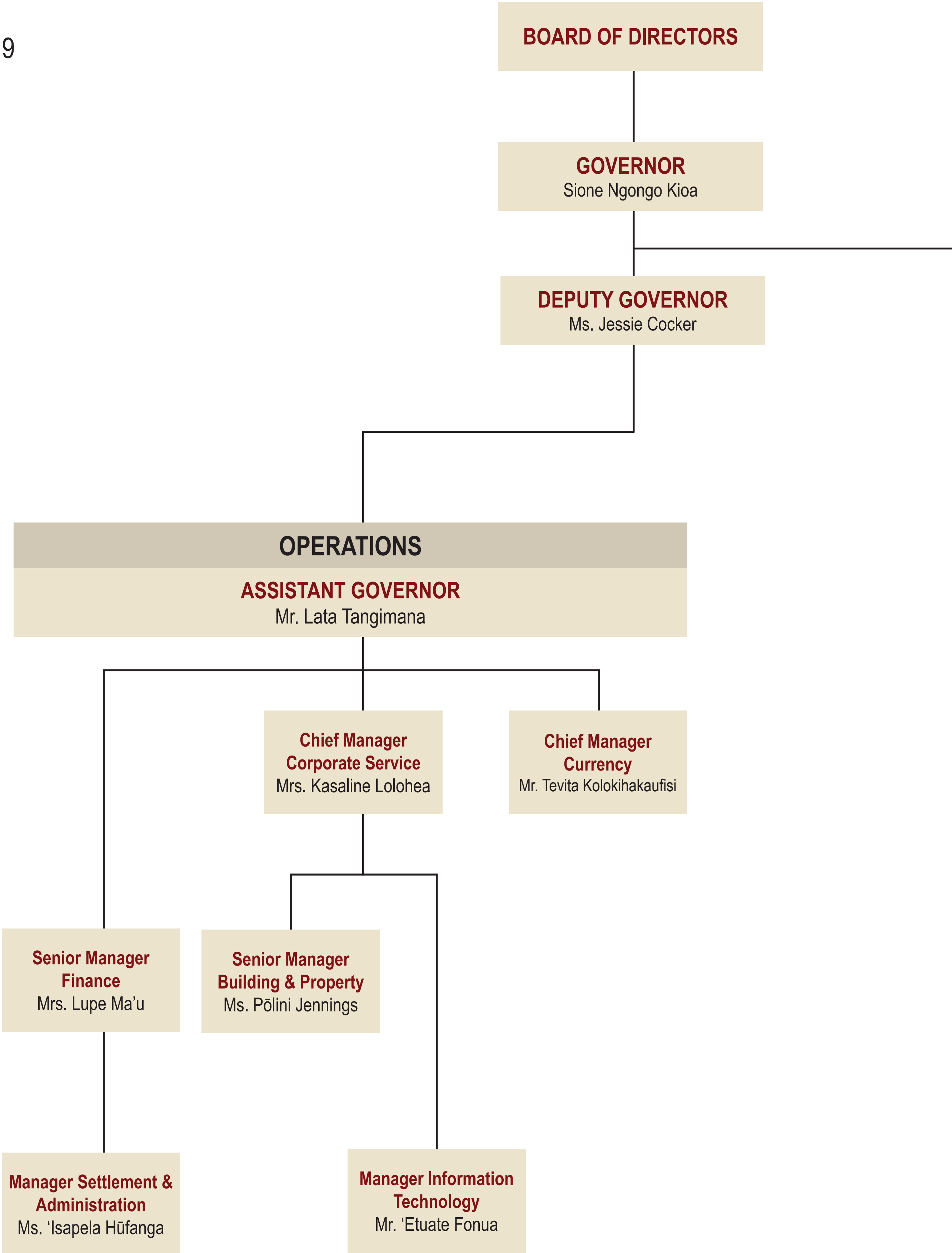
During the year, to ensure financial stability was maintained and that depositors funds are protected at all times. The Directors discussed the commercial banks' liquidity, capital, credit growth and profit-ability as well as their exchange rates, interest rates and fees & charges. The Directors supervised 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 NRBT'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 2019/20 annual budget and the organization chart of the Bank as well as the operations and Annual Report for 2017/18. 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.

National Reserve Bank of Tonga
Organisational Structure

June 2019



POLICY

ASSISTANT GOVERNOR
Ms. ‘Ungatea Lātū *(secondment)*

Chief Manager Financial Systems
Mr. Tevita Vaha’i

Chief Manager Financial Markets
Mrs. Teisa Tongia

Chief Manager Economics
Mrs. Mefilina Tohi *(Acting)*

Chief Manager Legal
Ms. Mele Māngisi

Head of Security
Mr. Teau ‘Isitolo

Senior Manager Banking Supervision
Mrs. Kueni Fifita

Senior Manager Financial Markets
Ms. Nanuma Fakatava

Senior Manager Economics
Mrs. ‘Ana Panuve *(Acting)*

Senior Manager Financial Intelligence
Mrs. ‘Olivina ‘Aholelei

Manager Non-Banking Supervision
Mr. Viliami ‘Akau’ola

Manager Risk & Compliance
Ms. Koloisa Tupou

Corporate Plan

In March 2018, the Board of Directors approved the revised Reserve Bank's Corporate Plan for 2018/19. This review resulted in a decrease in the number of measurable targets from 400 to 337. 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 2018/19 was based on performance up to the end of December 2018. This was conducted by each department's manager and was then presented to all staff on the 7th, 8th and 11th March 2019. This review showed that overall the Reserve Bank has achieved 82% of the 337 Corporate Plan targets for 2018/19. The result is a significant improvement from the 73% achieved in the previous year, albeit the fall in the number of measurable targets. Some of the targets 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 direction from external stakeholders. Of the 18% unachieved targets, 13% are currently work in progress that were either awaiting management's finalisation, or delayed due to reasons beyond our control and/or targeted to be completed within the next 3 months. These unachieved / work in progress targets were either re-prioritised and scheduled for the NRBT Corporate Plan 2019/20 or 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.

In 2018/19, the Bank has achieved 82% of its 337 targets outlined in the corporate plan

Chief Manager Currency; Mr. Tevita Kolokihakaufisi presenting the Currency Department's Corporate Plan.

Governor Sione Ngongo Kioa during the first day of the Corporate Plan Review.

Economic Overview

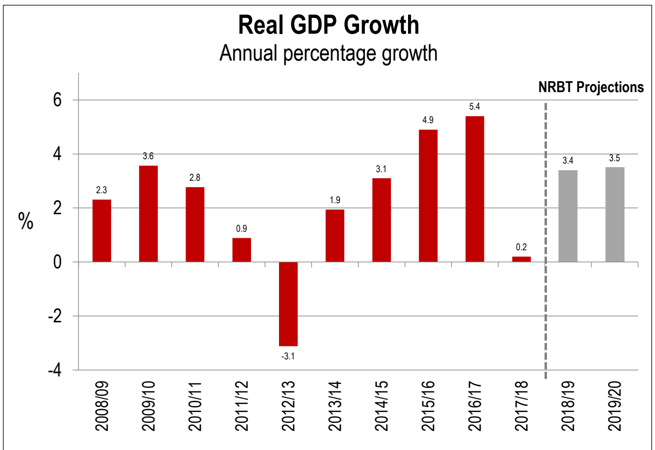
Overseas Economies

Global economic growth for 2019 was further downgraded to 3.3% from 3.7% according to the IMF's April 2019 World Economic Outlook (WEO). This was attributed to the US-China trade tensions, loss of momentum in the euro area economy, and tightening of financial conditions in larger advanced economies. In advanced economies, growth is expected to continue slowing at a steady pace due to the impact of the fading US fiscal stimulus, aging trends, and low productivity growth. Consequently, slower growth was observed amongst Tonga's major trading partners such as New Zealand and Australia for June 2019. Commodity prices have been volatile recently reflecting supply influences particularly in oil prices, relative to a backdrop of softened demand from Asia. Headline inflation remained subdued in most advanced and developing economies and has remained below target. According to Reuters, world oil prices averaged around US$68.65 per barrel in the year to June 2019 rising from US$65.58 in the year to June 2018. This was partially due to the civil conflict in Venezuela and Libya, and the US sanctions on Iran. However, the average oil price for the month of June 2019 was US$62.86 per barrel, lower than the US$78.75 average price in June 2018. This lower average price was due mostly to weaker global demand and despite the agreement by the Organization of the Petroleum Exporting Countries (OPEC) and non-OPEC countries in December 2018 to cut production for an initial period of six months.

Developments in the Domestic Economy

The Tongan economy expects stronger growth in 2018/19 following the preliminary estimate released by the Statistics Department of 0.2% Real GDP growth in 2017/18. The Reserve Bank projects the economy to grow by 3.4% in 2018/19 (revised down from 4.5%). The forecasted growth is supported by on-going recovery works from Tropical Cyclone (TC) Gita, implementation of government infrastructure projects, private housing constructions, and rebounds in the primary sector performance and services sector. The outlook on the domestic economy is expected to continue expanding at 3.5% in 2019/20.

Figure 1: Real GDP Growth

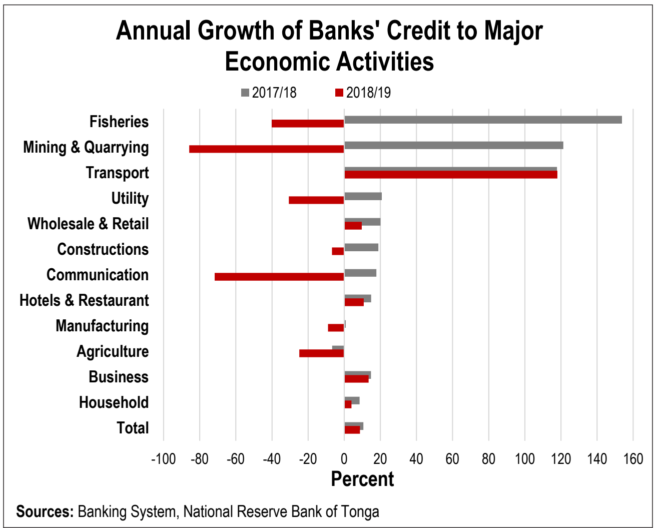


Sources: Statistics Department & National Reserve Bank of Tonga

the Reserve Bank projects a **3.4% growth** to the economy in **2018/19**

The primary sector is expected to grow by 0.6% in 2018/19, after it experienced negative growth of 1.0% in 2017/18. Positive performance was seen in the Fishing sector, with exported volumes of fish rising by 562 metric tons (47.0%) for the year ending June 2019, mostly due to rising tuna exports. At the same time, exports of aquarium products also rose by 28.8%. This is reflected by a 42.6% rise in proceeds from exports of fish and marine products over the year. Meanwhile, the adverse effects of TC Gita on the agricultural products were evident in the decline in export volumes by more than 4,034 tonnes (30.7%) over the year to June 2019. The decline in export volumes was mostly driven by lower exports of squash, cassava, and coconuts. Consequently, the export proceeds for agricultural products also declined by 10.1% in 2018/19. Similarly, the Domestic Market Survey Report pointed to a decline in total agricultural products available for sale at the domestic market by 1063 tonnes (24.6%) over the same period. The slow recovery of the agricultural sector may partially offset the growth in the fishing sector.

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



The industry sector is expected to drive the overall growth for the year 2018/19, supported by active construction activities. The construction sector is projected to grow by 11.0% in 2018/19 supported by recovery works from the TC Gita damages, completion of various construction projects of Government Ministries and businesses, and housing construction by private households. Housing loans rose by 5.4% in 2018/19 compared to 11.8% in 2017/18. The active construction activities will have spillover effects on the utility, manufacturing, and the mining & quarry sectors. A new business complex was also completed for the Utility sector, and the Tonga Village Network Upgrade project is work in progress. The Nuku'alofa Network Upgrade project has also commenced which will further contribute to the Utility sector. The road development project benefits the mining & quarrying, and the manufacturing sectors.

The services sector is projected to continue to expand in 2018/19, with mostly favourable indicators. Import payments continue to rise by 9.1%, over the year to June 2019, in line with the 16.9% rise in container registrations. Lending to Wholesale & retail businesses also rose by 9.7% indicating growth in the trade sector. Credit growth for the year was 8.7% supporting the banking sector. The number of cargo ships that arrived during the year to June 2019 rose by 37 ships, while new shipping vessels and more domestic flights available supported the transportation sector. International air arrivals also rose by 3.7%, coinciding with a 16.3% rise in travel receipts pointing to growth in tourism.

According to the Reserve Bank's survey on job advertisements, the total number of vacant positions that were advertised in the local newspapers and the Matangi Tonga website rose by 46 vacancies over the year. Recruitment intentions were mainly for non-government organizations reflecting plans for the implementation of donor-funded projects. However, the Reserve Bank expects an increase in demand for labour in the near term that would contribute to lower unemployment rate.

Monetary Policy Formulation

Monetary Policy Actions

The Reserve Bank maintained its accommodative monetary policy stance throughout 2018/19. The Tongan economy experienced favourable growth, and indicators suggest continuing growth in the future. Annual headline inflation has returned below the minimum reference rate of 5% since December 2018, and has remained below the reference rate in the first half of 2019. Foreign reserves is very comfortable above the minimum of 3 months imports cover, while exchange rates remain competitive. The financial system is sound, supported by strong capital position, excess liquidity, adequate profits, and low non-performing loans.

In light of the above developments and the outlook on the monetary policy targets, the current accommodative monetary policy stance is still considered appropriate. This accommodative monetary policy stance will: encourage the utilization of the excess liquidity in the banking system to increase lending, particularly to developing sectors; support domestic economic growth; and strengthen the monetary policy transmission. The following monetary policy measures remained unchanged:

- Maintained the monetary policy rate (interest rate on bank's exchange settlement accounts or excess reserves) at 0% (zero interest rate policy);
- Maintained the minimum loans/deposit ratio at 80%;
- Maintained the Statutory Reserve Deposit ratio at 10%;
- Maintained the inflation reference rate at 5%;

In addition to the above measures, the following policy actions were implemented by the Reserve Bank during 2018/19 to enhance its role in promoting macroeconomic and financial stability and achieve its core objectives:

- Three legislations were given royal assent, and were gazette in July 2018. These are the Foreign Exchange Control Act 2018, Microfinance Institutions Act 2018, and Moneylenders Act 2018. The Foreign Exchange Control Act comes into force at the same time, while the Microfinance Act was proclaimed on the 21 June 2019, however, the Moneylender Act will come into force on a date to be proclaimed by Cabinet;
- Reviewed the exchange rate basket of currencies during the year and became effective in September 2018;
- Implemented the requirements of the new Foreign Exchange Control Act 2018 and issued the Exchange Control Directive, effective in November 2018;
- Continued to closely monitor the effects of the Foreign Exchange Control requirements on the economy, financial stability and 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 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 conducted presentations to the Minister of Finance, Foreign Delegates, Development partners, and other stakeholders 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.

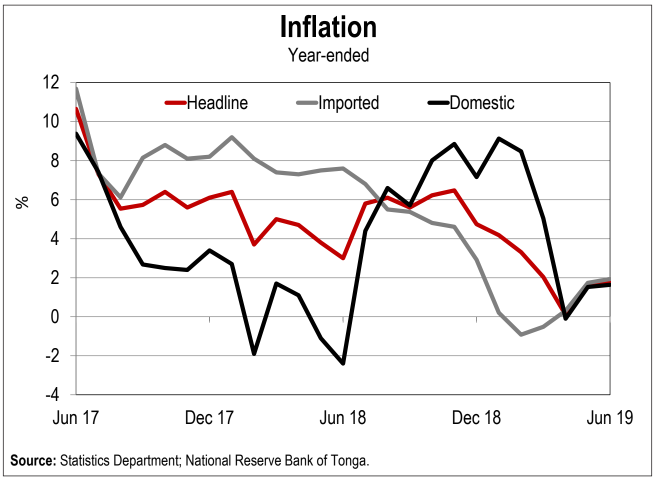
Monetary Policy Outcomes

The Reserve Bank's monetary policy objectives were observed during the 2018/19 financial year.

Inflation

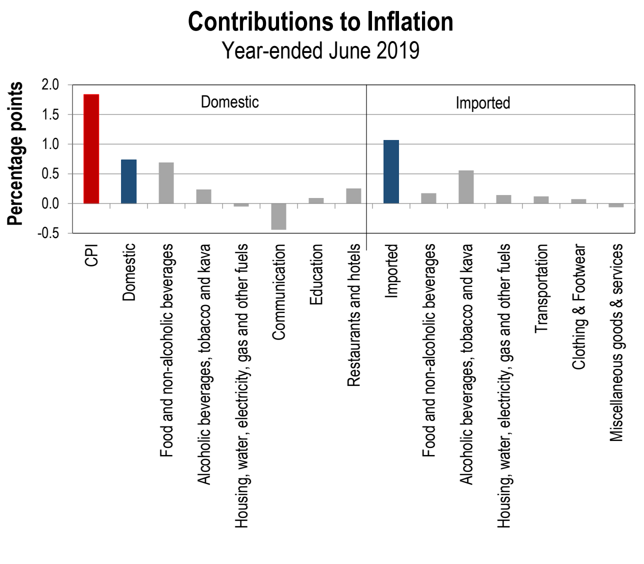
The annual headline inflation averaged at 4% which is below the 5% reference rate during the 2018/19 financial year, although it edged up during the 5 months prior to November 2018 to peak at 6.5%. The annual headline inflation was lower at 1.8% in June 2019, compared to 3% in the same period last year. The Statistics Department also rebased its Consumer Price Indices (CPI) to the base period September 2018. Starting in October 2018 they published the CPI reports using the updated set of weights and basket of representative goods and services. The new basket has 12 major groups compared to only 7 in the old basket. More weight are allocated to Alcohol beverages, tobacco & kava; Furnishings, household equipment and household maintenance; Transport; and Education groups while the weight of the remaining groups were reduced.

Figure 3: Inflation



The high inflation in 2018 reflects the impacts of TC Gita on local food prices coupled with the new Customs excise taxes being implemented in July 2018 on imports of unhealthy food, beverages, and tobacco. Additionally, rising global oil prices also contributed to higher imported inflation.

Figure 4: Contributions to Inflation

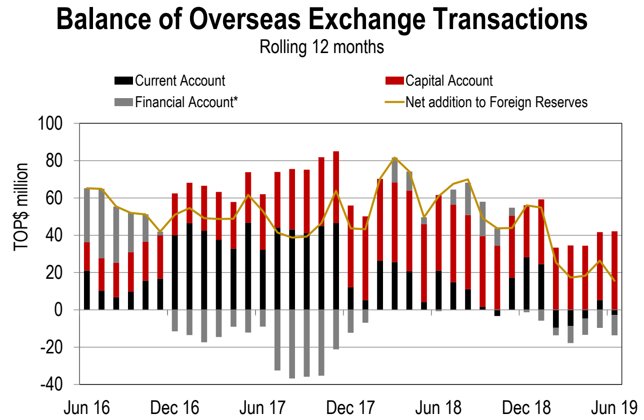


Sources: Statistics Department, National Reserve Bank of Tonga

However, starting from December 2018 and towards the first six months of 2019, annual headline inflation has fallen below the reference rate. Improvement in the supply of local food products such as root crops, fruits and vegetables and the general decline in prices of Kava reduced the inflationary pressure in domestic prices. Global food and fuel prices were also favourable in the first half of 2019, and the steady exchange rates kept imported inflation low and consequently moderate headline inflation.

Balance of OET

Figure 5: Balance of Overseas Exchange Transactions



**Includes unclassified transactions*

Source: National Reserve Bank of Tonga; Banking System

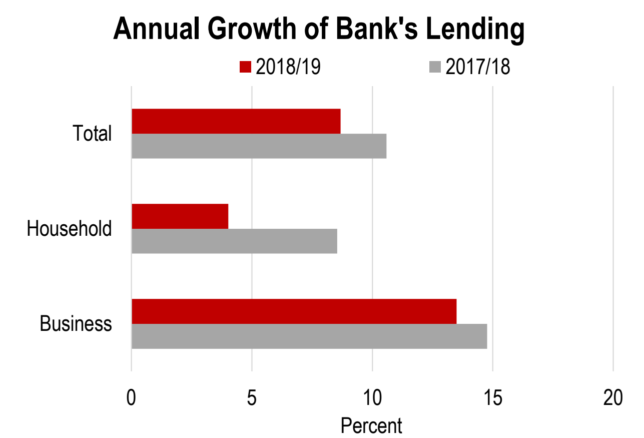
The overall Overseas Exchange Transaction (OET) balance for the year ended June 2019 was $15.6 million lower when compared to a $60.9 million surplus in June 2018. The smaller surplus was driven by higher payments which outweighed the steady level of receipts over the year. The total OET payments rose over the year to June 2019 by $45.5 million (6.3%) to $762.2 million, and were attributed to higher import and services payments, particularly for imported commodities and services such as travel, freight, maintenance & repair, and computer & information services.

Higher payments from the financial account were also noted for interbank transfer payments and investments abroad. Contrastingly, total OET receipts remained at high levels, $833.1 million (-0.5%) over the year ended June 2019. However, travel receipts rose by $18.2 million (16.3%) followed by growth in proceeds from marine exports, and primary income. These were outweighed by the decline in receipts from other various services, interbank transfer receipts, private transfers and export proceeds.

Official Foreign Reserves

The official foreign reserves rose from $468.7 million in June 2018 (7.8 months of import) to $484.3 million in June 2019 equivalent to 8.1 months of import cover. The annual growth resulted mainly from higher receipts of budget support, grants, and cyclone relief funds from development partners. Furthermore, remittance receipts also contributed to the annual increase in foreign reserves. The level of foreign reserves has remained at a very comfortable level during the 2018/19 financial year maintaining the months of import coverage above the Reserve Bank's minimum range of 3 months. The Reserve Bank continues to publish 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

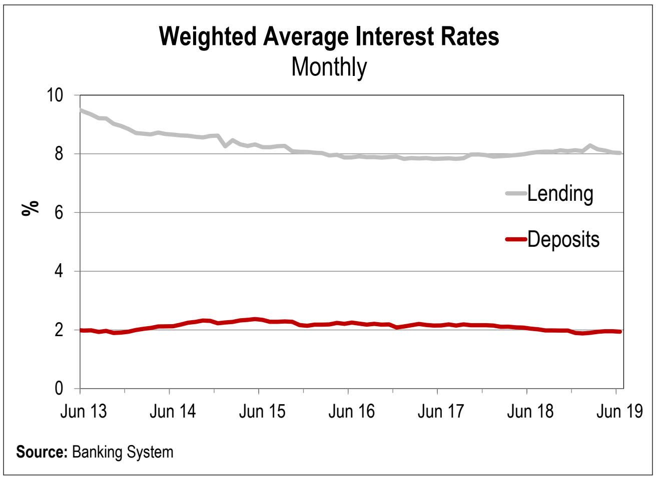


Sources: Banking System, National Reserve Bank of Tonga

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

The annual credit growth for June 2019 was 8.7% ($38.9 million), compared to a 10.6% growth recorded in June 2018. Total banks' lending rose to $486.2 million although May 19 recorded the highest total lending at $487.3 million. This year's growth was attributed to a 13.5% increase in business loans (transport, professional & other services, wholesale & retail, tourism) and a 4.5% rise in household loans (housing and other personal) reflecting active investments throughout the year. However, the annual credit growth was lower than the Reserve Bank forecast of 13% for 2018/19. The lower than expected credit growth was due to delays and cancellation in implementing projects. Additionally, it also reflects households' ability and capacity to access loans. Lending activities in the non-bank financial institutions also increased over the year to June 2019 by $27.4 million (16.9%) to $189.5 million, largely reflecting an increase in household lending.

Deposit Balances

The total banks' deposit for 2018/19 was $611.0 million, an increase of $14.8 million from $596.2 million recorded in June last year. Both saving and demand deposits rose and offset the decline in time deposits. This resulted from the conversion of some long term investments by individuals, retirement funds, churches and schools into short term investments (saving and demand). The increase in savings deposit rates also supported this trend. However, the increase in demand deposits were mainly driven by private businesses demand deposit accounts.

Interest Rates

The weighted interest rate spread widened over the year to June 2019, by 10.7 basis points from 5.98% to 6.09%. This resulted from an increase in the weighted average lending rates by 0.36 basis points to 8.03% and a decrease in the weighted average deposit rates by 10.3 basis points to 1.94%. Both business (manufacturing, distribution, utilities) and household (vehicle, housing, other personal) lending rates increased, while lower deposit rates were mainly demand and time deposit rates. Despite the increase in lending rates and the fall in deposits rates, both loans and deposits volumes continued to grow reflecting the public's high demand for access to loans regardless of the cost of borrowing and also the excess liquidity in the banking system.

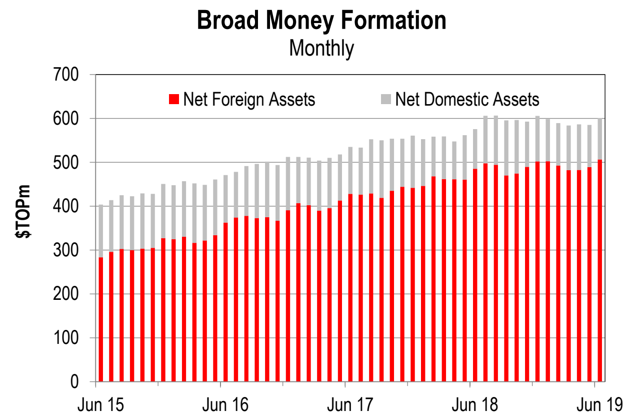
Broad Money Balances

Over the year to June 2019, broad money rose by $24.7 million (4.3%) to $600.1 million. The continuous increase in the foreign reserves resulted in the rise in net foreign assets and broad money. The receipt of cyclone relief funds, project grants, budgetary support as well as improved government revenue collection during the

In 2018/19, the **Foreign Exchange Control Act 2018, Microfinance Institutions Act 2018** and **Moneylenders Act 2018** were all given **royal assent** and published in the gazette in 2018.

year increased both government deposits and foreign reserves. This was also supported by an increase in net domestic assets mainly by higher credit to private sectors.

Figure 8: Broad Money Formation



Sources: Banking System, National Reserve Bank of Tonga

Economics Corporate Plan Targets

In 2018 calendar year, the Economics Department was allocated with 26 measurable targets. A review of the corporate plan was carried out in March 2019 which revealed that the Department achieved 24 targets and 2 targets were not achieved, mostly due to delays in releasing of reports due to other work priorities that arose during the year. There were no new targets for the Economics department hence it remains with 26 targets for the year 2019, of which 3 are shared targets with other Departments. Over the first six months of 2019, the Department was able to achieve 19 targets while work is being done to complete and improve on the remaining targets for the remainder of 2019.

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, regulating and supervising of financial institutions both banks and non-bank financial institutions (NBFIs). The Reserve Bank continued to implement the Foreign Exchange Control Act 2018 while the Microfinance Act 2018 was proclaimed by Cabinet to be effective on 21st June 2019. The Moneylenders Act awaits a declaration date by Cabinet. In addition, legislation for the licensing and supervision of Insurance Companies, Pension Funds and Capital Markets are still being drafted. A credit information systems applicant has been granted a license subject to conditions and formally supervised under the Credit Bureau Licensing Guidelines.

As at the end of June 2019, there were 4 banks licensed to operate in Tonga. The Bank of South Pacific Tonga Limited continued to build on their outreach programs with increased number of access points mainly for EFTPOS and agents/in-store banking. BSP's number of agents/in-store banking facilities increased from 22 the year before, to 26 this year. In February 2019, BSP conducted a site visit to Nomuka rolled out their Go Green campaign, financial literacy workshops and identified potential agents in the island. ATMs for both BSP and ANZ also increased by one ATM each, over the year. Tonga Development Bank continued to build on their market share on remittances with their 'Ave Pa'anga Pau platform. In February 2019, TDB launched a partnership with the Pacific Financial Inclusion Program (PFIP) to increase access to financial services to more Tongans, especially women and children. The partnership is also hoping to broaden the remittance product to include other financial services like insurance and school fees payments.

All banks maintained their head offices in Tongatapu. MBf Bank Limited and ANZ Bank also maintained their branches and sub-branches in Vava'u. 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 (Niuatoputapu 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.

Table 1: Banking Services in Tonga

Banks	ANZ	BSP	MBf	TDB
Branches *(including Head Office at Nuku'alofa)*	3	4	2	8
Agents/Instore banking	-	26	-	-
ATMs	14	13	-	-
EFTPOS	152	383	-	-
Internet Banking	Yes	Yes	No	Yes
Money Transfer Services	Yes	Yes	Yes	No

Banking System Supervision and Regulation

During 2018/19 the Reserve Bank continued to prioritize its supervisory roles on ensuring the maintenance of prudent credit lending standards by banks particularly with housing loans, as its growth stemmed from re-construction activities after cyclone Gita, coupled with banks housing loan campaigns. The Reserve Banks' current accommodative monetary policy stance also assisted in encouraging banks credit growth as banks utilised the excess liquidity in the system. In addition, legal and prudential requirements continue to be closely monitored to promote an ongoing safe and sound financial system, and also ensure a fair 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 2019, one of the banks achieved this target while the other three banks continued to utilize their excess liquidity in order to achieve the 80% loan to deposit minimum requirement. The Reserve Bank will continue to monitor the banks' loans/deposit ratio and at the same time ensure that there is no overheating in the domestic economy.

During the year the Reserve Bank approved the continuation of 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 within the timeframe. Towards the end of the year, one of these temporary breach was regularized after further capital injections by new shareholders to one of the banks.

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 October 2018 and November 2018. The onsite examinations were mainly to identify red flags such as extending loans to borrowers more than their capacity to repay. This will contribute to the level of household indebtedness. Furthermore, these onsite visits were to also verify the banks' ongoing compliance with their internal policies as well 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 prioritize improving the quality of banks' reports for offsite monitoring and to form the basis of the Reserve Bank's policy decisions. Enhanced checking of banks' reports to the Reserve Bank such as mapping of source data to reporting templates continued over the year as part of the data quality assurance process.

Throughout the year, the bank supervision staff met responded to bank license inquiries and held meetings with these prospective bank license applicants. However, as at the end of June 2019 no formal or completed bank license application has been submitted for review. The amendment of the Financial Institutions Act to be renamed as the Banking Act has been circulated to the Minister of Finance to be tabled in Cabinet at their earliest convenience.

Monthly bilateral meetings with the banks and their external and internal auditors as well as bi-annual meetings 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 developments 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 kept 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 every month.

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 $945,669.05 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 $24,817.04 was forfeited to the Government's account according to the requirements of the Financial Institutions Act.

Banking System Financial Performance

Financial Position

The total assets of the banking system reached $973.7 million at the end of June 2019, a growth of $46.5 million (5.6%) over the year 2018/19. This resulted mainly from ongoing credit growth of 9.3% ($40.7 million) and an 8.1% ($3.9 million) growth in non-financial assets as one of the banks invested in developing its premises over the year. This was partly offset by the $17.0 million (9.9%) decrease in the Exchange Settlement Account over the year.

Private individual loans was the main contributor to credit growth over the year to June 2019 at 54% ($258 million). Housing loans made up the bulk of the loans to individuals at $201 million which reflected the continuous demand for housing loans during the year. Also, loans to the business sector also rose during the 2018/19 financial year by $21.9 million (16.1%). Majority of the business loans were for businesses in the professional & other services, transport, retail & wholesale, hotels

& restaurants sector, which indicates positive 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 2019 was at $7.7 million compared to $9.5 million in June 2018. Of the total outstanding loan as of June 2019, 49.2% was lent to the agricultural sector followed by the education and fisheries sectors at 17.0% and 14.9% respectively.

Table 2: Financial Sector Deposit Account

	2017/2018	2018/2019
Demand Deposits		
Number of Accounts	36,777	39,664
Value of Deposits ($m)	244.5	262.8
Saving Deposits		
Number of Accounts	49,058	47,976
Value of Deposits ($m)	95.0	113.5
Time Deposits		
Number of Accounts	2,266	1,876
Value of Deposits ($m)	256.7	234.8
Total Number of Accounts	**88,101**	**89,516**
Total Value of Deposits ($m)	**596.2**	**611.0**

Total banks' liabilities rose over the year by $20.8 million (3.1%). Total deposits continued to rise with mainly demand and savings deposit categories increasing by $18.3 million (7.5%) and $18.4 million (19.4%), respectively. This reflected the growth in non-financial corporations demand deposits by $18.3 million (19.7%) and statutory non-financial corporations savings deposits of $7.1 million (204.1%). On the other hand, demand deposits fell by $21.9 million (8.5%), reflecting the fall in individual's time deposits partially due to conversion of foreign currency term deposits to operating accounts as required under the new Foreign Exchange Control Act 2018.

The total number of deposit accounts reported by banks slightly increased over the year by 1.6% to 89,516 while the total value of deposits increased by $14.8 million to $611.0 million.

Profitability

The profitability of the total banking system remained profitable in 2018/19 hence lower profit compared to the previous financial year. The banks recorded an after-tax profit of $19.864 million for the year ended June 2019, which is equivalent to 2.3% of average assets, and compared to an after-tax profit of $21.115 million for the previous year, which was equivalent to 2.6% of average assets. This reflected a strong growth of 8.9% in total average assets over the year. The lower profit recorded was attributed mainly to a rise in provision expenses of $6.0 million as well as an increase in non-interest expenses of $2.4 million. This was partially offset by $6.7 million increase in net interest income.

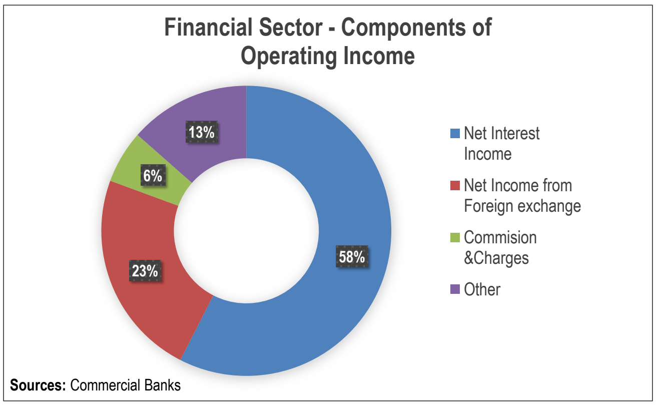
Table 3: Financial Performance

	2017/2018	2018/2019
Pre-tax Net Profit (% average total assets)	3.4%	3.1%
After-tax Net Profit (% average total assets)	2.6%	2.3%
Total Operating Income (% average total assets)	7.0%	7.4%
Net Interest Income (% average total assets)	3.7%	4.2%
Non-interest income (% average total assets)	3.3%	3.1%
Average Net Interest Margin (%)	3.4%	3.9%
Total Operating Expenses (% average total assets)	3.7%	3.7%
Consolidated Risk-weighted Capital Ratio (%)	28.2%	30.2%

Total operating income of the banks was comprised mainly of net interest income at 58% followed by net income from foreign exchange at 23 % compared with 53% and 23.2% respectively in June 2018. The growing net interest income is in line with the strong credit growth over the year for all banks.

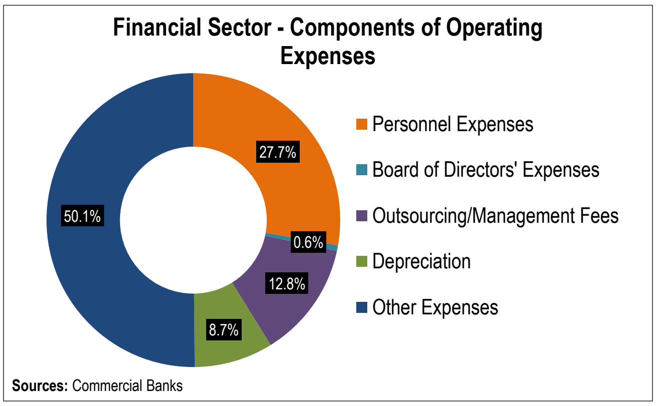
At the end of 2018/19, the **banking system's total assets** reached ... **TOP$973.7 million**

Figure 9: Financial Sector - Components of Operating Income



Total operating expenses of the banks largely comprised of Other Expenses at 50.1% followed by Personnel Expenses at 27.7% and outsourcing & management fees at 12.8% compared with 44.2%, 30.0% and 16.4% respectively in the previous year. The increase in other expenses largely reflected the higher administrative expenses to fund renovations of one bank's premises over the year.

Figure 10: Financial Sector - Components of Operating Expenses

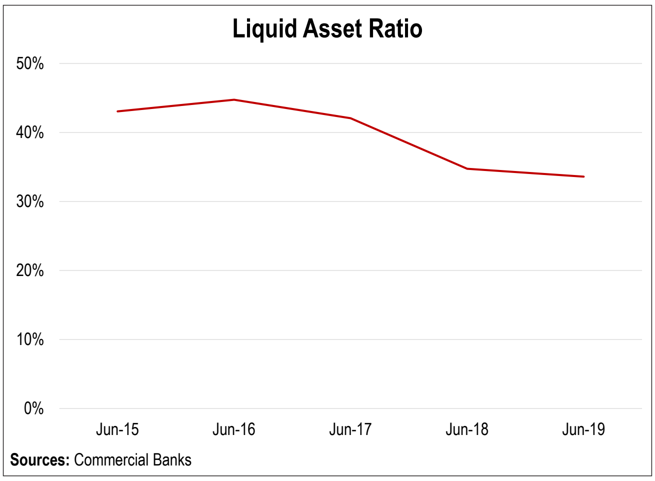


The Reserve Bank expects profitability of the banks to remain comfortable, supported by the outlook for positive economic activities and credit growth to continue subject to the risk of any further deterioration in the quality of the banks' loan books.

Liquidity

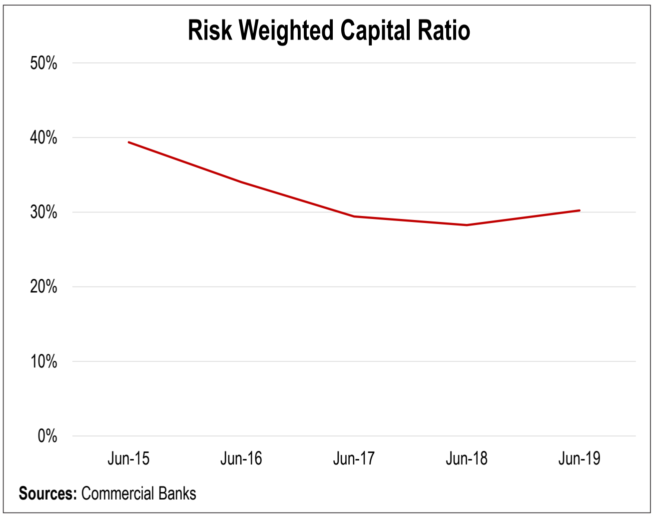
The banking system's liquidity continued to remain high during 2018/19 financial year. The decrease in eligible liquid assets by $1.9 million over the year, was mainly due to the lower Exchange Settlement Accounts due to continuous funding of loan growth over the year. Total loans as a proportion of deposits increased to 78.3% in June 2019 from 73.4% that was recorded in June 2018. The Liquid Asset Ratio slightly fell to 33.6% in June 2019 compared to 34.7% in June 2018 but continued to remain well above the Reserve Bank's minimum requirement of 5%.

Figure 11: Liquid Asset Ratio



Capital

Figure 12: Risk Weighted Capital Ratio



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 improved to 30.2% at the end of June 2019 from 28.2% in June 2018. This was mainly due to a $24.8 million (18.7%) increase in eligible capital due to previous year's earnings and the capital by the new shareholders in one of the banks. This outweighed the increase in risk-weighted assets of $51.4 million (11.0%) reflecting the continuous credit growth over the year.

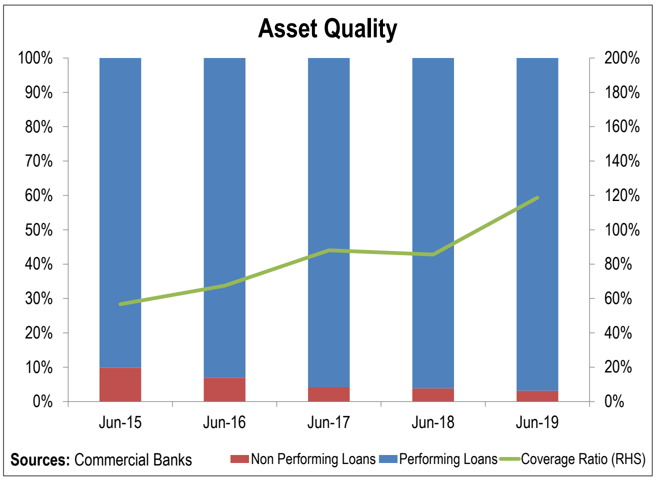
Asset Quality

The overall quality of the banks' assets slightly improved over the year to June 2019. Total non-performing loans declined by $0.8 million (4.7%) to $15.6 million at the end of June 2019. This largely reflected some loan settlements and write-offs over the year. The ratio of non-performing loans to total loans therefore fell to 3.2% from 3.7% in June 2018.

Household loans accounted for 71% ($10.7 million) of the total non-performing loans in June 2019, compared to 57% in June 2018, while the remaining 29% ($4.4 million) was for business loans. Housing loans accounted for 52% ($7.8 million) of total non-performing loans followed by personal loans with 18% ($2.8 million) and non-performing loans from the tourism sector at 8% ($1.2 million).

Total provisions against loans increased by $4.5 million (32.3%) to $18.5 million which reflects the banks compliance with the new IFRS 9 provisioning requirements. The coverage ratio of the non-performing loans by total loan loss reserves, therefore, improved to 118.7%, compared with 85.6% in June 2018. 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



Non-Bank Financial Institutions Supervision

The supervision and oversight of all non-bank financial institutions remains work in progress. The Reserve Bank is implementing the requirements of the legislations that were recently approved for the supervision of microfinance institutions, money lenders, and foreign exchange dealers. The Cabinet proclaimed the Microfinance Institutions Act 2018 to come into force with effect on 21st June 2019. The South Pacific Business Development the only microfinance institution in Tonga is required to submit their license application form within three months from the effective date. Whilst work is underway for the legislations to license and supervise insurance and retirement funds, the Reserve Bank continue to collect financial reports (Balance Sheet and Profit & Loss statements) from most of the Non-Bank Financial Institutions on their operations. The current reporting entities include twelve (12) foreign exchange dealers, one (1) microfinance institutions and two (2) retirement funds who are submitting reports on a monthly basis while four (4) insurance companies submits their financial reports on a quarterly basis. The purpose of these reporting templates is to understand the type of business that these NBFIs are conducting and also to monitor their financial positions and performance to ensure they are solvent. 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, Tonga has been affected by de-risking mainly on money transfer service industry. The Reserve Bank continued to work out a solution to assist local foreign exchange dealers in maintaining their business. There were also technical meetings, trainings and discussions with 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 with the aim of maintaining and reducing the cost of remittances to Tonga.

Licencing & Supervision of Restricted Foreign Exchange Dealers

The licensing and supervision of foreign exchange dealers continued under the new Foreign Exchange Control (FEC) Act 2018. There are 12 licensed authorized restricted foreign exchange dealers of which 5 are license type A (inward & outward remittances), 6 with license type B (inward remittances only) and 1 license type C (foreign currency conversion only). All twelve (12) existing licensed foreign exchange dealers were re-issued with a new license under the new FEC Act after it became effective in July 2018. Even though there were a few prospective applicants and enquiries on applying for a foreign exchange dealer's license over the year, there were no new applications granted as these applications were not complete or the enquiries did not progress further. With regards, to the impact of de-risking, one authorized foreign exchange dealer temporarily ceased their operations for a few months due to their inability to maintain a bank account with any of the commercial banks overseas. They were later able to resume operations due to their account being re-opened with another bank.

The annual compliance checks at the end of the year 2018 found that almost half of the foreign exchange dealers were generally non-compliant with the conditions of their license due mainly to their inability to maintain overseas bank account. This then warranted further close monitoring of Foreign Exchange Dealers operations where some of the foreign exchange dealers that are licensed to only receive and disburse inward remittances (License Type B) were recommended to apply for a License Type A so that they can deal with both inward and outward remittance to/from Tonga. The Reserve Bank issued over the year, 3 letters of warning under the FEC Act, to unauthorized foreign exchange dealers to immediately cease their operations and apply for a license under the Act or face legal consequences. The Reserve Bank also continue to raise awareness over the year with key stakeholders and the general public on the requirements of the new Foreign Exchange Control Act.

Two of the commercial banks, namely BSP and MBf Bank continued to hold agency arrangements with MoneyGram. TDB continues to also offer their 'Ave Pa'anga Pau (product) as another platform for receiving and sending remittances. All banks are licensed as authorized dealers under their banking license.

Ongoing quarterly spot checks, training of the authorized foreign exchange dealers, stakeholder and quarterly meetings when required will contributed to improve the understanding and compliance of the licensed non-bank financial institutions.

Financial System's Corporate Plan Targets

The Financial System Department including banks and non-bank supervision committed to 28 targets in the 2018 corporate plan in which 20 were successfully achieved. During the review of the 2018 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 42 targets for 2019.

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 promptly, and to be reviewed as and when required. A total of 152,654 cheques were presented for clearance at the Reserve Bank during the financial year 2018/2019, a decrease of 0.1% from the previous year. The decrease in the number of cheques presented for clearance was driven by the wider usage of electronic payment systems 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. The Reserve Bank also commenced work on developing a national payment system to better facilitate the circulation of money, and that is suitable for Tonga's financial system and the number of transactions to maintain low transaction costs.

Settlement Corporate Plan Targets

During the year, Settlement Unit participated in the review of the 2018 Corporate Plan. The Unit was assigned eighteen measurable targets for the calendar year 2018 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.

A total of **152,654 cheques** were presented for clearance during **2018/19**

Access to Finance

Financial Inclusion Initiatives

The Reserve Bank continues to encourage financial inclusion to promote inclusive economic growth and macroeconomic stability. The financial inclusion's key objectives are to enhance access to finance by creating a conducive environment including establishing an efficient system to: monitor the access, usage, and quality of financial products; strengthen and develop the Micro, Small and Medium Enterprises (MSMEs); and improve access to a broader range of affordable and appropriate financial products; as well as promote a reliable, sound and affordable digital financial services (DFS). The Reserve Bank's Financial Access Unit has three main policy areas which focus on Individuals, MSMEs, and DFS.

During the year, a comprehensive database was developed and updated to establish a national baseline and monitor the financial inclusion indicators and guide policies to improve access to finance of individuals, MSMEs, and Digital Financial Services. The database was expanded to capture access points for non-bank financial institutions which include foreign exchange dealers, insurance companies and microfinance. In addition, the database also includes data on local money transfer collected by foreign exchange dealers. An access to finance dataflash has been released on the website for public awareness and relevant stakeholders. The challenges in updating the database was the timeliness of the reporting data in the 3 focus areas, as well as the lack of sex-disaggregated data which a common challenge in the region and is part of the units work plan to address.

According to the financial inclusion indicators in *Table 4*, access to finance in terms of access points by commercial banks improved over the year. This increase was mainly due to an increase in the number of Bank of South Pacific (BSP) and ANZ's EFTPOS terminals in Tongatapu and the outer islands. This reflects the commercial banks expansion of their digital service platform to their customers in the outer islands and remote areas. BSP has increased their EFTPOS in Tongatapu and the outer particularly in Ha'apai and 'Eua. This supported the financial consumer's accessibility to financial services in these outer islands and remote areas.

Table 4: Access Indicators in Tonga

	2018	2017	2016[1]	2015[2]
1.0 Number of cash-in and cash-out access points per 10,000 adults[3]	93	84	79	32
1.1 Number of branches per 10,000 adults	3	3	2	2
1.2 Number of ATMs per 10,000 adults	4	4	3	3
1.3 Number of EFTPOS per 10,000 adults	83	74	70	26
1.4 Number of Agents per 10,000 adults	3	3	3	1

Over the year to June 2018, the number of financial access points increased by 61, compared to June 2017. The increase was attributed to the increase in the number of eftpos terminals and agents. BSP was the main contributor to the increase in eftpos terminal with 38 eftpos followed by ANZ with 22 eftpos terminal. The rise was due to the major banks facilitating the use of their digital services platform and promoting their visa cards. In terms of the location of the access points, Tongatapu 2, Tongatapu 8 and Vava'u 15 constituencies contributed the most to the rise in the number of EFTPOS and agents access points *(refer Table 5)*. The increase in the number of agents was driven by the Bank of South Pacific (BSP) given they are the only commercial bank which conducts in-store banking in Tonga.

The Non-Bank financial institutions' access points complements the commercial banks' financial access points, and there are 350 access points in Tonga as of June 2018 with 49 access points from Foreign Exchange

1 Adult population (15 yrs old+) - 64,076 use Census report 2016
2 Tonga's financial inclusion benchmark
3 Total access points

Table 5: Summary of Access Points by Constituency

Constituency	June 18					June 17					2016 Census Report
	Total Access Points	No. of branches	No. of Agents	No. of EFTPOS	No. ATMs	Total Access Points	No. of branches	No. of Agents	No. of EFTPOS	No. ATMs	Total Adult Population
Tongatapu 1	**42**	0	1	39	2	**44**	2	2	35	2	**11,219**
Tongatapu 2	**305**	5	2	285	13	**181**	1	1	169	10	**11,874**
Tongatapu 3	**26**	0	0	25	1	**74**	1	0	72	1	
Tongatapu 4	**29**	0	0	26	3	**54**	1	0	50	3	
Tongatapu 5	**12**	0	1	11	0	**19**	1	2	16	0	**2,716**
Tongatapu 6	**8**	1	1	6	0	**11**	0	3	7	1	**4,975**
Tongatapu 7	**7**	0	0	7	0	**31**	0	1	29	1	**8,236**
Tongatapu 8	**32**	0	4	27	1	**14**	0	2	11	1	
Tongatapu 9	**29**	2	5	21	1	**22**	2	1	18	1	**4,362**
Tongatapu 10	**4**	0	2	2	0	**3**	0	3	0	0	**4,418**
'Eua 11	**8**	2	1	4	1	**6**	2	0	3	1	**3,020**
Ha'apai 12	**18**	2	2	13	1	**11**	2	1	7	1	**2,779**
Ha'apai 13	**0**	0	0	0	0	**0**	0	0	0	0	**1,102**
Vava'u 14	**4**	0	1	3	0	**11**	0	0	11	0	**2,514**
Vava'u 15	**71**	4	2	62	3	**44**	3	3	35	3	**3,374**
Vava'u 16	**2**	0	0	2	0	**11**	1	0	10	0	**2,683**
Ongo Niuas 17	**2**	2	0	0	0	**2**	2	0	0	0	**804**
TOTAL	**599**	**18**	**22**	**533**	**26**	**538**	**18**	**19**	**473**	**28**	**64,076**

Dealers (FEDs) and 299 from South Pacific Business Development (SPBD) including Village Meeting Centers. About 84% (295 access points) of the total are access points via village meeting centers followed by 13% (46 access points) which are branches access point *(refer to Table 6:)*. The village meeting centers are where SPBD members make deposits to their saving accounts and repay their loans whilst loan drawdown are conducted at SPBD main branches (Head office). On foreign exchange dealers access points, Fexco and Manatu 'Ofa have the most access points, with Fexco is the only FED that has a branch in all the outer islands, including the Niuas. The high number of Fexco's access points is supported by its network in the market as well as the convenient service and its accessibility compared to other FEDs. Island Flexi and Manatu 'Ofa are the only two FEDs that have an agent located at Ha'afeva and Nomuka (Ha'apai 13).

Table 6: Non-Banks' Access Points in Tonga by Constituency

Constituency	June 18			
	Total Access Points	No. of Branches	No. of Agents	No. of SPBD Village Centers[4]
Tongatapu 1	17	1	0	16
Tongatapu 2	33	11	1	21
Tongatapu 3	16	1	0	15
Tongatapu 4	25	3	0	22
Tongatapu 5	24	1	2	21
Tongatapu 6	28	0	1	27
Tongatapu 7	21	1	0	20
Tongatapu 8	19	1	0	18
Tongatapu 9	22	2	0	20
Tongatapu 10	27	2	1	24
'Eua 11	31	7	0	24
Ha'apai 12	14	7	0	7
Ha'apai 13	14	0	3	11
Vava'u 14	19	0	0	19
Vava'u 15	22	7	1	14
Vava'u 16	16	0	0	16
Ongo Niuas 17	2	2	0	0
TOTAL	**350**	**46**	**9**	**295**

4 South Pacific Business Development (SPBD) Village Meeting Centers

Usage of Financial Services

On the other hand, the usage of financial services rose by 5% over the year ended June 2018, owing to an increase in the number of deposit accounts outweighing a decline in the number of loan accounts. The increase in the number of deposit accounts is mainly due to commercial banks efforts to encourage the uptake of their digital services platforms while the decline in the number of loan accounts (including Government Development Loans) was due to the pay off of some of the individual loans, mainly for two of the commercial banks.

Access to Finance – Insurance services

During 2018/19, the Reserve Bank submitted an Access to Finance reporting form for Insurance Companies to collect data on the access and usage of insurance financial services and to be used as a standard form for collecting data from Insurance companies, going forward. This data was collected on an annual basis commencing from June 2016 up to June 2018. The report form will be collected on a quarterly basis starting from July 2018 onwards.

Table 7: Summary of Access Points for Insurance services

Insurance Companies	June 18			
	Total Access points	No. of Branches	No. of Agents	No. of Brokers
National Pacific Insurance (NPI)	1	1	0	0
Family Assurance	1	1	0	0
Capital (Dominion)	3	1	1	1
Federal Insurance	1	1	0	0
TOTAL	**6**	**4**	**1**	**1**

The total number of insurance's branches, agents and brokers remained unchanged over the year ended June 2018 *(refer Table 7)*. Capital Insurance is the only company who has a branch and a broker in the outer island of Vava'u, whereas the facilities of the rest of the insurance companies are all established in Tongatapu only. Furthermore, Family Assurance Company is the only insurance company in Tonga who offers life insurance, whereas the rest of the insurance companies provide general insurance, which includes housing, vehicle, natural disaster, health, etc.

Micro, Small and Medium Enterprises Report

Over the year ended June 2018, 1,977 MSME's were able to access loans from a bank, an increase of 307 MSME's (18%) compared to the previous year. According to the banks, the value of outstanding MSMEs loans rose by $4.2 million (22%) to $22.9 million, higher than T$18.7 million in 2016/17. These loans were to MSMEs in the manufacturing, agriculture and other services sectors *(refer Table 8)*. The lower interest rate on the Government Development Loan (GDL) scheme, an SME loan campaign by one of the commercial bank's, as well as the increase in domestic economic activities over the year, supported the increase in loans to MSMEs. Furthermore, the growth in the total number of MSMEs loans was attributed to the increase in MSME loans by both TDB and the GDL which outweighed a decline in the number of MSMEs loans for both the 2 large Banks.

However, there are various challenges that limit the MSMEs from accessing finance which are: inadequate information such as no record of credit history or cash flow in their bank statement (agriculture & fisheries sector) to support the information provided in the loan proposal; inadequate fund allocation in the GDL scheme; lack of business experience in the MSMEs sector.

Digital Financial Services

The number of Digicel branches, registered and active agents' outlets remained unchanged over the year ended June 2018. These facilities are established in all of Tonga's island groups except the two Niuas. The total number of active mobile money accounts continued to increase over the year ended June 2018 by 3,589 (14%) to 29,523 active mobile money accounts. After Tropical Cyclone Gita, non-Digicel customers bought Digicel sim cards and activated the mobile money accounts to easily transfer money. This is reflected in the significant increase in the total number of mobile money transactions by 35% to 133,644 transactions and coincides with a 47% increase in the total value of mobile money transactions. Majority of these mobile money transactions were customers in Tongatapu (55%), followed by Vava'u

Table 8: Summary of MSME Loans by Sector

Type of Sectors	2017/18		2016/17		Change over the year			
					No. of MSMEs		MSMEs Outstanding Balance	
	No. of MSMEs	MSMEs Outstanding Balance *(T$m)*	No. of MSMEs	MSMEs Outstanding Balance *(T$m)*	Change	% Change	Change *(T$m)*	% Change
Overall Total	**1,977.0**	**22.9**	**1,670.0**	**18.7**	**307.0**	**18.4%**	**4.2**	**22.4%**
Agriculture	956.0	6.2	729.0	4.4	227.0	31.1%	1.8	40.3%
Construction	74.0	1.2	23.0	1.2	51.0	221.7%	0.1	4.4%
Fisheries	80.0	1.5	69.0	1.4	11.0	15.9%	0.1	5.7%
Forestry	2.0	0.0	6.0	0.0	-4.0	-66.7%	0.0	-72.2%
Manufacturing	515.0	3.5	473.0	1.2	42.0	8.9%	2.2	181.0%
Other services	247.0	4.5	280.0	3.3	-33.0	-11.8%	1.2	35.4%
Tourism	28.0	1.4	28.0	2.3	0.0	0.0%	-0.9	-39.4%
Transport	3.0	0.6	3.0	0.3	0.0	0.0%	0.3	91.8%
Wholesale/Retail	72.0	4.1	59.0	4.5	13.0	22.0%	-0.4	-9.6%

(39%), Ha'apai (3%) and 'Eua (2%).

AFI Membership

Through the Reserve Bank's Alliance for Financial Inclusion (AFI) membership, the Bank participated in the AFI Global Policy Form (Russia) in September 2018, the 19th Digital Financial Services Working Group in March 2019 and the Pacific Islands Regional Initiative (PIRI) meeting in the Solomon Islands in June 2019. At the global forum the latest technology innovations were discussed and how innovation in mobile technology has allowed access in rural areas that banks cannot reach. The risks such as cybercrime, blockchain, and climate change, and its impact was also discussed. The Bank is also privy to access the AFI policy repository, case studies of developed countries that are leading in financial inclusion, to assist with developing policies to enhance access to finance. Also, the Reserve Bank became a member of the new AFI Working Group (WG) on Inclusive Green Finance which was established to provide policy leadership and regulatory guidance in this emerging policy areas. The Reserve Bank also collaborated with Pacific Financial Inclusion Program in consultation with key stakeholders to enhance Tonga's resilience to natural disasters and also the probability of developing a micro-insurance product.

The Financial Inclusion department committed to 22 targets in the 2018 corporate plan in which 16 were successfully achieved and 6 were work in progress. However early this year, 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 9 targets were approved in the 2019 corporate plan which the department is currenlty working towards achieving them. This includes extending the database to include the access points of credit unions, moneylenders and co-operatives in Tonga to draw a comprehensive picture of the total non-banks access point in Tonga.

The Reserve Bank remains committed to monitor financial access and usage given financial inclusion supports the development of the financial sector. This includes supporting reforms and policies to enhance financial inclusion by monitoring and reporting the level of financial inclusion and its challenges, as well as providing an enabling regulatory environment for financial services. In addition, policies to regulate, license and supervise the Non-bank financial institutions would further improve access to finance and usage. Efforts continue to enable access to finance of affordable financial products and services for MSMEs would encourage the utilization of the excess liquidity in the banking system to increase lending and support domestic economic growth.

Financial Intelligence Unit

During the year, the FIU continued carrying out its functions stipulated under the Money Laundering & Proceeds of Crime Act. This year, the key focus of the unit was on coordinating preparations of the Working Group on Serious Financial Crimes for Tonga's second Mutual Evaluation by the Asia/ Pacific Group on Money Laundering while also trying to get its operation up to standard and ready for this evaluation.

Supervision & Compliance

In July 2018, a delegation from Tonga attended the Asia/ Pacific Group on Money Laundering (APG) 21st Annual Meeting in Kathmandu, Nepal together with over 520 senior delegates from 49 countries and 12 international organizations. During the meeting, members adopted four significant mutual evaluation reports for the Cook Islands, Indonesia, Myanmar and Palau. Members also agreed on a new project on de-risking aimed at assisting members to prepare national plans of action to address the drivers of de-risking along with support for the development of risk-based supervision manuals for the Money Value or Transfer Services (MVTS) sector. Tonga's technical assistance & training needs were also discussed with the donor partners during the meeting.

As a member of the APG, Tonga's framework is currently being evaluated against the Financial Action Taskforce's 2012 Recommendations on combating money laundering, terrorist financing and proliferation of weapons of mass destruction. Tonga underwent its first mutual evaluation in 2009, and the APG adopted and published Tonga's first mutual evaluation report in 2010. Tonga's preparation for the mutual evaluation is led by the Working Group which consists of the National Reserve Bank of Tonga, Ministry Trade and Economic Development, Ministry of Revenue and Customs, Tonga Police, Attorney General's Office, Ministry of Foreign Affairs and supported by the Ministry of Justice and Ministry of Finance. The Government Ministries and Agencies are also partnering and relying on the critical support of financial institutions and cash dealers in their understanding and compliance with Tonga's legal requirements on anti-money laundering and the financing of terrorism and proliferation of weapons of mass destruction. Several meetings of the Working Group on Serious Financial Crimes have been held throughout the year in preparation for the country's evaluation. This working group reports to the Cabinet Committee on Serious Financial Crimes. In September 2018, the Cabinet Committee on Serious Financial Crimes replaced the Cabinet Committee on Money Laundering and Terrorist Financing Activities that was established in 2003 which mainly focuses on policy matters relating to the AML/CFT regime of the country. The Working Group on Serious Financial Crimes (WGSFC) was also formed in support of the Cabinet Committee with the following members; CEO for Justice as Co-chair, Head of FIU as Co-chair, CEO for Finance, CEO for Revenue & Customs, CEO for Trade and Economic Development, Secretary for Foreign Affairs, Solicitor General, Police Commissioner and Ministry of Justice & National Reserve Bank as Joint Secretariat.

As part of the evaluation process, Tonga is required to understand the risks it faces in money laundering and terrorist financing as well as proliferation financing. This process began in 2015 with assistance of New Zealand experts, the working group together with representatives from the private sector conducted Tonga's first national risk assessment. Several meetings of the working group were held during the year to discuss and finalise this National Risk Assessment (NRA) report. The NRA report identified areas of threats and vulnerabilities that are of high risk to the country in terms of money laundering as well as terrorism financing. The working group plans to conduct consultations with the private sector to confirm the risk areas identified as well as to enhance awareness of the evaluation process that the country is undergoing. This NRA report will form the basis of the Tonga's National AML/CFT Strategy to mitigate the threats and vulnerabilities identified.

In October 2018, the legal team of the International Monetary Fund responded to a request from the bank to advice on the extent to which Tonga's Money Laundering and Proceeds of Crime Act and Regulations comply with international standards relating to money laundering and terrorism financing. This review will assist Tonga generally in the improvement of our legal framework for AML/CFT and specifically in our preparation for the mutual evaluation in 2019. The working group referred this review to the New Zealand Counsel Office requesting for their assistance in drafting of legislative amendments but was unsuccessful due to other priorities. The Attorney General's Office has requested for technical assistance on the drafting of this legislation as a matter of priority in terms of the country's mutual evaluation.

In November 2018, the APG engaged a provider to assist the FIU with regards to its AML/CFT Supervision function. This project engaged FIU and Financial System supervisors in a scope of work aimed at developing foundational documents for risk based supervision and identifying areas for specialized implementation technical assistance that would support supervisors to conduct onsite inspections of priority entities. The technical assistance provider first visited the bank in February 2019 for a week to assist the team in conducting a sectorial risk assessment of the financial sector. The project was finalised in May 2019 with the second visit to the bank to conclude supervision documents as well as preparing supervision staff for the first risk based onsite planned towards the end of 2019.

The FIU also supports a joint AML/CFT onsite inspection in Tonga. This opportunity will greatly benefit both FIUs in terms of knowledge sharing as well as enabling access to information that would be of interest towards our efforts in combating money laundering and countering financing of terrorism. Arrangements for the joint onsite inspection is still under discussion with the Papua New Guinea Financial Analysis and Supervision Unit (FASU).

Over the course of this year, the FIU continued contact with its counterpart in 5 foreign countries to arrange for a mechanism to enable sharing of information. Template MOUs were received from these counterparts to initiate this process. The FIU have received clearance on the content of these MOUs from the Acting Attorney General and have proceeded with the negotiation process with each of the 5 counterparts. The 5 foreign counterparts are New Zealand FIU, Bangladesh FIU, Republic of China FIU, Taiwan FIU and Thailand FIU. The signing of these MOU's will facilitate the sharing of information with other FIUs while the NRBT applies for Egmont membership.

The Working Group met several times during the year to update on progress with each members preparation for Tonga's Mutual Evaluation. The first part of Tonga's evaluation which was its Technical Compliance Response was submitted to the APG in March 2019. Tonga received technical assistance from APG on Effectiveness Response in June 2019 from Ms. Cheryl McCarthy, Deputy Commissioner of Financial Supervisory Commission, Cook Islands. The second part of the evaluation which is the Effectiveness Response focuses on whether our regulatory framework, policies and processes in place are operationally effective in combatting money laundering and counter terrorist financing. Tonga filed its first draft of Effectiveness Response to APG in June 2019.

In collaboration with the Non-Banks Division, compliance visits were conducted to all licensed and registered foreign exchange dealers as part of the annual license renewal process. In terms of AML/CFT related obligations, the results were generally compliant.

Mrs. Cheryl McCarthy from the Cook Islands sharing their experience with the Financial Intelligence Team in preparation for the Mutual Evaluation.

Reports & Statistics

1. Number of reports received

Table 9: Number of reports received

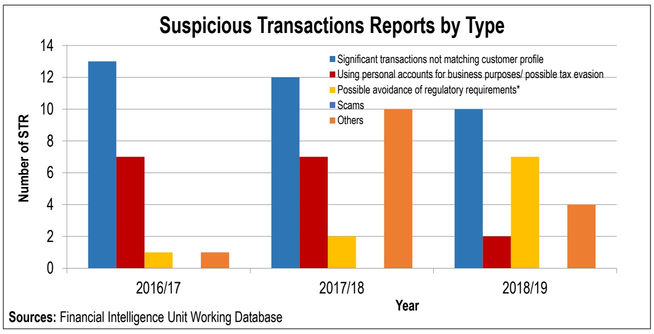
Types of reports filed	2016/17	2017/18	2018/19
Suspicious Transaction Reports (STRs)	22	31	23
Currency Transaction Reports (CTRs)	8,668	10,892	14,068
Border Currency Reports (BCRs)	80	108	97

The FIU received 22 STRs from the banks and foreign exchange dealers during the year, decreasing by 9 reports from the previous year. Total BCRs also decreased this year to 97 reports filed by the Ministry of Revenue & Customs. In contrast, the number of CTRs increased from the previous year totalling to 14,892 reports filed from reporting entities this year. The FIU retains the information obtained in these reports to assist in its analysis function.

Reports analysis & Information sharing

2. STR Analysis

Figure 14: Suspicious Transactions Reports by Type



The dominant STR indicator continued to be significant transactions that were inconsistent with the customer's known background followed by reports related to possible avoidance of regulatory requirements such as structuring of transactions and possible avoidance of Exchange Control related requirements. Reports relating to the use of personal accounts for conducting of business transactions decreased from the previous year. The remaining STRs were related to several indicators such as transactions of adverse media reported persons, third party transactions and atypical business transaction.

Marie Campbell & Eliot Kennedy of the Asia Pacific Group on Money Laundering working together with the Financial Intelligence Team during a workshop on Anti-Money Laundering.

3. Number of STRs disseminated

Table 10: Number of STRs disseminated

Law Enforcement Agencies	2016/17	2017/18	2018/19
Ministry of Police	1	7	7
Ministry of Revenue & Customs	8	14	7
Ministry of Foreign Affairs (Immigration)	1	1	0
MCCTIL	1	3	0
Other[5]			11

Following the analysis of the 23 STRs received, 12 reports were disseminated to law enforcement agencies for further investigations. Seven (7) reports were disseminated to the Ministry of Revenue & Customs for possible contravention of tax related requirements. Seven (7) reports were passed to Police for further investigation of possible serious offences. The remaining 11 reports were treated as follows; 5 reports were referred back to the reporting entities to complete due diligence checks, 2 reports were referred to the Exchange Control units to be included for their spot checks and 5 reports were retained with the FIU due to lack of suspicious indicators.

4. CTR Data Analysis

Table 11: CTR data analysis

	2015/16 *(TOP$M)*	2016/17 *(TOP$M)*	2017/18 *(TOP$M)*	2018/19 *(TOP$M)*
Movement of transactions				
Inwards	119.5	132.6	183.4	243.2
Outwards	59.6	68.7	84.8	139.2
Purpose of transactions				
Business	83.5	91.6	144.4	250.9
Personal	95.6	109.7	123.8	131.5
Transaction type				
TT	34.5	25.2	28.9	34.7
Cash	72.2	103.6	132.8	163.4
Cheque	41.4	40.9	54.9	103
Other[6]	26.8	25.6	38.2	55.4
Cash/ Cheque	4.2	6.0	13.4	25.9

From the 14,068 reports received this year, majority of the report volume were for inward transactions which are classified into cash, cheque, telegraphic transfers and other deposits. Similar to the previous year, majority of the transactions reported were for business purposes. Cash continued to be the dominant type of transaction reported over the year followed by the use of cheques and telegraphic transfers.

5. BCR Data Analysis

Table 12: BCR data analysis

	2015/16 *(TOP$M)*	2016/17 *(TOP$M)*	2017/18 *(TOP$M)*	2018/19 *(TOP$M)*
Movement of transactions				
Inwards		0.6	0.8	1.0
Outwards		36.5	42.3	43.4
Purpose of transactions				
Business		36.4	42.0	43.5
Personal		0.7	1.1	0.9

The FIU received 97 BCRs this year filed from the Ministry of Revenue & Customs. Majority of the reports were for outbound funds across the border. The shipments of currencies for currency conversion companies and commercial banks are the most common type of outbound funds reported. Outbound funds for these entities have received prior approval of the Reserve Bank before transporting them across the border. Similar to the previous years, very few reports were received for outbound individual travellers. Some of these reports were for individual travellers with no proper approval in place. These funds were confiscated by the border officials prior to their travel. Inbound funds carried across the border were mostly for individual travellers returning or visiting Tonga.

With the Inter-agency MOU in place, the FIU have been able to respond to 12 requests for information submitted by the Ministry of Revenue & Customs and the Attorney General's Office in relation to subjects previously referred for further investigation as well as subjects that are under investigations for possible tax and/or drugs offences. The FIU also responded to 1 request for information from the FIU of Papua New Guinea on investigations relating to accounts of Papua New Guineans overseas to uncovering illicit funds generated from environmental crimes in PNG that may have been laundered throughout the region. Information sharing between the two FIUs is covered by the MOU of the Association of Pacific Islands FIUs signed in 2012.

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

5 Reports referred back to the reporting entity
6 Other type of transactions includes transfer between accounts, exchange of currency and other type of payment not specified above

of the Non-Cooperative Countries and Territories and countries that are subject to the Financial Action Task Force's public statements.

NRBT AML

During the year, the FIU also conducted background checks on more than 190 individuals and entities for: Exchange Control applicants/suppliers; new NRBT customers or clients; as well as bank and non-bank financial institutions licenses applicants. The FIU also responded to surveys from the NRBT's correspondent banks on the NRBT AML procedures.

FIU Corporate Plan Targets

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 2018/19, the FIU had a total of 20 targets to achieve. 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.

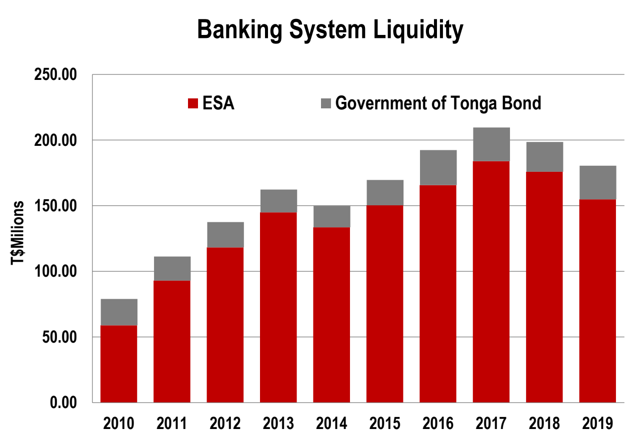
Financial Markets Operations

Domestic Market Operations

The Reserve Bank accommodative monetary policy stance continued to remain unchanged during the financial year 2018/2019 and the Reserve Bank therefore did not issue any Reserve Bank notes. This was to continue leaving excess liquidity in the system to encourage banks to lend and support economic growth.

As of the 30 June 2019, the banking system liquidity fell to $180.4 million from $198.5 million at the end of June 2018. The banking system liquidity comprised mainly of $154.8 million in the banks' Exchange Settlement Accounts (ESA) held with the Reserve Bank and $25.6 million of Government of Tonga's Bonds held by the banks. The lower liquidity this year was in-line with the higher import payments and the permitted offshore investments pressing for higher returns.

Figure 16: Banking System Liquidity



Sources: National Reserve Bank of Tonga

The Financial Markets Department continued to review its current measures of Banks' precautionary demand to better reflect the excess liquidity in the banking system. The exercise shows that there is still a lot of excess liquidity in the banking system. In this regard, the Reserve Bank will continue to explore ways to reduce the excess liquidity in the system in order to improve its monetary policy transmission mechanism.

Due to the excess liquidity in the banking system, 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 its Minister and as approved by the Reserve Bank Board.

Foreign Exchange Operations

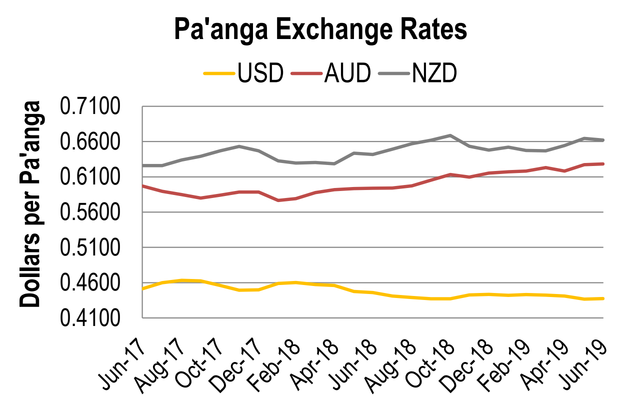
The Reserve Bank determines the rate at which the Tongan pa'anga is exchanged for foreign currencies on a daily basis by reference to a weighted basket of currencies of Tonga's major partners in foreign trade and foreign receipts and payments transactions. The exchange rates set on a daily basis generally 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 and became effective on the 1st September 2018. The review resulted in the Tongan Pa'anga being stronger against the other major trading currencies than they would have been if the weights were left unchanged.

The Reserve Bank monitored 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 re-evaluate the Pa'anga against the basket of currencies in order to safeguard external stability.

Over the year ended June 2019, Tongan pa'anga fluctuated against the Australian dollar (AUD) in wider bands, compared to last year reflecting increased volatility in the AUD while TOP fluctuated against the US dollar (USD) & New Zealand dollar (NZD) in a narrower band compared to last year reflecting decreased volatility in the USD & NZD 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 Reserves after lifting interest rates by 0.5% over the financial 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 USD appreciated while the AUD & NZD depreciated against the TOP over 2018/19.

Figure 16: Pa'anga Exchange Rates



Sources: Commercial Banks 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 were not revised. The Reserve Bank in collaboration with the Association of Banks in Tonga (ABT) also directed the banks not to pass on the levy burden to customers through an additional fee. These directives 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$0.7 million in levy tax to the Ministry of Finance during 2018/19.

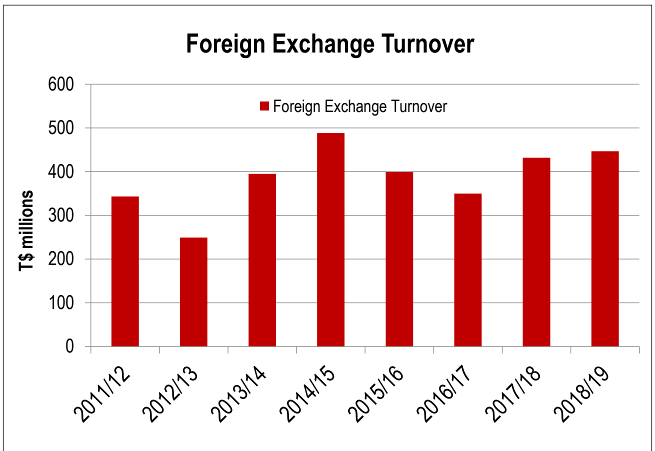
Foreign Reserves reached a record high of TOP$468.7 million in June 2019.

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$485.6 million on 25th June 2019, equivalent to 8.1 months of import cover compared to T$468.7 million (8.0 months of import cover) as at 29th June 2018. The significant increase in the level of foreign reserves was attributed mainly to receipts of remittances, government budget support and Cyclone Gita relief grants. The Reserve Bank continues to monitor the banks' compliance with their respective nostro limits and that excess foreign exchange is sold to the Reserve Bank, one of the foreign reserves management tools to ensure an adequate level of foreign reserves is maintained.

Figure 17: Foreign Exchange Turnover



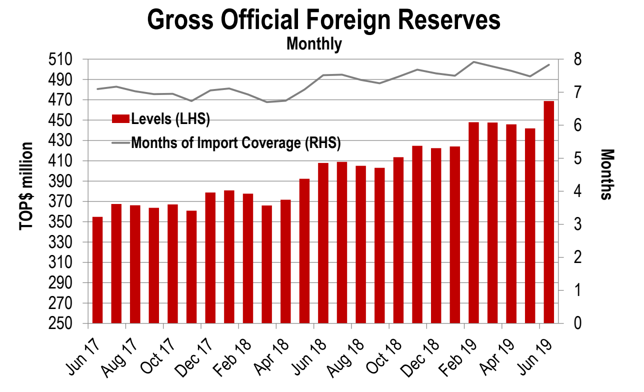
Sources: Commercial Banks Exchange Rates

During the year, the Reserve Bank was a net purchaser in the spot foreign exchange markets. Foreign exchange purchases of T$231.1 million exceeded sales of T$215.5 million giving a total foreign exchange turnover for the year of T$446.6 million. This is an increase from T$431.6 million last year due mainly to an increase in the volume of foreign exchange transactions. The Reserve Bank conducted foreign exchange operations for its customers, but especially 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 $2.7 million compared with the previous year, which is in line with the significant increase in the level of foreign reserves of $16 million.

Figure 18: Gross Official Foreign Reserves



Sources: Financial Markets; Economics Department

Recommendations from the IMF technical assistance visit and attachment program with the Reserve Bank of Fiji on the Reserve Bank's foreign reserve management in 2017, were combined with existing risk parameters to form the new Reserve Management Policy which came into effect in August 2018. The Reserve Bank complied with the new Reserve Management Policy during the year which include 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.

Exchange Control Operations

The Reserve Bank implemented the requirements of the new Foreign Exchange Control Act 2018 that was enacted in June 2018, by formulating the Exchange Control Directive which became effective on 1st November 2018. The Exchange Control Directive includes the existing Exchange Control Policy Guideline and new Exchange Control application forms. The main changes from the Foreign Exchange Control Act 2018 was on the realization and repatriation requirements for the return of export proceeds on exports that originated from Tonga and offshore investments sourced from Tonga. The requirements for Foreign Currency Accounts (FCAs) held with local banks were also tightened to ensure FCAs are held for operational purposes only and not for investment. The Reserve Bank continued to remove all requirements to provide tax clearance certificates for payments that was effective in July 2017. This was to clarify to the banks, authorized restricted 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 outlook for the foreign reserves to remain at comfortable levels and the current monetary policy stance, the Reserve Bank did not introduce any new restrictions on the Exchange Control Requirements in 2018/19.

As such, the Reserve Bank processed 1005 exchange control applications for current and capital payments. This included 402 applications of amounts below the delegated limit of $100,000 mostly for customers referred to the Reserve Bank for further monitoring who were non-compliant with the exchange control requirements. The approved exchange control applications amounted to T$300.1 million in 2018/19 (of which 14.1% were classified as capital transactions) compared to the 767 exchange control applications (of which 14.0% were capital transactions) processed in 2017/18 amounting to T$262.0 million. The target for a half day turnaround time for processing and approval of applications were mostly achieved, delays in approvals were mainly due to incomplete or supporting documents that did not meet all the requirements. The exchange control data on foreign currency payments by large customers including the

Government, large importers particularly for oil importers and offshore investment customers were key inputs to the Reserve Bank's foreign reserves forecast and monetary policy decisions. Furthermore, the exchange control requirement for supporting documents ensures the payments are genuine transactions.

The Reserve Bank also processed and approved 95 applications for the removal of cash (both Tongan pa'anga and foreign currency notes totalling T$10,000 and above) across the border which amounted to a total of T$67.2 million. This increase in applications from the 84 applications that were approved and processed last year, totalling T$49.2 million. The higher number of applications reflected the preference of banks and foreign exchange dealers to exchange foreign currencies notes overseas due to the more favourable exchange rates. The approval for removal of cash is subject to the banks and foreign exchange dealers repatriating these proceeds from the sale of foreign currency notes within a month of the application. 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 authorized restricted foreign exchange dealers were compliant with the exchange control directive. 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 (FX above 50K), Forward exchange contracts (FEC) and the Foreign currency accounts (FCA). Press releases were posted on the website, and the Reserve Bank provided awareness training for the banks and authorized restricted foreign exchange dealers to keep them informed of the revision to the exchange control directive and to also raise issues identified from the spot checks. The Reserve Bank continued to issue the Gift list for those who have reached 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 was also issued for those who have breached the delegated limit for Travel allowance of T$20,000 per travel and an Import Referred Customer list was issued for those who have not provided the custom import entry form when

Members from the Banks and Foreign Exchange Dealers during the Exchange Control Directive awareness.

the goods arrived in Tonga. Non-compliant customers will be referred to the Reserve Bank for processing and approval for all their foreign exchange payments. Close monitoring of these non-compliant customers continued to ensure they consistently comply with the exchange control requirements, and that payments made are bona-fide transactions to strengthen the Reserve Banks anti-money laundering initiatives.

Financial Market Corporate Plan Targets

A review of the 2018 corporate plan and targets was also conducted during the financial year. The review showed that the Financial Markets Department (FMD) had achieved or was in line of achieving 38 out of the 39 targets, leaving only 1 target still outstanding. The unachieved target were recommendations by an IMF technical assistance mission on domestic market development that were surmised to be unattainable as it is beyond the Reserve Bank's total control and they had to be implemented in collaboration with other ministries and institutions. As such, this target was removed going forward. In addition, 11 new targets from the Reserve Management Policy were added to the FMD's corporate plan while 3 targets were removed resulting in an increase in the total targets for 2019 FMD Corporate plan to 47 targets.

Risk Management

The Reserve Bank continued its effort of inculcating a risk awareness culture and integrating an effective risk management framework into all policy oriented and operational activities. The Risk Management Unit under the Governor's Office work in collaboration with all Departments in identifying, assessing, managing and monitoring the many risks the Reserve Bank faces. Extensive use of Management Committees set up ensures that all risks, inherent and emerging, are considered with regular reporting to the Board of Directors.

The main financial risks to which the Reserve Bank is exposed to are credit risk, liquidity risk and market risk which includes interest rate risk and foreign exchange risk. Financial Markets and Financial System from the Policy side and Finance Department from the Operations side are actively managing these financial risks with oversight from the Risk Management Unit. Like most central banks, the nature of the Reserve Bank's operations creates exposure to a range of operational and reputational risks. Such risks are found in our Information Technology and Systems Unit, Building and Property Unit and Currency Department. These operational and reputational risks are addressed in the various Management committees and monitored by the Risk Management Unit.

Incident Reporting is part of the Risk Management Framework of the Reserve Bank. A reporting framework is in place for reporting and monitoring of risk incidents to document events that occur and may adversely affect the achievement of the Reserve Bank's mandate as outlined in the Act. There were thirty-six incidents reported over the year and have all been resolved. Thirty-nine percent of these incidents were related to Information Technology issues and thirty-three percent were related to Property and Building issues. These risk incidents are presented at the monthly meeting of the Risk Management Committee and presented also to the Board of Directors.

Internal Audit

A strong, independent and objective internal audit function is a key part of the Reserve Bank's overall commitment to good corporate governance practice. The Risk Management Unit is also tasked with the internal audit function to assist in the effective oversight of risks. Monthly program of routine audits as well as a number of specific reviews to ensure that proper controls, governance and risk management processes are operating effectively for Currency Department, Financial Markets Department, Settlement and the Accounts Department. Adhoc review of compliance with departmental procedures are conducted as and when an incident is reported that warrants an in-depth audit. Risk based checks were undertaken during the year on high risk areas such as currency and foreign reserves management. The results of these checks and reviews were reported to the Board on a monthly basis.

Delegation of Authority

All activities and expenditure in the Bank must be authorised in accordance with the respective delegations, policies and procedures. The Risk Management Unit is responsible for the review and updating of the delegation of authority. At the end of this financial year, work is currently being carried out to update this document due to changes in job titles and the expansion of job descriptions for Senior Officers.

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. During the year, two complaints were lodged with the Reserve Bank against licensed financial institutions. These complaints were regarding credit product terms and conditions, and accounts maintenance process. To address these complaints, the Bank held meetings with complainants and the licensed financial institutions. Both complaints were resolved by 30 July 2019.

Risk Management Corporate Plan Targets

In the approved revised Reserve Bank's Corporate Plan for 201819, the Risk Management Unit was allocated with eight specific measurable targets. A review of the calendar year corporate plan was carried out in March 2019 which revealed that the Unit achieved six targets while two targets were current work in progress. Targets related to draft Risk and Compliance Policy and the risk assessment of Currency activities which are to be completed before end of the year.

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.

In accordance with Section 25(1) of the National Reserve Bank of Tonga Act, a redesign concept was implemented into the new 5 and 10 seniti coins dated 2018. The changes focused on increasing the size of the numeral "5" and "10" also re-sizing and re-positioning all design elements on each coin to enable easiest visual identification of each denomination. The 5 and 10 seniti (2015 series) coins will remain in circulation and will co-exist with the 5 and 10 seniti coins bearing the new designs.

2015 Series	2018 Series
5 Seniti *(Reverse Side)*	
	
10 Seniti *(Reverse Side)*	
	
(Obverse Side) - for both 5 & 10 Seniti	
	

Currency in Circulation

As at 30 June 2019, total currency in circulation was T$90.6 million. The value of banknotes in circulation as at 30 June 2019 rose by 3.9% to T$86.5 million from the end of June 2018 (T$83.2 million). There were 34.7 million coins, worth T$4.1 million in circulation at the end of June 2019. The value of coins in circulation increased by 10.8% to T$4.1 million from the end of June 2018 (T$3.7 million). The increase in banknotes and coins in circulation was mainly attributed to the increase in lending, grants and donor funded projects.

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. All banknotes returned to the Reserve Bank through the Commercial Banks and public are processed and sorted for fitness by a note processing machine.

While the serviceable banknotes are easy to process and clear on a timely basis there are still challenges in trying process the unserviceable (poor quality) banknotes. The Currency Division invested in a new state-of-the-art note processing machine that can count, authenticate and sort these poor quality banknotes as and when received from the Commercial Banks.

As at 30 June 2019, T$83.8 million returned banknotes were processed. Of this, T$31.2 million were deemed fit for reissue while T$52.6 were deemed unfit.

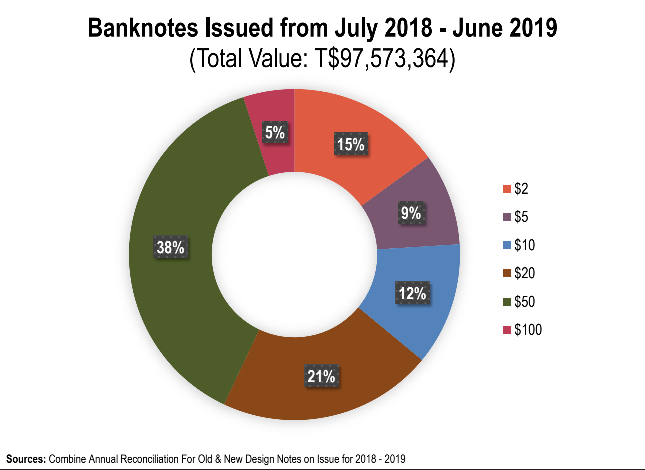
Table 13: Note Processing

July 2018 – June 2019		
Details	**Value** *($ Million)*	**Pieces** *(Million)*
Notes saved for reissue	31.2	0.7
Notes destroyed	48.2	1.1
Notes to be destroyed	4.4	0.8
Total Processed	83.8	2.6

Banking Transactions

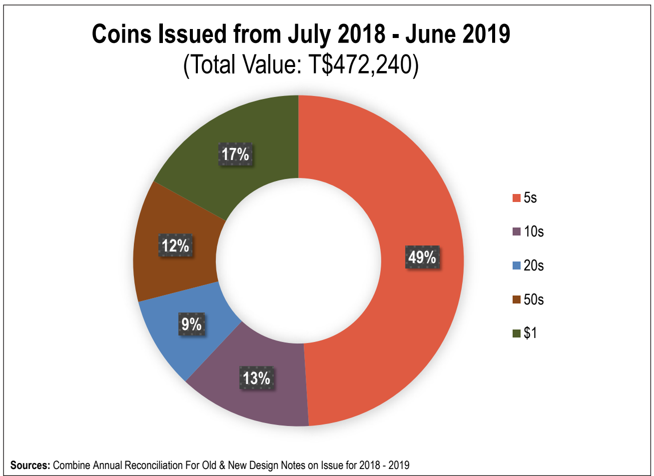
During the financial year 2018/19, the value of currency issued to the commercial banks and public was T$97.97 million, of which T$97.5 million was in banknotes and T$0.47 million in coins.

Figure 19: Banknotes Issued from July 2018 - June 2019



The T$20 and T$50 banknote continued to be widely used which demonstrate the public's growing reliance on higher denominations for daily transactions and demand for higher denomination banknotes through the ATMs.

Figure 20: Coins issued from July 2018 - June 2019



Numismatics

Numismatic or "collector" currency income as of 30 June 2019 amounted to T$196,542.01.

The Reserve Bank continued with the sale of its existing commemorative coins, circulating banknote and coin folder sets and other currency collectable items.

Currency Division Corporate Plan Targets

Under the Corporate Plan for 201819, the Currency Division was allocated with 4 targets of which all were achieved. The targets were related to availability of currency, currency stock, redeemed currency parcels and note trust depot in the outer islands. The Currency Division has put in place long term contracts with our bank notes and coin suppliers for the achievement of the currency availability and stock cover targets. In addition, the procurement and operations of the Cobra Machine assisted in the accomplishments of the counting/ destruction process of redeemed parcels targets and availability of the Currency staff to conduct the quarterly spot check of the Note Trust Depot in the outer islands.

Total Currency in circulation amounted to **TOP$90.6 million** at the end of June 2019

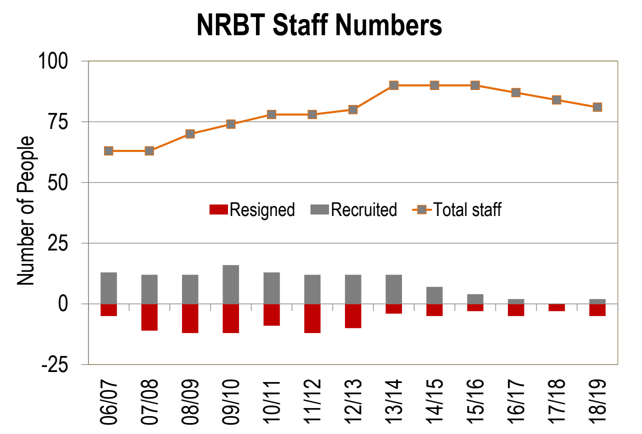
Corporate Services

Staffing

The Human Resources Department in the financial year 2018/2019 continued to focus on implementing its strategic targets to attract, develop and retain high performance employees. Similar to previous years, the Human Resource's policies were reviewed from time to time to meet and align with the emerging changes in the Reserve Bank. This includes the review of the Staff Terms & Conditions policy, Rules & Order, the Bank's Reward and Recognition, Staff benefits and Study Leave policy.

At the end of June 2019, the Reserve Bank maintained a staff of 81 employees, 20 per cent on fixed term contract, 78 per cent permanent employees and 2 per cent are new recruited staff who are still on probation. The staff on fixed term contract increased by 7%, mainly targeted to enhance the leadership role in each department hence strengthening staff capacity and at the same time support staff engagement in further studies and job attachments overseas. Of the 81 staff, 52 per cent are women and 48 per cent are men. The staff turnover in 2018/19 financial year slightly increased to 6% where 5 employees exited the Bank due to overseas migration and various reasons. Mr. Sione Vaka (Transport Supervisor) retired at the age of 63 from his service at the Bank after 27 years of service.

Figure 21: NRBT Staff



Source: National Reserve Bank of Tonga

To help build the Reserve Bank's capacity, 2 employees were recruited to the Economics Department and the Administration Department. With only 81 employees onboard, the Bank continued to facilitate and deliver its core responsibilities to achieve the Bank's objective and Strategic priorities.

To promote the Reserve Bank as the Employer of Choice, Human Resource continued to encourage staff continuous improvements of performance through carrying out annual appraisal performance 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 across Departments. The staff job descriptions and the organizational structure were reviewed and updated during the year to facilitate the emerging changes in the organization and its functions.

Training and Development

During the year, the Bank supported its staff to upskill and develop their capabilities and competencies through online courses, part time correspondence studies as well as professional full time studies overseas. The bank also invested in building the capacity of its staff through the attendance at meetings and workshops to address new risks to macroeconomic and financial stability such as de-risking of foreign exchange dealers accounts and correspondent banks, as well as climate change issues, cybersecurity and anti-money laundering. In 2018/19 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. One bank scholar graduated with postgraduate degrees from the Australian National University and two scholars are currently studying at Nagoya University, Japan and the University of Sydney, Australia. The Bank is again grateful to the Australian Award Scholarship program and the Pacific Leaders Educational Assistance for Development of States for these fully funded scholarships. The Assistant Governor Policy also took up a 2 year secondment at the IMF. The Bank also acknowledges the technical support

Above: Staff during the NRBT Golf Day 2018; promoting a healthy lifestyle.

Left: Mr. Sione Vaka receives the Bank's gifts as a token of appreciation during a Farewell Function marking his retirement.

and advisory services provided through the IMF, Pacific Financial Technical Assistance Centre (PFTAC),Asia Pacific Group (APG) and Alliance for Financial Inclusions (AFI) throughout the year.

Organizational Health and Safety

In 2018/19 financial year, the Bank continued to promote and encourage a healthy working environment by supporting staff to participate in corporate netball tournaments, golf tournaments and various health activities. The Reserve Bank believes that a healthy employee not only improves the self-confidence and health but it will also improve staff productivity and overall morale.

Human Resources Unit Corporate Plan Targets

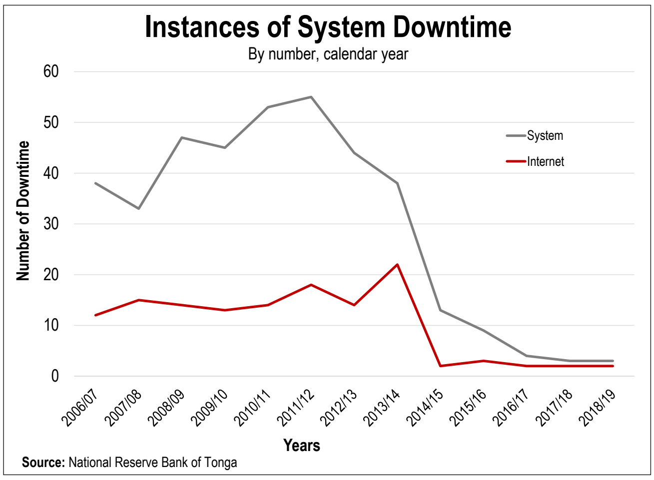
The Human Resource Unit was assigned with twenty-one Corporate Plan targets under the Reserve Bank's Corporate Plan for 201819. A review of the calendar year corporate plan was carried out in March 2019 showed that seventeen targets (80%) were achieved, two targets (10%) were currently work in progress and the remaining two targets (10%) were unachieved. Work in progress targets are set to be completed by end of the financial year and unachieved targets were due to other work priorities and being redefined realistically and rolled over to the new financial year.

Information Technology

The Information Technology (IT) Department continued to support the core functions of the Bank by, maintaining 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 2018/19 financial year, IT re-enforce the alignment of its processes and project implementation to international best practices and standards with emphasis on preventing and managing cyber-risk. The department continued to implement controls within the SWIFT system 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 department also conducted an Internal IT Audit; where critical system & services of the bank is thoroughly checked against the IT Policy and international standards to ensure the level of security is maintained and the corporate network is secured.

The IT Department also implemented various key projects during the year which includes: upgrade of the Secondary Domain Controller, upgrade of the network switch backbone infrastructure in with fibre optic cabling, and the upgrading of the Web Proxy server. The 2018/19 year was a challenging year for the IT department and the Bank as a whole, during the internet outage due to the cut in the fibre optic cable. The Bank has now implemented a satellite connection as a backup connection should such an event of this magnitude recurs again. The development of the National Payment System with the assistance of Third Party will continue on to the 2019/2020 financial year. Throughout the year, the IT Department continued to develop its staffs' technical skills through on-the-job trainings, professional training and self-learning.

Figure 22: Instances of System Downtime



IT Corporate Plan Targets

In the 2018/19 financial year, the IT Department reviewed its level of implementation and achievement of the Department Corporate Plan targets and achieved 70% of the targets. The remaining 30% were rolled over to the 2019/20 financial year.

Property, Security and General Administration

In 2018/2019 financial year, the Property Department continued to maintain the standards of the Bank's building, property, plant and equipment to uphold the welfare and promote a safe and secure working environment to its staff and tenants. This involved carrying out a number of refurbishment projects including converting of the 4th Floor into an International Conference Centre with state of the art technology that caters for the public's regional and international conferences as well as diversifying and generating more income for the Bank following the exit of one of its tenants. The Reserve Bank building was partially damaged by the Tropical Cyclone Gita and the Bank contracted an external contractor (Fletchers Ltd) to conduct the general repair works including exterior repainting of the entire building. The Bank continues to engage contractors to maintain and service the elevators, standby generator, physical and electronic security system to minimize risk and avoid any failure that can cause a disruption to the Bank's operation.

Security Unit

The Security Unit continued to carry out its responsibilities of ensuring the security and safety of the Bank's staff, tenants as well as the Bank's premises and assets at all times. It continued to assist the Property Division with ensuring the security and safety of the operations of the building, plant and equipment as well as additional security to the Meetings at the NRBT 4th Floor Conference Centre.

General Administration

The Administration Unit continued to provide support services to the other departments through its responsibilities for procurement of goods, organizing events, as well as manage the transport services. Records management, commitment budget, electronic filing system, and corporate communications systems are also support services provided by the Administration Unit.

Property, Security and General Administration Corporate Plan Targets

The Property Division Corporate Plan targets for the year ended 2018/2019 result in achieving 70% targets and the remaining 30% of the targets were reviewed and revised to complete in the next financial year 2019/2020.

In 2018/19 financial year, the Security Division managed to achieved 85% of it department's corporate plan targets by consistently upholding the department mission & vision by maintaining the safety and security of the Bank's assets, staff & tenants and also make sure to provide a conducive and secure work environment for all staff, tenants and bank's customers. The remaining 15% were re-prioritized and rolled over to the 2019/20 financial year.

Above: The first ever meeting to be held at the NRBT Level 4 Conference Centre by the World Meteorology Organization in October 2018.

Left: Day 1 of the Climate Change Donor Round Table meeting held in October 2018.

Below: Participants of the Climate Change Donor Round Table meeting during a morning tea break at the refreshment area of the Conference Centre.

Financial Performance

The gross income from operations for the year ended 30 June 2019 amounted to $14.33 million, compared to $11.38 million of the previous year. This largely comprises of interest income from overseas investments as a result of higher foreign reserves and better interest rates in the US. Fees and charges on conducting foreign exchange transactions were higher due to higher volumes of foreign exchange transactions in 2018/2019. Demand for numismatic notes and coins also resulted in the increase in the income on sales of numismatic notes and coins.

Other Income also increased by 47 percent due to the final insurance claim proceeds from damages to the building caused by Tropical Cyclone Gita in February 2018.

Total Expenditures incurred during the year was $8.33 million compared to $8.37 million, in the previous year. The 0.50 percent decline was due to the decrease in legal fees from PICB court case and the NRBT not hosting any special meetings or conference during the year compared to 2017/2018.

The net profit for the year ending 30 June 2019 was $6.00 million, compared to $3.01 million of the previous year. The financial result for 2018/2019 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$4.20 million will be paid to the Government.

Minister of Finance & National Planning, Dr. Pohiva Tu'i'onetoa, receives the dividend from Chairman of the Board.

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National Reserve Bank of Tonga Financial Statements

YEAR ENDED 30 JUNE 2019

National Reserve Bank of Tonga Financial Statements

For the year ended 30 June 2019

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Directors' Report

Financial Statements - for the year ended 30 June 2019

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 2019, 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 2019 was $6,000,600 (2018: $3,010,978).

4. GENERAL RESERVES

In accordance with Section 8(1)(b) of the National Reserve Bank of Tonga (Amendment) Act, 2014, the amount of $1,800,180 (2018: $903,293) 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 $4,200,420 (2018: $2,107,685) 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 the preparation of financial statements is appropriate and the Bank will be able to continue in operation for at least 12 months from the date of this statement. Accordingly the directors believe the classification and carrying amounts of assets and liabilities as stated in these financial statements to be appropriate.

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.

12. 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 23rd day of September, 2019.

....	....
Mr Steve Edwards	**Sione Ngongo Kioa**
Chairperson	**Governor**

Statement by Directors

Financial Statements - for the year ended 30 June 2019

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 2019;

(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 2019;

(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 2019;

(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 2019; 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 2019.

For and on behalf of the Board of Directors by authority of a resolution of the Directors dated this 23rd day of September, 2019.

....
Mr Steve Edwards
Chairperson

....
Sione Ngongo Kioa
Governor

pwc

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 2019, 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 2019 (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.

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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 managements 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 represents 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

23 September 2019
Suva, Fiji

Balance Sheet
as at 30 June 2019

	Notes	2019	2018
ASSETS		**$**	**$**
Foreign Currency Assets			
Short Term Investments and Current Accounts	8	456,351,580	440,571,670
Accrued Interest		11,598,190	10,240,857
International Monetary Fund (IMF)	9		
- Reserve Tranche Position		10,868,542	10,972,647
- Special Drawing Rights		17,087,464	17.186.574
Local Currency Assets			
Cash on Hand	18	11,826	24,586
Accrued Interest		35,678	20,664
Other Assets	10	10,818,563	10,547,514
International Monetary Fund - Currency Subscription	9	32,662,559	33,060,789
Property, Plant and Equipment	11	9,521,633	9,213,978
Total Assets		**548,956,035**	**531,839,279**
LIABILITIES			
Foreign Currency Liabilities			
Accrued Interest		7,116	4,916
Demand Deposits	12(a)	52,697,631	55,606,074
IMF Special Drawing Rights Allocation	9	20,812,134	21,011,485
Local Currency Liabilities			
Payable to Government	13	4,200,420	2,107,685
Demand Deposits	12(b)	244,039,067	228,859,354
Accrued Interest		30,012	22,671
Other Liabilities	16	2,188,550	1,454,941
Currency in Circulation	14	90,674,349	86,969,701
Statutory Reserve Deposits	15	56,734,000	54,868,000
International Monetary Fund - Currency Subscription	9	32,662,559	33,060,789
Employee Provisions	17	164,852	155,342
Total Liabilities		**504,210,690**	**484,120,958**
NET ASSETS		**44,745,345**	**47,718,321**
CAPITAL AND RESERVES			
Authorised Capital		5,000,000	5,000,000
Paid up Capital		5,000,000	5,000,000
General Reserves		15,130,790	13,377,850
Revaluation Reserve Account		24,614,555	29,340,471
TOTAL CAPITAL AND RESERVES		**$44,745,345**	**$47,718,321**

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

Statement of Comprehensive Income

for year ended 30 June 2019

	Notes	2019	2018
Income		**$**	**$**
Interest Income	4	11,733,041	8,981,339
Other Income	5	2,593,500	2,397,831
Total Operating Income		**14,326,541**	**11,379,170**
Expenses			
Interest expense	6	312,663	226,516
Administration and other expenses	7	7,997,875	8,141,676
Allowance for impairment losses		15,403	-
Total Operating Expenses		**8,325,941**	**8,368,192**
Net profit available for distribution		**6,000,600**	**3,010,978**
Net gains/(losses) arising from the translation of foreign currency balances to local currency		(4,725,916)	449,481
Other comprehensive income for the period		**(4,725,916)**	**449,481**
Total comprehensive income		**$1,274,684**	**$3,460,459**

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

Statement of Distribution

for year ended 30 June 2019

	Notes	2019	2018
		$	$
Net profit available for distribution		**$6,000,600**	**$3,010,978**
Distribution as follows:			
Transfer to General Reserves as required under Section 8(1)(b) of the National Reserve Bank of Tonga (Amendment) Act, 2014	2(n)	1,800,180	903,293
Balance Payable to Government of Tonga as required under Section 8(1) of the National Reserve Bank of Tonga (Amendment) Act, 2014		4,200,420	2,107,685
		$6,000,600	**$3,010,978**

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

Statement of Changes in Equity

for year ended 30 June 2019

	Paid up Capital	General Reserves	Revaluation Reserve Account	Total
	$	$	$	$
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**	**$47,718,321**
IFRS 9 transition impact through retained earnings (Note 2(a))	-	(47,240)	-	(47,240)
Net losses arising from the translation of foreign currency balances to Tongan currency	-	-	(4,725,916)	(4,725,916)
Transfer to General Reserves (as provided for under Section 8(1)(b) of the National Reserve Bank of Tonga (Amendment) Act 2014, and approved by the Minister of Finance	-	1,800,180	-	1,800,180
Balance 30 June 2019	**$ 5,000,000**	**$15,130,790**	**$24,614,555**	**$44,745,345**

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

Statement of Cash Flows

for year ended 30 June 2019

	Notes	2019	2018
CASH FLOWS FROM OPERATING ACTIVITIES		**$**	**$**
Interest received		10,360,694	11,382,391
Rental income		543,343	628,083
Numismatic sales		195,370	205,454
Other income		1,972,079	1,564,294
Purchase of currency		(1,853,242)	-
Interest paid		(303,121)	(242,561)
Payments to suppliers and employees		(4,471,720)	(6,205,044)
Net cash inflow from operating activities		6,443,403	7,332,617
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchase of fixed assets		(833,736)	(683,145)
Net movement in IMF accounts		203,215	(1,342,957)
Net movement in staff loans		(1,107,667)	(309,657)
Net cash used in investing activities		(1,738,188)	(2,335,759)
CASH FLOWS FROM FINANCING ACTIVITIES			
Increase in currency in circulation		3,704,649	11,751,076
Increase in demand deposits		12,271,270	13,272,723
Increase in statutory deposits		1,866,000	30,198,000
Net movement in Government of Tonga account		(2,107,685)	(1,996,814)
Net movement in funds held for clearance		252,968	(127,367)
Net movement in IMF SDR Allocation		(199,351)	972,522
Net cash inflow from financing activities		15,787,851	54,070,140
Net increase in cash and cash equivalents		**20,493,066**	**59,066,998**
Cash and cash equivalents at the beginning of the financial year		**$440,596,256**	**$381,079,777**
Net effect of change in exchange rates	**2 (b)**	**(4,725,916)**	**449,481**
Cash and cash equivalents at the end of the financial year	**18**	**$456,363,406**	**$440,596,256**

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

Notes To and Forming Parts of the Financial Statement

Financial Statements - for the year ended 30 June 2019

1. GENERAL INFORMATION

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.

These financial statements have been approved for issue by the Board of Directors on 23rd September 2019.

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, which has no regard to changes in the levels of prices. Unless otherwise stated, the accounting policies adopted are consistent with those of the previous year.

New and amended standards adopted by the Bank

i) IFRS 15 Revenue from Contracts with Customers

IFRS 15 establishes a comprehensive framework for determining whether, how much and when revenue is recognised. It replaced IAS 18 Revenue, IAS 11 Construction Contracts and related interpretations. Under IFRS 15, revenue is recognised when a customer obtains control of the goods or services. Determining the timing of the transfer of control - a point in time or over point in time - requires judgement.

The Bank has adopted IFRS 15 using the cumulative effective method with the effect of initially applying this standard recognised at the date of initial application (i.e., 1 July 2018) and applying the requirements to only contracts that are not completed contracts at the date of initial application. Accordingly, the information presented for 2017 has not been restated - i.e. it is presented, as previously reported, under IAS 18 and related interpretations. Additionally the disclosure requirements of IFRS 15 have not generally been applied to comparative information.

The adoption of IFRS 15 Revenue from Contracts with Customers did not impact the timing or amount at revenue from contracts with customers and the related assets and liabilities recognised by the Bank. Accordingly, the impact on comparative information is limited to new disclosure requirements of the standards.

ii) IFRS 9 Financial Instruments

The Bank has adopted IFRS 9 *Financial Instruments* issued in July 2014 with a date of initial application of 1 July 2018. The requirements of IFRS 9 represent a significant change from IAS 39 *Financial Instruments: Recognition and Measurement*.

As a result of the adoption of IFRS 9, the Bank adopted consequential amendments to IAS 1 *Presentation of Financial Statements* which requires impairment of financial assets to be presented in a separate line item in the statement of profit or loss and other comprehensive income. Previously, the Bank's approach was to include the impairment on financial assets in other expenses.

Additionally, the Bank adopted consequential amendments to IFRS 7 *Financial Instruments: Disclosures* that are applied to disclosures about 2018 but generally have not been applied to comparative information. The nature and effects of the key changes to the Bank's accounting policies resulting from its adoption of IFRS 9 are summarised below.

i. Classification of financial assets and financial liabilities

IFRS 9 contains three principal classification categories for financial assets: measured at amortised cost, fair value through other comprehensive income (FVOCI) and fair value through profit or loss (FVTPL). The classification of financial assets under IFRS 9 is generally based on the business model in which a financial asset is managed and its contractual cash flow characteristics. IFRS 9 eliminates the previous IAS 39 categories of held to maturity, loans and receivables and available for sale.

For an explanation of how the Bank classifies and measures financial assets and accounts for related gains and losses under IFRS 9, see Note 2(d).

The adoption of IFRS 9 has not had a significant effect on the Bank's accounting policies for financial liabilities.

ii. Impairment of financial assets

IFRS 9 replaces the 'incurred loss' model in IAS 39 with an 'expected credit loss' (ECL) model. The new impairment model applies to financial assets measured at amortised cost, contract assets, debt investment at FVOCI, but not to investments in equity instruments. Under IFRS 9, credit losses are generally recognised earlier than under IAS 39.

iii. Transition

Changes in accounting policies resulting from the adoption of IFRS 9 (2014) have been applied retrospectively, except as described below.

- Comparative periods have not been restated. Differences in the carrying amounts of financial assets and financial liabilities resulting from the adoption of IFRS 9 are recognised in general reserve as at 1 July 2018. Accordingly, the information presented for 2018 does not generally reflect the requirements of IFRS 9 and therefore is not comparable to the information presented for 2019 under IFRS 9.
- The determination of the business model within which a financial asset is held is an assessment that has been made on the basis of the facts and circumstances that existed at the date of initial application.
- If an investment in a debt security had low credit risk at the date of initial application of IFRS 9, then the Bank assumed that the credit risk on the asset had not increased significantly since its initial recognition.

iv. Classification of financial assets and financial liabilities on the date of initial application of IFRS 9

The following table shows the original measurement categories under IAS 39 and the new measurement categories under the IFRS 9 for each class of the Bank's financial assets and financial liabilities as at 1 July 2018.

	Original classification under IAS 39	New classification under IFRS 9	Original carrying amount under IAS 39 $'000	New carrying amount under IFRS 9 $'000
Financial assets				
Short term investment and current accounts	Held to maturity	Amortised cost	440,571,670	440,549,695
Accrued interest	Held to maturity	Amortised cost	10,261,521	10,260,685
Other assets	Loans and receivables	Amortised cost	10,547,514	10,523,177
International monetary fund	Loans and receivables	Amortised cost	61,220,010	61,219,918
Total financial assets			**522,600,715**	**522,553,475**

There were no changes to the classification and measurement of financial liabilities.

Reconciliation of impairment allowance balance from IAS 39 to IFRS 9

The following table reconciles the Bank's prior period's closing impairment allowance measured in accordance with the IAS 39 incurred loss model to the new impairment allowance measured in accordance with the IFRS 9 expected loss model at 1 July 2018:

Measurement category	Loan loss allowance under IAS 39	Reclassification	Re-measurement	Loan loss allowance under IFRS 9
	($)	($)	($)	($)
Loans and receivables (IAS 39)/Financial assets at amortised cost (IFRS 9)				
Short term investment and current accounts	-	-	21,975	21,975
Accrued interest	-	-	836	836
Other assets	-	-	24,337	24,337
IMF Balances	-	-	92	92
Total loan loss allowance			**47,240**	**47,240**

ii) IFRS 6 Leases

IFRS 16 'Leases' (IFRS 16) is applicable for annual reporting periods beginning on or after 1 January 2019. The Bank has applied IFRS 16 with a date of initial application of 1 July 2018, as permitted for entities that apply IFRS 15 at or before the date of initial application of IFRS 16.

In accordance with the transition provisions in IFRS 16 the new rules have been adopted retrospectively with the cumulative effect of initially applying the new standard recognised on 1 July 2018. Comparatives for the prior year have not been restated. The adoption of IFRS 16 resulted in changes in accounting policies and presentation. The nature and effects of the key changes to the Bank resulting from its adoption of IFRS 16 are summarised below.

The impact arising from adoption IFRS 16 was limited to changes in accounting policies, as the Bank does not enter into significant lease contracts as a lessee.

b) Foreign Currencies

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

Exchange gains and losses arising during the year from changes in the valuation of foreign currencies are taken to the Revaluation Reserve Account in accordance with the provisions of Section 33 of the 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 rate" (IAS 21). The impact of this in the statement of comprehensive income would be a decrease in net profit by $4,725,916 (2018: increase by $449,481).

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 Reserves 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) – Provisions for impairment of financial assets
Note 2 (i) – Provisions for employee entitlements

d) Financial Assets and Liabilities

Financial instruments

Policy applicable from 1 July 2018

i) Recognition and initial measurement

Debt securities issued are initially recognised when they are originated. All other financial assets and financial liabilities are initially recognised when the Bank becomes a party to the contractual provisions of the instrument.

A financial asset or financial liability is initially measured at fair value plus, for an item not at FVTPL, transaction costs that are directly attributable to its acquisition or issue.

ii) Classification and subsequent measurement

Financial assets

On initial recognition, a financial asset is classified as measured at: amortised cost; FVOCI - debt investment; FVOCI - equity investment; or FVTPL.

Financial assets are not reclassified subsequent to their initial recognition unless the Bank changes its business model for managing financial assets in which case all affected financial assets are reclassified on the first day of the first reporting period following the change in the business model.

A financial asset is measured at amortised cost if it meets both of the following conditions and is not designated as at FVTPL:

- it is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

A debt investment is measured at FVOCI if it meets both of the following conditions and is not designated as at FVTPL:

- it is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and
- its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

On initial recognition of an equity investment that is not held for trading, the Bank may irrevocably elect to present subsequent changes in the investment's fair value on OCI. This election is made on an investment by investment basis. All financial assets not classified as measured at amortised cost or FVOCI as described above are measured at FVTPL. This includes all derivative financial assets. On initial recognition, the Bank may irrevocably designate a financial asset that otherwise meets the requirements to be measured at amortised cost or at FVOCI as at FVTPL if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise.

Financial assets: Business model assessment

The Bank makes an assessment of the objective of the business model in which a financial asset is held at a portfolio level because this best reflects the way the business is managed and information is provided to management. The information considered includes:

- the stated policies and objectives for the portfolio and the operation of those policies in practice. These include whether management's strategy focus on earning contractual interest income, maintaining a particular interest rate profile, matching the duration of the financial assets to the duration of any related liabilities or expected cash outflows or realising cash flows through the sale of the assets;
- how the performance of the portfolio is elevated and reported to the Bank's management;
- the risks that affect the performance of the business model (and the financial assets held within that business model) and how those risks are managed;
- how managers of the business are compensated - e.g. whether compensation is based on the fair value of the assets managed or the contractual cash flows collected; and
- the frequency, volume and timing of sales of financial assets in prior periods, the reasons for such sales and expectations about future sales activity.

Transfers of financial assets to third parties in transactions that do not qualify for derecognition are not considered sales for this purpose, consistent with the Bank's continuing recognition of the assets. Financial assets that are held for trading or are managed and whose performance is evaluated on a fair value basis are measured at FVTPL.

Financial assets: Assessment whether contractual cash flows are solely payments of principal and interest

For the purposes of this assessment, "principal' is defined as the fair value of the financial asset on initial recognition. 'Interest' is defined as consideration for the time value of money and for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks and costs (e.g. liquidity risk and administrative costs), as well as a profit margin.

In assessing whether the contractual cash flows are solely payments of principal and interest, the Bank considers the contractual terms of the instrument. This includes assessing whether the financial asset contains a contractual term that could change the timing or amount of contractual cash flows such that it would not meet this condition. In making this assessment, the Bank considers:

- contingent events that would change the amount or timing of cash flows;

- terms that may adjust the contractual coupon rate, including variable rate features;
- prepayment and extension features; and
- terms that limit the Bank's claim to cash flows from specified assets (e.g. non-recourse features).

A prepayment feature is consistent with the solely payments of principal and interest criterion if the prepayment amount substantially represents unpaid amounts of principal and interest on the principal amount outstanding, which may include reasonable additional compensation for early termination of the contract.

Financial assets: Subsequent measurement and gains and losses

Financial assets at FVTPL

These assets are subsequently measured at fair value. Net gains and losses, including any interest or dividend income, are recognised in profit or loss.

Financial assets at amortised cost

These assets are subsequently measured at amortised cost using the effective interest method. The amortised cost is reduced by impairment losses. Interest income and impairment are recognised in profit or loss. Any gain or loss on derecognition is recognised in profit or loss.

Debt investments at FVOCI

These assets are subsequently measured at fair value. Interest income calculated using the effective interest method and impairment are recognised in profit or loss. Other net gains and losses are recognised in OCI. On derecognition, gains and losses accumulated in OCI are reclassified to profit or loss.

Equity investments at FVOCI

These assets are subsequently measured at fair value. Dividends are recognised as income in profit or loss unless the dividend clearly represents a recovery of part of the cost of the investment. Other net gains and losses are recognised in OCI and are never reclassified to profit or loss.

Policy applicable before 1 July 2018

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 financial assets that are not classified as fair value through profit or loss, 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 fair value plus transaction costs. 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.

Derecognition

Financial assets

The Bank derecognises a financial asset when the contractual rights to the cash flows from the financial asset expire, or it transfers the rights to receive the contractual cash flows in a transaction in which substantially all of the risks and rewards of ownership of the financial asset are transferred or in which the Bank neither transfers nor retains substantially all of the risks and rewards of ownership and it does not retain control of the financial asset. The Bank enters into transactions whereby it transfers assets recognised in its statement of financial position, but retains either all or substantially all of the risks and rewards of the transferred assets. In these cases, the transferred assets are not derecognised.

Financial liabilities

The Bank derecognises a financial liability when its contractual obligations are discharged or cancelled, or expire. The Bank also derecognises a financial liability when its terms are modified and the cash flows of the modified liability are substantially different, in which case a new financial liability based on the modified terms is recognised at fair value. On derecognition of a financial liability, the difference between the carrying amount extinguished and the consideration paid (including any non cash assets transferred or liabilities assumed) is recognised in profit or loss.

Modifications of financial assets

If the terms of a financial asset are modified, the Bank evaluates whether the cash flows of the modified asset are substantially different. If the cash flows are substantially different, then the contractual rights to cash flows from the original financial asset are deemed to have expired. In this case, the original financial asset is derecognised and a new financial asset is recognised at fair value. If the cash flows of the modified asset carried at amortised cost are not substantially different, then the modification does not result in derecognition of the financial asset. In this case, the Bank recalculates the gross carrying amount of the financial asset and recognises the amount arising from adjusting the gross carrying amount as a modification gain or loss in profit or loss. If such a modification is carried out because of financial difficulties of the borrower then the gain or loss is presented together with impairment losses. In other cases, it is presented as interest income.

Offsetting

Financial assets and financial liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Bank currently has a legally enforceable right to set off the amounts and it intends either to settle them on a net basis or to realise the asset and settle the liability simultaneously.

Impairment

Financial instruments

The Bank recognises loss allowances for ECLs on financial assets measured at amortised cost. The Bank measures loss allowances at an amount equal to lifetime ECL, except for the following, which are measured as 12 month ECL:

- debt securities that are determined to have low credit risk at the reporting date; and
- other debt securities and bank balances for which credit risk (i.e. the risk of default occurring over the expected life of the financial instrument) has not increased significantly since initial recognition.

When determining whether the credit risk of a financial asset has increased significantly since initial recognition and when estimating ECL, the Bank considers reasonable and supportable information that is relevant and available without undue cost or effort. This includes both quantitative and qualitative information and analysis, based on the Bank's historical experience and informed credit assessment and including forward looking information.

The Bank assumes that the credit risk on a financial asset has increased significantly if it is more than 30 days past due.

The Bank considers a financial asset to be in default when:

- the counter-party is unlikely to pay its credit obligations to the Bank in full, without recourse by the Bank to actions such as realising security (if any is held); or
- the financial asset is more than 90 days past due.

The Bank considers a debt security to have low credit risk when its credit risk rating is equivalent to the globally understood definition of 'investment grade'. The Bank considers this to be B or higher per rating agency Standards & Poor's.

Lifetime ECLs are the ECLs that result from all possible default events over the expected life of a financial instrument.

12 month ECLs are the portion of ECLs that result from default events that are possible within the 12 months after the reporting date (or a shorter period if the expected life of the instrument is less than 12 months).

The maximum period considered when estimating ECLs is the maximum contractual period over which the Bank is exposed to credit risk.

Measurement of ECLs

ECLs are a probability weighted estimate of credit losses. They are measured as follows:

- financial assets that are not credit-impaired at the reporting date: as the present value of all cash shortfalls (i.e. the difference between the cash flows due to the entity in accordance with the contract and the cash

flows that the Bank expects to receive);
- financial assets that are credit-impaired at the reporting date: as the difference between the gross carrying amount and the present value of estimated future cash flows; and
- ECLs are discounted at the effective interest rate of the financial asset.

Credit-impaired financial assets

At each reporting date, the Bank assesses whether financial assets carried at amortised cost are credit-impaired. A financial asset is ‘credit-impaired' when one or more events that have a detrimental impact on the estimated future cash flows of the financial asset have occurred.

Evidence that a financial asset is credit impaired includes the following observable data:

- significant financial difficulty of the borrower or issuer;
- a breach of contract such as a default or being more than 90 days past due;
- the restructuring of a receivable by the Bank on terms that the Bank would not consider otherwise;
- it is probable that the borrower will enter bankruptcy or other financial reorganisation; or
- the disappearance of an active market for a security because of financial difficulties.

Presentation of allowance for ECL in the statement of financial position

Loss allowances for ECL are presented in the statement of financial position as follows: financial assets measured at amortised cost: as a deduction from the gross carrying amount of the assets.

Write-off

The gross carrying amount of a financial asset is written off (either partially or in full) to the extent that there is no realistic prospect of recovery. This is generally the case when the Bank determines that the debtor does not have assets or sources of income that could generate sufficient cash flows to repay the amounts subject to the write off. However, financial assets that are written off could still be subject to enforcement activities in order to comply with the Bank's procedures for recovery of amounts due.

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) Coins sold as numismatic items

Policy applicable from 1 July 2018

Revenue is measured based on the consideration specified in a contract with a customer. The Bank recognises revenue when its transfers control over a good or service to a customer.

The following table provides information about the nature and timing of the satisfaction of performance obligations in contracts with customers.

Products and services	Nature, timing of satisfaction of performance obligations and significant payment terms	Revenue recognition under IFRS 15 (applicable from 1 July 2018)
Sale of numismatic coins	Sales include the selling of numismatic to the customer. Performance obligation is satisfied when the customer receives the numismatic coins. Hence, revenue is recognised at a point in time.	Revenue and associated costs are recognised when the goods are provided - i.e. when the numismatic is issued to the customer and payment is due immediately when the goods are provided to the customers.

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.

g) Income Tax

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

h) 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%

i) 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.

j) Cash and cash equivalents

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

k) Revenue

Interest income

Interest income is recognised using the effective interest method. The 'effective interest rate' is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to:

- the gross carrying amount of the financial asset; or
- the amortised cost of the financial liability.

In calculating interest income, the effective interest rate is applied to the gross carrying amount of the asset (when the asset is not credit impaired) or to the amortised cost of the liability. For financial assets measured at amortised cost, the effective interest rate method is used to measure the interest income recognised in the Statement of Profit or Loss and Other Comprehensive Income.

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.

l) Provisions

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

m) 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.

n) Revaluation Reserve

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

o) Leases

Policy applicable from 1 July 2018

As a lessee

Assets and liabilities arising from a lease are initially measured on a present value basis.

Lease liabilities include the net present value of the following lease payments:

- fixed payments (including in-substance fixed payments), less any lease incentives receivable
- variable lease payment that are based on an index or a rate
- the exercise price of a purchase option if the lessee is reasonably certain to exercise that option, and
- payments of penalties for terminating the lease, if the lease term reflects the lessee exercising that option.

The Bank does not have leases which contain the following:

- amounts expected to be payable by the lessee under residual value guarantees

The lease payments are discounted using the interest rate implicit in the lease, if that rate can be determined, or the Bank's incremental borrowing rate. Right-of-use assets are measured at cost comprising the following:

- the amount of the initial measurement of lease liability

Right-of-use assets are subsequently depreciated using the straight line method from the commencement date to the earlier of the end of the useful life of the right-of-use asset, or the end of the lease term. The estimated useful lives of right-of-use assets are determined on the same basis as those of property and equipment. In addition, the right-of-use asset is periodically reduced by impairment losses, if any, and adjusted for certain re-measurements of the lease liability.

Cash payments for the principal portion of the lease liabilities are presented as cash flows from financing activities. Cash payments for the interest portion are presented as cash flows from operating activities, consistent with presentation of other interest payments. Short-term lease payments, payments for leases of low-value assets and variable lease payments that are not included in the measurement of the lease liabilities are presented as cash flows from operating activities.

As a lessor

When the Bank acts as a lessor, it determines at lease inception whether each lease is a finance lease or an operating lease.

To classify each lease, the Bank makes an overall assessment of whether the lease transfers substantially all of the risks and rewards incidental to ownership of the underlying asset. If this is the case, then the lease is a finance lease; if not, then it is an operating lease. As part of this assessment, the Bank considers certain indicators such as whether the lease is for the major part of the economic life of the asset.

If an arrangement contains lease and non-lease components, the Bank applies IFRS 15 to allocate the consideration in the contract.

Lease income from operating leases where the Bank is a lessor is recognised in income on a straight-line basis over the lease term. The respective leased assets are included in the balance sheet based on their nature.

p) Functional and Presentation Currency

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

q) 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 NRBT 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.

	2019	2018
	$	$
Foreign currency assets		
Short Term Commercial Paper and current accounts	456,351,580	440,571,670
Local currency assets		
Staff loans	3,048,770	1,954,549
Total financial investments	**$ 459,400,350**	**$ 442,526,219**

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	2019	2018
		$	$
Australia	AAA	450,584	201,012
	AA-	141,811,842	179,231,751
	A+	85,121,654	49,771,220
New Zealand	AA	169,944	292,646
	AA-	153,749,881	122,126,420
United States of America	AA+	30,249,423	10,940,496
Switzerland	AAA	44,528,322	77,736,476
United Kingdom	AA	228,197	250,549
Fiji	B+	43,689	21,100

Tonga	N/R	3,062,216	1,954,549
		$ 459,415,753	**$ 442,526,219**
Less: Allowance for impairment losses		(15,403)	-
Total Financial Investments		**$ 459,400,350**	**$ 442,526,219**

(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 2019.

Maturity Analysis as at 30 June 2019

	0-3 Months	**3-12 months**	**1-5 years**	**Over 5 Years**	**No Specific maturity**	**Total**
Foreign Currency Assets						
Short Term Investments and current accounts	31,746,628	330,863,046	93,741,906	-	-	456,351,580
Accrued Interest	11,598,190	-	-	-	-	11,598,190
IMF						
• Reserve Tranche position	10,868,542	-	-	-	-	10,868,542
• Special drawing Rights	17,087,464	-	-	-	-	17,087,464
Local Currency Assets						
Cash on hand	11,826	-	-	-	-	11,826
Accrued Interest	35,678	-	-	-	-	35,678
Other Assets	10,818,563	-	-	-	-	10,818,563
IMF - Currency Subscription	32,662,559	-	-	-	-	32,662,559
Property, Plant,& Equipment		-	-	-	9,521,633	9,521,633
Total Assets	**114,829,450**	**330,863,046**	**93,741,906**	**-**	**9,521,633**	**548,956,035**
Foreign Currency Liabilities						
Accrued Interest	7,116	-	-	-	-	7,116

Demand Deposits	52,697,631	-	-	-	-	52,697,631
IMF Special Drawing Rights Allocation	-	-	-	-	20,812,134	20,812,134
Local Currency Liabilities						
Payable to Government	4,200,420	-	-	-	-	4,200,420
Demand Deposits	244,039,067	-	-	-	-	244,039,067
Accrued Interest	30,012	-	-	-	-	30,012
Other Liabilities	-	2,188,550	-	-	-	2,188,550
Currency in Circulation	90,674,349	-	-	-	-	90,674,349
Statutory Reserve Deposits	-	-	-	-	56,734,000	56,734,000
IMF - Currency Subscription	-	-	-	-	32,662,559	32,662,559
Employee Provisions	-	6,379	124,908	33,565	-	164,852
Total Liabilities	**391,648,595**	**2,194,929**	**124,908**	**33,565**	**110,208,693**	**504,210,690**
Net Assets	**(276,819,145)**	**328,668,117**	**93,616,998**	**(33,565)**	**(100,687,060**	**44,745,345**

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
Foreign Currency Assets						
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
Local Currency Assets						
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
Total Assets	**171,978,318**	**350,646,983**	**-**	**-**	**9,213,978**	**531,839,279**
Foreign Currency Liabilities						
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
Total Liabilities	**286,600,700**	**1,460,576**	**46,174**	**103,533**	**195,909,975**	**484,120,958**
Net Assets	**(114,622,382)**	**349,186,408**	**(46,174)**	**(103,533)**	**(186,695,997)**	**47,718,321**

(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 2019 in Tonga Pa'anga equivalents.

	2019	2018
	$	$
United States Dollar	236,127,852	189,981,905
Australian Dollar	68,971,731	70,720,377
Great Britain Pound	232,989	255,454
New Zealand Dollar	109,853,991	134,210,294
Other	7,204,290	7,181,243
Total Net Foreign Exchange Position	**422,390,852**	**402,349,273**

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:	**2019**	**2018**
Change in equity due to a +/-5% appreciation / depreciation of the Tonga Pa'anga	21,119,543	20,117,474
Change in profit/loss due to a rise/drop of +/-1 percentage point in interest rate	115,911	102,361

4. INTEREST INCOME

	2019	**2018**
	$	**$**
Overseas investments	11,620,675	8,901,300
Staff loans	112,366	80,039
	$ 11,733,041	$ 8,981,339

5. OTHER INCOME

	2019	**2018**
	$	**$**
Numismatic coins	195,370	247,517
Rental income	426,051	628,083
Gain on sale of assets	-	-
Forex sales/ purchases	1,353,076	1,162,876
Bank user fees	42,603	55,441
Miscellaneous	576,400	303,914
	$ 2,593,500	$ 2,397,831

6. INTEREST EXPENSE

	2019	2018
	$	$
Foreign currency accounts	218,515	143,840
Domestic currency accounts	94,148	82,676
	$ 312,663	$ 226,516

7. ADMINISTRATION AND OTHER EXPENSES

	2019	2018
	$	$
Administration	2,381,704	2,776,686
Retirement fund	466,695	456,479
Staff costs	3,254,814	3,135,203
Audit fees	30,000	30,197
Currency issue	1,338,582	1,206,726
Depreciation	526,080	536,445
	$ 7,997,875	$ 8,141,676

8. SHORT TERM INVESTMENTS AND CURRENT ACCOUNTS

	2019	2018
	$	$
Current accounts	31,746,628	12,300,196
Short term investments	424,606,909	428,271,474
	456,353,537	440,571,670
Less: Impairment allowances for financial instruments	(1,957)	-
	$456,351,580	$ 440,571,670

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 2019, Tonga's membership subscription to the International Monetary Fund was SDR13,800,000 (2018: SDR13,800,000). Of this total amount, SDR3,436,633 (2018: 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 2019, the Special Drawing Rights holdings had a balance of SDR5,403,056 (2018: SDR5,382,835).

10. OTHER ASSETS

	2019	2018
	$	$
Staff loans and advances	3,062,216	1,954,549
Currency and numismatics	5,376,842	4,862,182
Other assets	2,392,951	3,730,783
	10,832,009	10,547,514
Less: Impairment allowance for staff loans	(13,446)	
	$ 10,818,563	$ 10,547,514

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
At 30 June 2017						
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
Year Ended 30 June 2018						
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
At 30 June 2018						
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**
Year Ended 30 June 2019						
Opening net book value	7,574,804	976,966	17,120	107,733	537,354	9,213,978
Additions	172,406	298,217	107,459	-	255,654	833,736
Net Transfer/Disposal	537,354	-	-	-	(537,354)	-
Depreciation	(240,044)	(200,250)	(42,442)	(43,345)	-	(526,080)
Closing net book value	8,044,520	1,074,934	82,137	64,388	255,654	9,521,633
At 30 June 2019						
Cost	10,807,164	2,179,331	248,084	364,249	255,654	13,854,483
Accumulated Depreciation	(2,762,645)	(1,104,398)	(165,947)	(299,861)	-	(4,332,850)
Net Book Amount	**8,044,520**	**1,074,934**	**82,137**	**64,388**	**255,654**	**9,521,633**

12. (a) FOREIGN CURRENCY DEMAND DEPOSITS

	2019	2018
	$	$
Government of Tonga	52,646,007	55,551,957
Other institutions	51,624	54,117
	$ 52,697,631	$ 55,606,074

(b) LOCAL CURRENCY DEMAND DEPOSITS

	2019	2018
	$	$
International banks	119,000	53,666
Domestic banks	154,795,770	175,855,128
Government of Tonga	89,124,297	52,950,560
	$ 244,039,067	$ 228,859,354

13. PAYABLE TO GOVERNMENT

	2019	2018
	$	$
Amount payable to government in accordance with Section 8(1) of the National Reserve Bank of Tonga (Amendment) Act 2014	$ 4,200,420	$ 2,107,685

14. CURRENCY IN CIRCULATION

	2019	2018
	$	$
Notes	86,565,966	83,212,153
Coins	4,108,383	3,757,548
	$ 90,674,349	$ 86,969,701

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.

16. OTHER LIABILITIES

	2019	2018
	$	$
Other creditors and accruals	1,269,429	1,080,289
NRBT Staff Provident Scheme	919,121	374,652
	$ 2,188,550	**$ 1,454,941**

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

	2019	2018
	$	$
Opening balance	155,342	132,711
Entitlements during the year	237,284	277,101
Utilised/reversals	(227,774)	(254,470)
	$ 164,852	$ 155,342

18. CASH AND CASH EQUIVALENTS

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

	2019	2018
	$	$
Cash on hand	11,826	24,586
Short term investments and current accounts	456,351,580	440,571,670
	$ 456,363,406	$ 440,596,256

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 2019 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).

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 $68,553 (2018: $81,784).

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:

	2019	2018
	$	$
Provident Fund payments made by the Bank	466,695	456,479
	$ 466,695	$ 456,479

The funds of the National Reserve bank of Tonga Staff Provident Fund are invested within the Bank at an average rate of 3.42% (2017: 3.67%) per annum. The total interest paid by the Bank for the financial year amounted to $11,002 (2018: $8,411). 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:

	2019	2018
	$	$
Purchase of goods	NIL	NIL

The Directors are paid fees and sitting allowances for services rendered. The Directors entitlements to the retirement fund at year end amounted to $244,819 (2018: $220,629). The Bank also provides non-cash benefits to the Executive officers in addition to their salaries.

Total remuneration below is included in 'administrative costs'

	2019	2018
	$	$
Executive officers	257,536	315,980
Director's fees and allowances	121,900	107,320
	$ 379,436	$ 423,300

20. COMMITMENTS

(a) 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:

	2019	2018
	$	$
Due not later than one year	336,307	238,203
Due later than one year but not later than five years	370,688	114,213
	$ 706,995	$ 352,416

(b) Capital and other commitments

	2019	2018
	$	$
Commitment not provided for in the financial statements are as follows:	$ 255,654	$537,354

21. CONTINGENT LIABILITIES

Contingencies not otherwise provided for in the accounts and which existed at 30 June 2019 comprise:

(i) Contracts for foreign exchange transactions was nil (2018: $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.