NATIONAL RESERVE BANK OF TONGA

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OFFICIAL PRESS RELEASE

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Monetary Policy Decision

The National Reserve Bank of Tonga's board of directors at its meeting on the 15th February 2018 approved to maintain its current monetary policy measures outlined below. This is to encourage utilisation of the excess liquidity in the banking system, through further lending, particularly to the growth sectors, in order to support economic growth, and strengthen the monetary policy transmission mechanism.

a. maintain the monetary policy rate at 0% (zero interest rate policy);
b. maintain the minimum loans/deposit ratio of 80%;
c. maintain the Statutory Reserve Deposit ratio at 10%; and
d. maintain the inflation reference rate at 5%.

The Governor of the Reserve Bank, Sione Ngongo Kioa, reported that the performance of all sectors of the domestic economy was favorable except for the agricultural sector recording lower export volume in December 2017. The on-going construction activities continued to boost performance in the secondary sector, which coincided with a growth in individual housing loans and loans for business construction respectively. The tertiary sector improved over the month, supported by the continuous increase in total lending. Total air arrivals increased as people travelled for vacation and to spend Christmas with their respective families, which is in line with a rise in travel receipts. In addition, total number of container registrations increased driven by rise in both private and business containers. Similar to previous years, total vehicle registrations rose due to higher light and heavy vehicles and cars registered. Electricity production slightly increased and more customers were recorded during the month. Agricultural exports, on the other hand, declined largely due to the end of the squash season.

The banking system remained sound maintaining strong capital position, supported by comfortable profitability, and non-performing loans continued to remain low. Liquidity in the banking system (reserve money) fell over December, driven by a decline in deposits by the commercial banks to the Reserve Bank vault. The banks' total loans to deposit ratio increased which reflected an increase in total lending outweighing the rise in total deposits. This continues to remain below the minimum loan to deposit ratio of 80% which indicates excess liquidity in the banking system remains and that there is capacity for further lending by banks. The weighted average interest rate spread narrowed over December to 5.784%. This resulted from a decline in the weighted average lending rate coupled with an increase in the weighted average deposit rate.

The foreign reserves declined to $422.5 million in December 2017 due mainly to higher import payments. This is equivalent to 7.8 months[1] of import cover, which is still above the Reserve Bank's minimum range of 3 – 4 months.

The annual headline inflation rose by 5.5% over the year to December 2017. Imported prices rose due to higher prices of imported food, tobacco, and petroleum prices. These included imported commodities such as fruits & vegetables, lamb flaps, chicken pieces, flour, winfield blue cigarettes, petrol and diesel. The local component of inflation also rose which was attributed to the rise in prices of electricity, kava-Tonga, house maintenance services, and seasonality of local food.

The Reserve Bank in its August 2017 Monetary Policy Statement expected a strong real GDP growth of 4.0% in 2017/18, higher than the 3.4% growth projected by the IMF Article IV mission in September 2017. The level of foreign reserves is also expected to remain at comfortable levels supported by expected higher receipts of remittances and foreign aid. This will be partially offset by the projected rise in imports. Upward inflationary pressure remains in the near term, however it is expected to fall below the Reserve Bank's inflation reference rate of 5% per annum in 2017/18. The adverse weather conditions and higher import prices pose a risk to these favorable projections.

The Governor concluded that the Reserve Bank will continue to closely monitor developments in the domestic and global economy and update its monetary policy setting, to maintain internal and external monetary stability, and to promote a sound and efficient financial system in order to support macroeconomic stability and economic growth. The Reserve Bank will also remain vigilant and continue to closely monitor developments for early signs of vulnerabilities which may indicate overheating of the economy.

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[1] Methodology used for this calculation has changed to include both imports of goods and services whilst the calculation used in previous reports used import of goods only