NATIONAL RESERVE BANK OF TONGA

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OFFICIAL PRESS RELEASE

16 March 2018

Monetary Policy Decision

The National Reserve Bank of Tonga's board of directors at its meeting on the 15th March 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 the recovery from Tropical Cyclone Gita, 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, stated that the monthly economic indicators mirrored usual trend in January of every year showing slower growth in economic activities. The supply of root crops in the domestic market were abundant whilst the supply of local fruits and vegetables declined due to seasonality. The agricultural export volume continued to fall over the month of January, due to a decrease in the export of coconuts and squash although the volume of exported root crops rose. Performance of the secondary sector slowed over the month as lending for individual housing and business manufacturing loans declined. Business construction loans, on the contrary, slightly rose. The tertiary sector slightly improved over the month, supported by the rise in total lending particularly higher lending to the trade and tourism sectors increased which may indicate a vibrant services sector. Although total air arrival passengers declined, travel receipts slightly rose.

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) slightly fell over January due mainly to the decline in currency in circulation as the commercial banks deposited cash back to the Reserve Bank vault following the busy Christmas festive month of December. The banks' total loan to deposit ratio slightly decreased which reflected an increase in total deposits outweighing the rise in total lending. This ratio continues to remain below the 80% loan to deposit ratio target 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 January, which resulted from a rise in the weighted average deposit rate outweighing the increase in the weighted average lending rate.

The foreign reserves rose to $424.1 million in January 2018 due mainly to lower import payments. This is equivalent to 7.7 months[1] of import cover, which is still above the Reserve Bank's minimum range of 3 – 4 months.

The headline inflation for the month is yet to be released by the Statistics Department. However, the Reserve Bank expects the annual headline inflation rate to increase further in January 2018 to 5.7% from the 5.5% recorded in December 2017. This anticipated higher inflation rate is due to higher expectations in the prices of food, transportation, alcohol, electricity and kava-Tonga.

While the outlook is promising in the years ahead as projected by the Reserve Bank in its August 2017 Monetary Policy Statement, this growth outlook is affected by the Tropical Cyclone Gita. 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 and expected to remain above the Reserve Bank's inflation reference rate of 5% per annum in 2018. 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