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 board meeting on the 30 June 2022, approved to maintain its current accommodative monetary policy stance while working in tandem with the Government to support economic recovery and macroeconomic stability. The following monetary policy measures are adopted:

To stimulate economic growth and support macroeconomic recovery while continuing to closely monitor developments in inflation, the Reserve Bank will:

a. Maintain the monetary policy rate at 0% (zero interest rate policy).
b. Maintain the current weights in the Exchange rate basket.
c. Maintain the minimum loans/deposit ratio at 70%.
d. Maintain the Statutory Reserve Deposit ratio at 10%.
e. Maintain the inflation reference rate at 5%.
f. Develop an enabling financial infrastructure to support prudent credit growth (credit registry, bankruptcy laws, land administration).
g. Explore other tools to encourage higher credit growth (loan guarantee, interest rate subsidy)
h. Collaborate with MOF to foster compatibility of fiscal and monetary policy objectives supporting inclusive and sustainable growth.
i. Explore ways to strengthen the monetary policy transmission mechanism.

In addition, to maintain a stable sound, and efficient financial system, conducive to macroeconomic stability and growth the Reserve Bank will:

j. Enhance financial sector supervision.
k. Maintain clear channels of effective communications with the financial institutions to ensure delivery of essential financial services to the public, especially during pandemic-related lockdown periods.
l. Modernise and improve the efficiency of the payments system, including by completing the rollout of the Domestic Electronic Payment System (DEPS) for increased automation of the settlement/clearing system.
m. Continue to implement measures to combat de-risking by global and local banks in order to retain banks' correspondent bank accounts and foreign exchange dealers' bank accounts.

The Governor of the Reserve Bank, Sione Ngongo Kioa, reported that the ongoing supply-side disruptions in the global markets resulting from the Russia-Ukrainian war, the faded pent-up demand, and the withdrawal of substantial policy support continue to put upward pressure on inflation amidst weaker global growth, putting the global economy at risk of stagflation. As an import-dependent economy, the stronger oil, food, and commodity prices will flow on to Tonga's inflation which can slow down economic recovery and quickly deplete real income. Central Banks including our major trading partner countries have already tightened monetary policies in an attempt to curb inflation.

In April 2022, domestic activities are gradually returning to normal operations following the Covid-19 outbreak in March 2022. The agricultural sector shows a slight recovery from the Hunga Tonga – Hunga Ha'apai (HTHH) disaster earlier in the year, although not as strong as the previous year. Agricultural export volumes rose by 184.5 tonnes attributed to a rise in cassava and Kava Tonga exports in April 2022. The secondary sector anticipates some positive movements from the rollout of the Government reconstruction projects from the HTHH disaster. At the same time, the production cost is also trending up in line with the higher energy prices. The majority of the services sector businesses were able to resume operations in April with some restrictions observed particularly for social distancing. Business container registrations increased by 5.5% depicting a more active trade sector as restrictions ease.

Headline inflation peaked at 9.4% over the year to April which is still above the 5% reference rate. Import prices rose on the back of higher prices of fuels, food items, construction materials, and liquefied petroleum gas. These movements reflect the impacts of the shocks in the global markets from the pandemic and the war, which are beyond the control of the Reserve Bank. Domestic prices also rose due to higher local food items and electricity prices, reflecting the impact of the HTHH disaster on local food supply and the pass-through of imported fuel prices to domestic energy prices. Core inflation (excluding energy and imported food) is at 5.6% indicating that the elevated inflationary pressure is mostly driven by energy prices.

Official foreign reserves rose by $22.6 million during April 2022 to $884.0 million, which is equivalent to 12.6 months of import cover. This is well above the Reserve Banks' minimum threshold of 3 months, and the IMF's optimal level of 7.3 months of import cover. In the year to April 2022, foreign reserves increased substantially by $204.4 million. This is mainly attributed to receipts of budget support, relief funds, official grants, capital inflows, and remittances.

The financial system is still sound, supported by strong capital positions, high liquidity, and adequate profitability. Reserve money and broad money expanded over the year by 34.3% and 18.5%, respectively. Meanwhile, credit growth is still negative over the year by 4.4%, while total deposits increased by 17.6% resulting in a lower loans to deposit ratio of 53.9% from 54.6% in March 2022. This is still below the new minimum threshold of 70%. Non-performing loans is slowly climbing to 4.8% of total loans reflecting the impact of the HTHH disaster and the Covid-19 lockdowns on both businesses and households. The weighted average interest rate spread widened over the year, as the weighted average lending rates increased while the weighted average deposit rates declined.

On the outlook, the Reserve Bank projects a contraction in GDP growth for FY 2021/22 as a result of the severe damages from the HTHH volcanic eruption and tsunami in January 2022, and the Omicron outbreak in February 2022. A moderate recovery is projected for FY 2022/23 in line with the anticipated reconstruction works and the re-opening of the international border. Inflation is expected to remain elevated in the near term in line with the rising global prices, before easing below the 5% reference rate by early 2023 as supply-side disruptions dissipate and the domestic economy recovers from the impacts of the HTHH disaster. The financial system is expected to remain sound with adequate capital to absorb any shocks to the system.

Against the background of stagnant economic growth and high inflation, the Reserve Bank considers its current accommodative monetary policy stance appropriate at this time to work in tandem with the fiscal policies in reviving the economy and preventing any further contraction in growth. This includes exploring measures to utilise the excess liquidity in the banking system. With regards to inflation, the Reserve Bank notes that these pressures are supply-driven and are beyond its control. Our major trading partner countries are already fighting inflation through the tightening of their monetary policies which will flow through in import prices to Tonga's inflation. Meanwhile, the Reserve Bank continues to engage in discussions on measures to curb inflation and address domestic food inflation.

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