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 31st July 2017 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 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% effective in July 2017; and
d. maintain the inflation reference rate at 5%.

The Governor of the Reserve Bank, Sione Ngongo Kioa, highlighted that the local partial indicators for May 2017 reflected mixed growth in the domestic economy. Performance in the primary sector improved where the agricultural exports rose due mainly to higher exports of root crops. The activities in the secondary sector continued to grow as reflected in the continued growth in housing loans over the month supporting the construction sector. The services sector indicated strong growth over the month as container registrations rose by 24.5%, and international air arrivals increased by 21.0%.

The banking system remained sound maintaining strong capital position, supported by comfortable profitability, and continued low non-performing loans. Liquidity in the banking system (reserve money) increased over the month to $284.8 million due mainly to higher cash deposits made by the commercial banks to the Reserve Bank vault. The loans to deposit ratio of banks remained below the 80% loan to deposit ratio target which indicate that excess liquidity in the banking system remains and the capacity for further lending by the banks exists. Furthermore, the weighted average interest rate spread narrowed slightly to 5.682% in May due to a decline in the weighted average lending rate which outweighed a fall in the weighted average deposit rate. The foreign reserves rose by $20.6 million to $392.3 million in May 2017 due mainly to the receipt of the budgetary support and grants by Government during the month. This is equivalent to 7.2 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 10.0% over the year to May 2017. This was due to mainly to a 11.8% rise in imported prices which largely reflected the impact of the new customs duty and excise tax introduced in July 2016. Similarly, the domestic annual inflation rate rose by 7.8% largely driven by the seasonality of local food, rise in electricity price, and the continued short supply of kava-Tonga.

The Reserve Bank's expectation for strong economic activity remains in the near term. The level of foreign reserves is also projected to remain adequate supported by estimated higher receipts of remittances and foreign aid and this will be partially offset by the expected increase in imports. Upward inflationary pressure remains in the near term due mainly to the impact of the new customs duty and excise tax effective on 1st July 2016, although it is expected to fall below the Reserve Bank's inflation reference rate of 5% per annum in 2017/18. However, adverse weather conditions and higher import prices poses 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