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 17th January 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 partial indicators of domestic activity were mixed in November but overall, broadly positive. According to the Reserve Bank's liaison program with growers in the domestic agricultural market, availability of crops during November was favorable compared to last month. Electricity consumption rose and more customers were recorded during the month. On-going construction activity continued to boost performance in the secondary sector, which coincided with a growth in individual housing loans. The financial sector remained strong during the month, supported by increase in lending. On the other hand, other partial indicators in the tertiary sector declined. Total air arrivals declined, in line with a decrease in travel receipts. In addition, total number of container registrations decreased, attributed to the lower number of business containers which outweighed the slight increase in private containers.

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) increased over November, driven significantly by an increase in deposits by the commercial banks to the Reserve Bank vault. The banks' total loans to deposit ratio rose slightly which reflected an increase in total lending outweighing the rise in total deposits. 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 November to 5.809%. This resulted from declines in both weighted average lending rate and weighted average deposit rate.

The foreign reserves increased to $424.8 million in November 2017 due to higher receipts for both telecommunication services and travel related services. This is equivalent to 7.6 months[1] of import cover, which is still above the Reserve Bank's minimum range of 3 – 4 months.

The headline inflation for November is yet to be released by the Statistics Department. However, the Reserve Bank expects the annual headline inflation rate to slow down from 6.1% recorded in October 2017 to 5.8% in November 2017. The inflation rate is expected to be driven by the prices of food, transportation, alcohol, electricity and kava-Tonga.

The Reserve Bank's outlook for strong domestic economic activity remains in the medium term. 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 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