NATIONAL RESERVE BANK OF TONGA

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OFFICIAL PRESS RELEASE

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Monetary Policy Statement for February 2018

At its meeting on the 18th September 2018, the National Reserve Bank of Tonga's Board of Directors approved to release its Monetary Policy Statement (MPS) for February 2018. This Statement reviews Tonga's economic growth and the Reserve Bank's conduct of monetary policy in the six months to February 2018 and its outlook.

The Reserve Bank maintained its accommodative monetary policy stance which supported the monetary policy objectives of maintaining internal and external monetary stability, promoting financial stability and a sound and efficient financial system and conducting its activities in a manner that supports macroeconomic stability and economic growth.

The Statistics Department has released its preliminary estimates of Real Gross Domestic Product (GDP) growth for 2016/17 of 5.0%, driven by the industrial and services sectors. Tonga's economic performance for 2017/18 remain positive despite the devastation caused by Tropical Cyclone (TC) Gita in February 2018. The Real GDP growth for 2017/18 has been revised downward from 4.0% to 3.1% due to downward revision to growth in the trade, agricultural, utility, fisheries, transport & communication and ownership of dwellings sectors.

Inflationary pressures eased in February 2018, falling below the Reserve Bank's 5% reference rate. This was the lowest headline inflation since it started rising in July 2016 when the new custom duties and excise taxes were introduced. The annual headline inflation was 3.4% in February 2018 compared to 8.9% in February 2017 and 5.5% in August 2017. The Reserve Bank expects the inflationary pressure to remain in the near term due to the impact of TC Gita on the domestic food supply, and is expected to fall below the Reserve Bank's inflation reference rate of 5% per annum by the end of 2018.

The overall OET balance for the past six months to February 2018 was a surplus of $43.0 million, leading to a rise in the official foreign reserves from $405.0 million to $448.0 million. This was sufficient to cover 8.1 months of import of merchandise goods and services[1], which remained above the Reserve Bank's minimum range of 3-4 months of import. The level of foreign reserves is also expected to remain comfortably above the minimum range of 3-4 months of import, supported by expected higher receipts of remittances and export proceeds, and anticipated Government receipt of budget support and grant funds from development partners. This will be partially offset by the projected rise in imports and the Government's external loan repayments.

Tonga's financial system remained sound as banks maintained a strong capital position which was supported by their comfortable profitability, high liquidity, and low level of non-performing loans. Total lending maintained consistent growth and reached a new record high in February 2018. Deposits climbed to new heights also which coincided with the high level of foreign reserves.

The banks' total loans to deposit ratio increased in February 2018 to 76.2% from 75.2% in August 2017 and from 73.3% in February 2017. This reflects the continued strong growth in lending. This ratio continued to remain below the 80% minimum loan to deposit ratio which indicates excess liquidity in the banking system remains and that there is capacity for further lending by banks. The Reserve Bank will continue to monitor the lending growth to avoid any overheating in the economy.

Net credit to Government continued to decline over the six months to February 2018 and anticipated to decline in the near term, as a result of expected Government budgetary support and grants receipts, as well as improved Government revenue collection. The Reserve Bank will closely monitor the implication of the fiscal policy measures on the monetary policy objectives.

In light of the above developments and the outlook on the monetary policy targets, the current monetary policy stance is considered appropriate in the medium term. Therefore, the Reserve Bank will maintain its monetary policy measures in the medium term in order to encourage the utilisation of the excess liquidity in the banking system to increase lending, particularly to the growth sectors, in order to support domestic economic growth and recovery from TC Gita, and strengthen the monetary policy transmission mechanism. Furthermore, 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.

For further details please contact:

[1] Method of calculation has changed in February 2017 to include both imports of goods & services (previous method used imports of goods only)

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