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OFFICIAL PRESS RELEASE

6th September 2019

Monetary Policy Statement for February 2019

The National Reserve Bank of Tonga's Board of Directors approved to release its Monetary Policy Statement (MPS) for February 2019. This Statement reviews Tonga's economic growth and the Reserve Bank's conduct of monetary policy in the six months to February 2019 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.

Preliminary figures released from the Tonga Statistics Department shows a Real GDP growth of 0.2% for 2017/18 following very strong growth of 5.4% in 2016/17. The slowdown in 2017/18 was mainly driven by negative growths in the construction, fisheries, and utility sector. Other sectors recorded slower growth compared to the previous year except for the Mining & Quarrying sector, and the Ownership of dwellings. The Reserve Bank forecasted a 3.1% growth for 2017/18 in its August 2018 MPS, underpinned by infrastructure projects, housing construction projects and rehabilitation activities following the TC Gita. However, delays to the implementation of these projects resulted in the much lower turn out. However, the Reserve Bank forecast a stronger growth of 3.4% for 2018/19 based on the implementation of the delayed projects from 2017/18 coupled with better performance from the primary, industry and tertiary sector as they slowly recover from the impacts of TC Gita.

The annual headline inflation has returned below the Reserve Bank's reference rate of 5% since December 2018. In February 2019 it has declined further to 3.2% mostly driven by lower import prices of food products and oil. Domestic prices increased by 8.5% over the year due to rising prices of local food items and tobacco. However, this was offset by the decline in import prices. Headline inflation is expected to remain below the 5% reference rate throughout 2019.

The balance of the Overseas Exchange Transactions (OET) recorded a $1.5 million deficit, over the six months to February 2019, compared to a $27.0 million surplus in the six months to August 2018. This deficit is underpinned by the widening of the current account deficit due to growing import payments and lower transfer receipts. Consequently, the official foreign reserves declined to $473.5 million in February 2019 from $475.0 million in August 2018, sufficient to cover 8.0 months of import of merchandise goods and services[1], which is still above the Reserve Bank's minimum of 3 months of import. The level of foreign reserves is expected to remain at comfortable levels, well above the minimum of 3 months of import cover supported by expected receipts of budgetary support, grant funds from development partners, and expected higher receipts of remittances. This will be partially offset by the projected rise in imports and scheduled repayment of external debt.

The banking system continued to remain sound supported by strong capital position, adequate profitability, high liquidity, and low levels of non-performing loans. Over the six months to February 2019, the total banks' lending continued to rise to a new record high, whereas deposits slightly declined. The weighted average interest rate spread also widened as lending rates increase while deposit rates declined.

Meanwhile, the banks' total loans to deposit ratio rose from 71.5% in August 2018 to 76.0% in February 2019. This remains below the 80% minimum loan to deposit ratio, which indicates there is still capacity for further lending by the banks. While strong credit growth is expected for 2018/19, the Reserve Bank continues to monitor this closely for any signs of overheating in the economy and any potential threat to financial stability.

Government deposits rose by 14.3% over the past six months to February 2019, resulting in the lower net credit to Government. Higher government revenue collection combined with receipts of budgetary support, grants, and cyclone relief funds from development partners supported the higher government deposits. Net credit to Government is anticipated to decrease in the near term as a result of expected Government budgetary support and Government 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.

Given the recent developments and the outlook on the monetary policy targets, the Reserve Bank considers its current monetary policy stance to be appropriate in the medium term. Therefore, the Reserve Bank will maintain its current

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

accommodative monetary policy measures in the medium term in order to encourage the utilization of the excess liquidity in the banking system to increase lending, particularly to the growth sectors, in order to support domestic economic growth, the recovery from TC Gita, and strengthen the monetary policy transmission mechanism. Furthermore, the Reserve Bank will continue to monitor developments in the domestic and global economy closely, and update its monetary policy setting to maintain internal and external monetary stability and to promote a sound and efficient financial system that supports macroeconomic stability and economic growth.

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