NATIONAL RESERVE BANK OF TONGA

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OFFICIAL PRESS RELEASE

3 September 2020

Monetary Policy Decision

The National Reserve Bank of Tonga's Board of Directors at its board meeting on the 31st of August 2020, approved to maintain its current monetary policy measures outlined below. This is to encourage utilization of the excess liquidity in the banking system, through further lending to growth sectors and to support the economy from the impacts of COVID-19.

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%.
d. Maintain the inflation reference rate at 5%.
e. Monitor the commercial banks' liquidity and adjust the SRD ratio if needed.
f. Monitoring the commercial banks' capital reserves and adjust further when required.
g. Ease the exchange control requirements when required.
h. Continue to issue Government Bonds.
i. Maintain clear channels of effective communications with the financial institutions for adequate preparedness.
j. Continue to be transparent and raise awareness of its monetary policy decisions through press releases to the public.
k. Closely monitor the impacts of the pandemic in the financial system for early detection of any signs of vulnerability.
l. Continue to ensure both commercial banks and non-bank financial institutions adheres to all Government declarations regarding COVID-19 in the workplace while delivering essential financial services to the public.

The Governor of the Reserve Bank, Sione Ngongo Kioa, reported that despite the impact of COVID-19 on domestic performance, the available economic indicators over the year to June 2020 did not contract as much as initially anticipated. The primary sector shows resilience as a result of the recovery from recent cyclones and effective preparatory measures to ensure food security. The secondary sector picked up on activities in the construction sector with the reconstruction projects from TC Gita and TC Harold. The mining & quarrying sector continue to benefit from the road improvement projects. The tertiary sector still struggles with the inactive tourism sector and weaker aggregate demand. However, businesses have expanded or diversified activities to new markets. As labour conditions tighten, many are turning to the informal sector for income such as subsistence farming and self-employment.

Inflation declined further in June by 1.2% as both local and imported prices declined by 1.3% and 1.1% respectively. Annual inflation for June 2020 also declined by -1.4%, which is lower than the 1.8% inflation in June 2019 and 0.1% in May 2020. Import prices fell due to lower global oil prices passing through to local transport and electricity prices. Similarly, domestic prices also declined over the year driven mainly by the lower Kava Tonga prices as supply improves along with the other local food supplies, while demand weakens.

The official foreign reserves significantly rose at the end of the fiscal year by $59.5 million. This was due to receipts of official funds as assistance for TC Harold, budget support, and for COVID-19 preparations and remittances. This brings foreign reserves to $543.8 million, equivalent to 8.2 months of imports of goods and services, well above the minimum 3 months of imports cover.

The total banking system still maintains its soundness supported by strong capital and adequate profits. The banks' total loans to deposit ratio declined to 77.9% from 80.5% last month as loans declined while deposits rose. Lower lending indicates cautiousness to invest, while the higher deposits suggest more preference to save, falling demand from lower consumption activities, and additional savings from the fiscal stimulus packages. Money supply and liquidity has expanded over the month and year as a result of the influx of foreign reserves boosting government deposits, while lending is subdued. The weighted average interest rate spread narrowed both over the month and year to June 2020 by 3.7 and 43.2 basis points respectively to 5.66%. This stems from lower average lending rates, coupled with higher average deposit rates.

Given the above developments, the Reserve Bank has reviewed its GDP forecasts and is now expecting a smaller downturn in the economy than previously anticipated. Foreign reserves is still expected to be well above the 3 months minimum threshold of import cover, while inflation is also expected to remain below the 5% reference rate. The banking system is still sound supported by high liquidity. Meanwhile, the Reserve Bank continues to be vigilant in closely monitoring its economic and financial indicators and stands ready to adjust its monetary policy settings if needed to maintain internal and external stability and support macroeconomic growth.

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