



**OFFICIAL PRESS RELEASE**

**15 October 2015**

**Performance of the Tongan Pa'anga (TOP)**

The Tongan pa'anga exchange rate is pegged to a basket of currencies comprising of its major trading partners. The Tongan pa'anga is determined by the movements of the currencies in the basket and their weights within the basket. Similar to the currencies of other Pacific island countries, the pa'anga has depreciated against the US Dollar, over the year to August 2015.

Global developments have seen the US Dollar strengthen against major currencies. The strong US dollar is attributed to the strong economic expansion supported by strong economic data, the Greek debt crisis, and the expectation of an interest rate hike by the Federal Reserve Bank. The declining global commodity prices and the market uncertainty in China saw commodity currencies such as the Australian Dollar (AUD) and the New Zealand Dollar (NZD) weaken over the year. Lower interest rates and the weak dairy prices also contributed to the depreciation of the AUD and NZD currencies.

Consequently, the pa'anga depreciated and Tonga's Nominal Effective Exchange Rate (NEER), which is the trade weighted average of TOP relative to currencies of its major trading partners, fell over the year to August 2015 by 1.6%. In principle, this means higher cost for imports which contributes to a rise in the imported component of inflation. However, as at August 2015, the consumer price index recorded an annual deflation of 1.0% as a result of imported prices declining by 6.0%.

The depreciation in the pa'anga benefits recipients of foreign exchange, such as tourism and export businesses, as well as individuals who receive remittances. Total Remittances rose by 6.3% to TOP\$215.1 million. Most of the remittances were received from the US (36%), Australia (35%) and New Zealand (23%). The Real Effective Exchange Rate (REER), which is the weighted average of the Tongan pa'anga relative to a basket of the currencies of our major trading partners adjusted for the effects of inflation, also declined over the same period by around 3.6%. The lower REER indicates an improvement in Tonga's price competitiveness against that of its major trading partners.

The official foreign reserves held by the National Reserve Bank of Tonga were at its highest level at TOP\$310.9 million at the end of August 2015. This is an annual increase of TOP\$27.0 million, sufficient to cover 8.6 months of imports, and well above the NRBT's minimum range.

The National Reserve Bank of Tonga believes that the current exchange rate policy is adequate and the exchange rate level is in line with Tonga's economic fundamentals, which is consistent with the IMF Article IV's assessment.

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