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 August 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 the recovery from Tropical Cyclone Gita, 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, stated that the indicators of economic activity suggest slowed growth over the month. Indicators showed mixed results in the primary sector where the total export volume of agricultural products declined, however, domestic food supply continued to improve as reflected in the decline in food prices. Activities in the secondary sector continued to be supported by the on-going construction activities, as the growth in banks' lending for housing and the construction sector continued to increase. Electricity consumption however declined which indicates a slowdown in economic activities over the month. Indicators of the tertiary sector were mixed over the month with prominent results from the banking sector reflected in the banking system's profitability continued to improve. The travel receipts had increased despite a fall in total air arrivals which coincided with less international flights arriving during the month. The total number of container registrations also declined over the month.

Consumption activities slowed over the month of June 2018. Despite an increase in household lending and the distribution of the Government's cash hand-outs to some of the cyclone affected families, the Consumption Tax (CT) collected over the month declined in line with a fall in businesses' total sales. Consumption activities however remained strong over the year. Year on year growth shows higher CT collected coinciding with a rise in total sales. Remittances and banks' lending to households also increased which may have translated into solid consumer spending. Going forward, consumption spending is expected to be strong supported by the continuous increase in new loan commitments to households and the expected continued increase in remittance receipts.

The banking system remained sound and maintained strong capital position, supported by comfortable profitability, and non-performing loans continued to remain low. Liquidity in the banking system (reserve money) increased over June in line with growth in banks' deposits which triggered an increase in the required reserves and the decline in the loans to deposit ratio. This ratio continued to remain below the 80% minimum loan to deposit ratio which indicates excess liquidity in the banking system and that there is capacity for further lending by the banks. Over the year, both banks' deposits and loans increased indicating improved access to banks' financial services. The total access points in the banking system increased making financial services more widely accessible. The weighted average interest rate spread widened over June due to an increase in the weighted average lending rate and a decline in the weighted average deposit rate.

The foreign reserves rose to $468.7 million in June 2018 due mainly to receipts of cyclone relief funds and other project funds. This is equivalent to 7.8 months[1] of import cover.

Food prices remained the main factor behind easing of headline inflation. The annual headline inflation rate slowed to 5.9% in June compared to a 9.4% last month and 10.7% in June 2017, which is closer to the Reserve Bank's reference rate of 5%. The slowdown of annual inflation was mainly due to developments in domestic food prices as the annual growth in June 2018 was much lower than it was in May 2018. The increase in imported prices was due to higher prices of imported meat, fuel and tobacco. Food prices continued to be the lead contributor to domestic prices followed by Kava-Tonga and coral aggregates.

Despite the largely slowed growth in June, developments in all sectors of Tonga's economy still support the strong growth that is expected in 2017/18 however weather uncertainty pose a risk to the outlook. According to the latest Climate Update from

[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

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the Tonga Meteorological Service[2], rainfall is forecasted to be average to below average in August to October 2018 and below average for all of Tonga from November to January 2019. This will negatively affect activities in the primary sector and other sectors of the economy in the future. The level of foreign reserves is expected to remain at comfortable levels and inflation is anticipated to fall below the Reserve Bank's inflation reference rate of 5% per annum at the end of 2018. The banking system is expected to continue to remain strong.

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. The Reserve Bank will continue to remain vigilant, closely monitor developments in the domestic and global economies and may change its monetary policy setting to support its monetary policy objectives.

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[2] Issued by the Ministry of Meteorology, Energy, Information, Disaster Management, Environment, and Climate Change & Communication on 7th August 2017. During El Niño, rainfall in Tonga is below average especially on the onset of El Nino.