

**OFFICIAL PRESS RELEASE****18 May 2018****Monetary Policy Decision**

The National Reserve Bank of Tonga's board of directors at its meeting on the 16<sup>th</sup> May 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 Statistics Department recently released Tonga's 2016-17 Real Gross Domestic Product (GDP) of 5.0% reaching its highest growth since 1998-99. The Governor of the Reserve Bank, Sione Ngongo Kioa, stated that the recovery works from the destruction caused by Tropical Cyclone (TC) Gita contributed to driving domestic economic activities during the month. Partial economic indicators were positive over the month. In the tertiary sector, total loans slightly rose over the month, and the total container registrations and international air arrivals also increased in March. The in-kind donations and picking up of trade activities following the cyclone contributed to the higher container registrations. The total agricultural exports increased driven by a rise in exported volume of root crops particularly yam reflecting its harvesting season. The exports of coconuts also increased in March indicates the increase in supply following the cyclone. Activities in the secondary industry remained positive supported by higher loans to individual housing and business manufacturing sectors.

The banking system remained sound maintaining strong capital position, supported by comfortable profitability, and non-performing loans continued to remain low. Liquidity in the banking system (reserve money) rose over March due mainly to a rise in deposits by the commercial banks to the Reserve Bank vault which coincided with a decline in currency in circulation. The banks' total loan to deposit ratio (including Government Development Loan (GDL) scheme) slightly increased from last month. Total loans to deposit ratio (excluding GDL) remained stable in March. It continues 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 weighted average interest rate spread widened over March, driven by a rise in the weighted average lending rate which was partially offset by a rise in the weighted average deposit rate.

The foreign reserves decreased slightly to \$447.7 million in March 2018 due to higher payments mainly for professional services and imports of wholesale and retail goods. This is equivalent to 8.0 months<sup>1</sup> of import cover, which is still above the Reserve Bank's minimum range of 3 – 4 months.

The official headline inflation rate for March 2018 is yet to be released by the Statistics Department. However, the impact of TC Gita in February on the domestic food supply is expected to push domestic inflation upward. Over the year, the headline inflation is anticipated to be around 4.0% compared to 3.4% in February 2018. The anticipated annual headline inflation is due to higher expectations in the price of food, transportation, tobacco, alcohol and kava-Tonga.

The growth outlook for Tonga remains positive in the years ahead. The Reserve Bank will revise its growth estimates to be published in its Monetary Policy Statement. The level of foreign reserves is expected to remain at comfortable levels well above the minimum range of 3-4 months of import cover supported by expected higher receipts of remittances and foreign aid. This will be partially offset by the projected rise in imports and the commencement of the Government's principal loan repayment to the EXIM Bank of China. Inflation is anticipated to remain below the Reserve Bank's inflation reference rate of 5% per annum in 2018. The adverse weather conditions and higher import prices pose a risk to these favorable projections.

The Governor concluded that 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. The Reserve Bank will also remain vigilant and continue to closely monitor developments for early signs of vulnerabilities which may indicate overheating of the economy.

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<sup>1</sup> 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