

**OFFICIAL PRESS RELEASE****21st September 2018****Monetary Policy Decision**

The National Reserve Bank of Tonga's board of directors at its meeting on the 18th September 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, indicated that the activities in the domestic economy picked up, suggesting a vibrant start for the 2018/19 financial year. From the primary sector, the total volume of agricultural exports increased due to a rise in exported yam, taro and coconuts. The demand for individual housing and business loan to mining and quarrying sector continued to support activities in the secondary production. In the tertiary sector, international air arrivals rose coinciding with an increase in travel receipts, supported by an increase in the number of scheduled flights and events took place during the month. Container and vehicle registrations also increased indicating a continued strong activity in the sector.

Consumption activities rose over the month as indicated by an increase in the Consumption Tax (CT) collected and businesses' total sales. This coincided with the increase in total containers and a rise in wholesale & retail import payments. Banks' lending to households also increased which may have translated into solid consumer spending. This is supported by remittance receipts and new loan commitments over the month. The anticipated rise in remittance receipts and the continuous increase in new loan commitments to households will support strong consumption spending in the future.

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) increased due to an increase in deposits by the commercial banks to the Reserve Bank's vault. Higher deposits outweighed the growth in lending over the month resulted in a decrease in the loans to deposit ratio. This 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. The weighted average interest rate spread widened over July due to an increase in the weighted average lending rate and a decline in the weighted average deposit rate.

The foreign reserves increased to \$476.5 million in July 2018 due mainly to lower services and primary income payments. This is equivalent to 7.9 months¹ of import cover.

Favourable movement in both local and imported food prices drove the continued decline in the monthly inflation. A decline in domestic prices over the month was driven by a fall in the domestic fruit and vegetable price. Imported prices however rose due to an increase in the prices of tobacco. Despite the fall in the monthly inflation rate, the annual headline inflation increased to 6.1%. This was attributed to lower commodity prices in July 2017 compared to the current period. Imported prices increased over the year due to higher prices of imported food, fuel and tobacco. The domestic prices also rose with food items as the lead contributor followed by kava-Tonga.

The Reserve Bank's outlook for strong domestic economic activity remains in the medium term however weather uncertainty pose a risk to the outlook. According to the latest Climate Update from the Tonga Meteorological Service², rainfall is expected to continue recording below average rainfall in the near term. This will pose an impact 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.

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

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 Niño.

Given the recent 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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