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Monetary Policy Decision

The National Reserve Bank of Tonga's Board of Directors at its board meeting on the 17th December 2019, 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 in order to support economic growth 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, reported that domestic economic activities continued to reflect mixed growth in October 2019. The primary sector showed mostly positive performances with proceeds for marine exports increasing by \$0.2 million (20.2%) whilst agricultural export proceeds remained the same. Meanwhile, the secondary and tertiary sectors showed varied growths with housing loans declining by \$0.4 million (0.2%) whereas import payments for construction materials rose by \$0.9 million (54.5%). The total number of international arrivals declined during October by 550 passengers (5.7%) whilst cruise ship arrivals and vehicle registrations rose. Container registrations decreased by 394 (30.6%) due to lower private and business container registrations. The measles outbreak that started in October has escalated leading to cancellation of schools and major events such as price giving ceremonies, reunions and other scheduled events which may contribute to slowing economic activities in the upcoming months.

The banking system continues to be sound supported by strong capital and adequate profits. The banks' total loans to deposit ratio slightly increased from 78.6% to 79.1% over the month, reflecting loans growing while deposits fell. This still remains very close to the 80% minimum loan to deposit ratio. However, the liquidity in the banking system remains relatively high indicating existing capacity is still available for further lending. The weighted average interest rate spread narrowed over the month and year by 1.7 basis points and 10.5 basis points respectively to 6.04%, due to a decrease in both weighted average lending rates and weighted average deposit rates.

The level of official foreign reserves fell by \$1.5 million to \$489.3 million, (equivalent to 7.8 months of imports cover) attributed to higher offshore investments and payments for services during October 2019. Over the year, foreign reserves rose by \$32.0 million as a result of higher receipts of budget support, grants and project funds from development partners.

Headline inflation increased by 0.5% over the month. Both domestic and imported prices rose by 0.9% and 0.2% respectively. Domestic prices increased in October due to higher prices of local food such as root crops, vegetables, seafood and eggs whilst imported prices rose driven by higher fuel prices, and imported food items such as mutton, apples, sugar, and flour. Annual headline inflation rose slightly by 0.2% in October 2019 compared to 0.4% in September and 6.2% inflation in October 2018 resulting to lower domestic prices. In particular, domestic prices fell by 1.3% attributing to lower prices of kava-Tonga, Tongan tobacco, electricity and local food prices such as root crops and vegetables. This offset a 1.5% annual rise in import prices.

The medium-term outlook on Tonga's economic performance remains positive, yet weather uncertainty and global uncertainties continue to pose a risk to this expectation. The level of foreign reserves is projected to remain at a comfortable level, and inflation is expected to remain below the reference rate of 5%. The banking system is anticipated to continue to remain sound.

Given the above developments and outlook, the current monetary policy stance is considered appropriate in the medium term. The Reserve Bank continues to adopt measures to encourage the utilization of the excess liquidity in the banking system to increase lending, support domestic economic activities, and strengthen the monetary policy transmission mechanism. Meanwhile, the Reserve Bank will continue to remain vigilant and closely monitor external and domestic developments and may change its monetary policy setting to support its monetary policy objectives.

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