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Monetary Policy Decision

The National Reserve Bank of Tonga's Board of Directors at its board meeting on the 19th July 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 activities experienced mixed performance in the month of May 2019. Partial economic data pointed to mixed sectoral performance in the primary sector. Receipts from exports of agricultural products rose during the month while proceeds from marine products slightly fell. Growth in lending to the agricultural sector increased by 10.4% in May and is expected to support the sector's growth in the medium term. Additionally, growth in lending to the manufacturing, construction and the utility sectors in May suggest positive activities in the industry sector. Individual housing loans continued to rise while payments for imports of construction materials also rose in May, further supporting the positive outlook for the construction sector. Total air arrivals rose by 30.5% over the month coinciding with the rise in the number of international flights landing in Tonga. Consequently, travel receipts also increased by 40.9% (\$3.5 million). Payments for imports of wholesale and retail goods also rose by 31.4% supporting the trade sector. However, the total number of container registrations decreased by 1.0% (8 containers) as lower number of business containers outweighed the increase in private containers.

The banking system remained sound as banks continued to maintain a strong capital position backed by adequate profits. The banks' total loans to deposit ratio increased over the month to 78.7% from 77.5% in the previous month. The monthly rise in the ratio reflects higher loans which increased to a new high of \$487.3 million against declining deposits. This ratio is slowly increasing towards the 80% minimum loan to deposit ratio, as commercial banks continue to utilize the capacity available for further lending. The weighted average interest rate spread narrowed in May driven by a decline in weighted average lending rates offsetting the slight rise in weighted average deposit rates.

Foreign reserves rose in May 2019 by \$4.1 million to \$468.3 million equivalent to 7.9 months of imports cover which was mainly driven by receipts of government grants and budget support.

The annual headline inflation remained below the 5% reference rate in May, at 1.6% compared to 0.2% in April 2019 and 3.8% in the same month last year. Both domestic and imported prices rose over the year to May 2019 by 1.5% and 1.7% respectively. Domestic inflation contributed 0.7% to the annual headline inflation as higher prices were noted for tobacco, food, and restaurant services. Imported inflation contributed 0.9% to the annual headline inflation due to higher prices of imported tobacco, alcohol, and fuel.

Tonga's economic performance continues to remain positive in the medium term. However, weather uncertainty and global oil price movements pose a risk to the outlook. 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.

In consideration of the above developments and outlook, the current accommodative 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. 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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