



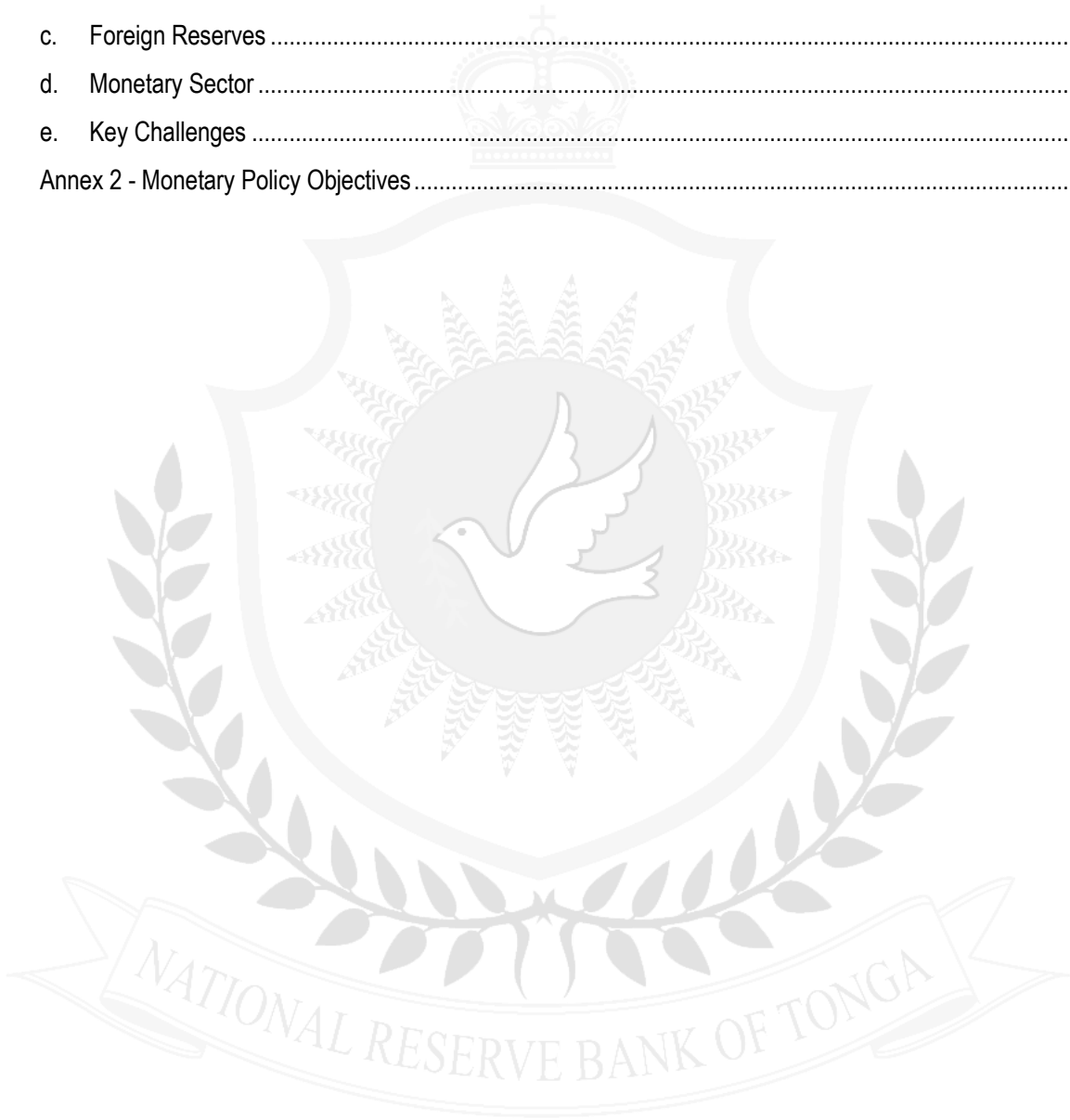
MONETARY POLICY STATEMENT

August 2024

National Reserve Bank of Tonga

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Executive Summary

The Tonga Department of Statistics published preliminary estimates for Tonga's GDP for financial year (FY) 2022 indicating an unexpected resilience and achieving a slight growth of 0.05% despite the impacts of the COVID-19 pandemic and the Hunga Tonga – Hunga Ha'apai volcanic eruption. The Reserve Bank estimates FY2023 to have experienced a stronger rebound of 2.4% on the back of a strong service sector as the borders reopened and businesses recovered. However, growth is expected to ease to 1.6% in FY2024, a downward revision from the 2.2% in the previous Monetary Policy Statement due to impact of the El Nino on the agriculture sector and delays in major infrastructure projects. Key challenges include labour shortages and a much more persistent food supply shortage. The agriculture sector faces difficulties with labour constraints and the impact of natural disasters. The services sector is showing positive signs with increased tourism and domestic consumption but tourism infrastructure needs improvement as it still has not recovered from the tsunami and the pandemic. Looking forward, the Reserve Bank forecasts growth for FY2025 to be around 2.7% from a rebound in agricultural production and greater implementation of public construction projects before reverting towards long-term growth. Foreign reserves remain comfortable, but challenges such as debt servicing and potential capital outflows need to be managed. The Reserve Bank is monitoring inflation closely and stand ready to implement measures to address inflationary pressures should high inflation continue.

Overall, Tonga's economy is on a path of recovery but faces significant challenges that require ongoing monitoring and both monetary and fiscal policy responses.

- Inflationary pressures remain a significant concern, with headline inflation edging above the 5% reference rate in June 2024 to 5.4%. However, the increase was due mainly to domestic food prices growing by more than 24% in June 2024 on the back of a 23% annual increase in June 2023. Though inflation is analysed to be transitory in nature, it may hover above the reference rate during 2024 if supply constraints persist. The Reserve Bank stands ready to implement measures to mitigate inflationary impacts should core inflation surprise on the high end compared to Reserve Bank's forecast and expectation.
- Foreign reserves remained at comfortable levels by the end of June 2024 at \$924.3 million, which is sufficient to cover 11.9 months of imports. However, ongoing debt servicing and potential capital outflows necessitate prudent management.
- The financial sector remains stable, with adequate capital and liquidity. However, there are compliance challenges with one of the commercial banks in the banking system.
- Credit growth of 4.1% was recorded for the year to June 2024, which was slower than expected. The continual high non-performing loans remains a concern. The Reserve Bank is implementing enhanced risk-based tools to ensure further risks to banks' asset quality are mitigated. The ongoing efforts to develop a credit registry will also help to monitor risks of household and corporate indebtedness, a tool for mitigating risks of rising non-performing loans. While the Reserve Bank is committed to promoting financial inclusion and supporting the growth of key economic sectors through greater credit accessibility, policies and controls are in place to ensure prudent lending by financial institutions is maintained.
- The persistently high level of excess liquidity in the banking system undermines effective monetary policy transmission. Relatively low term deposit rates and limited trading activities in the Government bond market continue, while the interbank and repo market remain inactive.
- Tonga's economy faces significant challenges due to its small size, geographic isolation, and susceptibility to external shocks. These factors, coupled with vulnerabilities to natural hazards, labour shortages, and data constraints, hinder economic growth and development. Additionally, the country's reliance on remittances and potential impacts from de-risking and de-banking pose further risks.

To sustain economic growth and stability, Tonga must address challenges related to labour shortages, infrastructure development, and climate change. Diversifying the economy and enhancing its resilience to external shocks are crucial for long-term prosperity.



Monetary Policy Decision

Reserve Bank Will Promote Access to Finance While Monitoring Inflation Closely.

1. In light of the most recent developments and projections, the NRBT considers its current Monetary Policy stance appropriate for the next six months. Therefore, the Reserve Bank aims to (1) maintain a vigilant stance on inflation addressing key drivers of high inflation in order to keep inflation below the reference rate¹ in the near term, and (2) step up its efforts on ensuring financial stability and expanding access to finance for vulnerable sectors to support sustainable economic growth. These efforts will require collaboration with the Government on targeted reforms and policy measures.

2. Monetary policy considerations include the following developments:

- Real GDP growth is volatile, trending lower since 2016 and below potential since 2017. The Tongan economy has generally been driven by consumption while contribution from investments to growth have been very little and at times negative. Potential output has continued to decline driven mostly by the increased frequency of natural disasters damaging some of Tonga's productive capital formations and an increase in labour shortages, suggesting the need for a structural policy response.
- Revised economic growth forecasts indicate lower than expected growth in key sectors, necessitating financial support for private sector development. Capital investments in resilient and sustainable infrastructure are vital to mitigate Tonga's climate-related risks.
- The tight labour market, compounded by skill mismatches and labour force migration are contributing to wage inflationary pressures. Addressing these issues is crucial for maintaining economic growth and price stability.
- Headline inflation accelerated to 5.4% in June 2024, surpassing the 5% reference rate, after staying below the reference rate for four (4) months since February 2024 while core inflation was low at 1.7%. Strong consumer demand during the festive season, coupled with supply constraints, fueled inflationary pressures. The overall inflationary environment remains challenging due to factors such as labour shortages, adverse weather conditions, and global commodity price volatility. The Reserve Bank expects inflation to gradually decline below the 5% reference rate later in the year.
- Foreign reserves will remain at comfortable levels in the near term, despite an expected rise in import payments.
- The banking system remains sound with strong capital and liquidity position. However, the level of non-performing loans pose risks to profitability and investment financing. To mitigate these risks, enhanced supervision of both banks and non-bank financial institutions is necessary. Using a Quarterly Projection Model (QPM) developed with technical assistance from the IMF, it was estimated that in a scenario of one of the banks failing, this would lead to a permanent loss in real GDP of 1.5% over two years through a hike in the country credit risk premium.
- Excess liquidity in the banking system is estimated at \$308 million. Though lower than the reported \$311 million in the February 2024 MPS, it is still high weakening the monetary policy transmission mechanism. The effective utilization of this excess liquidity is vital in improving the effectiveness of monetary policy and will help with the development of Tonga's financial markets.

3. To continue to support growth and macro-stability, the Reserve Bank will maintain its current monetary policy measures below:

¹ Inflation reference rate of 5% (lowered from 6 – 8%) in 2016 under IMF advice to be more consistent with historic inflation rates taking into account vulnerability to shocks beyond the control of NRBT. Changes to the reference rate will need to be publicly disclosed.

- i. Maintain monetary policy rate of zero percent.
- ii. Maintain the Statutory Reserve Deposit ratio at 15 percent.
- iii. Consider further easing of exchange control requirements.
- iv. Review and maintain an exchange rate regime that is supportive of greater macro-economic stability.
- v. Collaborate with Government agencies to align monetary and fiscal policy, particularly in reducing inflation, and coordinating price control measures to break the cycle of high inflation with low growth.

4. In addition to its monetary policy actions and in coordination with the Ministry of Finance, International Institutions, domestic financial institutions and relevant stakeholders, the NRBT aims to:

- Establish a concessional credit facility for specific businesses, particularly those in the fisheries, and manufacturing sectors. This support will also target situations where there are barriers to obtaining finance, such as funding for women- or youth-owned and operated businesses.
- Establish a facility to provide partial credit guarantee to the productive sectors, such as agriculture, handicrafts, tourism and investment where access to finance is hindered by the lack of security and collateral.
- Develop the domestic financial market by providing new financial instruments in order to better utilize the banking system excess liquidity for productive investment. These financial instruments may be used to fund capital investments for private businesses seeking to mitigate the negative impacts of severe weather events (e.g. tropical cyclones, droughts), and slowdown in growth of credit for private sector development and resilience while building capacity for ocean-based operations.
- Improve efficiencies within the financial sector by assisting in the establishment of a domestic credit registry and collaborating with the Government to strengthen insolvency and debt enforcement capabilities and enhance financial consumer protection measures.
- Implement the National Financial Inclusion Strategy that focuses on 1) improving and deepening the access to financial services 2) enhancing MSMEs' (Micro and Small Medium Enterprises) access to finance; 3) promoting and supporting responsible Digital Financial Services (DFS) and product innovation and delivery; 4) promoting consumer protection and financial competencies; and 5) fostering inclusive green financing.





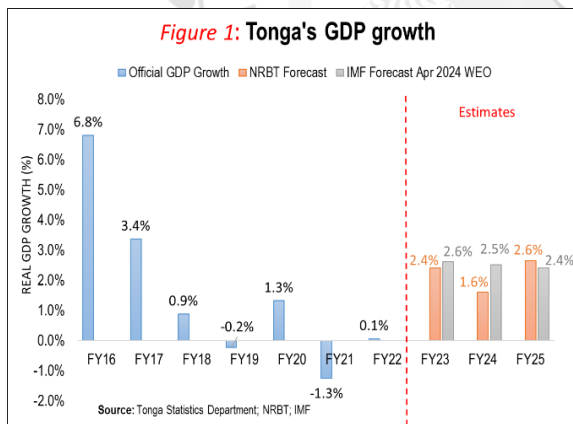
Annex

1. Annex 1 - Economic and Financial Developments

a. GDP Growth

Despite the adverse impacts of the COVID-19 and HT-HH volcanic eruption, the Tonga Statistics Department (TSD) published an estimated slight growth of 0.05% in FY2022, underpinned by strong performance in the agricultural and construction sectors. Official figures for FY2023 are yet to be published but the Reserve Bank estimates the economy to have rebounded by 2.4%, largely influenced by positive recovery in the services sector specifically with the reopening of Tonga's international borders. However, FY2024 growth is estimated to have been at a slower pace of 1.6%, compared to the previous 2.2% growth outlook. This reflects lower than expected performance in the agricultural sector reflecting the adverse effects of the El Nino conditions later in 2023. Moreover, the implementation of some major projects targeted for 2024 were still delayed such as the Fanga'uta Lagoon Bridge, new Parliament building, and Courts complex, amongst others.

Local festivities boosted demand in the primary sector



during the year. These included church conferences, the Heilala Week Festival and events to mark His Majesty's 65th Birthday. Given the high demand during the festive season amidst seasonal supply constraints, this led to increased imports of agricultural products, particularly vegetables, to meet domestic demand. Consequently, prices within the sector rose significantly. Labour shortages further exacerbated the sector's challenges, affecting both supply capacity and prices. Over the six months to June 2024, total agricultural exports decreased by 1,113.1 tonnes

(32.0%) compared to the same period in 2023. Root crops fell due to lower exports of taro, cassava, and yam, along with squash and watermelon exports. This decline may reflect the lingering effects of El Nino, and the robust demand during the festive season. Marine exports also declined by 380.1 metric tonnes (32.5%) over the six months to June 2024 while aquarium exports fell by 8,547 metric tonnes (26.1%). During the cyclone season (Nov 2023 – April 2024), Tonga was met with several strong winds which caused fishing vessels to be less active.

The Government is allocating around \$9.1 million in the new financial year 2024-25 to support the Public Private Partnerships (PPP) initiatives under the key economic sectors, which include the agriculture and fisheries sectors. The initiatives include the Tonga Circular Economy and the Tuna Lining Facility projects. Investment on capital formation is critical in this sector given the labour shortages, to ensure domestic production is enhanced with minimal costs. Hence, Nishi Trading's greater investments on agricultural technology and advanced machinery to streamline operations and reduce the high costs associated with labour shortages is a welcome initiative and much-needed in the current environment. However, the sector's future growth remains susceptible to the climate conditions and other natural hazards.

Indicators in the secondary sector showed positive trajectory driven by ongoing infrastructure projects of the Government and other private sectors. Several large-scale projects have reached their completion stage, such as private dwellings under the HTHH recovery program, the new His Majesty's Armed Forces (HMAF) Leadership Development Centre, and the Tonga Pharmaceutical & Medical Facility, to name a few. Nonetheless, the Government's Budget Statement for FY2024-25 outlined several infrastructure projects to be implemented that will continue to boost the sector's performances. These include infrastructure projects such as the new Parliament House, the Tapanekale Affordable Housing Program, Fanga'uta Bridge, Tonga National

Museum, Ngū Hospital in Vava'u, the reconstruction of the Queen Salote Nursing School, and the Fua'amotu Luxury Five Star Resort. Meanwhile, the Tonga High School Sport Complex is anticipated to be completed for the Pacific Island Forum Leaders meeting in August 2024, along with the Tourism Industry Accommodations project (approx. 200 container houses). Meanwhile, the Queen Salote Wharf and several projects under the Tonga Safe & Resilient Schools Project are currently underway through the PPP program. The Government is also looking at initiatives to enhance domestic production such as a Flour Mill.

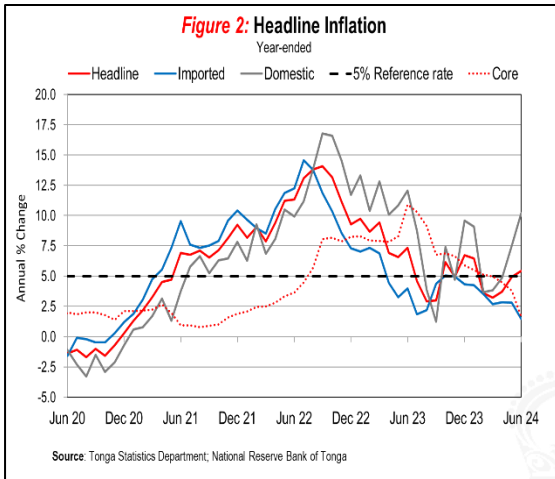
The services sector remains vibrant. A number of events took place during the year including the Family month activities in May, the opening of the Church of Tonga's new school, Anastasis College, annual church conferences, the Heilala Week festival, royal celebration of the King's birthday, and the inauguration of the new noble Lord Ma'afu. International travels were boosted as the Tongan diaspora abroad travelled and attended these occasions, along with the arrival of diplomatic officials for the Royal events. In the six months to June 2024, the total passenger arrivals rose by 5,644 passengers compared to the same period in 2023, which also reflects the arrival of cruise ships and yachts during the year. Coincidentally, the total travel receipts also increased by \$13.0 million (22.8%). Consequently, demand for services such as accommodation and food, transportation, and distribution were significantly high with new established food vendors and other recreational activities during the celebratory season. The vibrant domestic activities were also indicative in the number of container registrations recorded over six months to May 2024 which increased by 1,275 containers (15.2%) compared to the same period in 2023. The increase was owed largely to higher business containers reflective of the stock replenishment by wholesalers and retailers. In June 2024, the import payments excluding oil rose by \$13.2 million (5.3%), with an increase in the wholesale and retail import payments of \$18.5 million (11.3%). The outlook for the service sector remains positive supported by the ongoing tourism initiatives, the "build back better" initiative, and the new Fua'amotu Luxury Five Star Hotel.

Labour market constraints remain a key concern with the ongoing labour mobility scheme and increasing emigration for better employment opportunities. High cost of labour in key economic sectors, such as agriculture, marine, and tourism continue to pressure production and prices. The reconstruction efforts and new project implementations are further intensifying labour demand, aggravating the labour demand-supply mismatches. According to the Reserve Bank's survey on job advertisements, total job vacancies increased by 18 vacancies (1.9%) at an annual rate. Majority of the total job vacancies were from the public administration, transport & communications, utilities, and hotel & restaurants sectors.

The economy is projected to expand by 2.6% in FY2025 underpinned by expected positive recovery in the agricultural sector, along with the implementation of delayed public infrastructure projects, positively supporting tourism and growth in related sectors. Government development initiatives such as the Tonga Circular Economy system provides progressive avenue for boosting potential growth in agricultural production, exports and income generation. Moreover, the Pacific Islands Forum Leaders meeting, ongoing housing reconstructions with development projects aimed at boosting the tourism sector are expected to contribute to job creation and growth in the services sector. However, unfavorable weather conditions and global geopolitical tensions remain as downside risks to the outlook.

b. Inflation

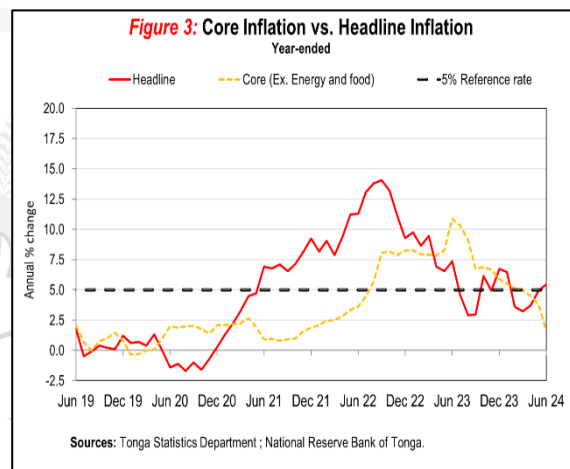
Headline inflation floated below the 5% reference rate starting in February 2024 with 3.6%. Nonetheless, headline inflation rose and surpassed the reference rate in June 2024 with 5.4%. Prices were aggravated by the resurgence in demand during the festive season from May to mid-July, fueled by increased remittance inflows. While global trading conditions improved compared to the pandemic period, ongoing geopolitical tensions in the Middle East pose risks to shipping logistics and freight costs, which could further exacerbate inflationary pressures. Despite the recent surge, average headline inflation for the year to June 2024 moderated to 4.6% from 10.3% in June 2023.



Domestic prices surged by 10.2% annually in June 2024, which is the highest rate since the 12.0% annual rise in June 2023. Domestic prices contributed around 4.6 percentage points to the headline inflation in June 2024. Most of the contribution was from the local food items (including non-alcoholic beverages) with around 4.3 percentage points. The elevated local food prices reflect the supply shortage during periods of robust demand and consumption from both households and businesses in preparation for the festive season. Local food prices surged by 23.9% after growing by almost 23% in the previous year as well. Persistent labour market shortages continued to drive the cost of production in the agriculture and fishery sectors, as producers compensated higher input costs by increasing the price of their goods. Furthermore, unfavourable weather conditions also adversely affected vegetable crop yields and impeded the ability of fishing vessels to operate resulting in lower production across both sectors. Consequently, to meet local demand requirements suppliers had to rely on imported agricultural substitutes. Other prices with high contribution to the headline inflation are kava Tonga, transportation components, alcoholic beverages, and catering services. In comparison to June 2023, prices of electricity, tertiary education, tobacco and labour cost were lower but their overall impact on headline inflation was outweighed by the substantial increase in food costs.

Imported inflation continued to ease compared to previous years reaching 1.5% in June 2024. This was attributed to favourable energy prices and improved trading conditions compared to the pandemic period. Imported inflation contributed around 0.8 percentage

points (pps) to the headline inflation, owing mainly to prices of fuel, goods for personal care, alcoholic beverages, household items, imported food items, and LP gas. While energy prices improved compared to the pandemic period, they remain susceptible to geopolitical tensions and global demand. In June 2024, the average of Brent Crude Oil prices settled at US\$82.82/barrel compared to US\$74.87/barrel in June 2023. Nevertheless, this was still lower than the highest level during the pandemic of US\$117.21 in June 2022. Imported inflation was 3.4% on average in June 2024, lower than the average of 8.3% in June 2023.

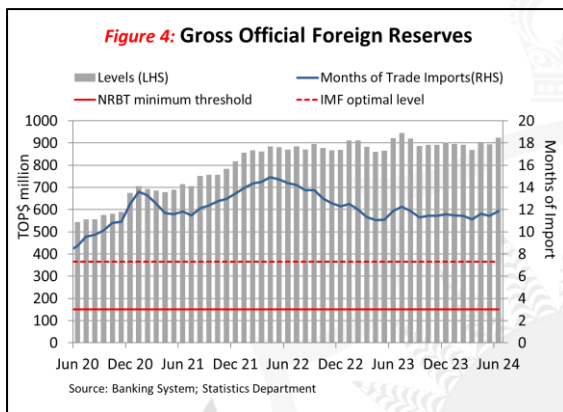


Core inflation (excluding food & energy prices) eased further to 1.7% in June 2024 from 4.5% in April 2024. This is the lowest rate since 1.6% in November 2021. This price increase was primarily due to further rise in prices of imported items such as goods for personal care, construction materials, household items, and alcoholic beverages. Meanwhile, prices of other goods and services tend to be more persistent.

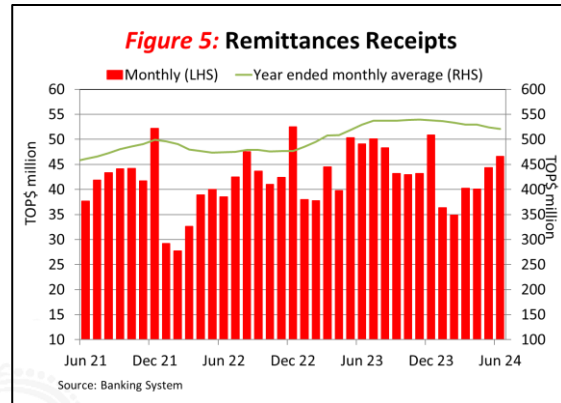
On the outlook, inflation is anticipated to fluctuate around the 5% reference for the rest of 2024. This is driven by the high volatility in local food prices given the resurging demand from the hosting of the Pacific Island Forum Leaders meeting and the upcoming Christmas holiday festivities. Nevertheless, there are signs of improved supply and the analysis suggests a downward trend in the near term. Demand shock during the festive season tend to be one-off and seasonal, and therefore transitory in nature. Tonga's high vulnerability to natural disasters and external shocks pose risk to the inflation outlook.

Nonetheless, the Reserve Bank will continue to vigilantly monitor the development in both the international and domestic economies, to ensure a low and stable inflation for Tonga. Given core inflation is low and inflationary drivers are also driven by supply side constraints, it requires effective policies and efforts from all relevant stakeholders particularly the Reserve Bank and Government.

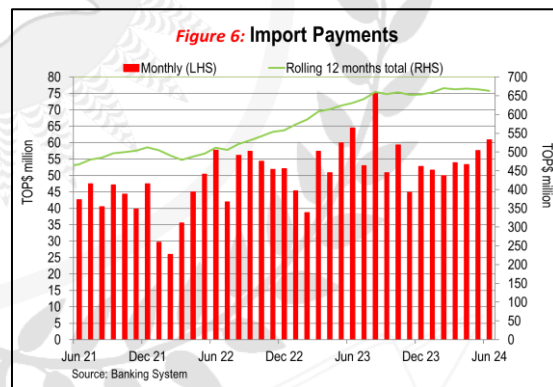
c. Foreign Reserves



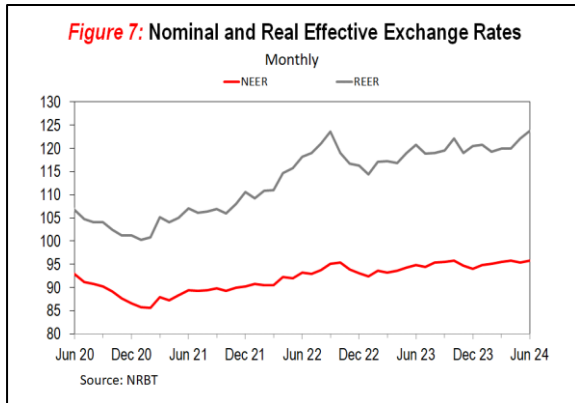
Tonga's official foreign reserves continued to remain comfortable with equivalence of over 11.9 months of imports at the end of June 2024, well above the IMF prescribed level of 7.5 months of imports. Foreign reserves were 2.5% (T\$22.6 million) higher than December 2023 and, last year by 0.3% (T\$28.3 million) with a total of \$924.3 million. This reflected receipts from development partners for Government budget support and development projects, coupled with increasing remittance and travel receipts outweighing the outflows for import and debt repayments. Remittances dropped slightly over the year to June 2024 by 1.5% underpinned mainly by lower private transfers. This reflected remittances being transferred in travel receipts as more Tongan diaspora visited the country to attend various events. Travel receipts accelerated over the year by \$69.9 million sustained by the robust travel activities such as local celebrations and annual festivities, supporting the recovery in the tourism industry. Foreign exchange outflows picked up by 9% in the year ended June 2024, resulting from the ongoing increase in payments for the import of goods and services. This was a 5.2% increase, reflecting large payments for wholesale and retail goods and other imports (mostly government). The increase in import payments also coincided with the rising imported inflation.



Foreign reserves is expected to remain adequate in the medium term, sustained by large inflows of donor funds for Government budget support and development projects. Nevertheless, increasing import expenditure for the ongoing infrastructure projects, offshore investments, coupled with debt servicing obligations, including the repayment of the Export – Import Bank of China (EXIM) loan may exert pressure on foreign reserves in the near to medium term. Remittances is expected to ease in the near term following the end of the celebratory months and local celebration, partially offset by the increase in travel receipts as the recovery in the tourism industry continues.



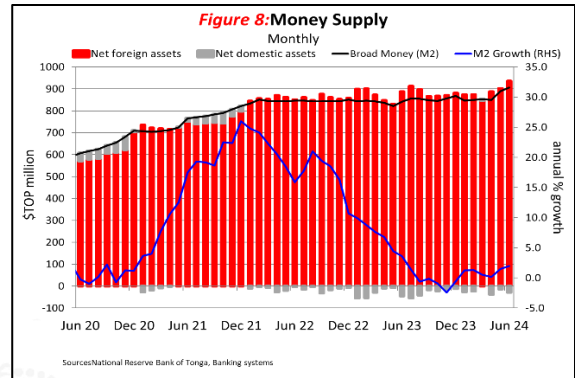
Safeguarding of foreign reserves remains a top priority for the Reserve Bank for maintaining external stability and supporting international trade. In consideration of the anticipated pressure on the foreign reserves identified above and the weak foreign investment and export proceeds inflows, prudent management of the foreign reserves, including adopting measures to manage any further capital outflows if needed, will continue.



The Nominal Effective Exchange Rate (NEER) rose by 1.8% over the last six months to June 2024 as the TOP strengthened against some of its major trading partners' currencies such as the NZD, AUD, JPY, EUR, FJD and CNY. The Real Effective Exchange Rate (REER) also increased by 2.7% during the same period, in line with the higher NEER. This may indicate a loss in Tonga's trade competitiveness. Over the year, both the NEER and REER increased by 1.1% and 2.4%, respectively.

d. Monetary Sector

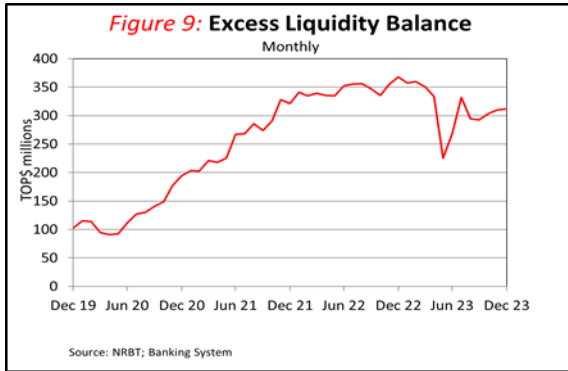
The banking system maintains financial soundness with adequate capital and liquidity levels. Total credit remained at high levels, reflecting the continuous recovery in economic activities, and the high demand for finance to fund both public and private projects. The weighted average interest rate spread widened on the back of the lower weighted average deposits rate, outweighing the decline in the weighted average lending rate. Money supply reached a new high level as the liquidity in the financial system remained at high levels. However, the rise in non-performing loans is a concern for the Reserve Bank. Enhanced supervision of banks is crucial while also stepping up the supervision of non-bank financial institutions to ensure risks to financial stability are moderated.



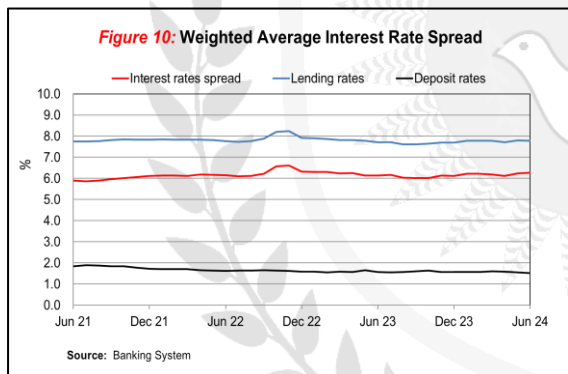
In June 2024, money supply peaked at \$906.1 million, rising by \$37.9 million (0.04%) from December 2023, and \$64.2 million (7.6%) from June 2023. The annual rise attributed mainly to lower foreign liabilities, underpinned by matured deposits of the Retirement Funds. On the other hand, the net foreign assets continued to increase, in line with the growing foreign reserves and high-level remittances. Similarly, net domestic assets rose over the year, corresponding to higher credit to the private sector. Reserve Money also increased to a new high level in June 2024, rising from December 2023 by \$19.9 million (3.2%) and annually by \$31.1 million (5.2%) to \$631.8 million.

The annual rise resulted from increases in all major components. Statutory Reserve Deposits expanded due to increased deposits while Currency in Circulation rose in line with higher currency demand. Additionally, the increase in the banks' Exchange Settlement Accounts, from higher commercial bank deposits to the Reserve Bank vault and Reserve Bank net foreign currency purchases from the commercial banks contributed to the overall growth.

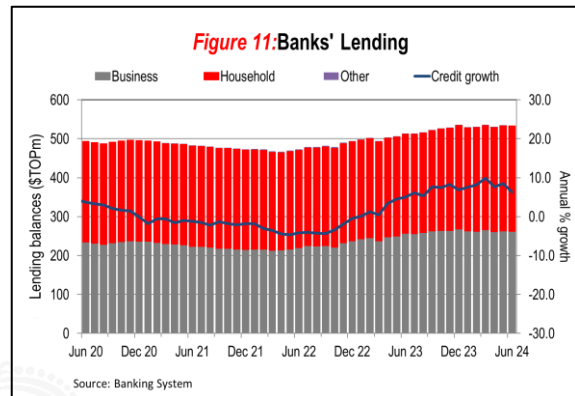
The Reserve Bank estimates excess liquidity of \$308 million in the banking system in June 2024, lower than \$311 million reported in the February 2024 MPS. The excess liquidity helped to lower interest rates, stimulating lending activity and economic growth. Managing excess liquidity is crucial for effective monetary policy transmission.



The weighted average interest rate spread widened over the past six months and year by 13.9 basis points and 13.1 basis points, respectively, reaching 6.3% in June 2024. Over the year to June 2024, the weighted average lending rate increased by 8.1 basis points whilst the weighted average deposit rate fell by 5.0 basis points. The loan rates offered to businesses within the agricultural, fisheries and the construction sectors increased whilst all households' loan rates fell over the year. The lower deposit rates however, were mostly driven by the significant increases in the volume of deposits.

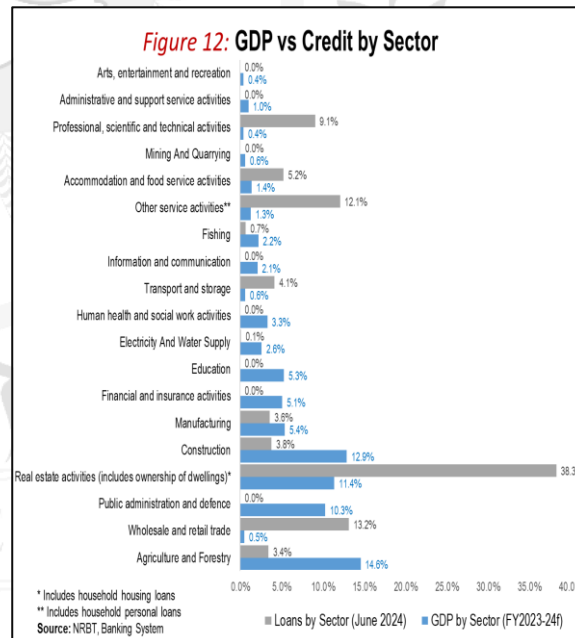


Total lending remained high in June 2024, with a slight decline of \$1.8 million (0.3%) from December 2023, but a significant year-on-year increase of \$20.9 million (4.1%), reaching \$533.5 million. Lending to both businesses and households grew over the year by 2.2% and 6.0% respectively. Sectors such as transport, tourism, and distribution experienced growth in business loans, along with all categories of household borrowing. Both rises reflected greater demand for credit and improved capacity for more loans.



Non-performing loans to total loans decreased to 11.2% in June 2024 from 11.8% in December 2023 but increased from 9.1% in June last year. The higher non-performing loans were mainly in the transport sector.

Credit growth is expected to remain high in the first quarter of FY2025. Stronger demand for credit is anticipated as the economy continues to recover, improving business confidence and investment appetite, thereby creating more employment opportunities. There were a number of loan campaigns in the second half of 2024, which is expected to improve competition and help to maintain lower interest rates.



While overall credit has expanded, the distribution of credit is a concern. Major productive and vulnerable sectors of the economy such as agriculture, manufacturing, fishing, and construction, are underserved in terms of accessing bank financing, as reflected on Figure 12. The Reserve Bank is actively

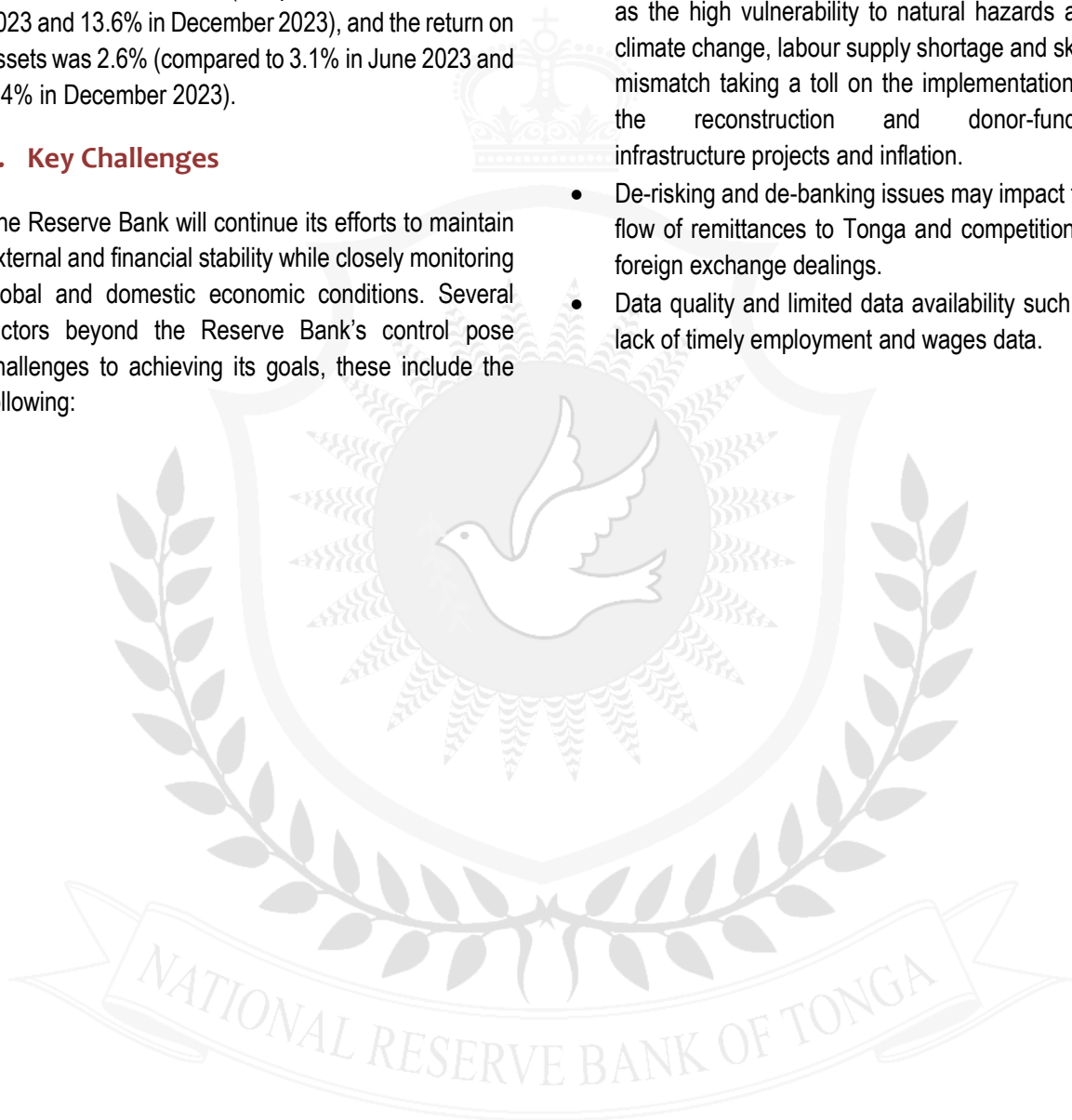
exploring strategies to enhance credit accessibility for these sectors and promote inclusive growth through its financial inclusion initiatives.

The banking system remained profitable throughout the year ending in June 2024, albeit lower than the previous year. It is expected to pick up the trend, primarily due to credit growth. The return on equity was estimated at 10.4% (compared to 12.6% in June 2023 and 13.6% in December 2023), and the return on assets was 2.6% (compared to 3.1% in June 2023 and 3.4% in December 2023).

e. Key Challenges

The Reserve Bank will continue its efforts to maintain external and financial stability while closely monitoring global and domestic economic conditions. Several factors beyond the Reserve Bank's control pose challenges to achieving its goals, these include the following:

- Narrow-based and geographically isolated economy that is highly vulnerable to domestic and external shocks such as global financial market volatility and global commodity prices developments, impacting the Tongan pa'anga exchange rate, inflation, as well as returns on foreign investments.
- Impediments to growth and growth potential such as the high vulnerability to natural hazards and climate change, labour supply shortage and skills mismatch taking a toll on the implementation of the reconstruction and donor-funded infrastructure projects and inflation.
- De-risking and de-banking issues may impact the flow of remittances to Tonga and competition in foreign exchange dealings.
- Data quality and limited data availability such as lack of timely employment and wages data.



Annex 2 - Monetary Policy Objectives

The Reserve Bank's principal objectives as laid out in Section 4(1) of the National Reserve Bank of Tonga (Amendment) Act 2014, shall be to:

- 1) Maintain internal and external monetary stability.
- 2) Without prejudice to its principal objective, the Bank shall:
 - a) Promote financial stability, and
 - b) Promote a sound and efficient financial system.

Subject to subsections (1) and (2), the Bank shall conduct its activities in a manner that supports macroeconomic stability and economic growth. Safeguarding macroeconomic stability requires addressing the imbalances in key macroeconomic variables in a sustainable manner, such as the foreign reserves and current account deficit, inflation, fiscal deficit and debt levels, and risks to employment, economic growth, and financial stability. This warrants policy trade-offs that must be carefully weighed to ensure the imbalances are manageable.

The Reserve Bank's monetary policy objectives are, therefore to maintain an adequate level of foreign exchange reserves and promote price stability in order to ensure internal and external monetary stability. Price stability entails low and stable inflation, which contributes to economic welfare, better economic performance, and sustainable economic development. Given Tonga's high dependence on imports, narrow export base, its small size, and vulnerability to external shocks and natural disasters, it is crucial to maintain the foreign reserves at an adequate level to meet the country's foreign currency needs such as payments for imports and the Government's external debt obligations.

In meeting the monetary policy objectives, the Reserve Bank can most effectively contribute towards macroeconomic stability, sustained economic growth, and raised prosperity for Tonga.

In accordance with Section 50(A) of the National Reserve Bank of Tonga (Amendment) Act 2014; The Bank shall, at least every six months, publish a Monetary Policy Statement and submit a copy to the Minister. The Statement shall contain:

- a. review of economic developments and the conduct of monetary policy in the period since the previous Statement;
- b. a statement of how the Bank intends to conduct monetary policy over the coming six months to achieve its objectives specified under the Act; and
- c. a statement of any other development outside its control, which are adversely affecting, or may adversely affect in future, the successful pursuit of the Bank's objectives under the Act.