Banking Sector Developments

July 2021

Release date: 04 November 2021

	Jul-21	Jun-21	May-21	Apr-21
Deposit rate (%)*	1.884	1.844	1.997	1.978
Lending rate (%)*	7.752	7.737	7.728	7.711
Total Deposits *(TSm)*	786.6	799.9	730.9	721.3
Total lending *(TSm)*	481.6	482.4	486.6	488.1
New commitments *(TSm)*	10.6	11.4	13.7	8.4
Broad Money *(TSm)*	769.7	764.9	724.7	712.3

*Weighted Average calculated as a function of interest rate and volume of deposits and loans

Total deposits decreased driven by lower demand deposits

Broad money

Broad money rose further in July 2021, by $4.8 million (0.6%) over the month and $152.8 million (24.8%) to $769.7 million over the year. Net domestic assets grew over the month, underpinned by higher net credit to central government, mainly on lower government deposits. This outweighed the decline in net foreign assets as foreign reserves decreased over the month due to large payments made for importing oil and other goods and services.

Table 1: Consolidated Balance Sheet of Depository Corporations

	Level as at			Change over the last	
	Jul-21 $TOPm	Jun-21 $TOPm	Jul-20 $TOPm	1 month % growth	1 year % growth
Broad money liabilities	**769.7**	**764.9**	**616.9**	**0.6**	**24.8**
Currency in circulation	97.2	94.5	76.1	2.9	27.8
Demand deposits	273.9	279.7	206.3	-2.1	32.8
Savings and term deposits*	398.6	390.6	334.5	2.0	19.2
equals					
Net foreign assets	**740.2**	**750.7**	**579.0**	**-1.4**	**27.9**
plus					
Net domestic assets	**30.3**	**15.0**	**38.4**	**102.2**	**-21.2**
Gross bank lending**	483.9	484.5	489.9	-0.1	-1.2
Public enterprises	50.0	50.3	59.3	-0.7	-15.8
Private Sector	432.0	432.2	428.1	0.0	0.9
Other financial corporations	1.9	1.9	2.4	-1.1	-21.1
Other***	-453.6	-469.5	-451.4	-3.4	0.5

* Also includes very minor amounts for securities other than shares.
** Differs slightly from standard measures of bank lending by amounts classified as accrued interest.
*** Includes mostly capital accounts of the banks and NRBT, and their net claims on the central government.
Sources: Banking system; NRBT

Over the year, net foreign assets rose and offset the decline in net domestic assets. Higher net foreign assets are in line with the substantial annual rise in foreign reserves from the receipts of official funds as loans, budget support, projects development, and financial assistance for COVID-19 preparations. However, the lower net domestic assets were attributed mainly to lower credit to public enterprises and lower net claims on the central government. The lower net claims on the central government is due to the receipt of the abovementioned government funds and the corresponding increase in government deposits over the year.

Liquidity

Liquidity in the financial system decreased over the month by $9.4 million (1.8%). The commercial bank's ESA declined over the month, from net purchases of foreign currencies from the Reserve Bank and net withdrawals from the Reserve Bank vault. This increased currency in circulation, which corresponded to the demand for currency from the festivities, and offset the rise in required reserves. However, higher liquidity over the year to July 2021 by $171.8 million (51.7%) was mostly driven by the bank's ESA, mainly on higher government deposits. Currency in circulation followed, in line with

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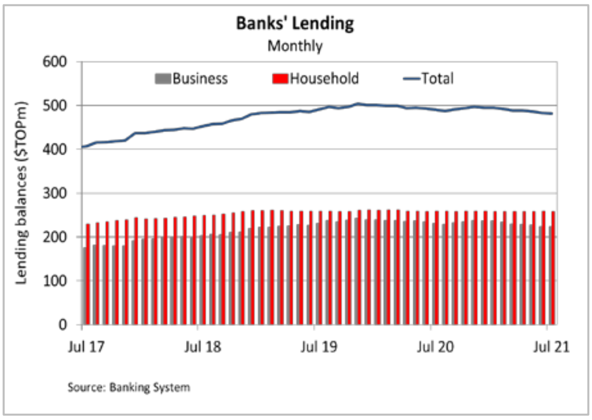
Kasanita Kisina, Economist | k.kisina@reservebank.to | +676 24057

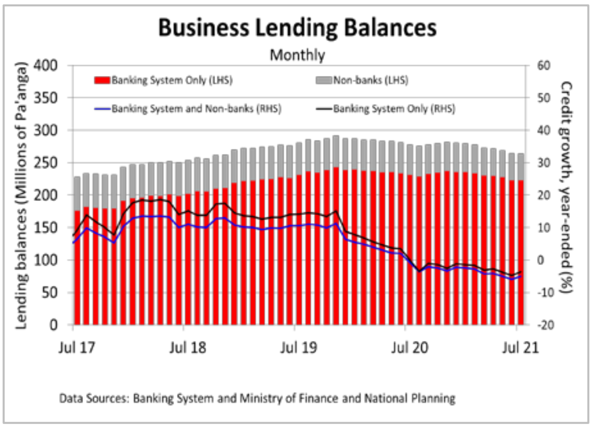
the festivities during the year, such as the churches annual donations, Easter and family Sundays', Christmas and New Year festivities, Kava Idol, and the Tonga High School Ex-Students' Fundraising. Required reserves also increased, corresponding to the rise in total deposits.



Lending

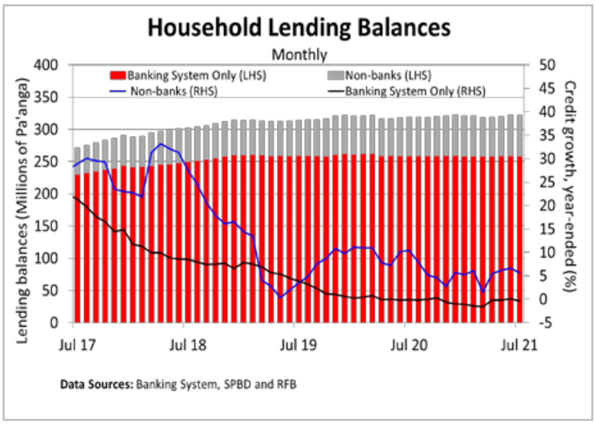
The banks' total lending declined again over the month and year to July 2021, by $0.8 million (0.2%) and $8.8 million (1.8%), respectively, to $481.6 million. The decline in lending resulted from loan run-offs and loan repayments by households and businesses.

Business lending



Over the month and year to July 2021, business loans decreased by $0.1 million (0.1%) and $8.3 million (3.6%), respectively, to $223.2 million. Both declines attributed to loan repayments made by public enterprises offsetting new loans to private businesses. Lower lending to businesses in the construction, professional & other services, and manufacturing sectors over the month and a decrease in loans to professional & other services, manufacturing, and transport sectors over the year also contributed to the decline. The slowdown in business lending reflects the impact of COVID-19 on investment appetite, as businesses remain cautious of the uncertainties while focusing on meeting their immediate financial obligations.

Household lending



Lending to households also declined in July 2021 to a total of $258.7 million, by $0.6 million (0.2%) and $0.9 million (0.3%) respectively over the month and year. The monthly decline was solely driven by lower housing loans, while decreased vehicle and other personal loans led to the annual decline.

Non-bank financial institutions

The total loans extended by the non-bank financial institutions increased over the month and over the year to June 2021 by $0.2 million (0.3%) and $3.4 million (5.6%). These loans are mostly offered to individuals in the informal and small-medium-sized enterprises (SMEs). This implies that non-bank financial institutions played a more significant role in financial access during the global pandemic. However, this may also contribute to household indebtedness.

Non-performing loans

In July 2021, the non-performing loans increased to 3.7% from 3.6% last month. However, non-performing loans improved from 4.3% in July 2020. The monthly rise was attributed mainly to downgrades made to some business loans coupled with arrears in various housing loans. The higher

Kasanita Kisina, Economist | k.kisina@reservebank.to | +676 24057

non-performing loans from the distribution, forestry and transport sectors also contributed to the monthly rise. However, over the year, the non-performing loans improved mainly for housing loans and businesses in the professional & other services, agricultural and transport sectors, reflecting loans restructured made by banks to its customers affected by COVID-19.

Table 2: Lending Balances (including new commitments)

	Level as at:			Change over the last:		*Shares of totals*
	Jul 21 TOPm	**Jun 21 TOPm**	**Jul 20 TOPm**	**1 month %**	**1 year %**	*%*
Lending, banks	481.6	482.4	490.4	-0.2	-1.8	100.0
Household	258.1	258.7	258.9	-0.2	-0.3	53.6
Business*	223.2	223.3	231.5	-0.1	-3.6	46.3
Other	0.4	0.4	0.0	-9.7	0.0	0.1
Lending, banks and other	586.5	587.6	597.4	-0.2	-1.8	100.0
Household**	322.0	322.4	319.4	-0.1	0.8	54.9
Business	264.1	264.8	278.0	-0.2	-5.0	45.0
Other	0.4	0.4	0.0	-9.7	0.0	0.1
New commitments, banks	10.6	11.4	8.1	-6.6	31.0	N/A
Undrawn commitments, banks	8.4	9.1	11.2	-7.1	-24.7	N/A
Implied repayments, banks	0.6	-0.9	10.6	-175.0	-93.9	N/A

* Method for calculating these series was updated in August 2014, resulting in revisions to the full history of data

* *Method for calculating these series was updated in January 2020, resulting in revisions to the full history of data

Sources: SPBD; RFB; MOFNP; Banking system

Private individual loans maintained the highest share of non-performing loans at 50.3%, mostly housing loans. The remaining 49.7% are business loans in the Agriculture (24.5%), Forestry (10.3%), Professional & Other Services (3.3%), Distribution (3.2%), Fisheries (3.2%)and Others (5.2%).

Deposits

In July 2021, the banks' total deposits fell by $13.4 million (1.7%) over the month. However, it rose over the year by $161.5 million (25.8%) to $786.6 million. Both demand and time deposits decreased over the month and outweighed the increase in saving deposits. The lower demand deposits is attributed to lower deposits by government and private businesses, reflecting the withdrawal of funds for government operations and COVID-19 projects as well as businesses' operational expenses. Similarly, time deposits decreased driven by matured pension fund term deposits. These offset the higher saving deposits over the month, which were mainly injected by churches annual donations.

Table 3: Deposit Balances

	Monthly				Annual		
	Jul-21	**Jun-21**	Change	**% Growth**	**Jul-20**	Change	**% Growth**
Total Deposits ($ in million)	786.6	799.9	-13.4	-1.7	625.1	161.5	25.8
Demand Deposits	335.2	356.0	-20.8	-5.8	245.3	89.9	36.6
Saving Deposits	161.8	151.1	10.7	7.1	114.5	47.3	41.3
Time Deposits	289.6	292.9	-3.3	-1.11	265.4	24.3	9.2

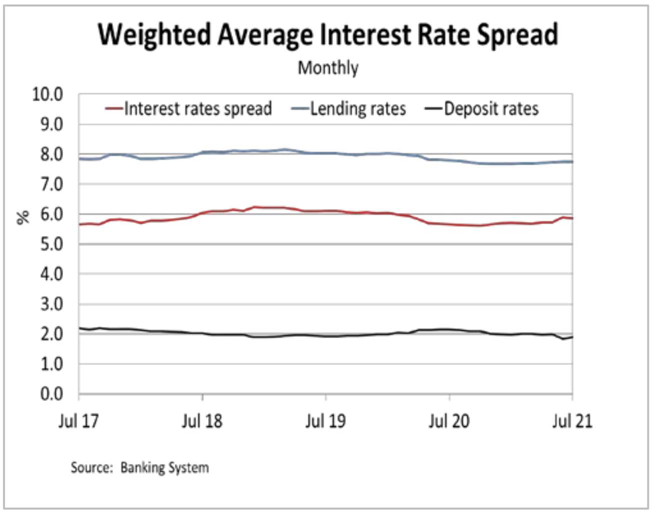
Sources: Banking Systems; NRBT

Annually, all categories of deposits increased, with demand deposits again rising the most due to deposits by the central government, public enterprises and private businesses. Savings deposits followed, resulting from higher deposits by the retirement funds, individuals and churches & schools. Time deposits also increased, underpinned by more deposits from churches & schools, private businesses and central government.

The increase in total deposits and the decline in total lending resulted in a lower loan to deposit ratio of 58.9% in June 2021, falling from 64.9% last month and still below the 80% minimum.

Kasanita Kisina, Economist | k.kisina@reservebank.to | +676 24057

Interest rate spread



The weighted average interest rate spread narrowed over the month of July 2021 by 2.5 basis points. This resulted from the weighted average deposit rates rising more than the rise in weighted average lending rates. Increased demand deposit rates solely drove the higher deposit rates. Lending rates increased for loans to the professional & other services and construction businesses as well as household housing and vehicle loans.

However, the weighted average interest rates widened by 21.2 basis points to 5.87%, over the year. The weighted average deposit rates decreased more than the fall in weighted average lending rates. All deposit rates fell, while business loan rates for construction, utilities and agricultural sectors also declined. The lower household other personal loan rates also supported the annual decline.

Table 4: Interest Rates

Weighted average of all banks						
	Level as at			Change over the last^		
	Jul-21 %	**Jun-21** %	**Jul-20** %	1 month bps	1 year bps	Share of loans/deposits %
Interest Rate Spread	5.868	5.893	5.656	-2.51	21.16	
Deposits all	1.88	1.84	2.14	4.03	-25.27	100
Demand	0.37	0.33	0.37	3.44	-0.07	41
Savings	2.48	2.54	2.60	-6.35	-11.61	22
Term	3.18	3.18	3.46	-0.95	-28.33	37
Loans all	7.75	7.74	7.79	1.52	-4.11	100
Housing	8.11	8.11	8.02	0.05	8.16	43
Other personal	11.30	11.30	11.34	-0.50	-4.80	11
Business	7.15	7.12	7.56	2.57	-40.99	30
Other	8.54	9.32	0.00	-78.57	853.82	16

*Method for calculating these series was updated in August 2014, resulting in revision to the full history of data

^Due to rounding errors some data may not aggregate precisely

Sources: Banking Systems; NRBT

Outlook

The NRBT continues to expect credit growth to remain subdued in the near term, with non-performing loans projected to rise for both businesses and households' housing and personal loans. These are mostly driven by the uncertainties of the COVID-19 pandemic, weak investment appetite, and softening aggregate demand. The Reserve Bank and the commercial banks closely monitor non-performing loans and adequacy of provisions to absorb any shock to the financial system, particularly, during the prolonged state of the pandemic.

Nonetheless, the current accommodative monetary policy stance encourages banks to utilize excess liquidity in the banking system for prudent lending to support economic recovery and growth.

The Reserve Bank will maintain financial and macroeconomic stability by closely monitoring all monetary indicators, such as credit growth, household and corporate indebtedness, and broad money.

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