Banking Sector Developments

October 2021

Release date: 12 May 2022

	Oct-21	Sep-21	Aug-21	Jul-21
Deposit rate (%)*	1.837	1.839	1.872	1.886
Lending rate (%)*	7.845	7.807	7.765	7.752
Total Deposits *(TSm)*	788.7	799.3	793.1	786.6
Total lending *(TSm)*	476.7	476.2	478.9	481.7
New commitments *(TSm)*	8.7	11.3	21.2	10.6
Broad Money *(TSm)*	789.7	783.8	775.4	769.7

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

Broad money rises on higher net domestic assets

Broad money[1]

Broad money continues to rise strongly over the month and year to October 2021, by $5.9 million (0.8%) and $134.5 million (20.5%) respectively, to $789.7 million. Net domestic assets rose in October as Government deposits fell, driving the monthly increase. This reflects the disbursement of funds for the Government's projects and operations during the month. This was partially offset by the decline in net foreign assets, mainly from lower banks' deposits offshore.

Table 1: Consolidated Balance Sheet of Depository Corporations

	Level as at			Change over the last	
	Oct-21 $TOPm	Sep-21 $TOPm	Oct-20 $TOPm	1 month % growth	1 year % growth
Broad money liabilities	**789.7**	**783.8**	**655.2**	**0.8**	**20.5**
equals					
Net foreign assets	**743.1**	**745.7**	**610.6**	**-0.3**	**21.7**
plus					
Net domestic assets	**47.5**	**39.0**	**45.6**	**21.9**	**4.2**
Gross bank lending*	479.5	478.6	493.7	0.2	-2.9
Public enterprises	47.6	48.6	58.9	-2.2	-19.2
Private Sector	430.0	428.1	432.6	0.4	-0.6
Other financial corporations	2.0	1.8	2.2	7.6	-11.6
Other**	-432.0	-439.6	-448.1	-1.7	-3.6

* 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

Annually, both the net foreign assets and net domestic assets increased. The receipts of official funds, budget support, projects development funds, and financial assistance for COVID-19 pushed the foreign reserves higher and thus net foreign assets. Similarly, the higher net domestic assets were underpinned by the increase in capital and non-financial assets.

Liquidity[2]

Liquidity in the financial system rose in October 2021 by $4.1 million (0.8%). The commercial banks' Exchange Settlement Accounts (ESA) and Statutory Required

Table 2: Liquidity in the financial system/Reserve Money

	Monthly			Annual	
	Oct-21	Sep-21	% Growth	Oct-20	% Growth
Liquidity in the financial systems/Reserve money ($ in million)	534.3	530.2	0.8	361.9	47.6
Currency in circulation	113.2	119.2	-5.1	98.7	14.6
Required reserves	74.7	74.2	0.7	60.5	23.4
Exchange Settelement Account balances	346.5	336.8	2.87	202.6	71.0

Sources: Banking Systems; National Reserve Bank of Tonga

[1] Broad Money (M2) consists of net foreign assets and net domestic assets.
[2] Liquidity in the Financial System is also called Reserve Money (M1) - consists of the NRBT currency in circulation, Statutory Required Deposits and Exchange Settlement Account Balances.

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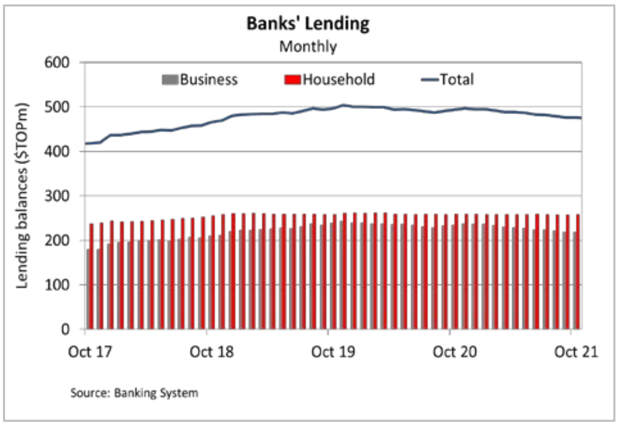
Deposits (SRD) increased by $9.7 million (2.9%) and $0.5 million (0.7%) respectively, and outweighed the $6.0 million (5.1%) drop in currency in circulation. The higher ESA is attributed mostly to net sales of foreign currencies to the Reserve Bank, corresponding to the inflow of remittance receipts.

Annually, liquidity continued to rise by $172.4 million (47.6%), again driven by the higher ESA, which rose by $143.8 million (71.0%) from higher net sales of foreign currencies to the Reserve Bank. SRD also rose by $14.2 million (23.4%), corresponding to the rise in total deposits. Currency in circulation was higher by $14.4 million (14.6%), reflecting higher demand for money for festivities such as the churches' annual donations, Kava Idol, and the Tonga High School Ex-Students' Fundraising.

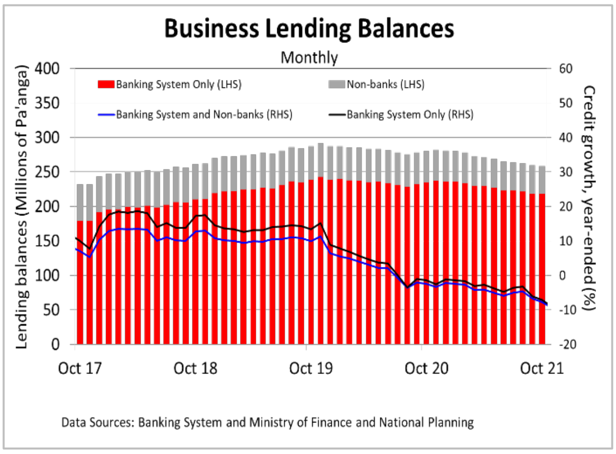
Lending

After declining for 10 consecutive months, the banks' total lending slightly rose over the month of October 2021, by $0.5 million (0.1%) to a total of $476.7 million. This was mostly driven by higher household loans. However, over the year, it continued to decline by $17.3 million (3.5%) as both business and household loans fell.



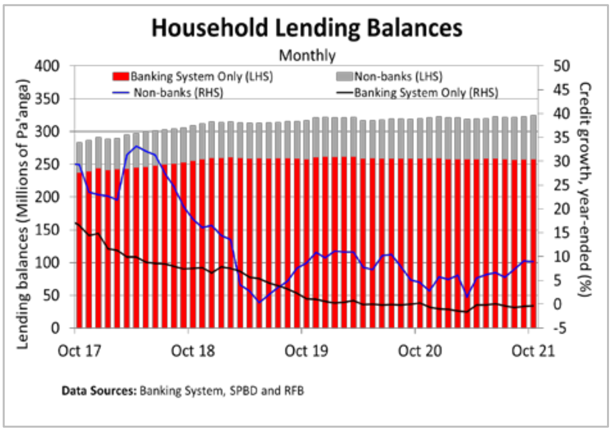
Business lending

Lending to businesses declined in October 2021, by $0.1 million (0.1%) and over the year by $16.6 million (7.0%) to $218.6 million. The monthly decline was attributed to loan repayments made by public enterprises and businesses within the construction, agricultural, and tourism sectors. These offset some of the new lending opportunities offered to the distribution, fisheries, and tourism sectors. Over the year, the lower business loans were mostly driven by the loan repayments made by public enterprises and businesses in the professional & other services, manufacturing, and transport sectors. Again these loan repayments offset some of the new loans issued. The new loan commitments reflect recoveries in these sectors, although most businesses remain cautious about the uncertainties associated with the COVID-19 developments.



Household lending

In October 2021, household loans increased over the month by $0.7 million (0.3%), however, declined annually by $1.0 million (0.4%) to $257.8 million. This was led by lower housing loans, followed by other personal loans, and vehicle loans.



Non-bank financial institutions

Over the month and year to October 2021, the total loans extended by the non-bank financial institutions (NBFIs) increased by $0.9 million (1.4%) and $5.4 million (9.0%), respectively. These loans are mostly offered to individuals in the informal sector, and small-medium-sized enterprises (SMEs). This reflects the NBFIs' role in promoting financial inclusion and access to finance for those whom the banking sector may not serve. However, this also raises concerns over household indebtedness.

Table 3: Lending Balances (including new commitments)

	Level as at:			Change over the last:		*Shares of*
	Oct 21 TOPm	Sep 21 TOPm	Oct 20 TOPm	1 month %	1 year %	*totals %*
Lending, banks	476.7	476.2	494.0	0.1	-3.5	100.0
Household	257.8	257.1	258.8	0.3	-0.4	54.1
Business*	218.6	218.8	235.2	-0.1	-7.0	45.9
Other	0.3	0.3	0.0	-13.3	0.0	0.1
Lending, banks and other	582.7	582.4	599.7	0.1	-2.8	100.0
Household**	324.1	322.5	319.6	0.5	1.4	55.6
Business	258.4	259.6	280.0	-0.5	-7.7	44.3
Other	0.3	0.3	0.0	-13.3	0.0	0.1
New commitments, banks	8.7	11.3	11.0	-22.7	-21.0	N/A
Undrawn commitments, banks	10.5	9.6	15.9	9.4	-33.6	N/A
Implied repayments, banks	-0.9	7.8	6.3	-111.7	-114.5	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

Non-performing loans

In October 2021, the non-performing loans accounted for 3.9% of total loans, compared to 4.2% in September 2021 and 3.6% in October last year. The monthly improvement reflects housing loan upgrades and, lower non-performing agricultural, distributions, and professional & other business sectors' loans. Annually, non-performing business loans increased mainly for the construction, agricultural, and forestry sectors despite improvements in non-performing household housing and vehicle loans.

Private individual loans contain the highest share of non-performing loans at 50.7%, comprised mostly of housing and other personal loans. The remaining 49.3% are business loans in the Agriculture (24.4%), Construction (13.1%), Distribution (3.0%), Forestry (2.3%), Fisheries (1.6%), Transport (1.4%) and Other (3.5%) sectors.

Table 4: Deposit Balances

	Monthly				Annual		
	Oct-21	**Sep-21**	Change	**% Growth**	**Oct-20**	Change	**% Growth**
Total Deposits ($ in million)	788.7	799.3	-10.6	-1.3	655.8	132.9	20.3
Demand Deposits	335.0	343.9	-8.9	-2.6	272.9	62.1	22.7
Saving Deposits	177.4	178.5	-1.1	-0.6	119.7	57.7	48.2
Time Deposits	276.3	276.9	-0.6	-0.23	263.1	13.1	5.0

Sources: Banking Systems; NRBT

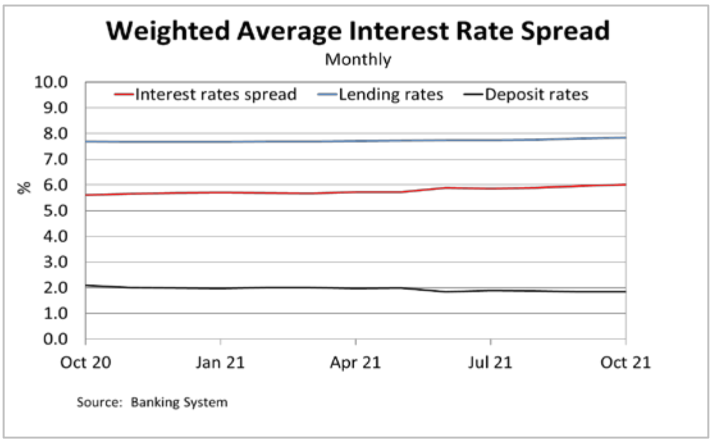
Deposits

In October 2021, the banks' total deposits declined by $10.6 million (1.3%) but rose annually by $132.9 million (20.3%). All the three categories of deposits declined over the month, led by lower demand deposits from Government and public enterprises. Saving and time deposits also declined due to lower savings by individuals and retirement funds' matured deposits.

However, annually, all the three categories of deposits rose. Demand deposits increased the most, underpinned by large deposits made by private businesses, government, and individuals. Similarly, the deposits made by the retirement funds, individuals, and churches continue to contribute the most to saving deposits. The higher time deposits resulted mainly from higher deposits made by Government, churches, and schools.

The lower deposits over the month together with the rise in lending resulted in an increase of the loans to deposit ratio from 58.2% in September 2021 to 59.1% in October 2021. However, the loans to deposits ratio fell from 73.8% last year due mainly to higher deposits coupled with lower lending, thus remaining below the 80% minimum threshold.

Interest rate spread



The weighted average interest rate spread widened over the month and year to October 2021, by 4.1 basis points and 39.9 basis points, respectively, to 6.01%. Both increases were attributed to the higher weighted average lending rate, coupled with the decline in the weighted average deposit rate.

The lending rates offered to businesses within the construction, distribution, and tourism sectors rose over the month, as well as households' vehicle and other personal loan rates. Similarly, higher lending rates were also offered annually to non-profit organizations, and businesses in the construction, utilities, and distribution sectors. This is in addition to higher lending rates for households' housing and vehicle loans.

Table 5: Interest Rates

Weighted average of all banks

	Level as at			Change over the last^		Share of loans/deposits
	Oct-21 %	**Sep-21** %	**Oct-20** %	1 month bps	1 year bps	%
Interest Rate Spread	6.008	5.967	5.610	4.09	39.85	
Deposits all	1.84	1.84	2.09	-0.27	-25.49	100
Demand	0.32	0.36	0.38	-3.47	-6.13	41
Savings	2.43	2.43	2.61	0.69	-17.87	24
Term	3.19	3.19	3.45	-0.59	-26.38	35
Loans all	7.84	7.81	7.70	3.82	14.36	100
Housing	8.10	8.10	8.06	-0.10	3.74	44
Other personal	11.31	11.30	11.34	0.83	-2.64	11
Business	7.38	7.29	7.19	9.52	19.49	30
Other	8.00	9.40	0.00	-140.23	800.00	15

*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

However, the lower weighted average deposit rate over the month was mainly due to declines in the demand and term deposit rates. Annually, all deposit rates declined.

Outlook

Credit growth is expected to remain subdued in the near term, while non-performing loans is projected to rise for 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 will continue to monitor non-performing loans and ensure adequate provisions are in place to absorb any shocks to the financial system.

The current monetary policy stance remains accommodative and the Reserve Bank will continue to ensure financial and macroeconomic stability is maintained, by closely monitoring all monetary indicators such as credit growth, household and corporate indebtedness, and broad money.

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