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Monetary Policy Decision

The National Reserve Bank of Tonga's Board of Directors at its board meeting on the 28th October 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 experienced mixed growth in August 2019. Agricultural exports decreased in August due to lower exports of root crops. However, the inflow of agricultural and marine export proceeds increased, and export proceeds are expected to rise in the upcoming months as harvesting of squash for exports continues. Activities within the secondary sector such as construction remain strong on the commencement of the reconstruction of schools, as well as the construction of church buildings and private individual houses. This is in-line with an increase in housing as well as construction sector loans. On the other hand, the services sector indicators were mixed with international air arrivals slowing in August while container registrations increased. Vehicle registrations fell over the month.

The banking system continues to be sound supported by strong capital and adequate profits. The banks' total loans to deposit ratio slightly rose from 78.4% to 79.0% over the month, reflecting loans increasing at a faster pace than the increase in deposits. Given that this is very close to the 80% minimum loan to deposit ratio, the liquidity in the banking system remains fairly high indicating existing capacity is still available for further lending. The weighted average interest rate spread widened to 6.11%. This is due to an increase in weighted average lending rates, offsetting the decline in weighted average deposit rates.

Official foreign reserves decreased by \$1.1 million to \$491.8 million (equivalent to 8.1 months of imports cover) in August 2019 and is attributed to higher oil and other import payments.

The annual headline inflation continued to be subdued, Tonga recorded deflation of 0.1% in August, compared to inflation of 6.1% last year. The yearly deflation was due largely to a fall in domestic prices by 2.5%, particularly for kava Tonga and local food items. The cheaper local food prices reflect a recovery of crops and vegetables from the impacts of Tropical Cyclone Gita last year. On the other hand, imported prices increased by 1.9% on the increase in imported prices except for transport, reflecting lower fuel 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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