NATIONAL RESERVE BANK OF TONGA

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OFFICIAL PRESS RELEASE

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Monetary Policy Decision

The National Reserve Bank of Tonga's Board of Directors, at its board meeting on the 5th of August 2021, approved to maintain its current monetary policy measures outlined below. This is to encourage utilization of the excess liquidity in the banking system by further lending to growth sectors and supporting the economy from the impacts of COVID-19.

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%.
d. Maintain the inflation reference rate at 5%.
e. Monitor the commercial banks' liquidity and adjust the SRD ratio if needed.
f. Monitoring the commercial banks' capital reserves and adjust further when required.
g. Ease the exchange control requirements when required.
h. Continue to issue Government Bonds.
i. Maintain clear channels of effective communications with the financial institutions for adequate preparedness.
j. Continue to be transparent and raise awareness of its monetary policy decisions through press releases to the public.
k. Closely monitor the impacts of the pandemic in the financial system for early detection of any signs of vulnerability.
l. Continue to ensure both commercial banks and non-bank financial institutions adheres to all Government declarations regarding COVID-19 in the workplace while delivering essential financial services to the public.

According to the Governor of the Reserve Bank, Sione Ngongo Kioa, the domestic economic activities showed some improvements in May 2021. The primary sector reported higher exports of agricultural products, particularly cassava and taro. Meanwhile, the secondary industry varied with lower lending to the manufacturing and utilities sectors, while lending to the construction sector rose. The service sector slightly improved over the month, with container and vehicle registrations rising. This aligned with a rise in import payments indicating a more active trading sector.

Inflation declined by 0.2% in May 2021 after increasing on a monthly basis since October 2020, mainly due to lower domestic food prices. Headline annual inflation rose again by 4.7% as a result of an increase in both imported and domestic prices. This stemmed from higher imported prices for fuel, food, and tobacco, whilst local food & tobacco prices drove domestic prices higher.

In May 2021, the official foreign reserves rose by $9.9 million to $689.5 million, equivalent to 12.0 months of imports. This was attributed mostly to receipts of donor funds to support Tonga's recovery from COVID-19. In year ended terms, foreign reserves still increased significantly by $199.9 million from receipts of budget support, official grants, and remittances.

The total banking system continues to maintain its soundness, supported by strong capital positions and excess liquidity. Total deposits rose by $9.5 million (1.3%) while total lending declined by $1.5 million (0.3%), resulting in a lower loan to deposit ratio of 64.9% in May 2021, falling from 66.0% last month and still below the 80% minimum. The weighted average interest rate spread marginally narrowed in May 2021 by 0.02 basis points, however, it widened annually by 3.9 basis points to 5.7%.

The Reserve Bank's GDP outlook projects a deeper contraction in the economy for 2020/21. Extended lockdowns and uncertainties, particularly in relation to COVID-19, remain the most significant risk to the outlook. However, foreign reserves is still expected to remain at sufficient levels above the 3 months minimum threshold of import cover. Inflation is expected to continue rising above the 5% reference rate in mid-2021, in line with the rebound in global oil and commodity prices. However, it is expected that inflation will fall back below 5% by the last quarter of 2021. The banking system is still sound supported by high liquidity, adequate capital and subdued credit growth. The Reserve Bank continues to be vigilant by closely monitoring its economic and financial indicators, and stands ready to adjust its monetary policy settings if needed to maintain internal and external stability and support macroeconomic growth.

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