

*National Reserve Bank of Tonga*

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*Annual Report 2006-07*

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*Pangike Pule Fakafonua 'o Tonga*



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**National Reserve Bank of Tonga**

**Annual Report for the Year Ended 30 June 2007**



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Salote Road  
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Postal Address: Private Mail Bag No. 25  
Post Office  
Nuku'alofa  
Tonga  
South Pacific

Enquiries: Phone: (676) 24-057  
Facsimile: (676) 24-201  
Email : nrbt@reservebank.to  
Telex: 94079763 NRBT G  
Swift BIC code: NRBTTONU

Subscription: Research Department  
National Reserve Bank of Tonga  
Private Mail Bag No. 25  
Post Office  
Nuku'alofa  
Tonga  
South Pacific

Discrepancies between the sum of the constituent items and the total, as shown in some tables, are due to rounding.  
Revisions to previously published statistics are included as they occur.

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## Governor's Forward

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The Tongan economy showed considerable resilience over 2006/07 in the face of substantial economic shocks. Significant increases in public service salaries paid in two tranches over the past two years, as well as large scale redundancies, placed considerable strains on inflation and the government's fiscal balance. Furthermore, the civil unrest in November 2006 threatened the macroeconomic stability of the country with the destruction of around 20 percent of Tonga's GDP. The Ministry of Finance forecasts economic growth to have contracted in 2006/07 by 3 to 4 percent. Ongoing record prices of imported commodities, particularly oil, added to the internal shocks, while appreciations in the New Zealand and Australian dollars placed further upward pressure on imported inflation. The culmination of these events presented major challenges to the conduct of monetary policy.

I am pleased to report that despite these many challenges, the external balance of the country continued to improve, stability and confidence in the financial sector was maintained and inflation eased. The level of official foreign exchange reserves remained above 4 months of import cover throughout 2006/07 and average inflation fell to 5.1 percent, the lowest level in 7 years. Beyond 2006/07, a moderate pick-up in activity is expected, underpinned by increased construction spending. It is pleasing to note that growth in lending for business investment is already gathering momentum.

The financial year began with growth in household credit continuing at an unsustainable pace, albeit well below the growth in 2005/06. Credit ceilings, introduced in January 2006, were extended to December 2006, allowing for an expansion of credit that was consistent with the protection of foreign exchange reserves and macroeconomic stability. However, the civil unrest of 16 November 2006 dramatically changed the economic outlook, therefore the Reserve Bank refocused its policy measures to maintain monetary and financial sector stability. Amid the crisis, the Reserve Bank liaised on a daily basis with the banks to ensure that the public's requirements for currency were effectively and securely satisfied. Foreign exchange guidelines were tightened and the quality of banks' loan portfolios was closely monitored. In February 2007, the credit ceilings were suspended, allowing affected businesses to have greater access to funds for reconstruction. Liquidity in the banking system nevertheless remained constrained and in April, the Reserve Bank reduced the required reserves ratio of commercial banks from 12.5 percent to 10 percent, resulting in an injection of T\$6.2 million into the banking system. Monetary policy has since remained accommodative, with the Reserve Bank choosing to leave excess liquidity in the banking system by refraining from issuing Reserve Bank notes in order to facilitate reconstruction.

In an important milestone in the development of Tonga's financial system, The National Reserve Bank Amendment Bill 2007 was passed by the Legislative Assembly in August 2007 after being deferred in 2005. This Act will strengthen the institutional capacity of the Reserve Bank and ensure greater autonomy in the conduct of monetary policy. The Act also strengthens the accountability and transparency of the Reserve Bank in exercising its powers. The Reserve Bank will be required to publish every six months a Monetary Policy Statement; the first Statement was published in September 2007. The release of regular Statements on Monetary Policy mean that commentary relating to the conduct of monetary policy will no longer be included in the Annual Report as in previous years.

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Separate to the Act and to further enhance accountability and transparency, the Reserve Bank reviewed its policies and procedures relating to liquidity management and in October 2006 commenced publishing daily liquidity data on its website. In December 2006, the terms and conditions of the Reserve Bank's Repurchase Agreement facility were revised and the repurchase agreement rate was set at 2 percent above the inter-bank market rate.

Substantial progress was also made in enhancing accountability and transparency within the wider financial system. The release of Prudential Statement No. 3, relating to administrative penalties, which became effective in September 2006, is designed to ensure the timely and accurate provision of data by banks, a vital prerequisite for sound economic and financial decision making. Furthermore, the release of Prudential Statement 4, Disclosure of Interest rates and Fees and Charges, requires banks to fully disclose the cost of their services and products and became effective in August 2007. This Prudential Statement was prepared after consultations with the newly-formed Association of Banks in Tonga (ABT), an initiative that was welcomed by the Reserve Bank. The establishment of the ABT in April 2007 is expected to provide an important forum for the discussion of issues that can only enhance the effectiveness and efficiency of the financial system.

Despite the unexpected crisis of November 2006, which interrupted the implementation of the 2006/07 workplan, the Reserve Bank successfully completed its target to update the documentation of the Bank's policies and procedures together with staff job descriptions. The Reserve Bank continued to carry out its regular functions that contribute to monetary and financial sector stability. These functions include the supply of Tongan currency, provision of daily settlement for inter-bank transactions, foreign exchange operations with the government and the banks, foreign exchange control administration and registrar of government bonds.

The Reserve Bank continued to develop the skills base of its staff, through local and overseas training. Staff participated in courses across the range of central banking functions, including bank supervision, reserves management, remittances, anti-money laundering, balance of payments reporting and information technology.

The annual accounts of the National Reserve Bank of Tonga comply with the requirements of the International Financial Reporting Standards, with the exception of the treatment of foreign currency gains and losses, which meets the provisions of the National Reserve bank of Tonga Act, 1988. The Reserve Bank's balance sheet expanded to T\$133.4 million, a 6.4 percent increase from the previous year attributed mainly to the increase in the level of official foreign reserves over the year. Consequently, the Reserve Bank's operating profit, reached T\$3.6 million, an increase of 14.5 percent over the previous year.

I thank the staff of the Reserve Bank for their efforts during a very challenging period for the Reserve Bank and the Tongan economy. I also thank the government and members of the financial sector for their part in ensuring that confidence and stability in the system was maintained. Appreciation is also extended to the members of the Bank's Board for their continued support during the year. The assistance from the International Monetary Fund, Pacific Technical Assistance Centre, the Reserve Banks of Australia, New Zealand and Fiji, other regional central banks, the Bank of England Centre for Central

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Banking Studies, AusAID, NZAid, AUSTRAC, AMLAT and the Pacific Antimoney Laundering Project is also gratefully acknowledged.

A handwritten signature in black ink, appearing to read 'Mafi'.

Siosi C. Mafi  
Governor

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**Board of Directors of the National Reserve Bank of Tonga  
as at 30 June 2007**

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HRH Princess Salote Pilolevu Tuita  
*Acting Chairperson*



Hon. Siosua T. T. 'Utoikamanu  
*Minister of Finance*



Mr. Richard Prema



Mrs. Siosi Cocker Mafi  
*Governor*

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## Principal purposes of the National Reserve Bank of Tonga

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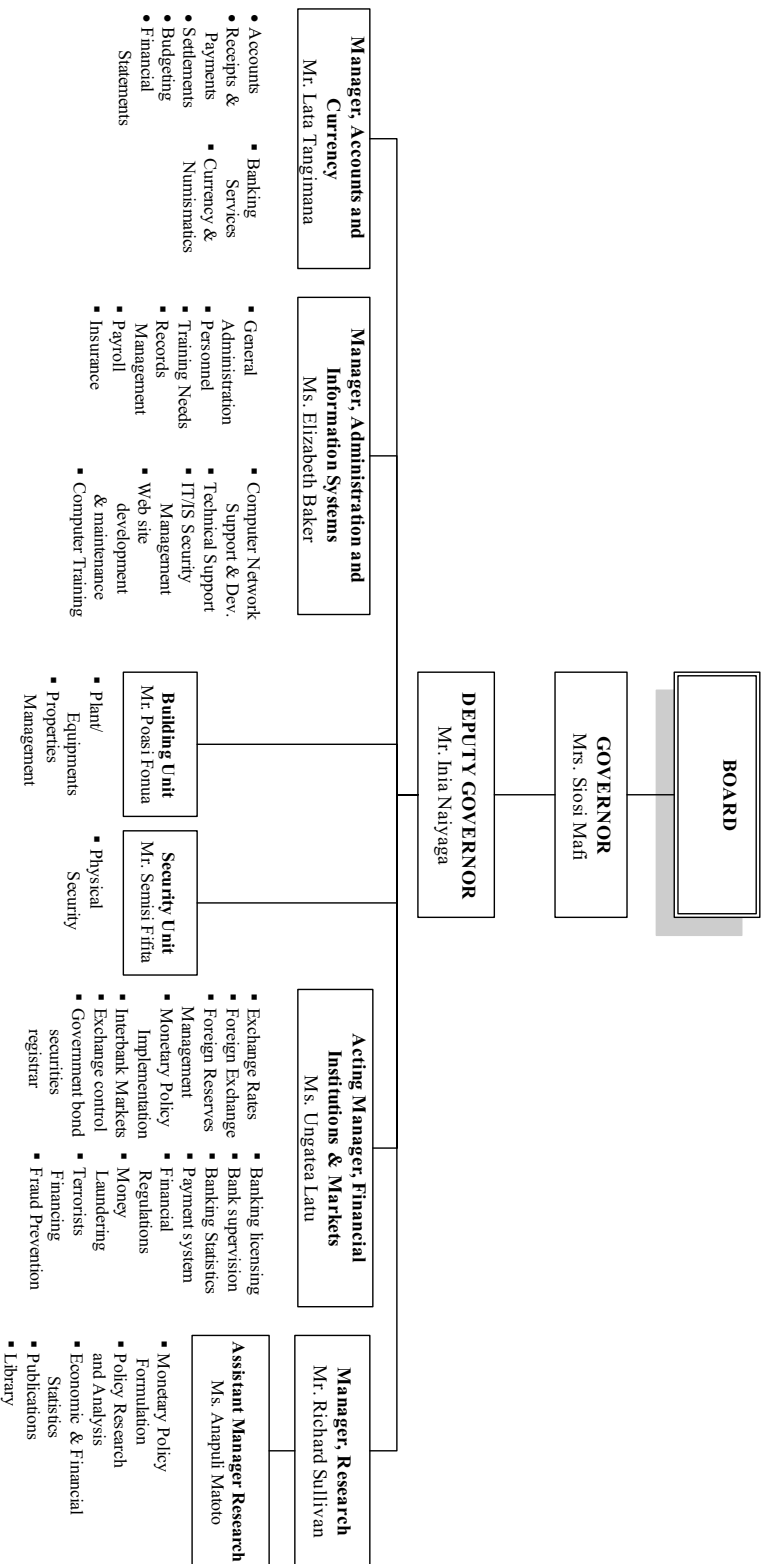
“The principal purposes of the National Reserve Bank of Tonga shall be:

- (a) to regulate the issue of currency, and the supply, availability and international exchange of money;
- (b) to manage the external reserves of the Kingdom;
- (c) to promote monetary stability;
- (d) to promote a sound financial structure;
- (e) to foster credit and exchange conditions conducive to the orderly and balanced economic development of the Kingdom;
- (f) to provide advisory services to the Minister on banking and monetary matters;
- (g) to be the principal banker and fiscal agent of the Government;
- (h) to undertake banking business, in Tonga or elsewhere, subject to the provisions of this Act;
- (i) to undertake the licensing and supervision of financial institutions.”

Section 4  
National Reserve Bank of Tonga Act, Cap 102

# NATIONAL RESERVE BANK OF TONGA

June 2007



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## Economic Overview

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### Overseas Economic Developments

The strong global expansion continued through the past year, with world economic activity estimated to have grown by 3.8 percent in 2006. The outlook is for the world economy to maintain solid growth through 2007 and 2008. Although growth in the United States slowed in the first half of 2007, activity is expected to expand strongly elsewhere. China and India are projected to once again record rapid growth, while above-trend levels of growth are expected in Japan and the Euro zone. Australia and New Zealand are expected to post economic growth at around trend.

The strong growth in China in particular has led to strong demand for industrial inputs, pushing input prices up throughout the world. In turn, inflation rose in most countries through 2006, prompting tighter monetary conditions in China, Japan, Australia, New Zealand, the United Kingdom and the Euro zone. Of Tonga's main trading partners only the United States did not increase interest rates in 2006/07. The outlook is for consumer prices to remain generally well contained, though with less upward pressure as China's attempts to curb growth appear to have some success stemming the upward pressure on industrial inputs prices.

Table 1 : INTERNATIONAL ECONOMIC INDICATORS									
	Real GDP			Consumer Prices			Current Account Balances		
	Annual percent			Annual percent change			Percent of GDP		
	2006	2007	2008	2006	2007	2008	2006	2007	2008
United States	2.9	1.9	1.9	3.2	2.7	2.3	-6.2	-5.7	-5.5
Japan	2.2	2.0	1.7	0.3	0.3	0.5	3.9	4.5	4.3
Euro area	2.8	2.5	2.1	2.2	2.0	2.0	-0.3	-0.2	-0.4
China	11.1	11.5	10.0	1.5	4.5	3.9	9.4	11.7	12.2
Australia	2.7	4.4	3.8	3.5	2.3	2.8	-5.5	-5.7	-5.6
New Zealand	1.6	2.8	2.3	3.4	2.4	2.7	-8.7	-8.5	-8.6

Source : IMF World Economic Outlook, October 2007

Global financial markets saw bond yields rise in response to expectations of ongoing global growth and for monetary policy to remain firm. Since the end of June 2007, an unwinding of 'carry-trades' and widespread defaults of sub-prime mortgages in the United States have seen bond yields fall as demand for safe-haven investments drives down yields.

Growth in the United States slowed significantly in 2006/07 as the soft housing market showed no signs of recovering and high energy prices continued to constrain industrial production. The Federal Reserve maintained the Fed Funds Rate at 5.25 percent throughout the year as worries about inflation offset weaker growth. Growth is expected to pick up in the second half of 2007, as business investment picks up. However, residential investment continues to show marked weakness and the recent sub-prime market turmoil has shown high indebtedness among poorly-rated borrowers. The ensuing turbulence in financial markets has swayed the Federal Reserve to look at easier monetary conditions despite ongoing inflation concerns.

Double-digit growth continues in China with exports rising rapidly, though the expansion is broadly-based. Concerns that the economy is overheating are mounting, and while inflation is well contained expectations are rising. China's authorities have regularly tightened financial conditions in an attempt to rein in activity, raising benchmark interest rates and reserve requirements for banks.

Japan's economy grew by 2.3 percent in the year ended June 2006, with a pick-up in domestic demand driving growth. Growth in the coming year is expected to be at about the same rate as industrial production and exports pick up. With the outlook for inflation to be above zero in the future, interest rates are also expected to rise further, following the end of the zero-interest rate policy last year. Elsewhere in Asia, growth is to be above trend, according to the latest Consensus Forecasts.

Australia's impressive economic expansion continues and heads into its 15th consecutive year. A massive boost to Australia's terms of trade from the industrial commodities boom has led to an increase in business investment that is expected to remain strong. The long period of growth is starting to show in capacity constraints with unemployment at historically low levels. As such inflationary pressures remain and despite holding rates steady for much of the last year, the Reserve Bank of Australia has resumed its tightening cycle with further monetary tightening expected before the end of 2007.

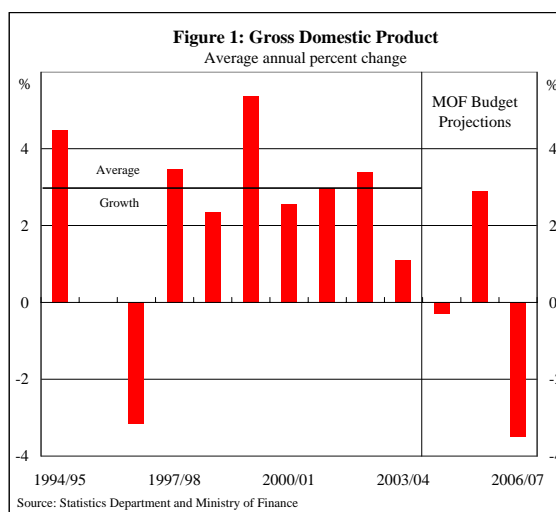
Similarly, New Zealand has experienced a terms of trade boost through high export commodity prices. Along with a very resource stretched domestic economy, a persistently strong housing market and high imported input costs, inflation remains of concern to policy makers. Four rate increases over the last year appear to have finally taken the heat out of the housing market, and a period of slower growth is expected. A lower New Zealand dollar will increase imported inflation concerns and the Reserve Bank of New Zealand is unlikely to ease monetary policy over the next year.

The Pacific region has seen mixed economic fortunes over the past year. Political turmoil in Fiji and the Solomon Islands have undermined those economies to greater or lesser extent. Fiji has experienced a large fall in tourism receipts, compounding the reduction in exports from a poor agricultural season. Investment and manufacturing are also subdued. In contrast, the civil unrest in Solomon Islands seemed to have had only a small impact on the economy there. High industrial commodity prices are supporting the mining industries there. Likewise Papua New Guinea benefits from its resource rich mining sector. In Samoa, a construction boom in preparation for the South Pacific Games boosted the economy and ongoing growth in tourism has seen the economy grow robustly.

## Domestic Economic Conditions

Economic growth was estimated by the Ministry of Finance to have fallen from 2.9 percent in 2005/06 to a contraction of 3.5 percent in 2006/07, which is the lowest rate of growth in the past ten years (Figure 1).

Agricultural output, which comprises nearly a quarter of GDP, again fell, though by less than in 2005/06. For the first six months of 2006/07, trade data suggests that production of squash, Tonga's main cash crop, as well as root crops, vanilla and nonu were subdued. Kava on the other hand made positive contributions to agricultural exports from Tonga. Output from fishing and other marine products rose as live and fresh fish exports recovered positively, more than offsetting the low export from agriculture sector.



Moderate growth in construction activity is estimated, as most of the arrangements in insurance and loan relief for rebuilding of the Nuku'alofa Central Business District (CBD) are still progressing. Household sector construction was also subdued after slower growth in housing credit during the financial year 2006/07.

The commerce, hotels & restaurants sector, which includes retailing and wholesaling, as well as many tourist activities fell in 2006/07, reflecting the destruction of nearly 80 percent of the Nuku'alofa CBD. However it is expected to pick up again after the reconstruction and settlement of insurance claims. Surveys conducted by the Reserve Bank reported moderate growth in vehicle sales.

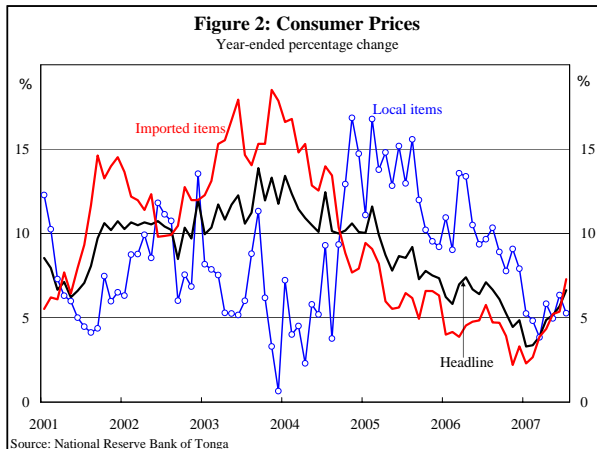
Total visitor arrivals to the Kingdom, which includes air and cruise ship arrivals, declined last year, for the first time in 5 years.

Table 2. TONGA MAIN ECONOMIC INDICATORS					
		2003/04	2004/05	2005/06	2006/07
<b>Economic Activity (1995/96 base)</b>					
Real GDP	% change	1.1	-0.3	2.9	-3.5
Tourist Air Arrivals	thousands	43.6	51.9	53.3	52.8
<b>Money, Prices &amp; Interest Rates</b>					
CPI (average)	% change	11.8	10.0	7.2	5.1
CPI (year-end)	% change	10.1	8.7	6.4	5.7
Money Supply (M2 - year end)	\$m pa'anga	180.3	203.5	237.3	265.5
Domestic Credit (year end)	\$m pa'anga	174.0	210.3	264.5	295.2
Weighted-term deposit interest rates (year end)	% per annum	6.5	6.0	6.8	6.6
<b>External Sector</b>					
Merchandise exports fob (OET basis)	\$m pa'anga	28.3	31.1	31.9	26.7
Merchandise imports fob (OET basis)	\$m pa'anga	169.0	204.2	245.4	217.5
Official foreign reserves (year end)	\$m pa'anga	89.7	82.1	83.2	91.6
Import coverage (year end)	months	5.4	4.4	4.3	4.4
Exchange rate (period end)	US\$/T\$	0.5	0.5	0.5	0.5
Sources: Ministry of Finance Budget 2007/08, Ministry of Tourism, Statistics Department and National Reserve Bank of Tonga					

## Prices

Headline inflation as measured by the Consumer Price Index (CPI) continued to slow in 2006/07. The CPI rose by 5.7 percent in the year ended June 2007, down from the 6.4 percent rise in year ended June 2006 (Figure 2). Average annual inflation in 2006/07 was 5.1 percent, down from 7.2 per cent in the previous year and also below the IMF forecasted average annual inflation rate of 10.3 per cent. The decline in the rate of inflation was mainly due to a slowing of price increases of domestic goods.

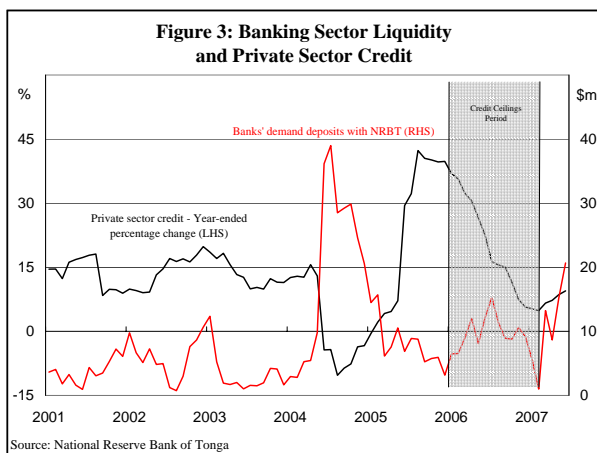
Domestic inflation increased at lower rate of 6.3 percent during the year ended June 2007, compared with a 9.4 percent increase in the previous year. The fall in domestic inflation reflected a fall in transportation prices by 0.4 percent compared to an 18.7 percent increase recorded in the previous year. The decline in transportation prices reflected a fall in world oil prices in early 2007. Other categories that contributed to the slowing inflation rate include clothing and hardware, tobacco and alcohol, and housing. Household operation prices recorded a rise of 15.5 percent and miscellaneous goods and services increased by 5.8 percent. Domestic food prices, notably fruits and vegetables, also recorded a fall due to favourable weather during the past year.



In contrast, the price of imported goods rose by 5.4 percent in the year ended 2007, compared with the 4.8 percent rise in the year ended June 2006. Food prices contributed the most with 2.7 percentage points to the annual inflation, reflecting New Zealand dollar appreciation against the Tongan pa'anga as more than half of the total imported goods are from New Zealand. Further, rises in overseas underlying inflation, particularly New Zealand and Australia over the year put pressure on prices of imported items.

### Financial Intermediation

Total broad money (M3), a broad measure of money supply, increased by 13.3 percent in the year-ended June 2007, this level of growth is similar to June 2006 although it is a pick up in growth in the second half of financial year 2006/07. The suspension of the credit ceiling in February 2007 and the lowering of the Statutory Required Reserves Ratio in April 2007 are to assist with the anticipated pick-up in the demand for credit to support reconstruction after the civil unrest of 16 November last year (Figure 3).



Throughout the financial year 2006/07, lending by the banking system was mostly towards the business sector (19.4 percent year-ended growth) with household credit falling to a year-ended growth of 2.2 percent in June 2007 from 22.4 percent in June 2006. Most of the lending to households was for housing and to a smaller extent, other personal purposes. Business lending was broadly based across other services, wholesale & retail, manufacturing and transport & storage.

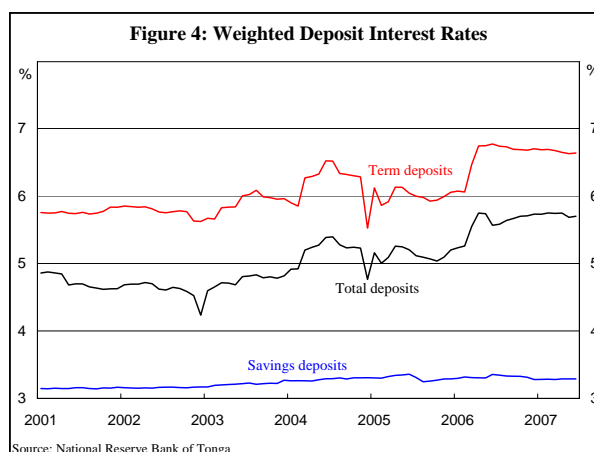
The increase in lending in 2006/07 was largely funded by a rise in term deposits and demand deposits, with term deposits increasing by 15.7 percent in the year ended June 2007. Saving deposits growth fell at the end of June, reflecting the one-off redundancy payments to retiring civil servants, being shifted into longer-term, higher yielding accounts.

The government continued to be a net lender to the banking system in the financial year 2006/07 accommodating the growth in credit to the private sector.

### Interest Rates

Interest rates were relatively stable in 2006/07, reflecting high liquidity in the financial system. In the second half of 2006, financial conditions continued to tighten mainly reflecting the continuous strong growth in lending over the previous twelve months and lower-than-expected receipts from squash

exports. The payments of civil service redundancies and the second tranche of the civil service salary increase from government deposits with the banking system heightened the need for banks to increase their liquidity levels. This underpinned strong competition amongst the banks for funds. In the first half of 2007, the Reserve Bank eased its monetary policy stance by removing the credit ceilings imposed on lending to private sector to allow banks to consider lending for the recovery of those who were affected by the civil disorder of 16 November 2006. In addition, the Reserve Bank reduced the required reserves to inject additional liquidity into the banking system to assist with the anticipated pick-up in the demand for credit to support reconstruction. By the end of June 2007, the Reserve Bank's term deposit indicator rate, a weighted average of interest rates paid by commercial banks, fell to 6.6 percent from 6.8 percent a year earlier (Figure 4). The lending indicator rate, a weighted average of interest rates across household and business lending, was largely unchanged at 12.3 percent.



The increase in nominal interest rates and the fall in inflation resulted in real deposit interest rates moving to positive territory. The move towards positive real interest rates has encouraged savings in financial institutions, thereby enhancing financial intermediation and promoting an environment conducive to economic development.

### External Developments

According to overseas exchange transactions data collected from the commercial banks, the deterioration in the current account deficit was offset by an improvement in net capital inflows, resulted in a rise in the level of official foreign exchange reserves (Table 3). The reduction in the trade deficit in 2006/07, reflected the substantial fall in imports, mainly consumer goods, since the civil unrest in November 2006, in which retail and wholesale businesses were greatly affected. The value of imports fell by \$27.9 million to \$217.5 million, consistent with the fall in private remittances and sluggish growth in credit to household sector over the year. Exports fell by \$4.3 million to \$26.7 million, largely reflecting lower export earnings from squash.

Net remittances, the main source of Tonga's foreign exchange earnings, fell by \$9.8 million to \$168.8 million in 2006/07, largely reflecting a fall in private transfer receipts and to a smaller extent a fall in private transfer payments. The deficit on the services account partly reflected a fall in tourist receipts as a result of the civil disorder of 16 November last year, while the net balance on investment income remained a modest surplus. These movements resulted in a widening of the current account deficit from around \$46 million to \$51 million or 11.1 percent of GDP.

The capital account surplus rose by \$8.5 million to \$53.8 million in 2006/07, reflecting an increase in official and private capital inflows. The improvement in the capital account together with the net unrecorded inflows more than offset the deterioration in the current account deficit, which resulted in a balance of payments surplus of \$8.4 million and a higher level of official foreign reserves. Gross official foreign reserves rose to \$91.6 million at the end of June 2007, an amount equivalent to 4.4 months worth of imports (Table 2).

<b>Table 3. OVERSEAS EXCHANGE TRANSACTIONS (OET): Annual Summary</b>				
	<b>2003/04</b>	<b>2004/05 <sup>2/</sup></b>	<b>2005/06 <sup>2/</sup></b>	<b>2006/07</b>
<b>A. Merchandise trade balance</b>	-140.8	-173.1	-214.4	-190.8
Exports, f.o.b.	28.3	31.1	31.0	26.7
Imports, f.o.b.	169.0	204.2	245.4	217.5
<b>B. Services balance</b>	-5.9	-19.3	-15.7	-35.8
Receipts	52.7	45.9	50.9	38.8
Payments	58.5	65.2	66.6	74.7
<b>C. Investment income balance</b>	-0.8	3.1	5.7	7.1
Receipts	5.6	6.6	9.9	12.9
Payments	6.4	3.5	4.2	5.8
<b>D. Transfers balance</b>	163.1	178.1	178.4	168.6
Receipts	185.7	208.7	205.5	187.3
<i>Private</i>	184.4	208.1	205.0	186.8
<i>Official</i>	1.3	0.6	0.5	0.5
Payments	22.6	30.6	27.1	18.7
<i>Private</i>	21.9	30.0	26.5	18.1
<i>Official</i>	0.7	0.6	0.5	0.6
<b>E. Current account balance (A+B+C+D)</b>	15.7	-11.1	-46.1	-50.9
<b>F. Capital account balance</b>	75.6	24.2	45.3	53.8
Official capital	28.1	9.4	16.9	19.7
<i>Inflows</i>	33.1	16.2	22.8	24.7
<i>Outflows</i>	5.0	6.9	5.9	5.0
Private capital	47.5	14.9	28.4	34.2
<i>Inflows</i>	56.5	34.2	37.5	39.9
<i>Outflows</i>	9.0	19.3	9.1	5.7
<b>G. Other items, net</b>	-38.5	-20.7	1.9	5.5
<b>H. Overall balance (E+F+G) <sup>1/</sup></b>	52.8	-7.6	1.1	8.4
1/ Corresponds to changes in gross official foreign reserves.				
2/ Revised				
Totals may not add up due to rounding.				
Source: National Reserve Bank of Tonga				

## Economic outlook

The economic outlook for 2007/08 is highly uncertain. The Tongan economy has coped with major economic shocks in the past two years, and shown significant resilience. Unless further major economic shocks occur, activity should increase over the next year, but this brings with it risks of higher inflation and lower official foreign reserves. The expected increase in activity, especially in construction and related industries will be affected by the likelihood of long delays in receiving funding for reconstruction, both in terms of aid and insurance.

World markets for Tonga's main agricultural export, squash, are poor and likely to remain so for some time. Despite efforts to diversify the squash production into other varieties, agricultural output is likely to be subdued over the next year. Similarly, fishing exports are expected to be low. Tourism receipts will recover from the low base of the 2006/07 year when tourist receipts significantly fell due to the November 2006 civil unrest.

The trade deficit is anticipated to be larger in 2007/08 due to expected higher imports and stagnant exports. As such, higher net services, and net transfers and higher capital account surplus are required to minimize the adverse impact on the level of official foreign reserves and the balance of payments position. Business investment appears to be recovering well from the lows experienced at the end of 2006, with higher growth in new business loans recorded in the first half of 2007 rising from 16.1 percent over the year to February 2007, to 19.4 percent at the end of June 2007. This growth is expected to continue, underpinning domestic activity, and some capital inflows. Net transfers appear to be picking up from the low level in the first half of 2007, and private remittances receipts are expected to increase in the second half of the year in line with a number of significant events in Tonga such as the Heilala festival, Tonga High School 60th anniversary, consecration of the Coadjutor Bishop of the Catholic Church, Tonga College 125th anniversary, dedication of the newly renovated Tonga Temple of the Church of Latter Day Saints, large regional conferences including the 38th Pacific Islands Forum, rugby tournaments, and family and island reunions.

Inflation is expected to remain under significant pressure from two main sources. First, the continuing high international prices for oil and food. The high world oil prices will exert upward pressure on domestic prices directly through the price of fuel and indirectly through the price of oil-related services such as electricity, transportation, etc. Second, the continuing appreciation of the New Zealand dollar will put upward pressure on imported inflation given New Zealand is the main source of imports. These pressures are unlikely to dissipate quickly, and therefore domestic prices are expected to be adversely affected.

Given the above and the uncertainty of the outlook for the Tongan economy, the Reserve Bank projects that the level of official foreign reserves will decline to around 3 months of import cover by the end of June 2008.

# Financial Markets

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## Open Market Operations

The Reserve Bank continued issuing Reserve Bank Notes, by tender to improve its ability to manage liquidity and enhance the efficiency of the banking system. The Reserve Bank concentrated on issuing 28 day Reserve Bank Notes by tender on a weekly basis at an average yield that is based on the latest published market rates which ranged between 4.65 percent and 5.0 percent per annum. However, since March 2007 there has been no issuance of Reserve Bank notes following the decision by the Reserve Bank to ease its monetary policy stance. This was to allow banks to consider lending for the recovery of those who were affected by the civil unrest in November 2006. Therefore, at the end of 30 June 2007, the outstanding Reserve Bank Notes was nil.

The National Reserve Bank of Tonga Act 1988 prohibits the Reserve Bank from making unsecured loans to any of its customers. Any borrowing from the Reserve Bank has to be secured by government bonds, NRBT notes or any other security specified by the Board. In order to improve the effectiveness and efficiency of its liquidity management function, the Reserve Bank reviewed its liquidity management policy and procedures in 2006/07. In October 2006, the Reserve Bank commenced publishing weekly liquidity data on its website and in December 2006, it revised the terms and conditions for its Repurchase Agreement facility for domestic banks. The repurchase agreement is to be arranged for a maximum period of 7 days with minimum amount of T\$50,000. The repurchase agreement rate was set at 2 percent above the inter-bank market rate or 10 percent per annum whichever is higher. As at the end of June 2007, the repurchase agreement rate was at 12 percent. In 2006/07, the Reserve Bank received one application and entered into a repurchase agreement transaction with one of the licensed financial institutions.

The Financial Markets department also monitors activities in the domestic inter-bank market. The record showed that inter-bank activities picked up during the 2006/07 financial year. Total loans of \$17.07 million were made during the year for maturities ranging from overnight to two months compared to total loans of \$12.35 million in the previous year. The increase in the total loans in the inter-bank market largely reflected the tight liquidity experienced by one of the licenced financial institutions. The interest rate charged by the banks for overnight loans increased to 10 per cent per annum in 2006/07 compared with 8 percent per annum in 2005/06.

## Reserves Management

The Reserve Bank is required to maintain, within the limit of its powers, an external reserve at a level of at least 3 to 4 months of imports. During the year the gross official external reserves ranged between 4.0 months and 4.6 months of import cover. The level of gross external reserves ranged from \$80.6 million to a peak of \$91.6 million at the end of June 2007. At 30th June 2007 the total official external reserves at \$91.6 million was estimated to be 4.4 months of imports. This compares with the level of \$83.2 million at 30 June 2006, equivalent to 4.3 months of imports. This reflected the decline in the growth of imports since December 2006. After the events of November 2006, both annual total foreign exchange receipts and annual total foreign exchange payments declined with the fall in total payments outweighing the decline in total receipts. The maintenance of the level of official foreign reserves above 4 months of imports contributed to maintaining confidence in the financial system of the country after the civil disorder of November 2006.

The Reserve Bank holds the external reserves mainly in US dollars, Australian dollars, New Zealand dollars, pounds sterling, euro and IMF special drawing rights. In managing the external reserves, the Reserve Bank's policy is to obtain the maximum income commensurate with safety, liquidity and the maintenance of overall value. Accordingly, the external reserves are invested in deposits with international banks that have a minimum A rating by international credit rating agencies, government securities and deposits with central banks.

### **Foreign Exchange Operations**

The Reserve Bank conducts foreign exchange operations with the domestic commercial banks in the intervention currency only, the US dollar. The Reserve Bank quotes daily buying and selling rates for the US dollar against the pa'anga. These rates generally form the basis of the commercial banks' publicly quoted foreign exchange dealing rates. The Reserve Bank also conducts foreign exchange operations for its other customers, and for its own account, in a range of currencies. The Reserve Bank was a net buyer in the spot foreign exchange markets during the year. Foreign exchange purchases of T\$92.9 million exceeded sales of T\$84.5 million giving a total foreign exchange turnover for the year of T\$177.4 million.

### **Exchange Control Operations**

The Foreign Exchange Control (Amendment) Regulations 2000 assigns the authority over sending money and securities out of the Kingdom to the Reserve Bank. This authority includes licensing of foreign exchange dealers. The Reserve Bank has licensed two authorized restricted foreign exchange dealers under the Foreign Exchange Control (Amendment) Act 2000. These authorized foreign exchange dealers are the Fund Management Limited which operates Western Union and Rowena Financial Services Limited. Commercial banks are authorized dealers under their banking licence.

The Reserve Bank continued to liaise with the Ministry of Labour Commerce and Industries to ensure all companies and businesses that are currently accepting foreign exchange and making foreign exchange payments and transfers are licensed. Any entity that is engaged in buying and selling foreign exchange must be licensed by the Reserve Bank under the Foreign Exchange Control Act. During the year, the Reserve Bank had issued a public notice to retail shops regarding illegal exchanging of foreign currency without a licence.

The Foreign Exchange Control (Amendment) Regulations 2000 gives the Reserve Bank the administrative powers of the Foreign Exchange Control Regulations. The Reserve Bank's prior approval is required for all outward current transfers of T\$50,000 and above and all capital transfers irrespective of the amount. All outward current transfers of less than T\$50,000 have been delegated to the commercial banks and licensed foreign exchange dealers subject to the Reserve Bank's foreign exchange control guidelines.

Following the 16 November 2006 riots, the Reserve Bank, under the Emergency Power (Maintenance of Public Order) Regulations 2006, introduced a requirement for obtaining of the Reserve Bank's prior approval for the removal of cash of over T\$10,000 from the Kingdom. During 2006/07, the Reserve Bank received 10 applications for removal of cash of over T\$10,000, of which 7 were approved totalling T\$0.3 million. In addition, the Reserve Bank amended the exchange control documentary requirement guidelines to reduce the delegated limit to the commercial banks and authorised foreign exchange dealers on travel payments to T\$20,000 from T\$50,000.

The Reserve Bank processed 872 exchange control applications totalling T\$156.5 million (of which 9 percent were classified as capital transactions) compared to 649 exchange control applications processed in 2005/06 amounting to T\$140.3 million. The increase in exchange control applications may be attributed to the increase in awareness by the banks and the authorized foreign exchange dealers on the exchange control requirements in Tonga.

The Reserve Bank continued to hold meetings with customers to clarify and improve the understanding of its Exchange Control policies and requirements. This included joint meetings with the Tonga Chamber of Commerce, the Tonga New Zealand Business Association, the banks and authorized restricted foreign exchange dealers, as well as bilateral meetings with some large customers. The Reserve Bank also conducted quarterly technical meetings with the Revenue Services Department and Customs to coordinate efforts in ensuring the objectives of the Exchange Control policies and requirements are being achieved.

### **Registrar of Government Bonds**

The Reserve Bank acts as registrar for all of the Government of Tonga's bond issues, the total value of which was \$24.7 million at 30 June 2007 compared to \$24.9 million in the previous year. The total value of government bonds declined towards the end of the year due to the payout of the government bonds which matured in June 2007. The Reserve Bank continued to seek to develop the domestic capital market in Tonga and is marketing its holdings of government bonds on its website. The Reserve Bank may also provide a secondary market for government bonds to increase or reduce liquidity in the banking system depending on the Reserve Bank's monetary policy stance.

## Financial Institutions

The National Reserve Bank of Tonga Act, 1988 and the Financial Institutions Act, 2004 authorise the Reserve Bank to undertake the prudential supervision of the licensed financial institutions. The primary objectives of the Reserve Bank in this area are the stability of the financial system and the security of depositors' funds with licensed financial institutions.

During the year, there was no change to the composition of the financial system in Tonga which is three commercial banks, a development bank and the central bank.

### Financial Sector: Facilities and Operations

#### *Licensed Financial Institutions in Tonga*

<u>Financial Institutions</u>	<u>Headquarters</u>	
Westpac Bank of Tonga	Nuku'alofa,	Tonga
MBf Bank Limited	Nuku'alofa,	Tonga
Australia and New Zealand Banking Group Limited	Melbourne,	Australia
Tonga Development Bank	Nuku'alofa,	Tonga

The Westpac Bank of Tonga (WBOT) maintained its head office and two branches on Tongatapu as well as branches on the islands of Vava'u, Ha'apai, and 'Eua. The operation of WBOT from its head office in Nuku'alofa was affected by the closure of part of Nuku'alofa at the wake of the civil unrest of November 2006. The MBf Bank Limited maintained its head office on Tongatapu and a branch on the island of Vava'u. The MBf Bank's head office in Nuku'alofa was severely damaged during the riots of November 2006 which caused the operation of MBF Bank Ltd in Tongatapu to be suspended for a few days. Prior to 16 November 2006, the ANZ Bank operated its main branch in Nuku'alofa Tongatapu and also maintained a sub-branch on Vava'u. The main branch of ANZ Bank in Nuku'alofa was completely destroyed during the riots on Thursday 16 November 2006. However, ANZ Bank worked remarkably hard to set up operation at Ma'ufanga, Nuku'alofa and was able to provide basic banking services in the afternoon of Monday 20th November 2006. In December 2006, ANZ Bank opened its Administration office in the Mailetaha Plaza Building in Nuku'alofa and on 26th March 2007, its second branch was opened in the Nuku'alofa CBD. This was a commendable achievement by the ANZ Bank and was crucial for maintaining confidence in the banking system. The TDB maintained its head office on Tongatapu, as well as branches on the islands of Vava'u, Ha'apai, 'Eua, Niuaotupapu and Niuafo'ou. TDB's banking services was also affected by the riots of November 2006 due to the closure of the

<b>Table 4. FINANCIAL SECTOR ACCOUNTS</b>					
	<b>2002/03</b>	<b>2003/04</b>	<b>2004/05</b>	<b>2005/06</b>	<b>2006/07</b>
<b>Demand Deposits</b>					
Number of Accounts	17,751	14,487	22,077	2,878	2,657
Value of Deposits (\$m)	57.4	69.7	68.3	56.1	66.7
<b>Saving Deposits</b>					
Number of Accounts	53,790	29,693	66,885	39,361	45,816
Value of Deposits (\$m)	36.9	37.1	41.9	62.4	54.1
<b>Time Deposits</b>					
Number of Accounts	5,546	2,002	2,428	2,318	1,710
Value of Deposits (\$m)	49.3	67.2	88.4	113.0	130.5
<b>Total Number of Accounts</b>	<b>77,087</b>	<b>46,182</b>	<b>91,390</b>	<b>44,557</b>	<b>50,183</b>
<b>Total Value of Deposits (\$m)</b>	<b>143.5</b>	<b>174.0</b>	<b>198.6</b>	<b>231.4</b>	<b>251.2</b>
Source: National Reserve Bank of Tonga					

Nuku'alofa area which included its head office in Nuku'alofa. TDB swiftly set up shop at Queen Salote College to serve its customers' banking requirements.

The total assets of the financial sector (licensed financial institutions) reached \$396.6 million in 2006/07, an increase of \$35.3 million (9.8 percent) over the year. Total net loans by the banks to the non-financial sector grew by \$16.6 million (6.0 percent) compared with a \$49 million (21.8 percent) growth recorded in 2005/06. At the end of the 2006/07, the banks' outstanding loans portfolio comprised: 53.1 percent for private individuals (of which 37.9 percent was for housing); 45.5 percent for industries and businesses including agriculture; and the remaining 1.4 percent was for other types of loans. The marked slow down in the growth in credit extended by banks to the private sector resulted in improved liquidity position in the banking industry. This slowdown in lending was not only attributed to the Reserve Bank's credit ceiling on the banks' private sector lending but also due to lack of bankable projects. Growth in total net loans slowed to 9.8 percent at the end of October 2006 before it fell to a low of 3.1 percent in February 2007. Following the easing of the Reserve Bank's monetary policy stance in February and April 2007 to allow banks to lend for the recovery of those customers that were affected by the civil disorder in November 2006, total net loans growth picked up to 6.0 percent at the end of June 2007. The remaining balance of banks' assets were invested in other domestic banks including the Reserve Bank.

On the liabilities side, total deposits by non-financial sector grew by \$19.8 million (8.6 percent) to \$251.2 million in 2006/07 and the total number of accounts increased by 12.6 percent to 50,183 (Table 4). Total notes and bonds issued by the banks increased by \$5.5 million (27.1 percent) over the year. The increase in deposits and investment in notes issued by the domestic banks supported the liquidity position of the banking industry during the year. Total borrowing by the banks from other financial institutions increased by \$6.3 million (22.0 percent) mainly sourced from domestic banks.

### Financial Performance

Despite the large provisions made by the banks for losses from the civil disorder of 16 November 2006, the total financial sector as a group showed a pre-tax profit of 4.9 percent in 2006/07, compared with 5.3 percent in 2005/06. This was due to an increase in the banks' average assets while profitability remained relatively unchanged over the year (Table 5).

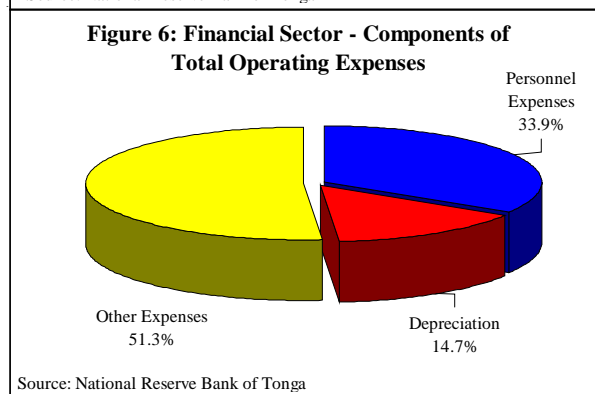
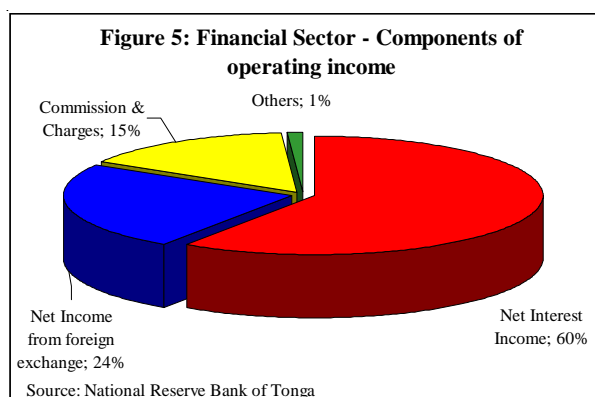
Total operating income was 11.2 percent of average assets, a slight decline from 11.5 percent in 2005/06. Net interest income was 6.6 percent of average assets, a slight decline from 6.9 percent in 2005/06.

**Table 5. FINANCIAL PERFORMANCE**

	2002/03	2003/04	2004/05	2005/06	2006/07
Pre-tax Net Profit (% average total assets)	5.5	5.2	6.1	5.3	4.9
Total Operating Income (% average total assets)	11.5	12.0	12.6	11.5	11.2
Net Interest Income (% average total assets)	7.4	7.4	7.7	6.9	6.6
Non-interest Income (% average total assets)	4.1	4.6	4.9	4.7	4.6
Average Net Interest Margin (%)	8.9	8.9	9.8	8.3	7.9
Total Operating Expenses (% average total assets)	5.0	5.6	5.7	4.9	5.5
Consolidated Risk-weighted Capital Ratio (%)	21.8	27.6	22.4	21.2	19.7

Source: National Reserve Bank of Tonga

Even-though the bulk of banks' operating income was derived from the extension of loans, the composition of net interest income slightly fell to 59.3 percent of total operating income in 2006/07 compared with 59.5 percent in 2005/06. Foreign exchange business made up 24.4 percent of total operating income, an increase from 23.4 percent in the previous year and the balance of 16.3 percent came from commission and charges plus other income sources. Total non-interest income, as a percentage of average assets slightly fell to 4.6 percent from 4.7 percent in the previous year. The average net interest margin (net interest income as a percentage of average earning assets) for the banks decreased to 7.9 percent in 2006/07 compared with 8.3 percent in 2005/06 which was due mainly to the higher growth in average earning assets during the year in particular investments with domestic banks and loans to the non-financial sector.



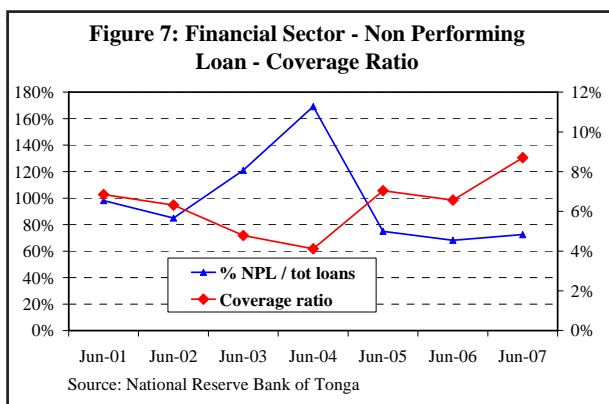
The operating expenses of the banks increased to 5.5 percent of average assets in 2006/07 compared to 4.9 percent in 2005/06. This was due mainly to an increase in the banks' operating expenses over the year attributed to losses incurred by the banks from damages to their properties and loan losses following the civil unrest on 16 November 2006. About 33.9 percent of administrative expenses of the banks were taken up by employees' remuneration, a decrease from 38.1 percent in the previous year. Depreciation and amortisation accounted for 14.7 percent of total administrative expenses and the balance of 51.3 percent was made up of the purchase of various goods and services necessary for the operations of the banks.

### Liquidity

Liquidity in the banking system had improved in 2006/07 underpinned by the slow down in credit growth and the improvement in the balance of payment. Net loans as a proportion of deposits decreased to 93.6 percent from 98.2 percent in 2005/06. Furthermore, the Liquid Asset Ratio slightly rose to 10.6 percent compared with 10.3 percent in 2005/06.

### Capital

Even-though the consolidated risk weighted capital ratio for all the banks decreased slightly to 20.7 percent at the end of 2007 compared with 21.9 percent at the end of June 2006, the capital position of the banking industry remains strong and above the minimum ratio required by the Reserve Bank. The decline in the capital adequacy ratio over the year was attributed mainly to the growth in risk-weighted assets, in particular loans to the private sector, outweighing the relatively unchanged profitability in the banking system during the year.



### Asset Quality

The overall quality of the banks' assets weakened over the year as more of the banks' loans were downgraded to non-accrual status following the civil unrest on 16 November 2006. Total non-performing loans slightly rose to 4.8 percent of total loans compared with 4.5 percent at the end of June 2006. At the same time, the banks increased provisions significantly over the year to take into account the effects of 16 November, therefore the coverage ratio of the non-

performing loans by total loan loss reserves markedly improved to 115.3 percent at the end of June 2007 from 98.5 percent at the end of June 2006 (Figure 7).

### Supervision of Licensed Financial Institutions

The Financial Institutions Department continued its supervisory role by monitoring and evaluating the overall strategies, policies and performance of licensed financial institutions. The soundness of the risk management systems of financial institutions and the competence of those managing them are assessed against legal and prudential criteria and minimum standards required by the Reserve Bank. The Reserve Bank continued to undertake its supervisory function through offsite and onsite surveillance. Reports from licensed financial institutions were analyzed to ensure that their activities complied with the terms and conditions of their licences and other specified regulatory and prudential standards such as capital adequacy, limits on credit exposures, asset quality, credit risk grading and provisioning. The reports were also analyzed for any significant changes in their financial conditions.

The Prudential Statement on Administrative Penalties issued for comments in February 2006 became effective in October 2006. This Statement outlines the Reserve Bank's administrative fee structure imposed on licenced financial institutions as stipulated under the Financial Institutions Act 2004. Draft Prudential Statements on Liquidity and Disclosure of Interest Rates and Fees and Charges were issued to the banks for comments during the year. The Prudential Statement on Disclosure of Interest Rates and Fees and Charges became effective in August 2007. This Statement sets out the Reserve Bank's requirements with regard to the form and content of the disclosure of interest rates and fees and charges relating to the products and services offered by licenced financial institutions in Tonga. This will enable the general public to compare interest rates and fees and charges between various services and products provided by banks. Moreover, this should foster market discipline and competition.

The Reserve Bank conducted an on-site examination of one licensed financial institution to review its risk management systems and their applications. The main focus of the risk management review was on credit, operational, liquidity, and interest rate risk management systems as well as compliance with anti-money laundering and combating the financing of terrorism laws. The Reserve Bank continued to hold regular meetings with licensed financial institutions in order to discuss their operations and compliance with the financial institutions regulations. In addition, the Reserve Bank continued to conduct quarterly technical meetings with each bank to clarify the Reserve Bank's reporting requirements, improve the accuracy of reporting to the Reserve Bank and to discuss issues of mutual interest to both parties. The Reserve Bank also held technical meetings with the Ministry of Labour, Commerce, and Industries to

coordinate efforts and to facilitate the procedures for licensing of banks and foreign exchange dealers.

The damage caused by the civil disorder in November 2006 threatened the stability and confidence in the financial system of the Kingdom. However, the Reserve Bank worked closely together with the banks, the government and the public to ensure that confidence in the domestic financial system was maintained. This was deemed successful in that there were no signs of capital flight and or abnormal increase in public demand for cash.

To assist businesses that were affected by the civil unrest of November 2006, a business recovery facility funded by the Australian and New Zealand Governments were established and the Reserve Bank is the custodian for this facility.

The Association of Banks in Tonga was established in April 2007 which was welcomed by the Reserve Bank as it will encourage coordination and cooperation among domestic banks which would support the soundness and stability of the financial system. It will ensure a level playing field and enhance the effectiveness and efficiency of the Reserve Bank in that all issues for the banking system would be dealt with through this Association.

### **Transaction Reporting Authority**

The Financial Institutions department is also responsible for carrying out the functions of the Transaction Reporting Authority (TRA) as stipulated under section 11(2) of the Money Laundering and Proceeds of Crime Act 2000. The functions of the TRA are similar to the functions of Financial Intelligence Units (FIU) in other countries.

During the year, the Reserve Bank continued with its effort to develop its suspicious transaction reporting framework in cooperation with licensed financial institutions and licensed foreign exchange dealers. The commercial banks and authorized restricted foreign exchange dealers reported a total of 19 suspicious transactions to the TRA during the year, a marked increase compared with 5 reports in the previous year. The increase in the number of suspicious transaction reported so far reflects an improvement in the licensed financial institutions' and licensed foreign exchange dealers' awareness regarding money laundering and terrorist financing. The Anti-Money Laundering Guidelines issued for comments in the previous year became effective in October 2006.

Following the 2006 annual meeting of the Asia Pacific Group on Money Laundering (APG), the Pacific Anti-Money Laundering Program (PALP) was established, funded by the U.S. Government and other donors. This program involves providing mentors in the areas of law enforcement, legal and FIU. The Legal Mentor, based in Tonga at the Crown Law Office, conducted a preliminary review of Tonga's Anti-Money Laundering/Counter Terrorist Financing (AML/CFT) legal framework and will assist in drafting legislative amendments where necessary.

The PALP Legal Mentor is working together with the members of the Committee on Money Laundering and Terrorist Financing established by Cabinet in 2003 of which the TRA is a member, towards Tonga's preparation for its mutual evaluation by the APG in 2009.

In March 2007, through Tonga's membership in the APG, a review of the Transaction Reporting Authority was conducted by an expert funded by the PALP. The TRA has begun to implement recommendations from this review.

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# Operations of the Reserve Bank

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## Currency Operations

### Circulation Notes

At the 30th June 2007, the face value of currency notes on issue, both new and reissuable, totaled \$20.6 million. This was an increase of 5 percent over the previous year of \$19.6 million. Currency notes issued during the year totaled \$44 million and currency deposited totaled \$42 million of which \$4.6 million were classified by the Reserve Bank as unfit for reissue and were destroyed; the balance was retained for reissue. In order for the Bank to maintain an adequate supply of currency notes to meet public demand, the Bank ordered and received new stock of \$50 currency notes during the year. The currency notes of the Kingdom are printed by De La Rue in the United Kingdom.

### Circulation Coins

At the end of June 2007 the face value of coins on issue totaled \$1.7 million, an increase of 6 percent from \$1.6 million the previous year. During the year, coins to a face value of \$94,768 were issued, \$34,200 of which were new coins. During the year the Bank did not order new coins.

### Note Trust Depots

The Reserve Bank has Note Trust Depot (NTD) service arrangement with all commercial banks. The record shows that commercial banks reduced their utilization of NTDs this year. During 2006/07 the commercial banks lodged a total of \$11.5 million (\$18.5 million in 2005/06) and withdrew \$12 million (\$19.1 million in 2005/06). Lodgements to and withdrawals from NTDs decreased by 38 and 37 percent respectively over the previous year while deposits to the NRBT vault decreased by 2 percent. The Bank conducted surprise checks of these NTDs during the year and all were in order.

### Currency Operations after the civil disorder of 16 November

To ensure the smooth and safe continuation of currency issue operations to the public by the two banks that were affected by the civil unrest of 16 November, the Reserve Bank increased its banking days to five instead of the normal two days per week. The Reserve Bank also waived all penalties relating to non-banking days withdrawals and deposits of currency notes and coins by banks. This was to ensure that the two banks kept only working stocks on their premises and were able to deposit surplus funds and withdraw as and when required from the Reserve Bank. This service to banks continued until the two banks were able to have their strong rooms restored and certified as secure by Chubb Security Agent, South Pacific Safe and Security Limited of New Zealand.

### Counterfeits

During the year 3 counterfeit notes were reported to the Reserve Bank compared to 7 cases in the previous year. One \$5 note, one \$20 note and one \$50 note. These counterfeit notes were reported by a member of the public and Westpac Bank of Tonga, Nuku'alofa branch in January and April, 2007. The Reserve Bank sent these counterfeit notes to De La Rue for testing and verification. Examination of these notes by De La Rue confirmed that they were indeed counterfeit. The Reserve Bank has produced and issued to the public brochures on identifying counterfeit notes both in English and Tongan. The public has also been advised to report to both the Reserve Bank and the Police if they receive any suspicious looking currency notes.

### Numismatic Coins

During the year numismatic coins were issued to collectors throughout the world under agreements between the Reserve Bank and various producers for the production and marketing of coins of various denominations. Total revenue collected from numismatic coins program during the year was \$81,804 and this amount has been included with other income of the Reserve Bank in its Income Statement.

### **Financial Performance**

Gross income from operations for the year ended 30 June 2007 amounted to \$7.434 million (2006, \$6.236 million). The improvement in the Reserve Bank's gross income in 2006/07 was mainly due to the higher than expected level of investible reserves and yield throughout the year. Interest expense, currency, administration and other costs totaled \$3.820 million (2006, \$3.079 million). The net operating profit for the year increased by 14.5 percent to \$3.614 million (2006, \$3.156 million).

The Minister of Finance has approved that the net profit of \$3.614 million for the year ended June 2007 be transferred to the Reserve Bank's General Reserve account increasing it to \$10.8 million. This would further strengthen the capital position of the Reserve Bank.

### **Information Systems and Technology**

In order to enhance the security and efficiency of the Reserve Bank's international payments transactions, the Reserve Bank outsourced a major part of the information and technology management system for its international payments system to Decillion Solutions in Sydney, Australia. This company is the authorized Swift Partner who serves Swift Clients in the Asia Pacific Region.

The Reserve Bank continued to improve its data management systems by securing an offsite location for storage of the Reserve Bank's electronic information as back up. It commenced implementation of an in-house database management system to improve efficiency and effectiveness of the work of the international financial markets unit. The documentation of the Bank's IT policies in the areas of Networking and Emailing was successfully completed to assist with the operations of the Department.

### **General Administration**

In addition to the normal services of administration to the Reserve Bank, one of the major achievements during the year was the implementation, monitoring and continued awareness training of staff on the new performance-based appraisal system. The Administration department was a major player in the successful compilation of two major documents of the Bank, a master departmental operations procedures and, a master staff job descriptions.

### **Staff**

Staff numbers were maintained at 65 at the end of June 2007 as new recruitments matched those that left the services of the Bank during the year. Mr. Brett Winton from the Reserve Bank of Australia had completed his 2 years contract as Manager of Research Department in March, 2007. He was replaced by Mr. Richard Sullivan from the Reserve Bank of New Zealand, who is funded by the Commonwealth Fund for Technical Co-operation (CFTC). Miss Jessie Cocker, Manager of Financial Institutions and Markets was nominated to take up one year Tonga's turn to provide an Advisor in the Office of the Executive Director of the South East Asia Group, International Monetary Fund, Washington D.C., United States of America. Ms Cocker's appointment commenced 1 May 2007.

During the year, the Reserve Bank continued to receive advisory and technical services provided by the International Monetary Fund, AusAID, NZAid, the Pacific Financial Technical Assistance Centre (PFTAC) based in Suva, Reserve Bank of Fiji, Reserve Bank of New Zealand and Reserve Bank of Australia. These advisory and technical services were mainly in the areas of liquidity management, banking supervision and onsite visits to banks. Other assistance was received from private service providers in the areas of information systems and technology and building management.

## **Training**

Staff training needs analysis (TNA) is part of the Reserve Bank's new performance based appraisal system. TNA was conducted for each member of the staff and was then used as the guide by the Reserve Bank during the year to provide local and overseas training opportunities for its staff to facilitate capacity building. The overseas training courses attended by staff included the IMF/STI courses in Singapore on Payment Systems – Sound and Efficient National Payment and Settlement Infrastructure, Bank of International Settlement workshop on Advanced Reserve Management, Commonwealth Secretariat seminar on Foreign Remittances and Development in the Pacific Region.

The Bank arranged for 2 senior staff to attend short training attachments at the Reserve Bank of Fiji with the Governor's Office and the Settlement Department. One of the staff members continues with her post graduate studies under the AusAID scholarship program in Australia.

Local training for staff included the United Nations Office on Drugs and Crime (UNODC) Anti-Money Laundering Training conducted at the Ministry of Police and Customer Service Training by S&K Performance Solution conducted at the Reserve Bank. Apart from on-the-job training, the Reserve Bank provided specific in-house training to the staff on banking supervision and microsoft applications. The Reserve Bank continued to support staff development through financial assistance to those undertaking approved part time and correspondence courses aligned to the Training Policy of the Bank.

## **Attendance at Meetings**

In July 2006, the Assistant Manager Financial Institutions attended the APG annual meeting held at Manila, Philippines. In September 2006, the Governor and the Manager of Research were part of the government's delegation to the annual meeting of the World Bank/IMF held in Singapore. In December 2006, the Governor attended the South Pacific Central Bank Governors' annual meeting held in Wellington, New Zealand. In March 2007, the Deputy Governor and the Assistant Manager Financial Institutions attended the Central Banking Course for the Pacific Islands held in Apia, Samoa. In May 2007, the Governor and Assistant Manager of Administration and Information Technology attended the Asian Development Bank (ADB) annual meeting held in Kyoto, Japan as part of the Government's delegation. The Governor attended a high level and bilateral meeting on the World Bank Remittances Project held in Sydney, Australia, in June 2007.

## **Security**

The Reserve Bank's security unit continued to carry out its responsibilities of ensuring that the security and safety of the Bank's staff and premises were maintained at all times. It strengthened its security measures during and after the civil unrest of November 2006 to ensure maximum security of the Bank's assets and tenants.

## **Building, Plant and Equipment**

The Reserve Bank's building, plant and equipment unit continued to maintain the Bank's building, plant and equipment at a high standard. The major project implemented this year was the upgrade of Level 5 of the Reserve Bank building. This is to prepare for the South Pacific Governors' annual meeting to be hosted by the National Reserve Bank of Tonga for the first time in December 2007.

**External Relations**

During the year, the Reserve Bank continued to submit reports for the government on the level of the foreign reserves, interest rates and exchange rates. The Reserve Bank conducted regular meetings with the government and the domestic banks in order to discuss and review activities in the economy and the financial system as well as to discuss Reserve Bank policy issues. The Reserve Bank also met with representatives of international aid agencies and bilateral aid donors to discuss matters of mutual interest. In April 2007, the Reserve Bank again hosted the IMF Article IV annual consultation.

**Board of Directors**

During the year, the Board of Directors met regularly to formulate the policies of the Reserve Bank and to monitor its operations. There were no changes to the members of the Board during the year.



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## Senior Officers

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### Senior Officers as at 30 June 2007

<b>Governor</b>	Siosi Cocker Mafi
<b>Deputy Governor</b>	Inia R. Naiyaga
<b>Manager, Research Department</b>	Richard Sullivan
<b>Manager Information System &amp; Technology and Administration</b>	Elizabeth Baker
<b>Manager, Accounts &amp; Currency</b>	Lata Tangimana
<b>Acting Manager, Financial Institutions &amp; Markets</b>	‘Ungatea Latu
<b>Assistant Manager, Research Department</b>	‘Anapuli Matoto
<b>Guard Commander</b>	Semisi Fifita
<b>Senior Building Officer</b>	Poasi Fonua

