



▲ Children playing at the wharf in Nuku'alofa, Tonga.

OCTOBER 2019

# PACIFIC FINANCE SECTOR BRIEFS

ADB PACIFIC LIAISON AND COORDINATION OFFICE

## TONGA

**Tonga faces many of the characteristic challenges of the small Pacific island economies**, including geographic remoteness, limited financial and human resources, increased costs of doing business and delivering services, and a small domestic market. Tonga's economy is narrowly based and strongly dependent on inflows of remittances, which totaled 27.4% of the gross domestic product (GDP) in 2017 (International Monetary Fund [IMF] 2018), and external assistance to supplement domestic revenue. The services sector (public administration, trade, and tourism) is estimated to account for 62.4% of GDP; the industrial sector (manufacturing, utilities, and construction) contributes 18.2%; and the primary sector (agriculture, forestry, and fishing) adds 19.4%.

**Tonga is highly vulnerable to domestic and external shocks.** Since 2005, the country's economy has been adversely affected by natural disasters, volatile prices of imported fuels and food, civil disturbances in 2005 and 2006, and the global financial crisis of 2008. Tonga had a slow and difficult recovery from the global financial crisis, which triggered a decline in remittances, tourist arrivals, and exports. However, growth in Tonga has been robust in recent years, averaging 2.4% from 2014 to 2018 supported by increases in tourism receipts and agricultural production, recovery in remittances, and infrastructure investment such as the upgrade of the Faua domestic wharf in Nuku'alofa. This is despite setbacks such as weakening agricultural export performance as well as the impacts of disasters such as Cyclone Winston in February 2016 and Cyclone Gita in February 2018. Cyclone Gita, with winds of more than 230 kilometers/hour, was Tonga's most devastating cyclone in at least 60 years. It caused extensive damage, including bringing down power lines and flattening the Parliament building. The aftermath of the cyclone particularly affected the agriculture and tourism sectors, which contributed to the growth rate slowing to 0.4% in 2018. However, with reconstruction and the expected recovery of the agriculture and tourism sectors, growth is projected to rebound to 2.1% in 2019 before easing slightly to 1.9% in 2020 as reconstruction winds down.

### TONGA AT A GLANCE

#### Population

100,100 (2017)<sup>a</sup>

#### GDP

\$450.2 million (2018)<sup>b</sup>

#### GDP per capita

\$4,295 (2018)<sup>b</sup>

#### GNI per capita

\$4,010 (2017)<sup>a</sup>

#### Domestic credit provided by the banking sector (% of GDP)

32.6% (2017)<sup>a</sup>

GDP = gross domestic product, GNI = gross national income.

<sup>a</sup> Source: Asian Development Bank. 2018. *Key Indicators for Asia and the Pacific*. Manila.

<sup>b</sup> Source: Asian Development Bank.

**Table 1: Nominal Gross Domestic Product, 2011–2017**

	2011	2012	2013	2014	2015	2016	2017
GDP (\$ million)	418.0	473.0	450.0	442.0	441.0	400.0	420.0
M2 (\$ million)	165.0	203.7	205.6	213.2	234.4	230.5	249.7
M2/GDP (%)	39.5	43.1	45.7	48.2	53.2	57.6	59.5
Private sector credit (\$ million)	135.0	144.2	138.5	138.5	150.7	157.0	172.2
Private sector credit/GDP (%)	32.3	30.5	30.8	31.3	34.2	39.2	41.1

GDP = gross domestic product, M2 = broad money.

Note: Figures were converted from pa'anga to United States dollars using the Asian Development Bank-recognized exchange rates for each year.

Sources: Asian Development Bank and International Monetary Fund.

## FINANCE SECTOR OVERVIEW

**As with some Pacific island economies, Tonga remains moderately monetized, with private sector credit growing steadily since 2014.** The ratio of Tonga's broad money (M2) to its GDP grew from 39.5% to 59.5% from 2011 to 2017, indicating a moderate monetization of the economy (Table 1). Meanwhile, the ratio of private sector credit to GDP declined in 2012 to 30.5% before rising steadily to 41.1% from 2013 to 2017. The recovery of this ratio was "supported mainly by the implementation of the government-managed loan-subsidy scheme, lower lending rates, a boom in construction, and an increase in commercial loans" (IMF 2016).

**Tonga's finance sector is stable, but regulatory vigilance is essential.** The rebounding of the Tongan economy was made possible partly through accommodative monetary policy. This led to a rise in credit in the formal sector as well as better access to finance to promote inclusive growth. The IMF (2018) noted that growth in credit is consistent with financial deepening. However, Tonga's banks are monitored closely to avoid a buildup of systemic financial risks. Although the risks are minimal in relation to the Government of Tonga's subsidy scheme with certain financial institutions, lenient lending standards have the potential to become a problem. Moreover, the number of nonbank financial institutions is small and these institutions remain effectively unsupervised, which could become a concern in the future.

## FINANCE SECTOR STRUCTURE

**Tonga's financial system lacks diversity, and is relatively underdeveloped.** There are four commercial banks licensed to operate in the country.<sup>1</sup> Two of the four banks are branches of international banks (ANZ Banking Group and Bank of South Pacific), while the other two are locally incorporated (MBF Bank and the Tonga Development Bank). Tonga has four licensed and seven registered money transfer dealers.

The National Reserve Bank of Tonga (NRBT) is the country's central bank, and is responsible for the licensing, regulation, and supervision of financial institutions.

**The government is pushing for financial stability through improvements to the NRBT's supervision, regulation, and legal framework.** The IMF (2018) recognized that efforts have been made to strengthen financial stability by amending the National Reserve Bank of Tonga Act and the Banking Act (formerly Financial Institutions Act), and raising banks' minimum reserve requirements to 10% of total deposits, but it also recommended that banks use flexible liquidity management tools as well as reserve requirements.

## FINANCE SECTOR PERFORMANCE

**Tonga's asset quality is improving and interest rate spreads are narrowing.** Available data indicate that Tonga's nonperforming loans ratio has been steadily declining since 2012. Meanwhile, interest rate spreads are narrowing, which may indicate increased banking sector competition and improved access to credit information (IMF 2016). Although the deposit rate fluctuated from 2011 to 2017, the lending rate gradually fell and this supported the recovery of credit provision from 2014 and 2017. Sustained flow of overseas remittances played a key role in the growth of the value of deposits, despite minimal improvement in deposit rates. The value of deposits grew at an average of 9.3% a year from 2011 to 2017.

## FINANCIAL INCLUSION

**Financial access in Tonga is high compared with some other Pacific island economies** (Table 3). Compared to its peers in the Pacific, Tonga has the most commercial bank branches per 100,000 adults and the fourth most ATMs per 1,000 adults (IMF 2018). Although the value of commercial bank loans in the country is low, Tonga had the third most loan accounts with commercial banks per 1,000 adults in 2016.

<sup>1</sup> There used to be five banks operating in Tonga. However, the National Reserve Bank of Tonga revoked the license of Pacific International Commercial Bank effective 26 July 2016 (<http://www.reservebank.to/index.php/news-archives/366-revocation-of-pacific-international-commercial-bank%E2%80%99s-license.html>). When revoking the license, the National Reserve Bank of Tonga committed to pay out all of the Pacific International Commercial Bank's former deposits and creditors (<http://www.reservebank.to/index.php/news-archives/374-pay-out-of-pacific-international-commercial-bank%E2%80%99s-deposits-and-creditors.html>).

**Table 2: Finance Sector Performance Indicators**

	2011	2012	2013	2014	2015	2016	2017
NPL ratio (%)		11.7	9.3	7.0	7.3	4.1	3.6
Deposits (\$ million)	50.0	66.6	77.8	78.1	90.5	89.8	81.1
Private sector credit (\$ million)	135.0	144.2	138.5	138.5	150.7	157.0	172.2
Deposit rate (%)	3.9	3.1	2.8	2.8	3.0	3.1	3.0
Lending rate (%)	11.4	9.9	9.4	8.6	8.2	7.9	7.9

NPL = nonperforming loans.

Note: Figures were converted using Asian Development Bank's 2017 exchange rate.

Sources: International Monetary Fund and World Bank.

**Table 3: Financial Access Indicators**

Access Indicators	2011	2012	2013	2014	2015	2016	2017
Number of bank branches	11	10	10	8	15	16	16
Number of ATMs	18	18	18	18	19	22	25
Number of depositors with commercial banks						63,882	73,387
Number of deposit accounts with commercial banks	38,203	48,653	52,424	60,735	69,560	53,722	74,998
Number of borrowers at commercial banks						10,872	10,648
Number of loan accounts with commercial banks	6,673	4,492	8,664	7,006	10,973	11,238	10,707

Note: Figures were converted using Asian Development Bank's 2017 exchange rate.

Source: International Monetary Fund.

Mobile money transactions are increasing over time, providing another opportunity to expand access to formal financial services.

**The government is taking steps to broaden access to finance in Tonga.** The IMF (2016) noted that the NRBT is currently implementing a project to finance small and medium-sized enterprises, as well as conducting a survey to determine the extent of credit demand across the country. Reforms to credit reporting and credit bureau coverage can help reduce the cost of conducting due diligence, which can expand access to finance. The IMF (2016) also observed that revisions to Tonga's Land Act would allow more people access to formal finance if land could be used as collateral for personal and business loans.

## REFERENCES

- Asian Development Bank. 2018. *Key Indicators for Asia and the Pacific*. Manila.
- Asian Development Bank and Asian Development Bank Institute. 2015. *Pacific Opportunities: Leveraging Asia's Growth*. Manila.
- International Monetary Fund. 2016. Tonga: Staff Report for the 2016 Article IV consultation. *IMF Country Report*. No. 16/178. Washington, DC.
- . 2018. Tonga: Staff Report for the 2017 Article IV consultation. *IMF Country Report*. No. 18/12. Washington, DC.
- National Reserve Bank of Tonga website: <http://www.reservebank.to/>.

### About the Asian Development Bank

ADB is committed to achieving a prosperous, inclusive, resilient, and sustainable Asia and the Pacific, while sustaining its efforts to eradicate extreme poverty. Established in 1966, it is owned by 68 members—49 from the region. Its main instruments for helping its developing member countries are policy dialogue, loans, equity investments, guarantees, grants, and technical assistance.

This **Finance Sector Brief** was prepared by ADB's Pacific Department.

The views expressed in this publication are those of the authors and do not necessarily reflect the views and policies of ADB or its Board of Governors or the governments they represent.

Asian Development Bank  
Pacific Liaison and Coordination Office  
Level 20, 45 Clarence St, Sydney, 2000, Australia  
+61 2 8270 9429

[www.adb.org/publications/pacific-finance-sector-tonga](http://www.adb.org/publications/pacific-finance-sector-tonga)

Corrigenda to ADB publications may be found at <http://www.adb.org/publications/corrigenda>

In this publication, "\$" refers to US dollars.  
All photos are from ADB.



Creative Commons Attribution 3.0 IGO license (CC BY 3.0 IGO)

© 2019 ADB. The CC license does not apply to non-ADB copyright materials in this publication.

Publication Stock No. BRF190374-2

DOI: <http://dx.doi.org/10.22617/BRF190374-2>