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Statement by the Hon. **PILIMILOSE BALWYN FA'OTUSIA**,
Governor of the Bank for **TONGA**

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Governor of the Bank for Tonga

Mr. Chairman
Mr. President of the World Bank Group
Madame Managing Director of the International Monetary Fund
Fellow Governors
Distinguished Delegates
Ladies and Gentlemen

I am honoured to have the opportunity to address the International Monetary Fund (IMF) and World Bank Group (WBG) Joint Board of Governors' 2017 Annual Meetings on behalf of the Government of Tonga. I wish to convey my sincere appreciation and gratitude to Madame Christine Lagarde and Dr Jim Yong Kim for their able and stellar performances in the leadership positions of our Bretton Woods institutions. They both have indeed contributed significantly to guiding the IMF and the WBG in maintaining and sustaining growth, financial stability and structural balances across the different corners of the world despite obvious multi-dimensional global challenges.

I would also like to use this opportunity to express sympathy and strong support from the Government of Tonga to all people who lost loved ones, properties and businesses in various States in the United States of America and the Caribbean Islands in the wake of monstrous hurricanes that made landfall back-to-back within 3 weeks in August and September 2017. We express our unflinching solidarity with the Governments of these member States as they confront huge rebuilding challenges of massive and largely unprecedented displacement and destruction. These and similar occurrences such as major floods in other parts of the world are indeed signs of the potency and associated disruptive consequences to local, regional and global economy of natural disasters that result from climate change. Occurrences like these are indeed a wake-up call to the global community and the Bretton Woods institutions to recognize the magnificent threat climate change poses to Pacific Islands and the world at large, and therefore the critical need to provide prompt and necessary support in times of these extraordinary events.

Global Economic Outlook

Mr. Chairman,

We are pleased that the global upswing in economic activity is strengthening with global growth projected to rise to 3.6 percent in 2017 and 3.7 percent in 2018. Broad based upward revisions in the Euro area, Japan, emerging Asia, emerging Europe, and Russia have more than offset downward revisions for the United States and the United Kingdom. However, we note that the recovery is not complete. While the baseline outlook is strengthening, growth remains weak in many countries, and inflation is below target in most advanced economies. Commodity exporters, especially of fuel, are particularly hard hit as their adjustment to a sharp step down in foreign earnings continue. However, the welcome cyclical pick up in global activity provides an ideal

window of opportunity to tackle key challenges – namely to boost potential output while ensuring its benefits are broadly shared, and to build resilience against persistent downside risks. While short term risks are broadly balanced, we need to be vigilant of medium term risks which are still tilted to the downside. In this vein, we urge both the Bretton Wood institutions to continue to assess and monitor the global economic conditions and to ensure that targeted timely strategic intervention and policy response measures are in place to assist countries towards achieving inclusive, diversified, sustainable and resilient socio-economic growth and development.

Tonga's Economy

Mr. Chairman,

The Tongan economy has experienced moderate and steady growth over the past decade. With a forecast of around 3.4 percent, a robust growth performance is expected in 2017/18. The major drivers of growth are high impact construction activities in government priority areas—many of which are funded by the WBG and other development partners—rebound in agriculture and tourism, enhanced domestic demand supported by sustained expansion in level of remittances inflow and a more vibrant financial sector.

Tonga's Strategic Development Framework 2015 – 2025 with the national vision for “*A more progressive Tonga supporting a higher quality of life for all*” broadly spells out government's strategic direction in the management of economic, social, political institutions, infrastructure and environment and is now in its second year of implementation. Mapped on a one-to-one basis with the Sustainable Development Goals (SDGs) and the Addis Ababa Action Agenda, it constitutes the foundation for medium term budgetary framework and annual budget strategies. In this regard, government's priority areas in the 2017/18 budget are: (i) sports development; (ii) improving total factor productivity; (iii) developing the private sector with manufacturing and tourism in particular; (iv) improving the functionality of existing infrastructure; (v) social development: health and quality of education; (vi) climate change resilience and renewable energy; (vii) good governance; and (viii) completion of on-going high impact capital projects. These priorities are hinged at the 2017/18 budget theme of “*Institutionalising of Planning the Work and Working the Plan with stronger monitoring and evaluation*” at all levels of government to ensure intended results are achieved towards a higher quality of life for all. With budgetary allocations based explicitly on articulations in their respective corporate plans, all Ministries, Departments and Agencies in Tonga are well aware of the importance of buying into this theme as well as the need for continuous monitoring and evaluation of efficient plan implementation and judicious management and utilization of resources towards achieving set targets.

As highlighted, Tonga's GDP in real terms is projected to grow 3.4 percent in 2017/18, leveling at an average of 2.8 percent in the medium term, due largely to projected improved activities in the secondary and tertiary sectors of the economy. Improved performance of the secondary sector in the near term is predicated on growing demand for quarrying products, electricity & water supply and manufacturing products, driven in large part by expansion in bank lending to the construction sector as well as increase in donor funded projects in various sectors. This also reflects the success of sustained government efforts at diversifying the economy through an appropriate mix of fiscal, monetary and structural policies. Similarly, the primary sector is projected to

experience steady growth in the near to medium term as benefits of the implementation of Tonga's first Agriculture Sector Plan (TASP) begins to gain momentum. In addition to promoting improved and diversified agriculture and fisheries outputs, TASP also promotes climate-resilient and smart farming systems.

Tonga's fiscal space continues to be prudently managed to ensure overall sustained economic and fiscal stability. The overall budget for the current financial year 2017/18 is TOP\$595.8 million, with in-kind support of TOP\$213.4 million. The fiscal balance, slightly tilted in deficit as it were, is financed from foreign concessional loans and domestic borrowing through the Bonds market. The 2017/18 budget is anchored on the need to maintain fiscal sustainability, respond to changing domestic, regional and global conditions, adhere to the budget support joint policy reform matrix and at the same time meet the aspirations of the people of Tonga. Government's fiscal policy continues to support the development of critical infrastructure and provides low interest loans through the Tonga Development Bank to small and medium scale enterprises in agriculture, fisheries, manufacturing and handicraft, including small loans for education.

Geographical and physical characteristics imply that Tonga, like many other Island states, faces inevitable developmental challenges of climate change and its magnifying impacts of recent times. This means Tonga requires stronger adaptation and close management of relevant persistent risks in terms of building resilience to natural disasters and climate change. The development of information campaigns to increase preparedness, early warning systems, contingency planning, risk reduction and building resilience to natural disasters involve huge public infrastructure projects far beyond what we can afford from our local budget. Even though global resources are available under the United Nations Framework Convention on Climate Change, the Global Environment Facility, the Green Climate fund, the Adaptation Fund and other resources from the WBG and the Asian Development Bank (ADB), accessing these funds remains quite challenging. For instance, we face the challenge of the rather demanding and stringent criteria especially in the light of our limited capacity to meet these requirements.

Tonga has been rated as one of the most vulnerable countries in the world to natural disasters and climate change and one intense cyclone can wipe out decades of development. Tonga is therefore pleased that the recent Debt Sustainability Assessment (DSA) has incorporated the vulnerability of our country to natural disasters and external shocks which should subsequently lead to better terms and conditions in future assistance from the WBG and the ADB.

The National Reserve Bank of Tonga (NRBT) continued to maintain an accommodative monetary policy stance that supports macroeconomic stability and growth whilst meeting its target of maintaining adequate level of foreign reserves and promoting low and stable inflation. Despite the significant increase in the annual inflation rate in June 2017 up to 10.3 percent, this has eased to 5.2 percent in August 2017, and the foreign reserves remained at comfortable levels at approximately 7 months compared to the minimum range of 3 months of import cover. The exchange rate remained broadly in line with fundamentals with no deterioration in competitiveness. The banking system also remained sound with strong capital and liquidity position maintained and non-performing loans remaining low. Total bank lending growth over the year to July 2017 was 15.7 percent due to growth in both household and business lending, which

supported domestic economic activities. Liquidity, however, continues to rise in line with the increase in the foreign reserves level.

The NRBT's monetary policy actions during the past year therefore continued to focus on measures to encourage the utilisation of the excess liquidity in the banking system to increase lending in order to support domestic economic growth, and strengthen the monetary policy transmission mechanism in the medium term. This included maintaining a zero interest rate policy (interest rate on banks' excess reserves), maintaining a minimum loans/deposit ratio of 80 percent, easing the Exchange Control requirements effective in February 2017 to assist individuals and business in making foreign exchange payments, and revising its inflation reference range from 6 percent to 8 percent to a reference rate of 5 percent as recommended by the IMF. In light of the strong credit growth over the year, the Statutory Reserve Deposit requirement was increased from 5 percent to 10 percent in July 2017 in order to encourage prudent practices whereby a portion of the excess liquidity is set aside as precaution against the growth in credit and to strengthen the monetary policy transmission mechanism.

The NRBT continued with its financial inclusion initiatives to improve access to financial services and continued to work towards providing further protection to the consumers through the regulation of non-bank financial institutions, introduction of a financial consumer protection policy, and enhancement of consumers' financial literacy.

The outcome of the accommodative stance of the NRBT's monetary policy of the last couple of years is evident in expanding credit to the private sector, narrowing interest rates spread, and the maintenance of high level of foreign reserves. The NRBT will remain vigilant and continue to closely monitor early signs of vulnerabilities and overheating of the economy and ensure enhanced supervision of banks to maintain the stability of the financial system.

Partnership with the World Bank Group

Mr. Chairman,

We welcome the significant progress in implementing the Forward Look - Vision for the WBG in 2030 with clients now experience a WBG that is more nimble, innovative and better able to address their country specific needs. We are also encouraged that the WBG is leading the global response to some of the largest global challenges of the day including climate change and crisis response in addition to playing a leading role in the paradigm shift to maximise finance for development by leveraging the private sector while optimising the use of scarce public resources.

With two years into the establishment and implementation of the twin Goals, the SDGs and the Paris Agreement at COP 21, countries having now entrenched all the facets of the goals into respective national development plans, medium term budgetary frameworks and annual budgets. We urge the WBG management not to waiver in its commitment of continuous offer of guidance, monitoring and evaluation to ensure that by 2030, no one is left behind in any nation of the world.

We are encouraged by the leadership of Dr Jim Yong Kim in highlighting the significance of the development of human capital or investing more and more effectively in people. This is

particularly relevant to Tonga as a small island state with its people as the most important resource. We congratulate the WBG in launching the World Development Report 2018: *Learning to Realise Education's Promise* which will assist with further policy formulation and advice to our country.

Tonga applauds the WBG's successful 18th replenishment of the International Development Association (IDA18) and very much welcome the scale-up of IDA 18 which will help support Tonga to address drivers of fragility. These would be in the areas of adaptation through building up our resilience to climate change and natural disasters in the transport and fisheries sectors, assisting with employment opportunities for youth, and developing e-government in addition to economic and fiscal reforms. We commit to build up our absorptive capacity to implement IDA18 going forward. In this regard, we welcome the proposed establishment of the Central Fiduciary Support Unit within the Ministry of Finance and National Planning while at the same time take heed of all the lessons learned from the implementation of IDA17 as highlighted in the recent joint WBG and ADB portfolio review held earlier this year in Tonga.

We are also appreciative of the WBG's Regional Partnership Framework (RPF) for the period 2017 to 2021. The RPF comes at a time when the WBG's presence and engagement across the Pacific continues to grow larger and stronger, reflecting a concerted effort to increase its presence in our countries that are considered to be the world's most remote and fragile. The RPF is quite distinct in its approach to engagement as it primarily focuses on avenues to support each country including Tonga rather than presenting a consolidated regional strategy.

With an ever changing climate, Tonga welcomes the *Pacific Possible* Initiative launched by the WBG that looks 25 years ahead to quantify increases in incomes, government revenue, and employment that would be possible if economic opportunities are fully exploited and risks appropriately managed. For the Pacific Possible to become a reality, we urge the WBG to be more innovative and proactive in its support and development assistances to the region so that development targets are achieved. Tonga further welcomes the launch of the *Small Island States Resilient Initiative and Climate Change Action Plan* which has underscored the Bank's commitment to provide significant assistance to island states in building resilience through expanding operational climate smart-policies and investing in green infrastructure. In this context, we observe with gratitude the strong focus on climate change adaptation and resilience under IDA18. In addition to its own resources, it can also use this as a platform to leverage additional finances for the implementation and also to raise the profile of the region in international debates on financial accessibility to global funding sources.

Tonga wishes to also acknowledge the valuable assistance provided by International Financial Corporation (IFC) over the years in support of growth in the private sector and towards the promotion of public-private partnership across the economic sectors. We also appreciate the fact that IFC is now able to scale up its engagement in Small Islands Development States under the IDA18 private sector window. Given Tonga's limited diversification, narrow economic base and its inability to exploit economies of scale, we urge IFC to continue its assistance to Tonga and encourage private partnership participation where there are opportunities in the public sector.

Tonga acknowledges the WBG survey on the withdrawal of correspondent banking relationships and de-risking. Although remittances to Tonga continues to rise, Tonga remains vulnerable to the

threat of de-risking. Whilst continuing to ensure enhanced supervision and monitoring of banks and money transfer operators' (MTOs) anti-money laundering/counter financing of terrorism (AML/CFT) compliance, Tonga continues to seek the assistance of the WBG and IMF on possible solutions to de-banking and de-risking including fintech solutions, as well as assistance to enhance our ability to facilitate these solutions, particularly in terms of upgrading of systems and regulatory framework to cater for these solutions in order to still maintain financial stability and ensure protection of customers.

There is continuing concern with no credit bureau operating in Tonga although it is noted that the IFC is in the process of finding a solution to this issue. It is crucial for the credit bureau to be operating in Tonga and appropriately regulated to ensure it is effective in improving the credit environment in the country and promote financial stability.

Partnership with the International Monetary Fund

Tonga acknowledges the support rendered and assistance provided by the annual IMF Article IV Mission which continues to offer tailor made policy advice and support to low-income countries including Tonga in order to pursue their development undertakings. These annual events have contributed significantly to sharpening economic policy analysis and policy design of our government. Tonga is encouraged by the IMF's leadership and recognition as well as incorporation of the vulnerability of Tonga to its DSA against the backdrop of an evolving environment which is a better reflection of the status and ability of the nation to sustain debt.

Tonga continues to applaud the successful adoption and implementation of the Managing Director's Global Policy Agenda (GPA). The GPA succinctly identifies the key challenges ahead and sets out concrete policy steps that can be pursued at both national and global levels and supports the call for a more potent three-pronged policy mix involving monetary policy, fiscal policy and structural reforms, working together and reinforcing each other to strengthen global growth prospects. The design of a new toolkit to identify structural policy gaps by the IMF and assist member countries with country-specific recommendations for reforms to boost productivity, investment, and growth also constitute a milestone in the IMF's advisory activities. In particular, we welcome the progress made in integrating macro-financial analysis into Article IV surveillance.

We are heartened that the IMF is examining ways in which macroeconomic policies can help countries, especially small states like Tonga, to build up resilience against natural disasters and climate change as highlighted in the 2016 policy note on Small States' Resilience to Natural Disasters. In addition, access to the IMF's emergency financing facilities and instruments such as the Rapid Credit Facility and Rapid Financing Instrument continue to serve as important sources of liquid support to small states like Tonga. As the IMF is well-positioned to assist small states in adopting appropriate macroeconomic policies to facilitate risk reduction and enhance crisis preparedness, we would further urge that the IMF continues to ensure that the features of these instruments, including access levels and eligibility criteria, remain relevant and appropriate.

Tonga, through the NRBT, benefited from technical assistance from the IMF to develop the domestic market in order to adopt open market operation to mop up the excess liquidity in the system. This would also provide local investment opportunities and avoid pressure on the foreign

reserves through outgoing capital investments. We also acknowledge the technical assistance provided by the IMF to review the NRBT's foreign reserves management.

Tonga also acknowledges the IMF's efforts to help countries whom are affected by the withdrawal of correspondent banking relationships and de-risking particularly when Tonga heavily relies on remittances and international trade for its people's livelihood.

We welcome the efforts of the IMF in working with other relevant organizations to facilitate international dialogue and promote industry solutions which include enhancing correspondent banks' capacity to manage risks, and help countries to strengthen the AML/CFT regulatory and supervisory frameworks. The current consideration of the IMF to integrate, where macro-critical, migration, gender (including the growth impact of increasing women's participation in the labor market), climate change analysis in surveillance and the sustainability of pension systems is long overdue. This will go a long way in redirecting the IMF's lending and advisory strategies to Pacific Island states where the issues of climate change top the menu of development framework, debt sustainability and growth. We further applaud the commitment of the IMF to increase its support to fragile and small states in the implementation of the 2030 Agenda and the Financing for Development agenda by way of strengthening domestic revenue and public financial management, deepen financial markets, and fostering data availability to policy makers in these countries.

Conclusion

Mr. Chairman, I once again thank the WBG and IMF for their leadership and guidance of global economic institutions and dynamics in these challenging times and wish both institutions success in the remaining months of 2017 and coming years.

Thank you very much for your attention.