1. EXECUTIVE SUMMARY

The global economy has generally strengthened since the October 2013 Inflation Report. Economic activity picked up in advanced economies, particularly in the US and UK. Fiscal consolidation, which has been a heavy drag on global growth in many advanced economies, has diminished. The Eurozone economy continued to grow, albeit at a slow rate. Growth is still uneven across the region, with stronger expansion in the core economies compared with countries with high debt and financial fragmentation. Emerging market economies have recorded sluggish growth, partly reflecting weak external demand and internal imbalances. In its latest World Economic Outlook (WEO)[1], the IMF expects global growth to improve from 3.0 per cent in 2013 to 3.6 per cent in 2014 and further to 3.9 per cent in 2015. Whilst the risks to the global growth outlook appear lower than in earlier periods, there are still a number of concerns regarding the sustainability of growth in China and other emerging market economies, low inflation in advanced economies and the possible impact of geopolitical tensions. Inflationary pressures are expected to remain subdued in 2014, with fears of deflation in the Eurozone remaining at the forefront of many policymakers' minds.

In Mauritius, the economy lost some momentum in the last quarter of 2013 as the slow pace of the Eurozone recovery continued to impact negatively on external demand. The sluggish rate of growth also reflected declining private investment and prolonged weakness in domestic consumption. All the main sectors recorded positive rates of growth, except the construction sector which contracted further. For the year 2013, the pace of growth declined slightly to 3.2 per cent, from 3.4 per cent in 2012.

With the pick-up expected in the global economy in 2014, the outlook for domestic growth has improved. Real output is projected to increase to a range of 3.7-4.0 per cent for 2014. Given the reliance of the country on exports, adverse external developments still pose downside risks to the growth outlook. The need for continued fiscal consolidation and for the private sector to decrease its high-debt burden also constitutes threats to growth. Statistics Mauritius forecast growth for 2014 at 3.7 per cent.

The labour market has remained relatively stable, with unemployment forecast to stay at around 8 per cent during 2014 due to a cautious expansion strategy on the part of firms and persistent structural skills mismatch. The projected improvement in the domestic economy and possible increase in business confidence may induce firms to increase their production capacity, thereby generating more employment opportunities.

Reflecting the pace of economic activity so far, money and credit aggregates have continued to grow moderately despite high liquidity conditions prevailing in the domestic money market. Excess liquidity rose to a daily average of Rs8.2 billion in the first quarter of 2014, mainly as a result of the increasing recourse by Government to foreign financing of its budget deficit. The net purchase of foreign currency by the Bank on the domestic foreign exchange market has also contributed to the excess liquidity. The Bank raised the cash ratio requirement to 8.0 per cent in October 2013, but it is expected that liquidity will remain high throughout 2014.

Y-o-y inflation rose in November 2013 in line with the hike in excise duties on alcoholic beverages and tobacco. It further recorded sharp increases in the first two months of 2014 due to temporary shocks to food prices from adverse weather conditions. As the impact of those shocks subsided, y-o-y inflation fell back in March 2014. Headline inflation has been rather stable since the October 2013 Inflation Report although it has increased slightly at the beginning of 2014. Core measures of inflation have indicated a moderate increase in underlying inflation pressures. The Bank's Inflation Expectations Survey carried out in February 2014 indicated that a majority of respondents expected a rise in the mean inflation rate to 4.6 per cent a year ahead.

The Bank staff forecast y-o-y inflation in the range of 3.9-4.1 per cent by June 2014, equivalent to a headline inflation forecast of 3.8-4.2 per cent. Over the longer forecast horizon, it is assumed that the temporary supply

[1] *IMF World Economic Outlook April 2014*

shocks to food prices will fade away as agricultural supplies return to normal. For December 2014, the Bank staff forecast that the y-o-y inflation will be in the range of 3.9-4.3 per cent, equivalent to a headline inflation forecast of 4.0-4.4 per cent.

At the Monetary Policy Committee (MPC) meetings held in February and April 2014, the majority of members were of the opinion that domestic economic conditions and the inflation outlook did not warrant changing the monetary policy stance. Some members, however, viewed that it was time to start normalising the Key Repo Rate (KRR) to better address banking system vulnerabilities. The KRR was left unchanged at 4.65 per cent per annum.