

3. RECENT DEVELOPMENTS IN INFLATION

Since the last Inflation Report in October 2013, headline inflation has been rather stable, albeit showing some increase at the beginning of 2014 while year-on-year inflation rose in November 2013 in line with the hike in excise duties on alcoholic beverages and tobacco. Year-on-year inflation showed some volatility in the first three months of 2014 with sharp increases in January and February 2014 and witnessed a substantial drop in March 2014, mainly due to movements in the price of vegetables and other food products.

3.1 Consumer Prices

In the last Inflation Report, the effect of the Budget 2014 on prices was still uncertain and Bank staff had forecast that y-o-y inflation could reach a range of 4.5 per cent to 4.9 per cent. This was based on the assumption of no change in monetary policy and a similar impact of the budget as in the previous two years. Assuming that the Budget 2014 would have no impact on prices, the Bank staff's y-o-y inflation forecast was lower, within a range of 3.7 per cent and 4.0 per cent by December 2013. It turned out that taxes on 'alcoholic beverages and tobacco' went up by a lower percentage than forecast. The Consumer Price Index (CPI) went up from 103.9 in October to 105.0 in November 2013, when the budgetary measures were announced, and remained almost unchanged in December 2013.

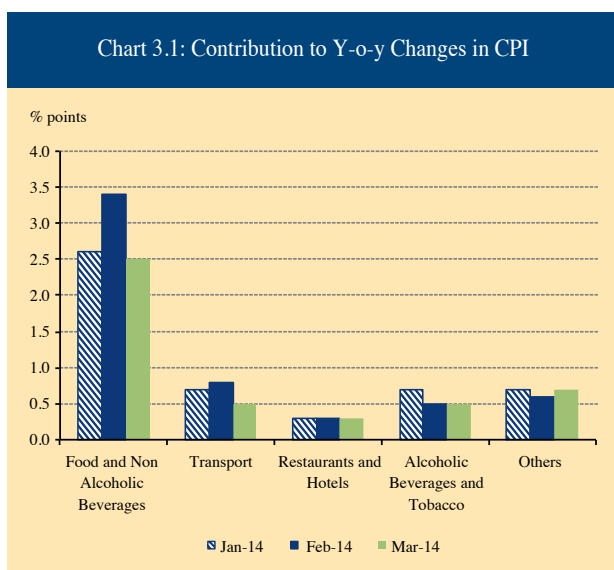
At the beginning of 2014, a significant increase was noted in the CPI which increased to 107.2 in January 2014 and further to 108.5 in February 2014. 'Food and non-alcoholic beverages' contributed 3.4 index points to the increase in the CPI. This reflected mainly hikes in the prices of vegetables during this period due to unfavourable climatic conditions that severely affected

crop production causing a supply shortage. The other divisions notably, 'Transport' and 'Alcoholic beverages and tobacco' added 0.7 index point and 0.5 index point, respectively, to the CPI. The contribution of the remaining divisions to the CPI was either flat or increased marginally between 0.1 and 0.3 percentage points. However, in March 2014, the CPI fell to 107.7, as the impact of adverse climatic conditions receded and prices returned to more normal levels (Chart 3.1).

Y-o-y inflation, which had started to rise gradually since August 2013, went up to 3.9 per cent in November 2013 on account of the increase in excise duties on 'alcoholic beverages and tobacco'. It surged further from 4.0 per cent in December 2013 to 5.1 per cent in January 2014 and 5.6 per cent in February 2014 following the temporary shocks to food prices. In March 2014, as the impact of those shocks subsided, y-o-y inflation fell to 4.5 per cent. Headline inflation has increased gradually since the last Inflation Report, reaching 4.0 per cent in March 2014.

Core inflation measures, which exclude the volatile elements of the CPI, indicated a moderate increase

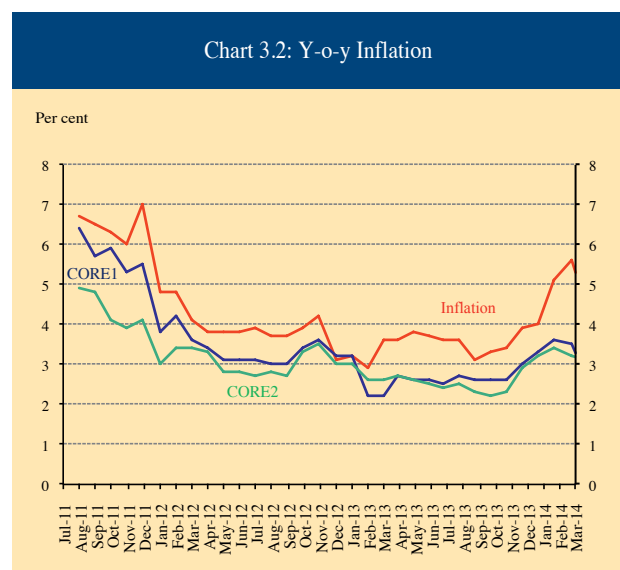
Chart 3.1: Contribution to Y-o-y Changes in CPI



* Others include clothing and footwear; housing and utilities; furnishings and household equipment; health; communication; recreation and culture; education and miscellaneous goods

Sources: Statistics Mauritius and Bank of Mauritius.

Chart 3.2: Y-o-y Inflation



CORE1 excludes "Food, Beverages and Tobacco" components and mortgage interest on housing loan from y-o-y CPI inflation.

CORE2 excludes Food, Beverages, Tobacco, mortgage interest, energy prices and administered prices from y-o-y CPI inflation.

Sources: Statistics Mauritius and Bank of Mauritius.

in underlying inflationary pressures. Y-o-y CORE1 and CORE2 inflation reached 2.7 per cent and 3.1 per cent in March 2014, from 2.6 per cent and 2.3 per cent, respectively, in August 2013 (Chart 3.2).

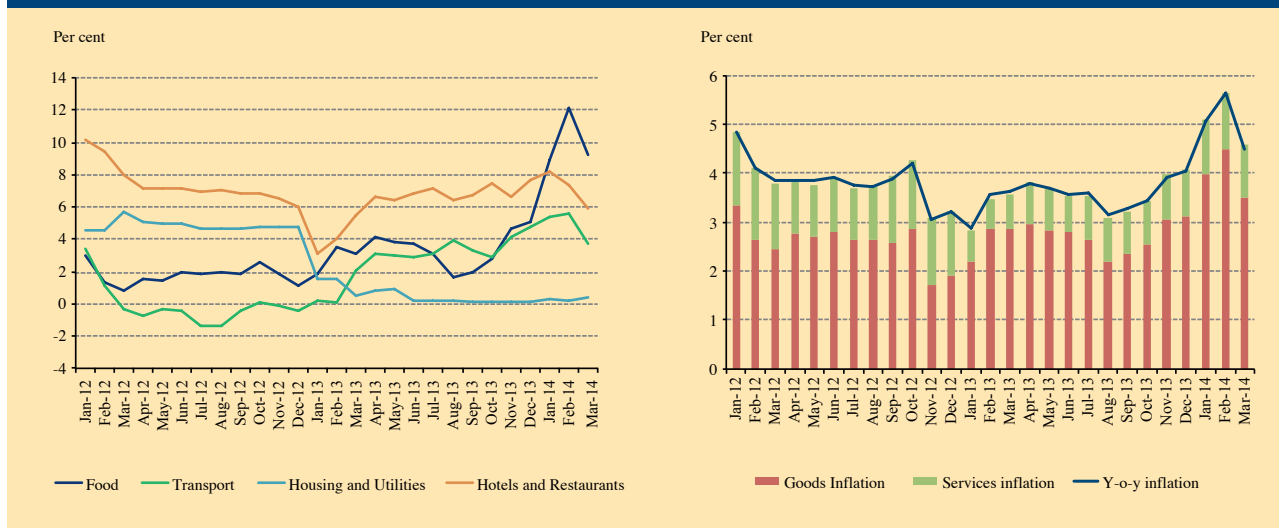
Reflecting the sharp rise in the prices of vegetables on the domestic market, the y-o-y food price inflation rose from a trough of 1.6 per cent in August 2013 to a peak of 12.2 per cent in February 2014 before dropping to 9.2 per cent in March 2014 (Chart 3.3). While local climatic factors were behind the recent increase in food inflation, risks to domestic food inflation from global developments persist.

Y-o-y goods inflation displayed a similar pattern to food inflation, mainly reflecting the hikes in prices of alcoholic beverages, tobacco, vegetables and other

food products. It rose from a trough of 2.2 per cent in August 2013 to a high of 4.5 per cent in February 2014 before retreating to 3.5 per cent in March 2014. Annual services inflation rose from 0.9 per cent in August 2013 to 1.1 per cent in March 2014, mainly affected by the rises in the prices of ‘Transport’ and ‘Restaurant & Hotels’.

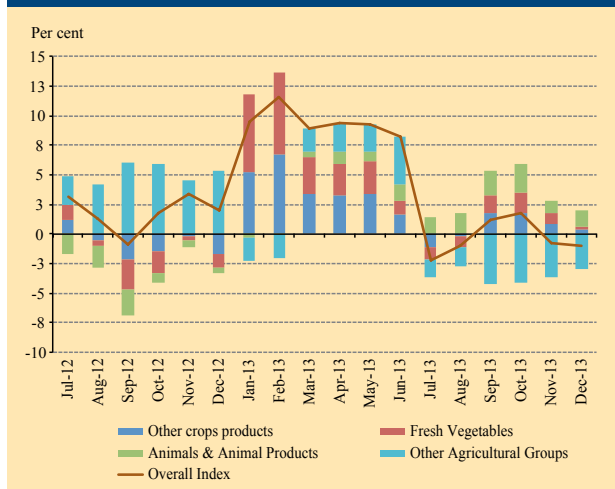
Data on the Producer Price Index (PPI) are available up to December 2013. They show that agricultural prices fell substantially as from 2013H2 as a result of a drop in the prices of crop products, excluding sugar cane, and fresh vegetables. In absolute terms, the PPI-A fell from 116.3 index points in June 2013 to 109.2 index points in December 2013. On a y-o-y basis, PPI-A inflation declined from 8.3 per cent in June 2013 to -1.0

Chart 3.3: Y-o-y Change in Prices of Selected Components



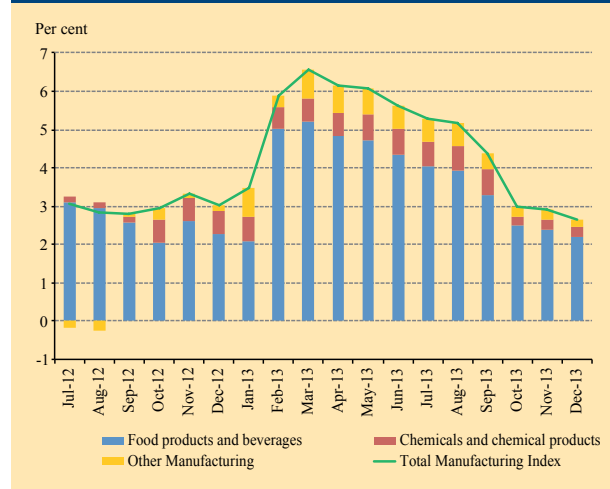
Sources: Statistics Mauritius and Bank of Mauritius.

Chart 3.4: Contribution of Selected Commodity Groups and Products to PPI-A



Sources: Statistics Mauritius and Bank of Mauritius.

Chart 3.5: PPI-M by Main Industry Group



Sources: Statistics Mauritius and Bank of Mauritius.

per cent in December 2013 (Chart 3.4). Going forward, it is expected that PPI-A could increase during 2014Q1 reflecting the recent rise in vegetable prices.

In the manufacturing sector, producer prices were on a declining trend during most of 2013, mainly on account of decreases in the prices of ‘food products and beverages’ (Chart 3.5). Y-o-y PPI-M inflation fell from a high of 6.6 per cent in March 2013 to 2.6 per cent in December 2013.

The decrease in PPI-M was consistent with the fall in the Import Price Index (IPI) registered since 2012H2. The IPI went down to 120.7 in 2013Q4, representing a y-o-y drop of 5.0 per cent. The fall in the IPI was mainly due to decreases in the prices of ‘machinery and transport equipment’ (-14.5 per cent), ‘food and live animals’ (-6.8 per cent) and ‘mineral fuels, lubricants and related materials’ (-4.0 per cent) (Chart 3.6).

Inflation Expectations

The Inflation Expectations Survey carried out in February 2014 showed that the proportion of respondents perceiving inflation to be higher increased from 8.7 per cent in August 2013 to 22.4 per cent in February 2014. While a majority still expected inflation to go up over the next twelve months, the proportion has decreased in the last three quarters (Chart 3.7). Respondents expected the mean inflation rates to be at 4.1 per cent, 4.4 per cent and 4.6 per cent, respectively, for the twelve months ending June 2014, December 2014 and a year ahead (Chart 3.8). Most respondents viewed external factors as the primary source of inflation in Mauritius.

Chart 3.7: Diffusion Index for Inflation Expectation

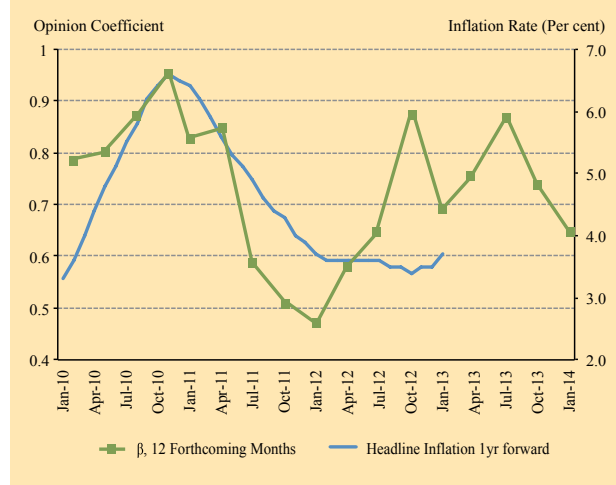


Chart 3.8: Inflation Expectations Mean-trend - A year ahead

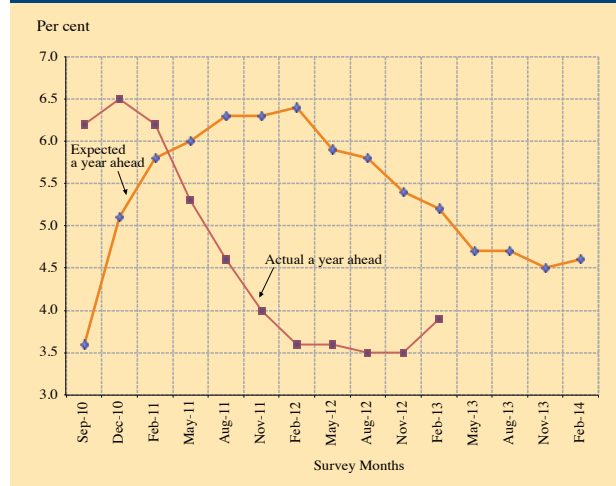
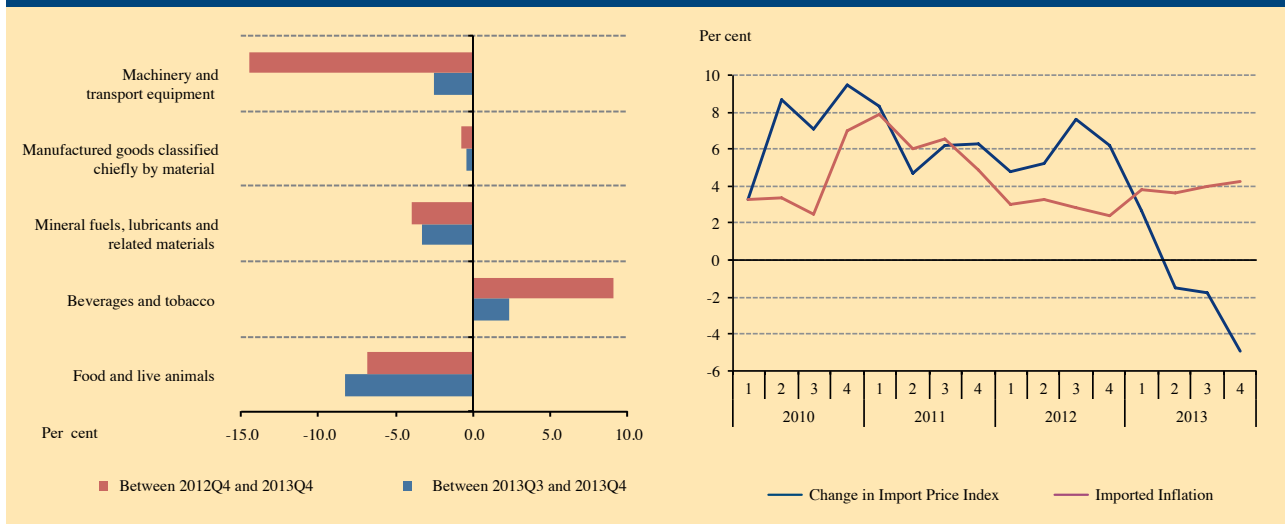


Chart 3.6: Import Price Index and Imported Component of Y-o-y Inflation



Source: Statistics Mauritius.

Box I: Factors Driving Recent Changes in the CPI

During the months of January and February 2014, a significant increase was registered in the consumer price index which increased to 107.2 in January 2014 and further to 108.5 in February 2014. 'Food and non-alcoholic beverages' contributed 3.4 index points to the increase in the CPI. This reflected mainly hikes in the prices of vegetables during this period due to unfavourable climatic conditions.

The substantial impact of higher prices of fresh vegetables on the overall CPI relative to previous years was due to a methodological change in the way Statistics Mauritius (SM) factors in the prices of fresh vegetables in the computation of overall CPI inflation.

Prior to July 2013, SM was using a seasonally-adjusted price series for fresh vegetables by carrying out a moving average of prices over 12 months. However, following an IMF Mission recommendation in January 2013, this practice was ceased and the actual monthly prices of fresh vegetables collected over 4 weeks during the month are now used for the index compilation, underscoring the importance of a CPI for a given month to be only influenced by prices in that month. As a result of this methodological change, there have been substantial fluctuations in the price index of fresh vegetables whenever there have been severe disruptions in supplies. Because of this methodological change, actual inflation trends are not strictly comparable with those prevailing prior to July 2013.

Table 1 gives the change in weighted contribution to inflation between December 2013 and March 2014 and the y-o-y change in March 2014.

DIVISIONS	Consumer Price Index				Weighted contribution to inflation (per cent)	
	Weights	Mar-13	Dec-13	Mar-14	Dec-13 to Mar-14	Mar-13 to Mar-14
Food and non-alcoholic beverages	273	102.2	105.3	111.3	1.6	2.4
of which						
<i>Fresh vegetables</i>	39	102.6	110.5	147.3	1.3	1.7
Alcoholic beverages and tobacco	96	110.2	116.2	116.6	0.0	0.5
Clothing and footwear	45	102.7	107.8	109.0	0.1	0.3
Housing, water, electricity, gas and other fuels	120	100.9	100.3	101.3	0.1	0.0
Furnishings, household equipment and routine household maintenance	61	102.5	102.0	102.8	0.1	0.0
Health	40	103.3	105.5	108.4	0.1	0.2
Transport	151	102.1	105.0	105.9	0.1	0.5
Communication	39	100.0	100.0	99.9	0.0	0.0
Recreation and culture	44	100.1	104.1	104.8	0.0	0.2
Education	45	102.6	101.9	103.3	0.0	0.0
Restaurants and hotels	45	105.0	109.5	111.3	0.1	0.3
Miscellaneous goods and services	41	102.7	102.3	104.7	0.1	0.1
Overall	1000	103.1	105.3	107.7	2.3	4.5

Out of the 1.6 percentage point contribution of 'Food and non-alcoholic beverages' to the overall CPI inflation between December 2013 and March 2014, higher prices of fresh vegetables in January and February 2014 contributed 1.3 percentage points (Table 1). The price index for fresh vegetables shot up from 110.5 in December 2013 to 135.4 in January 2014 and further to 167.4 in February 2014 on account of heavy rains disrupting supply and declined to 147.3 in March 2014. For the year ended March 2014, higher prices of fresh vegetables contributed for 1.7 percentage points out of the 2.4 percentage point contribution of 'Food and non-alcoholic beverages' to the overall CPI annual inflation.

Other divisions' weighted contributions to the overall increase in CPI inflation between December 2013 and March 2014 were either flat or negligible, not exceeding 0.1 percentage point. Over the year to March 2014, 'Alcoholic beverages and tobacco' and 'transport' contributed 0.5 percentage point each followed by 'Clothing and footwear' and 'Restaurants and hotels' with a 0.3 percentage point each. The remaining 0.5 percentage point came from contributions of higher price level in 'Health' and 'Recreation and culture' with 0.2 percentage point each while 'Miscellaneous goods and services' added 0.1 percentage point.

Food, other than fresh vegetables, added 0.2 percentage point to the overall CPI inflation between December 2013 and March 2014 and contributed an estimated 0.6 percentage point in the overall CPI inflation over the year to March 2014.

Within food, the contribution of imported primary commodities to the overall CPI inflation continued to be tame reflecting lower international price pressures in rice and dairy products. However in March 2014, there was a notable increase in the international price of wheat according to the IMF primary commodities statistics due to adverse weather conditions in some major exporting countries. For several other food items, their respective weighted contribution to food inflation was either negative or flat.