4. THE DOMESTIC ECONOMY

The growth momentum of the domestic economy slowed in the last quarter of 2013 as the mild pace of the Eurozone recovery continued to have an adverse impact on external demand. The slower rate of growth reflected low private investment and prolonged weakness in consumption. With the exception of the construction sector which declined further in the last quarter of 2013, all major sectors recorded positive growth rates. Conditions in the labour market remained relatively subdued, partly reflecting a cautious expansion strategy on the part of firms and structural skills mismatch. Domestic economic growth is expected to improve in 2014 as global economic activity picks up with real output projected to grow close to its potential. Nevertheless, downside risks to the domestic growth outlook remain and stem from the continued process of fiscal consolidation and the need for the private sector to reduce its high-debt burden. Besides, external demand might still be constrained by the weak recovery in the Eurozone.

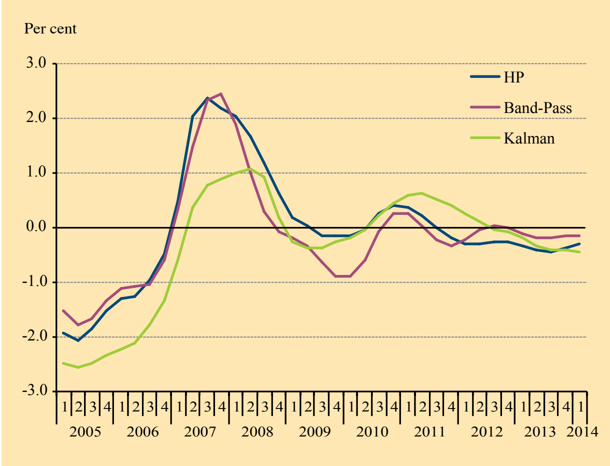
4.1 Economic Activity and Demand

The rate of domestic economic growth slowed in 2013Q4, with seasonally adjusted q-o-q growth falling to 0.3 per cent compared with 1.0 per cent in 2013Q3. On a y-o-y basis, growth fell to 2.9 per cent, from 3.4 per cent in the previous quarter (Chart 4.1). According to Statistics Mauritius, the Mauritian economy is forecast to grow by 3.7 per cent in 2014 compared with 3.2 per cent in 2013.

Taking into account the latest national accounts data, it is assessed that the domestic economy continued to operate with some degree of spare capacity given the continued weakness of domestic and external demand (Chart 4.2).

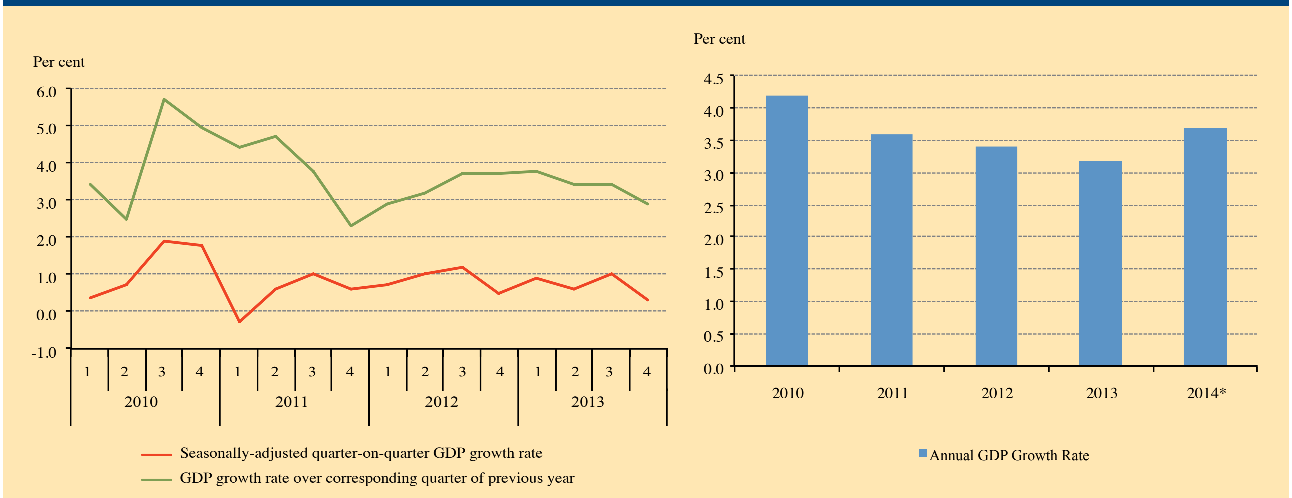
The sluggish rate of growth primarily reflects low private investment. Gross domestic fixed capital formation (GDFCF) contracted by 3.5 per cent in 2013 despite an increase in 2013Q4 as a result of the acquisition of several fishing vessels, which had a one-off impact on investment. In 2014, GDFCF

Chart 4.2: Domestic Output Gap



Sources: Statistics Mauritius and Bank of Mauritius Estimates.

Chart 4.1: Real GDP Growth Rate



**Forecast.*

Source: Statistics Mauritius.

is expected to grow by 1.2 per cent, led by growth of 12.8 per cent in public sector investment whilst private investment is forecast to decline for the third consecutive year (Chart 4.3).

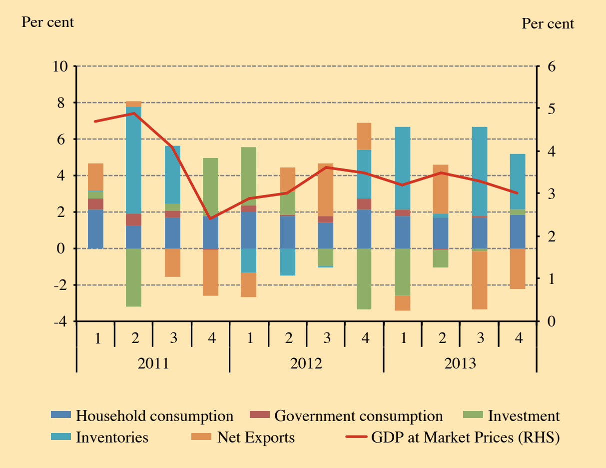
It is expected that private investment would continue to be affected by the slow economic recovery of our main trading partners, the muted business confidence and high levels of indebtedness in the corporate sector. The financial positions of some businesses remain difficult, thus restraining their ability to invest.

The business confidence survey of the Mauritius Chamber of Commerce and Industry (MCCI), carried out in March 2014, revealed that only 23 per cent of respondents were planning to increase their investment level over the next twelve months while 26 per cent mentioned that they would reduce it. The survey showed a decline in business confidence for all the three sectors of activity, namely, manufacturing, services and distributive trade, with the overall index going down by 2.7 points to 85.3 points in 2014Q1 (Chart 4.4). The cost of doing business was assessed as the main factor having a negative impact on business performance.

The projected recovery in public investment in 2014, after the contraction of 4.9 per cent registered in 2013, is based upon the expectation of additional investment already earmarked for various infrastructural projects. However, the implementation of those public sector projects is subject to uncertainty as there may be capacity constraints. In fact, the public investment rate has been on a declining trend for more than 10 years (Chart 4.5). The quarterly pattern of capital expenditure has remained broadly similar in recent years whilst the medium-term macroeconomic projections in the Budget 2014 indicate that public investment may stagnate over the next 3 years (Chart 4.6).

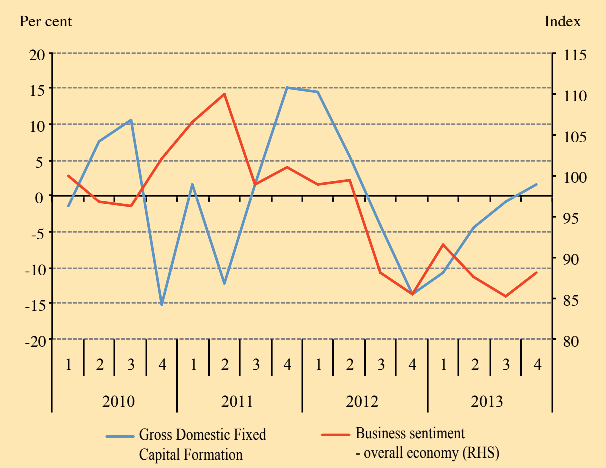
Growth in consumption remained low in 2013Q4, still falling short of the rates observed in the pre-crisis years. Growth in final consumption expenditure picked up by 0.1 percentage point to 2.3 per cent, led by an increase in household consumption expenditure which expanded by 2.8 per cent, from 2.6 per cent in 2013Q3. Statistics Mauritius projects that final consumption expenditure will grow by a higher rate of 2.6 per cent in 2014, from 2.3 per cent in 2013.

Chart 4.3: Contribution of Components of Aggregate Demand to Growth



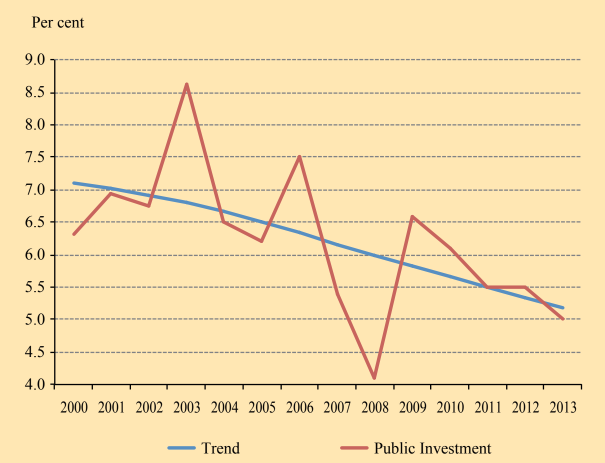
Source: Statistics Mauritius

Chart 4.4: Gross Domestic Fixed Capital Formation and Business Sentiment Index



Sources: Statistics Mauritius and MCCI.

Chart 4.5: Public Investment Rate



Sources: Statistics Mauritius and Bank of Mauritius Estimates.

Nevertheless, growth in household consumption expenditure, the major part of final consumption expenditure, is still moderate. This is due to low economic activity and relatively subdued labour market conditions that will continue to impact negatively on income and consumer confidence. Salary increases in the private sector have not kept pace with the increases in the public sector, but we may expect households to begin slowly to spend more during 2014. Statistics Mauritius estimates that household consumption expenditure will grow by 2.7 per cent in 2014 compared with 2.6 per cent in 2013.

The TNS Analysis survey carried out in January 2014 indicated renewed consumer confidence mainly as a result of seasonal factors. The consumer confidence index increased to 79.4 in 2013Q4, from a low of 65.4 in the previous quarter, while the proportion of respondents who were pessimistic about the future economic outlook went down to 41.8 per cent, from 54.9 per cent in 2013Q3.

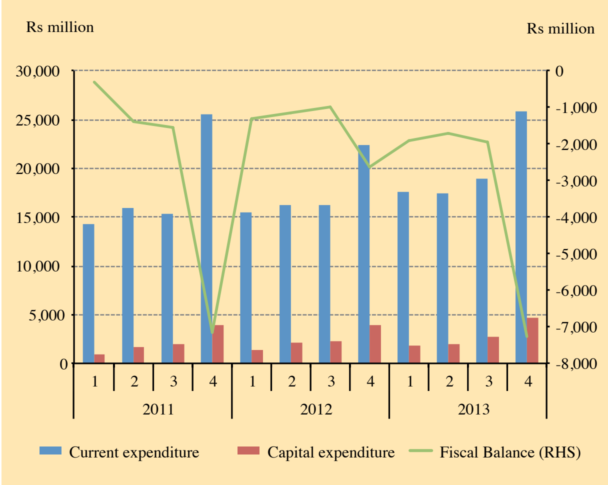
Reflecting the low savings rate in the economy, it is found that households continue to consume more than their disposable income. This indicates that the household savings index, which is defined as the difference between household disposable income and household consumption, is negative (Chart 4.7). The negative real interest rate on savings deposits may have partly contributed to this situation in recent years.

Government consumption expenditure declined by 0.1 per cent in 2013Q4 as against an expansion of 0.4 per cent in 2013Q3. It is expected to register a higher expansion of 2.0 per cent in 2014, from 0.6 per cent in 2013, although the contribution of government consumption to GDP growth should remain minor, as in previous years.

The contribution of external demand to output growth was mostly negative in 2013, indicating that the domestic economy remained vulnerable to the challenging conditions in main export markets (Chart 4.8).

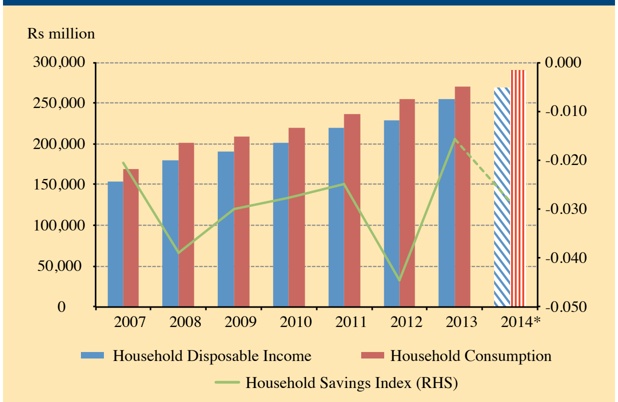
For 2014, the external demand indicator, which is constructed by weighing the real GDP growth of countries making up at least 70 per cent of Mauritian goods exports, shows that foreign

Chart 4.6: Government Fiscal Balance



Source: Ministry of Finance and Economic Development.

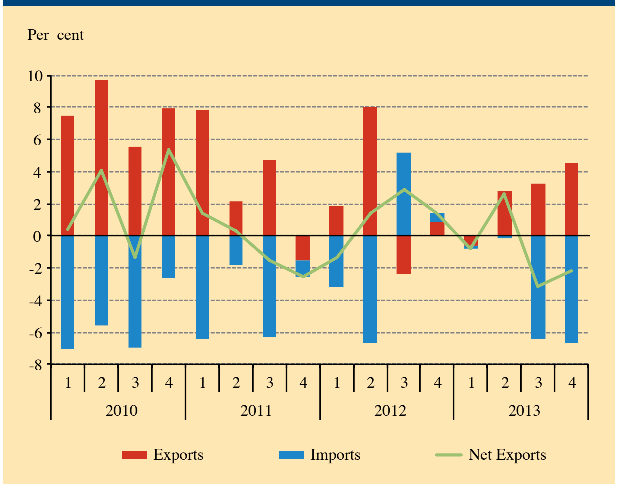
Chart 4.7: Household Disposable Income, Consumption and Savings Index



**Forecast.*

Sources: Statistics Mauritius and Bank of Mauritius Estimates.

Chart 4.8: Contribution of External Demand to Growth

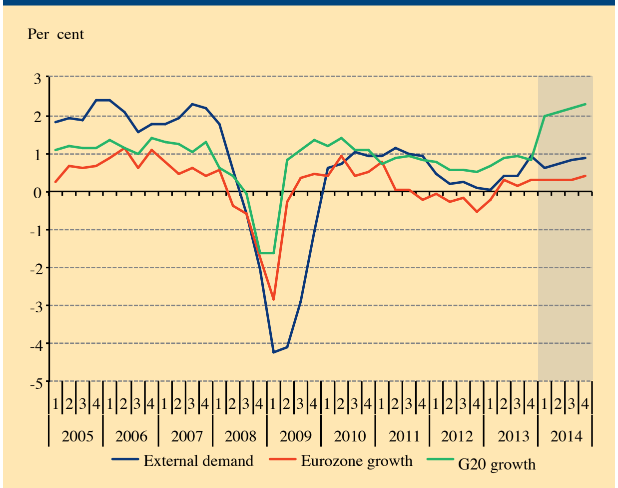


Source: Statistics Mauritius.

demand for domestic exports is likely to remain subdued. However, there has been a gradual improvement during the year as growth in the Eurozone, our main export market, has been picking up (Chart 4.9).

Latest trade data showed that total exports of goods increased by 11.3 per cent y-o-y in 2013H2, primarily led by a pick-up of 33.8 per cent in ships, stores and bunkers. Excluding this item, exports of goods grew at a slower pace of 7.4 per cent in 2013H2. There was a substantial increase of 114.3 per cent in the exports of ‘machinery and transport equipment’, which reflected a large rise in freeport re-exports of telecommunication equipment that contained a sizeable import element. Exports were also led by

Chart 4.9: External Demand, Eurozone Growth and G20 Growth

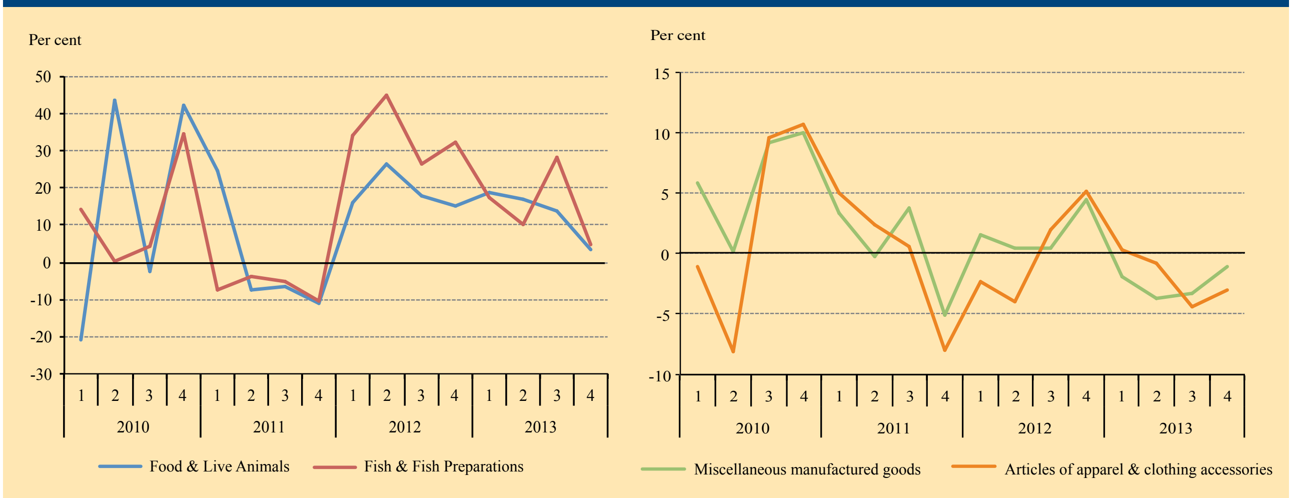


‘food and live animals’ and ‘manufactured goods classified chiefly by material’, which registered growth rates of 8.3 per cent and 17.3 per cent, respectively. By contrast, there was a decline in exports of ‘miscellaneous manufactured goods’, mainly explained by a decrease in exports of ‘articles of apparel and clothing accessories’ which have constituted one of our main export commodities. This highlights the persistent difficulties faced by local exporters (Chart 4.10).

Total imports c.i.f. went up by 6.7 per cent y-o-y in 2013H2. This largely reflected an increase of 25.8 per cent in imports of ‘machinery and transport equipment’ on account of the purchase of two marine vessels and, as mentioned above, higher imports of telecommunications equipment (Chart 4.11). Excluding these components which are not expected to have a considerable impact on the economy’s productive capacity, it is estimated that the imports of goods went up by 2.2 per cent in 2013H2. Separately, imports of ‘food and live animals’ and ‘mineral fuels, lubricants & related products’ increased by 5.6 per cent and 5.7 per cent, respectively.

The coverage ratio, which represents the ratio of exports to imports, fell in 2013H2. Concurrently, the merchandise trade deficit deteriorated by 2.8 per cent (Chart 4.12). Reflecting lower surpluses on the services and income accounts, the current account deficit widened to Rs21.4 billion in 2013H2, from Rs16.6 billion in 2012H2 (Chart 4.13).

Chart 4.10: Y-o-y Growth in Exports by Selected Commodity Groups



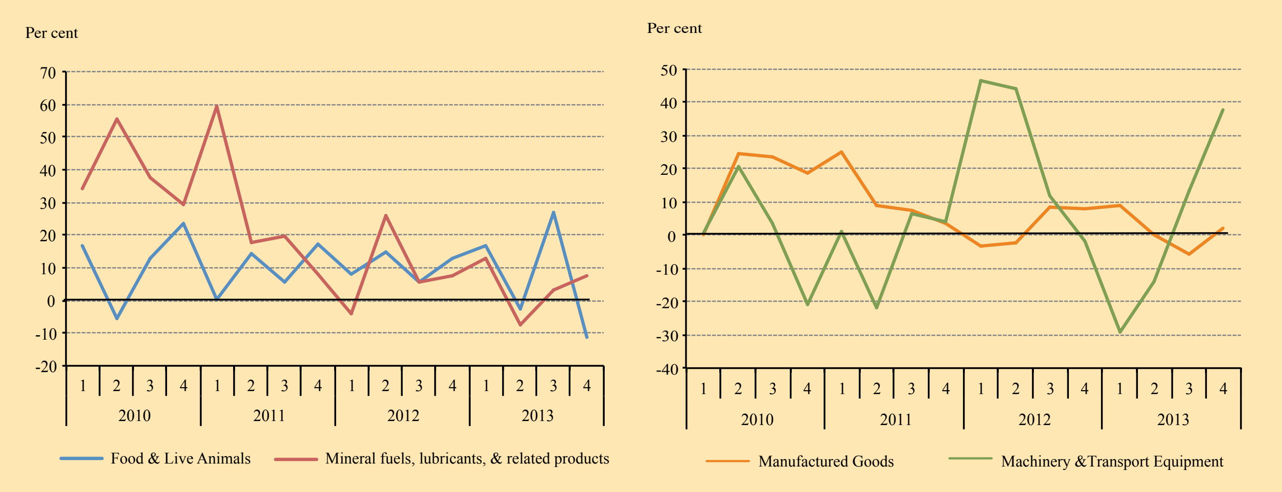
Source: Statistics Mauritius.

Going forward, given a somewhat more favourable external environment and assuming a relatively stable rupee exchange rate, it is expected that exports might gradually strengthen. Moreover, intensive marketing campaigns to consolidate the share of Mauritian exports in traditional markets and diversify exports to emerging markets are estimated to support export growth. Among the main commodities, 'miscellaneous manufactured goods' exports might revert to growth in 2014 while the exports of 'food and live animals', which had fallen in 2013Q4, are projected to increase to higher levels in 2014. Foreign investment in the seafood sector is increasing, which may contribute to boost production capacity.

4.2 Supply

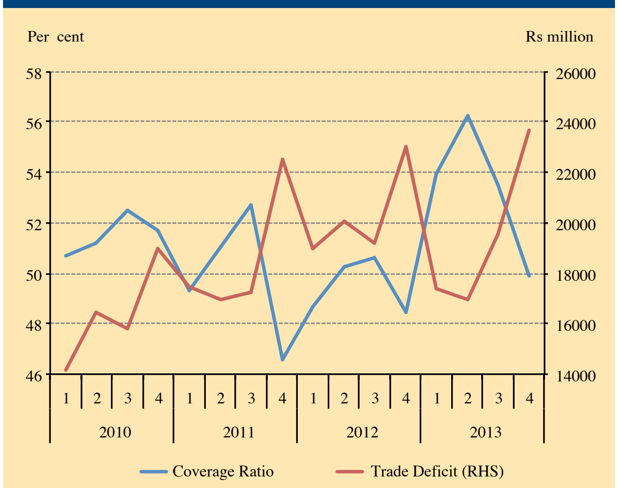
The balance between demand and supply is an important determinant of the degree of inflationary pressures in the economy. On the supply side, all economic sectors exerted a favourable impact on the quarterly change in real GDP in 2013Q4, except 'construction', which maintained a declining trend. The 'manufacturing' (0.9 per cent), 'financial and insurance activities' (0.5 per cent) and 'wholesale and retail trade' (0.4 per cent) sectors made the highest contribution to GDP growth. In contrast, the 'construction' sector contributed negatively to output growth (-1.2 per cent) (Chart 4.14).

Chart 4.11: Y-o-y Growth in Imports by Selected Commodity Groups



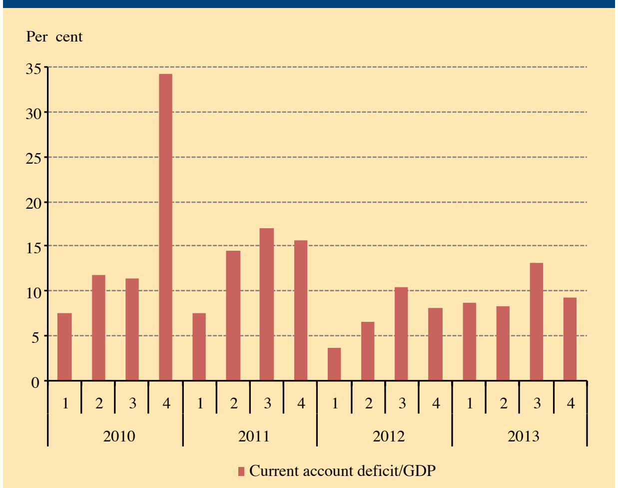
Source: Statistics Mauritius.

Chart 4.12: Coverage Ratio and Trade Deficit



Source: Statistics Mauritius.

Chart 4.13: Current Account Deficit as a percentage of GDP



Sources: Statistics Mauritius and Bank of Mauritius.

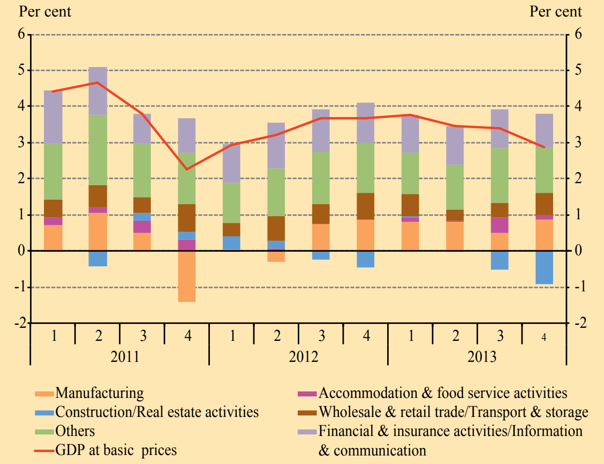
Among the main sectors, the 'manufacturing' sector posted the fastest growth rate of output in 2013Q4 compared with 2013Q3. The 'wholesale and retail trade' sector also registered a higher growth rate in 2013Q4. In contrast, activity in the 'financial and insurance activities' and 'accommodation and food service activities' sectors decelerated in 2013Q4. 'Construction' was the only main sector that contracted in 2013Q4, as it had in the previous quarter.

In the tourism sector, arrivals increased by 2.9 per cent y-o-y in 2013 (Chart 4.15). For the first three months of 2014, however, tourist arrivals went down by 0.8 per cent y-o-y. This highlights that this sector remains vulnerable to the difficult economic situation in our main markets. Tourist earnings have not kept pace with arrivals. They are estimated to have fallen by 8.6 per cent y-o-y in 2013 and further by 4.5 per cent y-o-y in the first three months of 2014 (Chart 4.16).

The drop in tourist earnings led to a fall in net travel receipts, from Rs15.0 billion in 2012H2 to Rs11.4 billion in 2013H2. This translated into a lower surplus of Rs8.7 billion in the services account of the Balance of Payments (BoP), representing a y-o-y decrease of 26.3 per cent.

Statistics Mauritius forecast tourist arrivals to increase to 1,030,000 in 2014, from 993,106 in 2013. The Bank projects that tourist earnings for 2014 will rise to Rs44,500 million compared with Rs40,557 million in 2013.

Chart 4.14: Contribution of Selected Sectors to GDP Growth



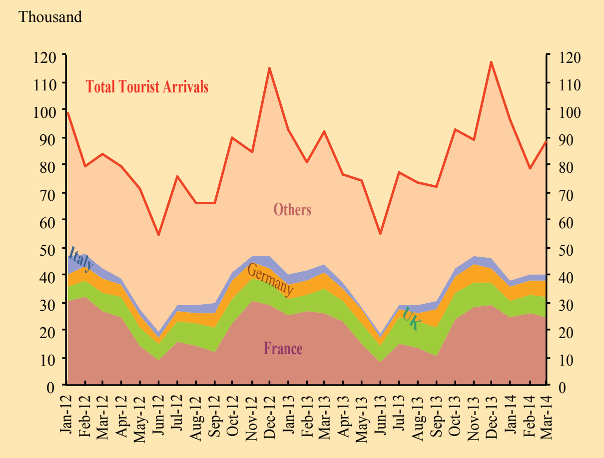
Source: Statistics Mauritius.

4.3 Capital Flows

Latest BoP statistics include the results of the FALS 2013 and the GBC1s Survey 2013. There have been substantial revisions in the BoP statistics for the years 2011 and 2012 regarding income, direct investment and private external debt in the 'other investment' category mainly and to a lesser extent in portfolio investment.

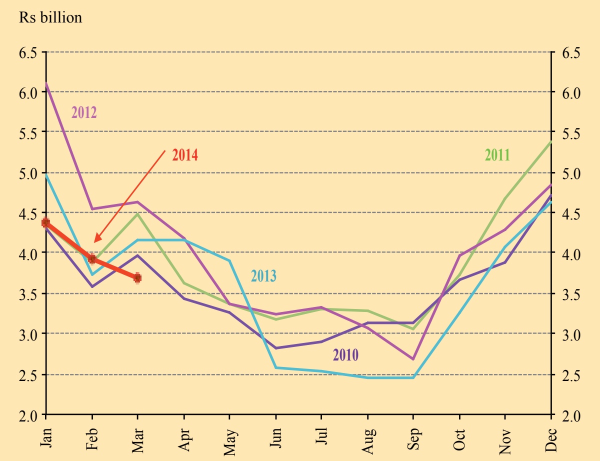
The capital and financial account posted significantly higher net inflows of Rs26.1 billion in 2013H2 due to surpluses from portfolio and direct investment which more than offset the net outflow in other investment (Chart 4.17). Direct investment, inclusive of cross-border transactions of GBC1s, posted net inflows of Rs36.6 billion in 2012H2 compared with Rs88.1

Chart 4.15: Tourist Arrivals



Source: Statistics Mauritius.

Chart 4.16: Tourist Earnings



billion in the corresponding period of the previous year. Portfolio investment, inclusive of GBC1s, recorded net inflows of Rs26.5 billion in 2013H2 compared with Rs17.6 billion a year earlier. Other investment, inclusive of GBC1s' cross-border transactions, posted net outflows of Rs35.9 billion in 2013H2 compared with net outflows of Rs98.0 billion in the corresponding period of 2012.

4.4 Labour Market

The unemployment rate, which had been on a declining trend since 2004Q1, started to increase gradually from 2010 (Chart 4.18). Latest data show that, although there was a slight improvement in 2013Q4, conditions in the labour market remained subdued, partly reflecting a cautious expansion strategy on the part of firms and persistent structural skills mismatch. The unemployment rate dropped to 7.5 per cent in 2013Q4, from 8.0 per cent in the previous quarter. Statistics Mauritius estimates that the unemployment rate has remained unchanged at 8.0 per cent in 2013 compared with 2012.

Over the year to 2013Q4, 13,500 jobs were created in the domestic economy, mainly in 'wholesale and retail trade' (+3,600) followed by 'manufacturing' (+2,600), 'accommodation and food service activities' (+1,700), 'transportation and storage' (+1,400), 'professional, scientific and technical activities' (+1,400), 'other service activities' (+1,400) and 'information and communication' (+1,100). Over the same period, jobs were lost in two sectors, namely, 'construction' (-1,700) and in 'agriculture, forestry and fishing' (-700) (Chart 4.19).

The drop in the unemployment rate in 2013Q4 reflects changes in labour force participation (Chart 4.20). Over the year, the participation rate of the 16-24 and 40-49 age groups declined while that of the 25-29, 30-39 and 50+ age groups increased. Lower participation of the 16-24 and 40-49 age groups partly reflected prevailing labour market rigidities, including structural skills mismatch and the unavailability of jobs due to reduced demand. Moreover, many young people often decide to pursue higher studies and are not registered in the labour force.

Over a longer time period, it is observed that the participation rate has increased quite substantially since 2012. This was mainly due to higher participation of the 30-39 and 50+ age groups. A reduction in household income in recent years

Chart 4.17: Capital flows including GBC1s

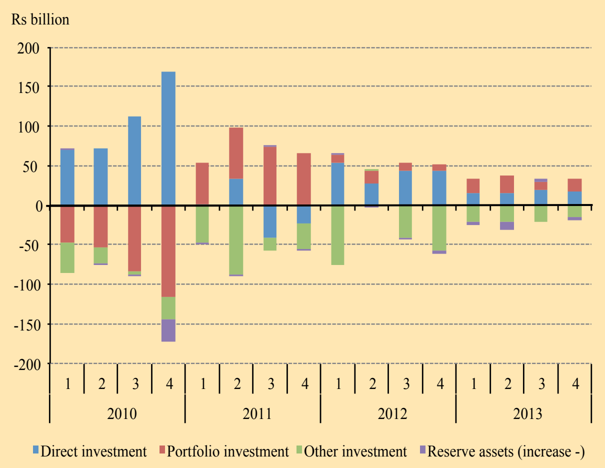
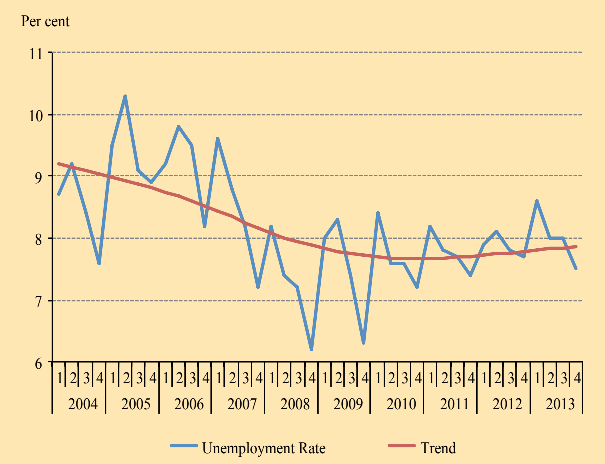
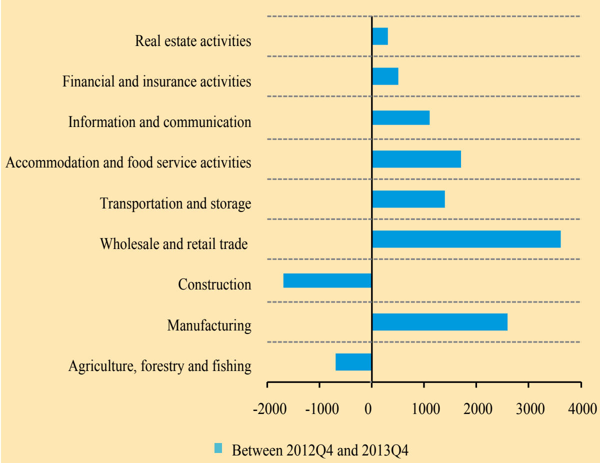


Chart 4.18: Unemployment Rate



Sources: Statistics Mauritius and Bank of Mauritius Estimates.

Chart 4.19: Change in Employment by Main Sectors

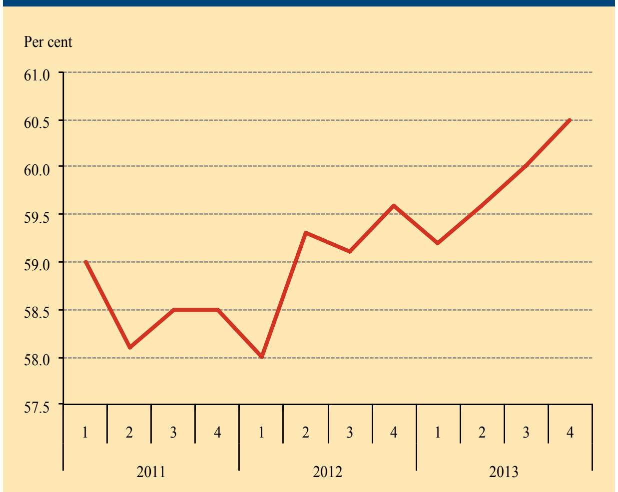


Source: Statistics Mauritius.

as well as lower savings may have encouraged more people to seek employment. In addition, rising unemployment abroad, due to the economic slowdown, has induced many Mauritians working overseas to return to the domestic labour market (Chart 4.21).

According to the latest Pluriconseil survey carried out in February 2014, a majority of analysts (67 per cent) forecast that the unemployment rate for 2014 will be higher than in 2013. The March 2014 MCCI business confidence survey showed that only 14 per cent of respondents were planning to increase their workforce in the coming months while 15 per cent were contemplating reducing their workforce given the continuing decline in domestic demand and the shortage of qualified labour in the market. Moreover, 71 per cent of entrepreneurs claim they will not increase their workforce. If the economy picks up in 2014, as expected, there might be a return of business confidence which would boost investment and create more job opportunities.

Chart 4.20: Labour Force Participation Rate



Source: Statistics Mauritius.

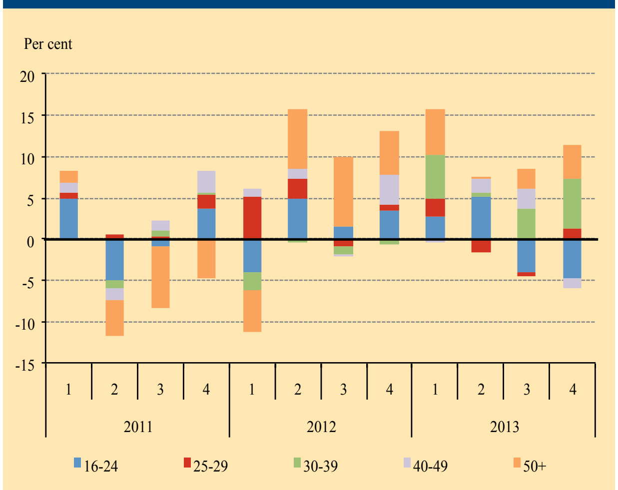
Wage Rate Index

The nominal Wage Rate Index (WRI) increased by 7.3 per cent y-o-y to reach 112.2 in 2013Q4. This increase was significantly higher than the y-o-y inflation rate of 3.5 per cent during the same period (Chart 4.22). If sustained, wage increases not matched by higher productivity could be a source of inflationary pressures.

The highest nominal wage increases were recorded in 'electricity, gas, steam and air conditioning supply' (20.1 per cent), 'education' (16.4 per cent), 'water supply, sewerage, waste management and remediation activities' (13.6 per cent), 'transportation and storage' (12.2 per cent), 'human health and social work activities' (9.7 per cent) and 'public administration and defence; compulsory social security' (8.4 per cent). Main decreases in wages were noted in 'arts, entertainment and recreation' (-0.7 per cent) and 'construction' (-0.5 per cent) (Chart 4.23).

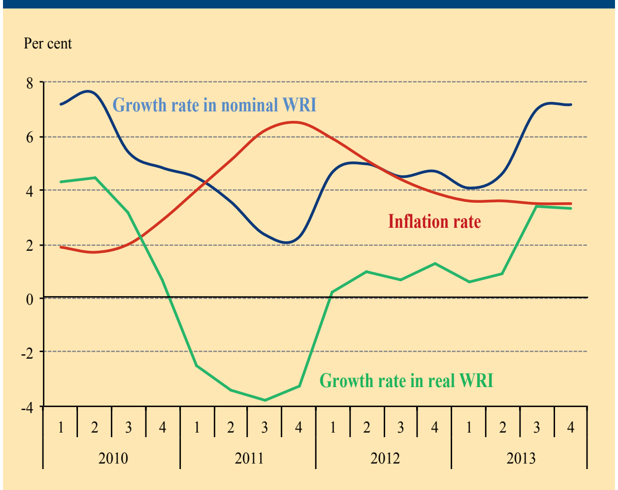
For the year 2013, the WRI for all sectors went up by 5.8 per cent but out of the 19 economic sectors, only eight sectors recorded a change in their WRI

Chart 4.21: Y-o-y Changes in the Labour Force Participation Rate by Age Group



Source: Statistics Mauritius.

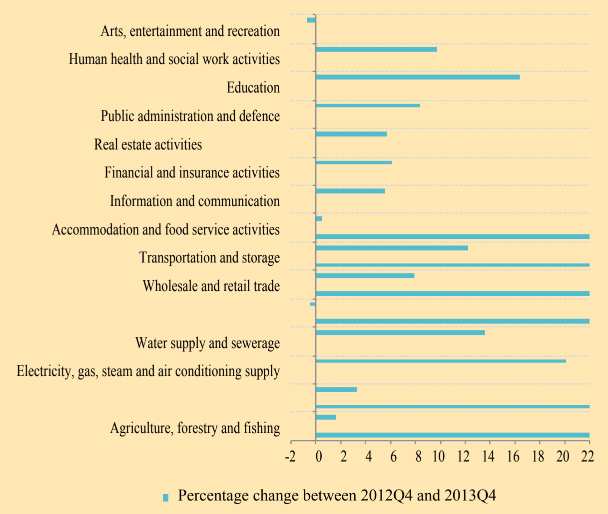
Chart 4.22: Growth in Wage Rate Index and Inflation Rate



Sources: Statistics Mauritius and Bank of Mauritius Estimates.

equal and greater than 5.8 per cent while in the remaining eleven economic sectors, the WRI was either showing a contraction or a lower increase.

Chart 4.23: Y-o-y Change in Wage Rate Index



Source: Statistics Mauritius.