**BANK OF MAURITIUS**

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# Minutes of the 28th Monetary Policy Committee Meeting 26 November 2012

The 28th meeting of the Monetary Policy Committee was held on 26 November 2012 at 10.00 hours at the Bank of Mauritius, with Mr Rundheersing Bheenick, Governor, in the chair.

Members present: Mr Yandraduth Googoolye, First Deputy Governor; Mr Mohammed Iqbal Belath, Second Deputy Governor; Mr Jitendra Nathsingh Bissessur, Head-Financial Markets Analysis Division, Bank of Mauritius; Mr Nishan Degnarain, Mr Pierre Dinan, Mr Alain Madelin and Mr Rajkamal Taposeea, External Members.

Professor Silvana Tenreyro, External Member, attended the meeting via video-conference.

Observers: Dr Streevarsen Narrainen, Senior Economic Adviser, Ministry of Finance and Economic Development, and Mr Neetyanand Kowlessur, Chief-Governor's Office, Bank of Mauritius.

## Summary of Staff Reports on Economic and Financial Developments

The Staff reported on economic and financial developments since the 27th MPC meeting held on 24 September 2012.

### *The International Economic Environment*

1. Global economic conditions had shown tentative signs of stabilising since the September 2012 MPC meeting. Strong policy initiatives by the ECB had calmed financial markets but economic sentiment stayed fragile. Leading economic indicators had underscored the slow pace of expansion of the global economy, which continued to be subject to substantial uncertainty from the debt and economic crisis in the Eurozone and, in the nearer term, from the so-called US fiscal cliff.

2. The US economy appeared to have grown faster than initially expected in 2012Q3 on stronger wholesale and factory inventories as well as higher merchandise export volumes. Consumer confidence had picked up alongside a slight improvement in the labour market where the unemployment rate had declined to 7.9 per cent in October 2012. Looking ahead, activity

indicators pointed to a modest recovery in 2013, with the worries related to the fiscal cliff representing a major downside risk to the growth outlook.

3. The Eurozone economy had receded by 0.1 per cent in 2012Q3 following a contraction of 0.2 per cent in 2012Q2. The unemployment rate had continued to increase, reaching another record high of 11.6 per cent in September 2012. Low consumer and business confidence amid fiscal austerity were expected to still act as major drags on growth in 2013.

4. After three consecutive quarters of negative growth, real output in the UK was estimated to have rebounded strongly to 1 per cent in 2012Q3 as a result of a series of one-off factors. However, growth was forecast to fall back significantly in 2012Q4 and to remain relatively subdued in subsequent quarters.

5. Growth in emerging economies had continued to be affected by the downturn in the euro area and the US though recent activity data in China and other emerging Asian nations had surprised on the upside and indicated that economic recovery might be gaining traction.

6. Global commodity prices had stayed at elevated levels since the September 2012 MPC meeting. While supply concerns had eased, they had remained sufficiently important for the FAO Food Price Index to be sustained at around its highest level in 2012. Crude oil prices had retreated somewhat on worries about the global economic slowdown and significant crude stock-builds in the US, which had temporarily outweighed geopolitical supply factors.

7. Global inflation had been affected by the surge in commodity prices at the beginning of 2012H2 but subdued economic conditions had prevented inflationary pressures taking hold in a number of countries.

8. Conditions in global financial markets had eased and risk appetite had returned as investors grew increasingly confident about the commitment of Eurozone policymakers to find a solution to the crisis.

***Domestic Economic Developments***

9. In Mauritius, the latest available data suggested that the domestic economy had withstood the external headwinds relatively well, notwithstanding sluggish growth dynamics in major export sectors. National accounts data for 2012Q2 showed that, on a seasonally-adjusted basis, the economy had registered growth of 1.3 per cent q-o-q after it had stagnated in 2012Q1. The expansion had been led by a recovery to positive growth in several sectors while **‘manufacturing’** had contracted.

10. The annual growth rate of the domestic economy had slowed to 2.7 per cent in 2012Q2, from an upwardly revised expansion of 3.0 per cent in 2012Q1. Growth had picked up in **‘real estate, renting and business activities’** and **‘wholesale and retail trade’** but had been lower

in **‘financial intermediation’**, **‘transport, storage and communications’** and **‘construction’**. **‘Hotels and restaurants’** had stagnated in 2012Q2 after contracting in 2012Q1. **‘Manufacturing’** had shrunk for a third consecutive quarter, recording negative growth of 1.6 per cent due to declines of 7.3 per cent and 3.4 per cent in *‘textile’* and *‘sugar’*, partly offset by an expansion of 3.4 per cent in *‘food’*.

11. In September 2012, Statistics Mauritius had revised down its growth projection for the domestic economy to 3.2 per cent for 2012, from 3.5 per cent previously. The Budget 2013 had forecast growth at 3.4 per cent for 2012 and 4.0 per cent for 2013.

12. **‘Final consumption expenditure’** growth had increased to 2.5 per cent in 2012Q2, from 2.2 per cent in 2012Q1, as a jump in *‘household consumption expenditure’* growth to 2.8 per cent had outweighed a slowdown in *‘general government consumption expenditure’* growth. **‘Gross domestic fixed capital formation’** (GDFCF) had decelerated sharply to 2.8 per cent in 2012Q2, mainly reflecting reduced growth of 5.3 per cent in *‘machinery and equipment’*. Excluding *‘aircraft and marine vessel’*, GDFCF was projected to contract by 0.7 per cent in 2012.

13. The most recent available trade data had shown that over the period January to September 2012, total exports, excluding *‘ships, stores and bunkers’* had grown by 2.6 per cent, driven by a rise in *‘food and live animals’* exports while *‘miscellaneous manufactured articles’* exports had dropped. Total imports *c.i.f.* had risen by 9.9 per cent on account of higher *‘machinery and transport equipment’* imports.

14. Weaker global demand had continued to undermine the tourism and textile sectors. Tourist arrivals had stalled over the period January to October 2012, with growth of 0.1 per cent y-o-y amid declines from key European markets. Gross tourist earnings were estimated to have increased by 6.0 per cent y-o-y over the period January to September 2012 to Rs31,954 million. In the textile sector, tapping the southern African and US markets had helped to keep orders full and had compensated to some extent for the fall in demand from the Eurozone.

15. To enhance its understanding on the challenges faced by the Mauritian textile and clothing industry, the MPC benefited from a presentation by Mr Eric Ng Ping Cheun of PluriConseil Ltd, a local consultancy firm. Members noted that the local industry had been affected by the Eurozone troubles while prices were being pressured by a production glut. Through economies of scale and geographical diversification, large companies had been in a better position than small and medium enterprises to improve their balance sheets and become more productive. They also had a greater capacity to borrow in foreign currency. The study confirmed that some textile companies were highly indebted. While some had increased investment and ensured reasonable return on equity, others were confronted with a lower return on equity than the cost of debt, which was not viable in the long run. The study recommended, among others, the need for more equity infusion in some companies, the creation of an international brand and

improved air access. It highlighted that a policy of rupee depreciation in the current global macroeconomic context would bring about higher inflation and eventually higher wage increases relative to productivity growth. In addition, interest charges were assessed as having a negligible impact on the financial expense of textile companies. Competitiveness, both in terms of cost and quality, was considered primordial for the future of the industry.

16. Preliminary estimates of the balance of payments, including cross-border transactions of GBC1s, indicated that the current account deficit had fallen to Rs10.8 billion in 2012Q3, from Rs13.4 billion in 2011Q3, driven by a higher net invisibles surplus, which had partly offset the widening trade deficit. The current account deficit had been financed by net inflows of Rs8.4 billion on the capital and financial account. *'Direct investment'* had recorded net inflows of Rs129.7 billion in 2012Q3 while *'portfolio investment'* and *'other investment'* had posted net outflows of Rs107.6 billion and Rs12.5 billion, respectively.

17. The unemployment rate had climbed by 0.2 percentage point to 8.2 per cent in 2012Q2. On a seasonally-adjusted basis, the unemployment rate had increased to 7.7 per cent, from 7.4 per cent in 2012Q1.

18. Monetary aggregates had recorded a slower pace of expansion since the September 2012 MPC meeting. The annual growth rate of broad money liabilities had decelerated from 7.5 per cent in July 2012 to 6.4 per cent in September 2012 and the annual growth rate of credit to the private sector had fallen from 15.7 per cent to 14.5 per cent over the same period.

19. Between August and October 2012, the CPI had edged higher by 0.4 point to 133.6. Headline inflation had pursued its decline to 4.3 per cent in October 2012, from 4.6 per cent in August 2012, while y-o-y inflation had risen to 4.2 per cent, from 3.7 per cent in August 2012. The main contributors to y-o-y inflation had been *'alcoholic beverages and tobacco'* (1.5 percentage points), *'food and non-alcoholic beverages'* (0.8 percentage point) and *'housing, water, electricity, gas and other fuels'* (0.6 percentage point).

20. Y-o-y underlying measures of inflation had seemed to indicate some emerging upward pressure on the price level as both CORE1 and CORE2 inflation had risen at a faster pace than y-o-y inflation. Between August and October 2012, CORE1 y-o-y inflation had climbed from 3.0 per cent to 3.6 per cent while CORE2 had increased from 2.7 per cent to 3.5 per cent.

***Domestic Financial Markets Developments***

21. Staff indicated that the overall excess liquidity in the domestic money market had gone up slightly to an average of Rs3.6 billion after the September 2012 MPC meeting, mainly as a result of the net redemption of Government securities and the purchase of foreign currencies by the National Resilience Fund.

22. At the primary auctions of Treasury Bills, the weighted average yields on 91-day, 182-day, 273-day and 364-day Treasury Bills had fallen to 2.97 per cent, 2.96 per cent, 3.05 per cent and 3.17 per cent, respectively.

23. The weighted average interest rate on rupee deposits and rupee advances had stood at 3.65 per cent and 8.49 per cent, respectively, as at end-September 2012, broadly unchanged from their levels in July 2012. The real interest rate on savings deposits, using the y-o-y inflation rate, had remained in negative territory since October 2010.

24. The Bank had signed three agreements with banks under the Special Foreign Currency Line of Credit of EUR600 million made available to operators in affected export sectors. It had disbursed funds totalling EUR8.9 million, mainly to operators in the tourism sector.

25. Reflecting the US dollar's broad-based strength on international currency markets and domestic demand and supply conditions, the dealt rupee exchange rate had depreciated against the US dollar, euro and Pound sterling. In nominal effective terms, both MERI1 and MERI2 had lost ground since the September 2012 MPC meeting.

### *Staff Economic Outlook*

26. Staff estimated that the weak and vulnerable world economy had continued to have an adverse bearing on domestic real activity. The output gap had remained negative in 2012Q3 and spare capacity within the economy had persisted. With latest data releases basically confirming the picture that had emerged at the September 2012 MPC meeting, the central domestic growth forecast for 2012 had been maintained at 3.3 per cent. A preliminary estimate for 2013 showed growth picking up to a range of 3.6 – 3.9 per cent as conditions in main export markets were projected to stabilise, allowing for some of the factors holding back external demand to recede. At the same time, diversification efforts were expected to support the domestic economy. The growth outlook nevertheless remained uncertain, with persistent downside risks from the Eurozone.

27. Staff assessed that the budgetary measures with regard to alcoholic beverages, cigarettes and cigars were expected to have an immediate impact on the CPI while the full effect of the public sector wage increases, which could add between 0.3 to 0.5 percentage point to inflation, would be felt most in 2013. External food price developments and the recent movements in the rupee exchange rate might also influence the future inflation path. On a no-policy change basis, Staff forecast y-o-y inflation at 5.7 per cent in December 2013.

## The Monetary Policy Decision

28. The MPC viewed that the international economic situation remained precarious due to the uncertainty over the resolution of the Eurozone debt crisis and the extent of fiscal contraction that might eventually take place in the US at the beginning of 2013. The Eurozone was in

recession and was projected to record, at best, very marginal positive growth in 2013 whereas the UK was forecast to rebound from recessionary conditions, with growth of around 1 per cent in 2013. The US fiscal cliff had the potential to derail growth prospects but the US economy was expected to overcome this problem and record moderate growth of around 2 per cent in 2013. The expansion of emerging economies was likely to continue outpacing that of advanced economies amid some evidence that growth in China and other emerging Asian nations was picking up. Concurrently, global inflationary pressures had remained contained but commodity prices, in particular food prices, still represented a major upside risk to the inflation outlook.

29. Members observed that the domestic economy had maintained a positive, albeit slowing, growth momentum even as the tepid global environment restrained activity in major export sectors. The economy was expected to be propped up by market diversification efforts and the relatively good performance of emerging sectors, notably the seafood sector. However, with private investment muted, public investment constrained by implementation capacity and consumption growth low, the economy was forecast to continue operating below trend over the policy-relevant horizon. The outlook for 2013 was, moreover, clouded by the uncertainty emanating from developments in the Eurozone and the US.

30. The situation in the real sector where corporate indebtedness was growing was discussed. Some members remarked that public sector investment had not been sufficient to compensate for the decline in private investment. Given the uncertain outlook, it was deemed necessary to appropriately balance fiscal consolidation and the implementation of counter-cyclical fiscal policy to stimulate the economy. Members generally considered it essential to create conditions conducive to improving output and productivity in the real sector. However, they reiterated that the structural weaknesses in the economy could not be addressed by monetary policy.

31. The slight increase in the unemployment rate in 2012Q2 had not fundamentally changed the outlook for the labour market. The basic problem remained that of a structural skills mismatch that could only be resolved through labour market reforms.

32. Noting the increase in the y-o-y and core inflation rates since its last meeting, the MPC took the view that upside risks to the inflation outlook had grown on account of elevated global food prices, the recent rupee depreciation, the expected impact of the wage award in the public sector and the latest budgetary measures. An anticipated adjustment in retail petroleum prices was also expected to add to the inflation risks. Members were of the opinion that these higher risks might have been reflected in the Budget forecast for headline inflation of 6.0 per cent in 2013.

33. The Committee weighed the risks to the growth and inflation outlook over the policy-relevant horizon and extensively discussed alternative interest rate scenarios. Members collectively

recognised the upside risks to inflation and expressed strong concerns over a possible resurgence of inflation. However, views differed on the extent to which monetary policy should react to those threats in the context of a global economic slowdown. For some members, although downside risks to the growth outlook were still significant, the balance of risks had tilted towards the inflation outlook given the range of factors that could push inflation higher. With further doubts about the possible ways in which the Budget estimate for inflation in 2013 might frame agents' expectations as well as concerns about the effects of the persistent negative real interest rate on savings and asset prices, they made a case for pre-emptive action to signal their worries over the worsening inflation outlook while stressing on the need to anchor inflation expectations and support savings. A marginal upward adjustment to the Key Repo Rate was consequently requested.

34. Other members were more inclined to support real economic activity at this juncture rather than focus on potential inflation risks. They argued in favour of maintaining the current stance of monetary policy, the more so that they judged it too early to assess the impact of the budgetary measures on the economy. A few of them viewed that the negative output gap might cap any inflation increase while there was uncertainty on the pressure for private sector wages to adjust to the increase in public sector wages.

***Voting Pattern***

35. At the conclusion of the discussion, after a third round of voting, the Committee voted with a majority of 5-4 to keep the Key Repo Rate unchanged at 4.90 per cent per annum while underlining its strong concerns on the inflation outlook. The four dissenting members voted to increase the Key Repo Rate by 10 basis points.

36. The MPC will maintain strong vigilance in monitoring economic and financial developments and stands ready to meet in between its regular meetings if the need arises.

37. The meeting adjourned at 17.58 hours. The next MPC meeting is scheduled on Monday 4 March 2013.

38. **Voting for the MPC action:** Mr Yandraduth Googoolye, Mr Nishan Degnarain, Mr Pierre Dinan, Mr Rajkamal Taposeea and Prof. Silvana Tenreyro.

39. **Voting against the MPC action:** Mr Rundheersing Bheenick, Mr Mohammed Iqbal Belath, Mr Jitendra Nathsingh Bissessur and Mr Alain Madelin.

*Bank of Mauritius*
*10 December 2012*

## Editor's Note

According to the Bank of Mauritius Act 2004, the primary object of the Bank shall be to maintain price stability and to promote orderly and balanced economic development. The Act gives the Monetary Policy Committee (MPC) responsibility to formulate and determine the monetary policy to be conducted by the Bank. The MPC meets on a regular quarterly basis.

In line with amendments brought to the Bank of Mauritius Act 2004 in December 2011, the composition of the MPC was revised in March 2012. Members of the MPC now comprise the Governor (Chairperson), three Senior Officers of the Bank appointed by the Governor, and 5 other persons (external members) appointed by the Minister of Finance and Economic Development after consultation with the Governor.

When the MPC met on 26 November 2012, the last available data on national accounts and employment were for 2012Q2 while the last data on the balance of payments were for 2012Q3. Monetary and external trade data on hand were for September 2012 and the last data available on CPI and inflation were for October 2012.

### *Abbreviations and Definitions*

**Headline inflation** is measured by the change in the average Consumer Price Index (CPI) over a twelve-month period compared with the corresponding previous twelve-month period.

**Y-o-y inflation** is measured by the change in the CPI for a given month compared with the corresponding month of the preceding year.

**CORE1 inflation** excludes food, beverages and tobacco and mortgage interest on housing loan from the CPI basket. Both headline and y-o-y CORE1 inflation measures are available.

**CORE2 inflation** excludes food, beverages and tobacco, mortgage interest, energy prices and administered prices from the CPI basket. Both headline and y-o-y CORE2 inflation measures are available.

**Dealt exchange rate** is the weighted average rupee selling rate derived from transactions of US$30,000, and above, or equivalent.

**MERI 1** is the Mauritius Exchange Rate Index, a nominal effective exchange rate introduced in July 2008, based on the currency distribution of merchandise trade.

**MERI 2** is the Mauritius Exchange Rate Index, a nominal effective exchange rate introduced in July 2008, based on the currency distribution of merchandise trade <u>and</u> tourist earnings.

**GBC1s** are resident corporations which conduct business outside Mauritius. The law has recently been amended to allow them to transact with residents provided that their activities in Mauritius are ancillary to their core business with non-residents.

**Other investment** includes all debt liabilities between unaffiliated non-residents and residents, which are not securitised. It can be classified by institutional sector: general government, monetary authorities, banks, and other sector, and sub-classsified between short-term and long-term.

**Y-o-y** refers to year-on-year changes.

**Q-o-q** refers to quarter-on-quarter changes.