BANK OF MAURITIUS

Released at 13.00 hours on 19 December 2011

Minutes of the 24th Monetary Policy Committee Meeting
5 December 2011

The 24th meeting of the Monetary Policy Committee was held on 5 December 2011 at 10.00 hours at the Bank of Mauritius, with Mr Rundheersing Bheenick, Governor, in the chair.

Present

Members: Mr Yandraduth Googoolye, First Deputy Governor; Mr Mohamed Iqbal Belath, Second Deputy Governor; Mr Jacques Tin Miow Li Wan Po and Mr Shyam Razkumar Seebun, Board Directors of the Bank of Mauritius; Mr Jagnaden Padiaty Coopamah and Mr Pierre Dinan, External Members.

Observer: Dr Streevarsen Narrainen, Senior Economic Adviser at the Ministry of Finance and Economic Development.

Summary of Staff Reports on Economic and Financial Developments

The Staff reported on economic and financial developments since the 23rd MPC meeting held on 12 September 2011.

The International Economic Environment

1. Global economic activity had continued to weaken since the MPC meeting in September 2011 against the backdrop of significant financial market turmoil and loss of confidence created, to a large extent, by the intensification of the euro area sovereign debt crisis. Growth had slowed significantly in a number of advanced economies and had moderated in several large emerging economies. Downside risks to the global growth outlook had increased.

2. In its September 2011 World Economic Outlook, the IMF had trimmed down global growth forecasts to 4.0 per cent for 2011 and 2012 and revised downwards growth in advanced, emerging and developing economies. Most recent institutional and private forecasts had downgraded global growth forecasts for 2012 more substantially. Reflecting weaker global demand, world trade volume had fallen by 1.0 per cent over the month to September 2011.

3. Latest economic data in the United States had been more positive than expected. The economy had grown at an annual rate of 2.0 per cent in 2011Q3. Consumer and business spending had increased while the unemployment rate had fallen. Activity indicators had suggested that the US economy might grow at a slow to moderate pace in 2012, with its outlook clouded by fiscal concerns and fallouts from the eurozone crisis.

4. The eurozone economy had expanded by 0.2 per cent q-o-q in 2011Q3, driven by Germany and France. Leading economic indicators had shown a marked deterioration in eurozone activity, which was expected to contract in 2012 as a result of fragile financial conditions and fiscal tightening in the monetary union.

5. The British economy had progressed by 0.5 per cent q-o-q in 2011Q3. However, weak manufacturing and non-manufacturing leading indicators had highlighted the loss in momentum in economic activity while the reduction to the euro area growth outlook was likely to spill over to the British economy.

6. Although emerging and developing economies had continued to outpace advanced economies, a number of leading economic indicators had pointed to slowing growth in China and other large emerging economies. Growth prospects in commodity-producer economies had also softened due to the reduction in global activity.

7. Global commodity prices had moderated since the last MPC meeting. The Food Price Index of the Food and Agriculture Organisation had dropped to an 11-month low in October 2011, reflecting sharp decreases in the international prices of all the commodities included in the Index as a result of slower global growth and easing supply concerns. However, the Index had remained above the levels prevailing over the past five years. Crude oil prices had shown a mixed picture but were expected to stabilize at around current levels.

8. Inflation had started to recede in many parts of the world although underlying inflationary pressures were still relatively elevated, especially in emerging and developing economies. Against growing pessimism about the global growth outlook, a number of advanced and emerging economies were easing monetary policy.

9. Financial markets had been volatile on account of developments in the euro area and US. Global equity prices and currencies had traded within large ranges while sovereign yields in the eurozone had increased markedly, even in core countries with triple-A ratings.

Domestic Economic Developments

10. The Staff noted that, according to national accounts data released in September 2011, the domestic economy had expanded at a seasonally-adjusted q-o-q pace of 0.2 per cent in 2011Q2.

11. Over the year to 2011Q2, growth had declined to 3.9 per cent, from an upwardly revised pace of 4.2 per cent in 2011Q1, mainly as a result of a sharper contraction in "construction" and deceleration in the "distributive trade" and "transport" sectors. Output growth in "manufacturing" had eased to 3.6 per cent, reflecting continued contraction in the "sugar" subsector and a slowdown in the "food" and "other manufacturing" subsectors, which more than offset double-digit growth of 17.0 per cent in the "textile" subsector. Real activity had picked up in "hotels and restaurants" and "financial intermediation" and had remained robust in "real estate, renting and business activities" while the contraction in "agriculture" had been reversed. Growth was forecast at 4.1 per cent in 2011.

12. "Final consumption expenditure" growth had eased significantly to 1.5 per cent y-o-y in 2011Q2, as both "households" and "general government" consumption expenditure growth slowed, but was projected to rise by 2.6 per cent in 2011. "Gross domestic fixed capital formation" had slumped by 16.1 per cent, reflecting significant falls in "building and construction work" and "machinery and equipment". Excluding "aircraft and marine vessel", "gross domestic fixed capital formation" was expected to grow by 1.9 per cent in 2011 as "public sector" investment growth of 7.5 per cent was forecast to be partially offset by a contraction of 0.6 per cent in "private sector" investment.

13. According to most recent available information, y-o-y nominal exports *f.o.b* growth had outpaced nominal imports *f.o.b* growth over 2011Q1-Q3. Activity in "textile" had been sustained so far by diversification efforts, significant restructuring and continued orders. In the "tourism" sector, tourist arrivals had risen by 4.2 per cent over the period January to October 2011 compared to the same period in the preceding year, with significant increases recorded from non-traditional markets, while tourist earnings had expanded by 6.4 per cent over the same period.

14. Provisional estimates of the balance of payments for 2011Q3 indicated that the current account deficit had widened to Rs10.5 billion compared to a deficit of Rs6.3 billion in 2010Q3, largely as a result of a worsening merchandise trade deficit and lower surpluses on the services and income accounts.

15. Financing of the current account deficit in 2011Q3 had come mainly from net inflows of Rs9.4 billion on "other investment", out of which banks' "net liabilities" posted an increase of nearly Rs6.1 billion. "Net direct investment" had made a positive

contribution of Rs1.4 billion while "portfolio investment" had recorded net inflows of Rs2.2 billion.

16. The seasonally-adjusted unemployment rate had fallen from 7.7 per cent in 2011Q1 to 7.5 per cent in 2011Q2.

17. Money and credit aggregates had grown at a moderate pace since the last MPC meeting. The annual growth rate of broad money liabilities had picked up between July and August 2011 but had eased to 6.3 per cent in October 2011. The annual growth rate of credit to the private sector, which had slowed between July and August 2011, had increased to 13.6 per cent in October 2011. The annual growth rate of the monetary base had accelerated between July and August 2011 but had lessened to 9.3 per cent in October 2011.

18. The CPI had decreased by a cumulative 0.2 index point in September and October 2011. Over the year to October 2011, food and non-alcoholic beverages (+1.9 index points) and alcoholic beverages and tobacco (+1.9 index points) had been the largest contributors to the CPI increase followed by transport (+1.4 index points).

19. Headline inflation had risen for the sixteenth consecutive month to reach 6.4 per cent in October 2011, mainly as a result of base effects. Y-o-y inflation had eased from 6.5 per cent in August 2011 to 6.0 per cent in October 2011. CPI inflation had continued to reflect imported inflation.

20. Core inflation measures had shown a mixed picture in October 2011. Y-o-y CORE1 inflation had increased from 5.7 per cent in August 2011 to 5.9 per cent in September 2011 before retreating to 5.3 per cent in October 2011. Y-o-y CORE2 inflation had receded for the sixth month running to reach 3.9 per cent in October 2011. On a 12-month average period, CORE1 had picked up to 5.9 per cent in October 2011, from 5.5 per cent in August 2011, while CORE2 had risen marginally to 4.8 per cent, from 4.7 per cent in August 2011.

21. The Bank's *Inflation Expectations Survey* of November 2011 had revealed that, compared to August 2011, a larger proportion of respondents (21.3 per cent) were expecting prices to go down over the next 12 months. Most respondents expected inflation to be within a range of 4.5-6.5 per cent over the forecast horizon, with the mean inflation rate one year ahead unchanged at 6.3 per cent.

Domestic Financial Markets Developments

22. Staff noted that rupee liquidity on the domestic money market had remained tight since the September 2011 MPC meeting. A net amount of Rs1,181 million of Government

securities had been issued while a net total of Rs1,076 million of Bank of Mauritius securities had matured.

23. The overnight weighted average interest rate had fluctuated between 2.08 per cent and 3.36 per cent since the last MPC meeting. On primary auctions, the weighted average yields on 91-day Bills had increased to 4.32 per cent. The weighted yield on 182-day Bills had remained unchanged at 4.36 per cent while the weighted yield on 364-day Bills had decreased slightly to 4.79 per cent over the same period. The weighted average yield on the 273-day Bill, first issued on 18 November 2011, stood at 4.69 per cent.

24. The weighted average rupee deposit rate and the weighted average interest rate on rupee advances had declined between July and October 2011. The real interest rate on savings deposits, as measured against both the 12-month average inflation and y-o-y inflation, had remained negative.

25. Reflecting movements of major currencies on international markets as well as domestic market conditions, the dealt rupee exchange rate had depreciated against the US dollar and had moved within ranges against the euro and Pound sterling. In nominal effective terms, the trade-weighted value of the domestic currency as measured by MERI 1 and MERI 2 had depreciated by 0.9 per cent and 0.7 per cent, respectively, between August and October 2011.

Staff Economic Outlook

26. Staff observed that domestic economic growth was losing momentum and the outlook increasingly clouded by continuing global uncertainty. The Staff's near-term projection for GDP growth was revised downwards to 4.1 per cent in 2011. The output gap was assessed to be slightly negative and was forecast to remain so for an extended period of time. Barring further deterioration of the euro area debt crisis, the Staff projected that domestic GDP growth would remain at around 4 per cent in 2012.

27. On current conditions, the Staff forecast headline inflation to remain strong until the end of this year. Subsequently, headline inflation was projected to decline to around 5.5 per cent by June 2012 while y-o-y inflation was expected to reach 5.1 per cent. The Committee noted that, on both measures, expected inflation was moving within a gradually narrowing range.

The Monetary Policy Decision

28. Members noted an increase in the downside risks to the global economy. The growth prospects of several advanced, emerging and developing economies had deteriorated while fears of a recession in the euro area had risen. Underlying inflationary pressures

were still significant, particularly in emerging and developing economies. Looking ahead, they were expected to be alleviated by the reduction in global economic activity and softer international commodity prices.

29. The domestic economy had performed relatively well, propped up by the key export sectors. Textile growth had been appreciable while tourist arrivals and earnings had continued to expand. The seafood and ICT sectors had also appeared to be resilient. Looking ahead, however, members were worried about the likely impact of the global economic slowdown on domestic growth. They expressed concerns about the decline in business and consumer confidence and observed that household consumption growth had waned while private investment growth had stagnated. There were fears that public investment growth might be constrained by implementation capacity.

30. Members observed a decline in externally-generated inflationary pressures. On the domestic front, actual y-o-y CORE2 inflation had declined for the sixth straight month. The recent increases in excise duties and forthcoming increases in utilities' charges were likely to have a sharp one-off impact on the CPI level although stronger wide-ranging second-round effects could not be discounted. Staff estimates suggested that the domestic economy had continued to operate with some spare capacity. The negative output gap was expected to close at a slower pace than previously estimated because of the adverse developments in the global economy. This, coupled with tame monetary aggregates, supported the view that inflation risks emanating from domestic demand would remain relatively muted.

31. The Committee weighed the risks to the growth and inflation outlook over the policy relevant horizon and discussed alternative interest rate scenarios. While the risks to the growth outlook were seen to have increased, a majority on the Committee was of the view that the fiscal stimulus provided by the 2012 budget measures had the potential to shore up growth. Inflation pressures seemed to have receded but most members of the Committee viewed the risks to the inflation outlook as still significant. They considered it important to continue to anchor inflation expectations and minimise the risk of second-round effects. The need to achieve a positive real rate of interest in the current environment was also underlined by some members.

32. On balance, given the expected impact of the budget measures, and with growth projected at around 4 per cent in 2012, the Committee felt that the economy, at this juncture, did not require a major change to the monetary policy stance. Members shared the view that the Key Repo Rate was broadly appropriate. A sizeable interest rate cut was unlikely to correct for the fragile external demand conditions. However, the Committee wished to signal its concerns about the low level of business and consumer confidence and decided to make a slight adjustment to the Key Repo Rate to boost confidence levels.

Voting Pattern

33. At the conclusion of the discussion, the Committee unanimously voted to cut the Key Repo Rate by 10 basis points to 5.40 per cent per annum.

34. **Voting for this action:** Mr Rundheersing Bheenick, Mr Yandraduth Googoolye, Mr Mohamed Iqbal Belath, Mr Jacques Tin Miow Li Wan Po, Mr Shyam Razkumar Seebun, Mr Jagnaden Padiaty Coopamah and Mr Pierre Dinan.

35. **Voting against this action:** None

36. The MPC would 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 next MPC meeting is scheduled on Monday 19 March 2012.

38. The meeting adjourned at 15.25 hours.

Bank of Mauritius
19 December 2011

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 responsibility to formulate and determine the monetary policy to be conducted by the Bank. The Committee meets on a regular quarterly basis. Currently, members of the Committee comprise the Governor (Chairperson), the two Deputy Governors, 2 other Directors of the Board of the Bank, and 2 other persons (external members) who are not Directors or employees of the Bank, the last 4 being appointed by the Minister of Finance and Economic Development.

At its 23rd meeting in September 2011, the Committee decided to discontinue the publication of a Monetary Policy Statement as from December 2011 and publish instead the Minutes of its meetings two weeks after each meeting takes place. Accordingly, the Minutes of the 24th meeting are the first to be published.

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.

MERI 1 is the Mauritius Exchange Rate Index, introduced in July 2008, based on the currency distribution of merchandise trade.

MERI 2 is the Mauritius Exchange Rate Index, introduced in July 2008, based on the currency distribution of merchandise trade and tourist earnings.

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

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