Minutes of the 62nd Monetary Policy Committee Meeting held on 09 March 2022

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The 62nd meeting of the Monetary Policy Committee (MPC) was held on Wednesday 09 March 2022 at 10:30 hours at the Bank of Mauritius. The following members attended the meeting:

- Mr. Harvesh Kumar Seegolam (Governor and Chairman)
- Mr. Mardayah Kona Yerukunondu (First Deputy Governor)
- Mrs. Hemlata Sadhna Sewraj-Gopal (Second Deputy Governor)

External Members

- Mr. Lim Chan Kwong Lam Thuon Mine
- Mr. Mohammad Mushtaq Namdarkhan (via videoconference)
- Dr Streevarsen Narrainen
- Mrs. Christine Marie Isabelle Sauzier (via videoconference)
- Professor Sanjeev Kumar Sobhee

Summary of Staff Report on Economic and Financial Developments

1. Bank staff briefed MPC members on global and domestic economic developments that took place since the 61st MPC meeting held on 15 December 2021. The MPC took note of the latest macroeconomic projections and assessed risks to the domestic economic outlook.

Global Economic Developments

2. The Russia-Ukraine war has added new layers of uncertainty to global growth which, at the turn of the year, had begun to gradually recover from the fallouts of the COVID-19 pandemic. Until the war was declared on 24 February 2022, momentum in global economic activity was positive and supported by progress being made globally in rolling out vaccination programmes and in re-opening of borders to international travel. The IMF, in its January 2022 update of the World Economic Outlook, projected 2022 growth rate at 4.4 per cent, a 0.5 percentage point downward revision compared to its projection made for 2022 in October 2021, mainly on the back of slower growth performance of a few countries in the advanced world and in emerging markets. The onset of the war between Russian and Ukraine may pose a downside risk to global growth projection for 2022, especially if the war stretches over a longer time horizon. High-frequency indicators are now pointing towards slower activity on the back of mounting geopolitical risks. The equity market took a hit shortly after the war was declared, with performance indicators such as volatility, pointing towards heightened risks. Global investors have been re-engineering their portfolios towards safer assets such as gold away from riskier securities, against a backdrop characterised by rising growth uncertainty.

3. The balance of risks to global inflation now appears to be relatively more tilted to the upside. Even before the war, global inflation was taking an upward trajectory, namely due to supply-side disruptions brought by the Omicron variant and which perturbed commodity and energy prices worldwide. The Russia-Ukraine war is likely to give further impetus to these inflationary pressures. The price of crude oil soared to near USD140 per barrel on 07 March 2022, its highest since the Global Financial Crisis of 2008. The price of gas is picking up rapidly due to the ongoing geopolitical tensions. Food and commodity prices are maintaining their ascending trends, against a backdrop of higher shipping costs.

4. The policy stance adopted by central banks prior to the Russia-Ukraine war was, in general, more hawkish in light of inflationary pressures that were expected to persist in 2022. Many central banks viewed the growing risks to inflation as relatively more important and, consequentially, proceeded with tightening their policy stance. The onset of the war has brought new challenges to policymaking. Some central banks are now adopting a relatively

more prudent approach in their policy stance, by factoring in the mounting uncertainty to the growth outlook posed by the war.

Domestic Economic Developments

5. The domestic economic dashboard continues to show positive signals. Sectoral analysis shows that nearly all economic sectors, including the main pillars of the economy, have registered positive growth. The full opening of borders to international travel in October 2021 has helped support aggregate demand through strengthened consumer and business confidence. The deployment of vaccination and of booster doses has also greatly helped in uplifting sentiment and in supporting ongoing recovery. Mauritius has welcomed around 262,000 tourists between October 2021 and February 2022. The revival of the tourism sector has created positive spillover effects on other sectors including, but not limited to, retail trade, commerce and construction. The recent decision by France to lift all travel restrictions with Mauritius and to open travel between Reunion and Mauritius can only augur well for the sector, given the importance of France and Reunion as a source country for tourists travelling to Mauritius. Orders have been on the rise for the manufacturing sector which, going forward, is expected to contribute positively to growth. Likewise, sectors such as financial services have gained further traction, the more so in the aftermath of the exit of Mauritius from the FATF list of countries under enhanced monitoring and from the EU black list. As a result of these positive developments, the external sector is expected to improve further this year with the current account deficit to GDP ratio projected to decline to around 12 per cent in 2022 compared to a revised estimate of 13.8 per cent in 2021.

6. The openness of the Mauritian economy means that inflation is influenced, to a great extent, by pressures stemming from outside, namely hikes in freight costs as well as soaring prices of energy and of other commodities. Given that Mauritius imports a relatively large proportion of what it consumes, these foreign disturbances are likely to affect the prices of imported items which account for an important share of the CPI Basket. In the first two months of 2022, inflation accelerated mainly on the back of upward price pressures emanating from fuel and food items. Seasonal factors also played an important part in influencing the prices of domestically produced food items, namely fresh vegetables. Headline inflation stood at 5.2 per cent in February 2022 while year-on-year inflation stood

at 9.0 per cent. Inflationary developments in the short to medium term will be impacted by the ongoing war, given the disruptions being brought to global supply chains and to pressures on global prices of commodities and of energy. The longer the duration of the war, the more likely it is that global inflation will persist for some time and will influence inflation in Mauritius.

7. The Bank has been managing the rupee excess liquidity situation through active liquidity management to ensure appropriate liquidity conditions in the market. The interventions conducted by the Bank have helped keep short-term yields within the interest rate corridor. The opening of the borders to international travel and the revival of the tourism sector have helped improve conditions in the FX market. The Bank has been conducting FX interventions to contain undue volatility in the exchange rate and to ensure adequate supply of FX to the market. The improvement in domestic FX market conditions has helped ease the need for the Bank's interventions in the FX market. The gross official FX reserves of the country stood at around USD7.8 billion as at end-February 2022, representing 20 months of imports. Reserves have thus remained at a level that is adequate to help shield the economy against external shocks.

8. The Bank is monitoring the recent developments taking place at the international level, namely the war between Russia and Ukraine, and has assessed the direct impact to be minimal on the banking sector. The monitoring exercise is ongoing. The banking sector continues to remain stable, resilient and sound, as evidenced by robust figures for the Capital Adequacy Ratio which stood at 19.5 per cent as at end-December 2021 and for the Liquidity Coverage Ratio which stood at 247.7 per cent for the same period. These buffers, both of which were well above the minimum regulatory limits imposed by the Bank, indicate robust solvency and liquidity situations for the banking sector. Credit flows were sustained, as evidenced by the annual growth in credit to the private sector which remained in positive territory as at end-January 2022. The extension of the moratoria and of some of the COVID-19 measures up to June 2022 have helped ease the cash flow constraints of households and corporates. The economic recovery which is under way has, in parallel, enabled banks extend new loans to growth-enhancing sectors. The drop in the amount of restructured loans since December 2020 is a tell-tale sign of activities picking up. These positive developments will enhance the ability of households and corporates to service debt. All these developments

point towards improved indebtedness, with reduced risks to financial stability. The ratio of non-performing loans to total loans remained in low territories at 4.9 per cent in December 2021, well below the ratio observed in the first quarter of the year. Coverage ratios for non-performing loans remain adequate. The asset quality of the banking sector is thus assessed to be sound. Latest stress test results confirm that the banking system in Mauritius remains robust and resilient and can withstand severe but plausible macroeconomic shocks.

Staff Economic Outlook

9. The onset of the Russia-Ukraine war has created new layers of uncertainty to global growth. Its impact on the main trading partners of Mauritius, on cross-border trade as well as investment flows will depend, to a great extent, on its duration. As a result, growth projection for 2022 becomes largely scenario-based, depending on the performance of the key sectors of the economy against potential headwinds posed by the war. So far, economic activities have been picking up and the momentum has been positive. The Bank thus projects growth for 2022 to stand between 7 and 8 per cent, depending on the number of tourist arrivals and on the performance of the exports sector. The war, and in particular how long it will last, may however pose downside risks to these scenarios.

10. Before the onset of the war, global inflation was already picking up, against a backdrop of pandemic-related global supply side disruptions which impacted freight costs and which resulted in rising commodity and energy prices. There are already visible signs that these global inflationary pressures will be further sustained with the war. Given the openness of the Mauritian economy, it is likely that inflation in Mauritius will, to a great extent, continue to reflect inflationary developments taking place abroad. In addition to these external factors, domestic seasonal factors -mostly climate-related- may weigh on inflation dynamics by affecting prices of fresh food items, namely vegetables. Over the medium term, inflation may be sustained by the second-round impact of recent price hikes, namely retail petroleum prices. Taking all these factors into consideration, the Bank projects headline inflation at 6.7 per cent for 2022.

MPC Decision

11. The MPC took cognizance of international and domestic developments that are likely to impact on the growth and inflation outlook for 2022. The Russian-Ukraine war has tilted the balance of risks to global growth more on the downside and that to global inflation more on the upside. On the domestic front, while growth momentum has been positive so far, economic activity may nonetheless be subject to headwinds from the war, should the latter be long lasting and should it impact on the main trading partners of Mauritius. Inflation in Mauritius has been picking up and, due to the war, may become more entrenched.

12. The MPC balanced the risks to the growth and inflation outlook in the light of these developments and acknowledged that monetary policy should respond to growing inflationary pressures, whilst not jeopardising macroeconomic conditions for recovery. As a result, the MPC has unanimously decided to raise the Key Repo Rate by 15 basis points to 2.00 per cent per annum.

13. The next meeting of the MPC is scheduled for June 2022. The MPC will monitor the economic situation closely and stands ready to meet before June 2022 if the need arises and depending on how the risks to the inflation outlook and to growth outlook unfold.

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