Minutes of the 63rd Monetary Policy Committee Meeting held on 03 June 2022

Released on 17 June 2022

The 63rd meeting of the Monetary Policy Committee (MPC) was held on Friday 03 June 2022 at 09:00 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
- Dr Streevarsen Narrainen
- Mrs. Christine Marie Isabelle Sauzier
- Professor Sanjeev Kumar Sobhee

Summary of Staff Report on Economic and Financial Developments

1. Bank staff briefed MPC members on global and domestic economic and financial market developments that took place since the 62nd MPC meeting held on 09 March 2022. MPC members were also apprised of the latest macroeconomic projections before deliberating on the policy rate.

Global Economic Developments

2. Global confidence continues to be impacted by the onset of the Russia-Ukraine war. Economic activity in major economies has been slowing down. This was confirmed by the GDP performance of some of the world's major economies during the first quarter of 2022. Real sector indicators for the first quarter of 2022 indicate a contraction by 0.4 per cent for the US economy after six consecutive quarters of positive growth and a contraction in growth for the European Union (EU) as well. The UK economy also registered a slowdown in growth, from 1.3 per cent in the last quarter of 2021 to 0.8 per cent in the first quarter of 2022. More recently, these tendencies towards a deceleration in activity have been confirmed by high frequency leading indicators such as the JPMorgan Global Composite Output Index which dropped to 51.0 in April 2022 from the previous level of 52.7 in March 2022, as well as the S&P Global Flash Purchasing Managers Index (PMIs) which pointed towards a weakening of economic activity in the US and in the Euro area in May 2022.

3. The balance of risks to the global growth outlook now appears to be tilted towards the downside. The euro area is relatively highly dependent on Russian energy and may continue to suffer from setbacks emanating from the war. China has undergone location-specific COVID-19 related lockdowns during the first quarter of 2022, although these are now gradually being lifted. In its April 2022 World Economic Outlook, the IMF revised its global growth projections for, both, 2022 and 2023 to 3.6 per cent, down from its January 2022 projections which stood at 4.4 and 3.8 per cent, respectively, for each year.

4. Rising global energy and food prices due to the ongoing geopolitical tensions and global supply bottlenecks continue to fuel global inflationary pressures. The Food and Agriculture Organisation (FAO) Food Price Index reached an all-time high of 159.3 in March 2022 (30.0 per cent higher compared to March 2021), before declining slightly in April 2022. Crude oil prices crossed the US$100 per barrel mark in March 2022 and are set to remain at high levels, especially with the decision of the EU to impose sanctions on Russian oil. In most countries, inflation continued to remain elevated and to overshoot their central banks' targets. In the US, for instance, year-on-year inflation edged down from 8.5 per cent in March 2022 to 8.3 per cent in April 2022 but remained well above the US Fed's target of 2.0 per cent. In the euro area, inflation remained unchanged at 7.4 per cent over the same period. The UK

experienced its highest inflation since 1982 in April 2022 when it stood at 9.0 per cent. Higher inflationary pressures were also prevalent amongst emerging market economies, including India and Brazil. The balance of risks to global inflation now appears to be relatively more tilted to the upside. The IMF forecast global inflation rate to rise from 4.7 per cent in 2021 to 7.4 per cent in 2022.

5. The tightening pace amongst several central banks, both in Advanced and Emerging economies, has quickened since the last MPC meeting. This hawkish policy stance reflects the fact that many central banks worldwide perceive the high inflation environment as more protracted than was initially thought.

Domestic Economic Developments

6. The domestic economic dashboard is showing encouraging signals. Real GDP growth in the last quarter of 2021 accelerated to 7.2 per cent, compared to 5.6 per cent in the third quarter of 2021 and -11.8 per cent in last quarter of 2020. Sectoral analysis shows that economic activity was sustained across most sectors of the economy and that positive growth performance was broad-based. Mauritius received 413,406 tourists over the period October 2021[1] to April 2022, with a noticeable increase of 28 per cent in the month of April when arrivals reached 84,268 (up from 66,066 in March 2022). The positive performance of the tourism sector has resulted in spillover effects to other sectors of the economy and has played a key role in supporting consumer and business confidence. Consumption, the key pillar of aggregate demand in Mauritius, has expanded by 1.7 per cent in the last quarter of 2021. High frequency indicators in the first quarter of 2022 show that this positive momentum is likely to be sustained, going forward.

7. The resumption of activities in the tourism sector has been beneficial for the services segment of the current account which moved from deficit since 2020Q2-2021Q3, to a surplus in 2021Q4. With the tourism sector gathering more momentum and manufacturing sector picking up in 2022, the current account situation is projected to improve in 2022, moving from a deficit of 13.7 per cent in 2021 to a projected deficit of around 12.0 per cent in 2022. The

[1] When borders were re-opened.

overall balance of payments is also expected to benefit from a strengthening of financial flows resulting from the country's exit from the Financial Action Task Force (FATF) grey list, the UK's list of high-risk countries and the EU's 'Blacklist'. Gross Official International Reserves (GOIR) as at end-April 2022 continued to provide a comfortable buffer against external shocks. The GOIR provided a cover of 14.8 months for imports of goods and services as at end-April 2022, against 14.2 months as at end-April 2021.

8. Headline inflation in Mauritius maintained its upward trend in April 2022 and closed the month at 7.0 per cent, 2.4 percentage points higher than in January 2022. Year-on-year (Y-o-y) inflation rose from 7.4 per cent in January 2022 to 11.0 per cent in April 2022. Inflation in Mauritius continues to be influenced by pressures stemming from outside and affecting global prices of energy, food items and freight costs. Given the high degree of openness of the Mauritian economy and its relatively high propensity to import, the duration of high inflation in Mauritius will, to a great extent, depend on the persistence of inflation at the global level. Core inflation, a measure of inflation excluding prices of highly volatile items and a more reliable indicator of whether inflationary pressures are broad-based and permanent, was also up during the period January - April 2022.

9. The Bank has been pursuing active liquidity management to ensure orderly liquidity conditions in the domestic financial market. The level of rupee excess liquidity in the banking system dropped significantly from an average of Rs30.3 billion for the period 15 December 2021 to 08 March 2022 to an average of Rs26.2 billion for the period 09 March to 31 May 2022. These interventions have helped keep short-term yields within the interest corridor and helped provide better traction for the Bank's monetary policy stance. In parallel, the Bank has been conducting foreign exchange (FX) interventions to contain undue volatility in the exchange rate and to ensure supply of FX to the market. The Bank conducted the largest ever single intervention to the tune of USD200 million on 13 April 2022. Since the last MPC meeting, the rupee has strengthened against the three major currencies, reflecting developments on the global foreign exchange market, domestic conditions, as well as the Bank's regular FX interventions. Effective August 2022, the Bank shall introduce a 7-day Bank of Mauritius Bills for liquidity management purposes.

10. The banking sector in Mauritius continues to remain resilient, stable and sound, despite a challenging external environment. Capital and liquidity buffers were assessed to be sound as at end-March 2022. In particular, the Capital Adequacy Ratio stood at 20.0 per cent as at end-March 2022. Liquidity Coverage ratio stood at 261.5 per cent for the same period. Both buffers were well above the minimum regulatory requirements imposed by the Bank and point towards overall resilience of the sector. Bank credit flows to the private sector were sustained at 1.8 per cent in April 2022, up from 0.6 per cent in January 2022. The gradual recovery in economic activity enabled banks to grant fresh loans to the main sectors of the economy. The level of indebtedness of households to banks relative to GDP is estimated to have increased slightly from 27.2 per cent as at end-December 2021 to 28.0 per cent as at end-March 2022. A similar trend could be depicted for corporate indebtedness with an increase to 43.2 per cent as at end-March 2022, compared to 42.8 per cent in December 2021. Likewise, a marginal increase could be noted in the debt-servicing cost of households during the first quarter of 2022. The asset quality of banks is assessed to be sound. This is reflected mainly in the ratio of Non-Performing Loans (NPLs) to total loans which stood at 4.9 per cent as at end-March 2022, the same as in December 2021. The coverage ratio of NPLs is assessed to be adequate. Moratoriums, deployed during the pandemic to avoid the shock from being transmitted to the financial sector, dropped during the first quarter of 2022 as economic recovery has begun to gather pace. Overall, the banking sector is assessed to be sound and resilient and this is also confirmed by stress test results.

Staff Economic Outlook

11. The positive momentum witnessed so far during 2022 is set to translate into higher growth prospects for the year compared to 2021 with most economic sectors expected to record solid improvements. On the expenditure side, consumption is expected to provide impetus to growth in 2022. Progress in implementing public infrastructure projects is also expected to support growth. At a global level, progress in the relaxation of travel restraints by an increasing number of countries is expected to provide fillip to trade and tourism, and to augur well for the country’s current account, as well as for its reserves position. However, the growth trajectory of Mauritius will also depend on a couple of uncontrollable factors stemming from outside: the evolution of the ongoing war in Ukraine, its duration and its effect

on the country's main trading partners; and any new developments pertaining to the pandemic which may stall global recovery efforts. As a result, the growth projection for 2022 becomes largely scenario-based. The Bank maintains its growth rate projection for 2022 at around 7 - 8 per cent.

11. Inflationary pressures in Mauritius are anticipated to continue through the first half of 2022, before easing away in the second half of the year. The effects of the recent price hikes for petroleum products will be felt in the near term, with the prices of energy-intensive consumer products expected to soar. In addition, global food prices are expected to remain elevated and will continue to add to inflationary pressures in Mauritius, given its high propensity to import. The evolution of freight costs and of the external value of the rupee are also perceived as important determinants of the future inflation trajectory. In the light of these developments, the Bank forecasts inflation at around 8.6 per cent for 2022, with the outlook remaining subject to upside risks emanating from the ongoing geopolitical tensions.

MPC Decision

12. The MPC took cognizance of the latest international and domestic developments that have emerged since the last MPC meeting and that are likely to impact on the growth and inflation outlook for 2022. The onset of the Russian-Ukraine war and its impact on global energy and commodity prices has tilted the balance of risks more towards the inflation side. The MPC took note that, despite the downward growth projections by the IMF for some of the major economies of the world, domestic economic activity has been positive in the first quarter of 2022 and that the momentum is likely to be sustained during the year. However, this positive growth outlook may be subject to headwinds, should the war persist and should it negatively impact on the tourism sector. The MPC also took note that the high level of inflation observed so far in Mauritius appears to be more entrenched and looks likely to persist for some time.

13. 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 impinging on macroeconomic conditions for recovery. As a result, the MPC has unanimously decided to raise the Key Repo Rate (KRR) by 25 basis points

to 2.25 per cent per annum. This increase represents the second consecutive hike of the year by MPC members who unanimously voted to raise the KRR by 15 basis points on 09 March 2022 (first MPC of the year).

14. The next meeting of the MPC is scheduled for September 2022. The MPC will monitor the economic situation closely and stands ready to meet before September 2022, if the need arises.

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