Minutes of the 64th Monetary Policy Committee Meeting held on 28 September 2022

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The 64th meeting of the Monetary Policy Committee (MPC) was held on Wednesday 28 September 2022 at 08:00 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

Bank staff briefed MPC members on global and domestic economic and financial market developments that took place since the 63rd MPC meeting held on 3 June 2022. MPC members were also apprised of the latest macroeconomic projections before deliberating on the policy rate.

Global Economic Developments

1. The global economy continues to be characterised by growing uncertainties tied to the ongoing Russia-Ukraine war, global inflationary spikes and COVID-19 economic disruptions in China. Economic performance across the advanced economies has been stalling, as evidenced by real sector growth indicators for the second quarter of 2022. Europe remains vulnerable to the direct effects of the Russia-Ukraine war. A complete cessation of Russian gas exports to European economies could curtail economic activity in the euro area. Quarter-on-quarter real GDP growth in

the euro area stood at 0.8 per cent in 2022Q2 compared to 2.0 per cent in 2021Q2. The US economy has experienced two successive quarters of mild contraction in 2022. The Chinese economy which grew by 1.4 per cent in 2022Q1, posted a contraction of 2.6 per cent in 2022Q2 against a backdrop of resurging COVID-19 cases and the reintroduction of lockdowns.

2. In its July 2022 World Economic Outlook Update, the IMF has further revised down global growth projections for 2022 to 3.2 per cent, from 3.6 per cent in its April 2022 forecast, amidst stalling growth in the world's largest economies. This deceleration in global economic activity is also reflected in high-frequency economic indicators. The Purchasing Managers Index data for several advanced countries confirmed ongoing downturns in these economies. The JPMorgan Global Composite Output Index fell from 50.8 in July 2022 to 49.3 in August 2022.

3. Inflationary pressures continue to persist in most countries on the back of the ongoing geopolitical tensions which disrupted prices of energy and commodities. Other contributory factors included global supply-chain induced bottlenecks as well as tighter labour markets. Year-on-year inflation in August 2022 remained high in the US (8.3 per cent) and in the UK (9.9 per cent), although it fell marginally in both countries compared to the July 2022 figures. In the euro area, inflation increased from 8.9 per cent to 9.1 per cent over the same period. Inflation in these countries continued to largely overshoot their central bank's respective inflation targets. Emerging market developing economies were not spared from elevated high inflation pressures, with inflation hovering at high levels in countries such as India (7.0 per cent), South Africa (7.9 per cent) and Brazil (8.7 per cent). The IMF forecast global inflation to increase from 4.7 per cent in 2021 to 8.3 per cent in 2022, with inflation in advanced economies projected at 6.6 per cent and 9.5 per cent in emerging market developing economies.

4. Central banks globally have been responding by tightening their monetary stances. The policy tightening cycle has become more synchronised across advanced and emerging economies with higher magnitudes for policy rate hikes. The US Fed raised the target range for the Federal Funds Rate by 75 basis points to 3.00-3.25 per cent at its September 2022 Federal Open Market Committee meeting. The European Central Bank (ECB) also increased its policy interest rate by 75 basis points to 1.25 per cent in September 2022. The Bank of England raised the Bank Rate by 50 basis points to 2.25 per cent at its September 2022 MPC meeting. Several emerging markets central banks have followed suit by raising their policy rates in response to growing inflationary pressures.

5. It is worth noting that although central banks view upside risks to inflation as being of main concern, the prices of many commodities have begun to decline more recently despite remaining at elevated levels compared to the same period of last year. The FAO Food Price Index dropped to 138.0 in August 2022, down by 1.9 per cent on a month-on-month basis, although it was 7.9 per cent higher compared to August 2021. Similarly, crude oil prices, as gauged by the ICE Brent, have also declined in August 2022, but remained around 42 per cent higher compared to August 2021.

Domestic Economic Developments

6. On the domestic front, the economic dashboard continues to show encouraging signals. Sectoral growth was broad-based with most sectors contributing positively to growth in 2022Q1, with some attaining pre-pandemic levels of activity. The *'Manufacturing'* sector expanded by 7.9 per cent as against a contraction of 9.8 per cent in 2021Q1. The *'Accommodation and Food Service Activities'* sector, which comprises hotels and restaurants, grew by 454.8 per cent in 2022Q1 compared to a contraction of 83.9 per cent in 2021Q1. Mauritius attracted 557,245 tourists over the period January to August 2022 compared to 6,966 over the same period in 2021. Gross tourism earnings amounted to Rs4.1 billion in August 2022. Since the start of this year, gross tourism earnings amounted to Rs34.5 billion. The outlook for the tourism sector remains optimistic, as gauged by increases in flight connectivity and forward bookings, suggesting that the target of 1 million tourists set by the authorities is largely within reach.

7. The recovery in tourism activity and improvement in travel sentiment have resulted in positive spillover effects on other sectors such as retail, construction, and transport, and played an important role in raising consumer and business confidence. The positive momentum in economic activity has helped improve labour market conditions. The unemployment rate fell to 8.7 per cent in 2022Q1, from 9.8 per cent in 2021Q1. Consumption, the key pillar of aggregate demand, expanded by 4.1 per cent in 2022Q1, benefiting mainly from the easing of sanitary measures. Investment expenditure went up by 3.4 per cent in 2022Q1, reflecting progress in implementing ongoing infrastructure projects with potential multiplier effects on economic activity. Exports of goods and services rose by 9.3 per cent in 2022Q1, driven mainly by the rebound in tourism activities while imports of goods and services increased by 5.8 per cent.

8. The current account deficit has been projected at 14.7 per cent of GDP in 2022 compared to 13.3 per cent of GDP in 2021, mainly on account of the higher expected trade deficit which offset the surplus on the services account reflecting the full resumption of tourism sector activities. Financial flows are projected to strengthen with ongoing efforts aimed at consolidating the image of the jurisdiction as a solid and credible International Financial Centre in the aftermath of the country's exit from the Financial Action Task Force grey list, the United Kingdom's list of high-risk countries and the European Union's list of high-risk third countries. Gross Official International Reserves (GOIR) continued to remain at a comfortable level as a buffer against external shocks. As at end-August 2022, GOIR represented around 15 months of imports.

9. Headline inflation in Mauritius maintained its upward trajectory in August 2022 and closed the month at 8.8 per cent, 1.8 percentage points higher than in April 2022. Year-on-year inflation, which reflects the inherent dynamics in the Consumer Price Index, stood at 11.5 per cent in August 2022. 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 June-August 2022 period. The relatively high degree of openness of the Mauritian economy and its high propensity to import mean that inflation in Mauritius will continue to be influenced by external factors including the geopolitical situation, supply-chain disruptions and freight costs which have begun to rise recently after a period of respite.

10. The Bank has been pursuing active liquidity management to ensure orderly liquidity conditions in the domestic financial market and to align market interest rates with the policy rate. Since the last MPC meeting held in June 2022, the Bank has issued a gross amount of MUR67 billion of securities to conduct monetary policy. In parallel, FX interventions by the Bank helped absorb rupee excess liquidity equivalent to around MUR5.9 billion. Excess liquidity in the banking system has averaged MUR26 billion for the period 1 June to 28 September. As a result of this liquidity management policy by the Bank, short-term yields have remained within the lower bound of the interest rate corridor and helped provide good traction for the Bank's monetary policy stance. As part of its new Monetary Policy framework, the Bank has introduced two new instruments: a 7-day Bank of Mauritius Bill to all banks since the beginning of August 2022 for short-term liquidity management; and a 4.0% Five-Year Bank of Mauritius Emerald Jubilee Bond with an amount of MUR7 billion issued.

11. Activity on the FX market remained on an upward trend and is poised to experience further momentum, going forward, as the peak season for tourist arrivals and end-of-year international trade activities set in. The Bank has been conducting foreign FX interventions to contain undue volatility in the exchange rate and to ensure supply of FX to the market, selling US$622 million from January 2022 till end-September 2022. The evolution of the exchange rate continues to reflect domestic economic fundamentals as well as international exchange rates.

12. The capital and liquidity positions of banks were assessed to be sound as at end-June 2022, with comfortable levels of buffers. The Capital Adequacy Ratio stood at 19.2 per cent. The Liquidity Coverage ratio stood at 265 per cent for the same period. Both ratios were well above the minimum regulatory requirements imposed by the Bank and point towards overall resilience of the sector. In an environment characterised by increasing risks stemming from outside Mauritius, the resilience of the banking sector in Mauritius was also buttressed by high levels of the Liquidity Coverage Ratio in FX which, at 194.2 per cent, provided comfortable buffer against external vulnerabilities.

13. The ongoing recovery in economic activity enabled banks to unlock fresh loans to the main sectors of the economy and to support the recovery process. The annual growth rate of bank credit to the private sector accelerated to 3.1 per cent in July 2022, from 1.8 per cent in April 2022. The portfolio of the banking system was assessed to be sound. Asset quality improved, as evidenced by the ratio of non-performing loans to total loans which dropped to 4.6 per cent in June 2022, from 4.9 per cent in the previous quarter. The coverage ratio of non-performing loans was assessed to be adequate. The unwinding of moratoria on loans, which were initially deployed during the pandemic to economic operators as well as households so as to avoid transmittal of real shocks to the financial sector, was completed on 30 June 2022. The decline in the outstanding value of moratoria as well as in the outstanding levels of restructured loans, are a positive signal that the economic recovery process is well under way. The overall soundness and resilience of the banking system is also confirmed by stress test results.

Staff Economic Outlook

14. The sustained momentum in activity across most economic sectors observed so far during the year is set to translate into higher growth for 2022, compared to 2021. Buoyancy in tourism is expected to generate positive spillover effects on other sectors. Consumption is anticipated to pick up and support growth as confidence sweeps in. The ongoing public infrastructure programs are projected to have a multiplier effect on economic activity and solidly buttress the growth impetus. Exports are expected to improve and to support aggregate demand as global activities pick up on the back of the normalisation process of economic activities globally. As a small open island economy, the growth trajectory of Mauritius is scenario-based and is tied to the pace of global recovery. Bank staff maintained their previous real GDP growth forecast at around 7.4 per cent for 2022, which remains largely within the Bank's previous forecast range of 7 to 8 per cent. Growth is projected at around 5.5 per cent in 2023. These growth projections however continue to remain subject to uncertainties tied to the geopolitical conflict, its duration and its effects on performance of the main trading partners of Mauritius, as well as on international trade and global financial markets.

15. Similarly, the trajectory of inflation in Mauritius, going forward, is scenario-based and is, to a large extent, linked to the evolution of the war and its impact on global commodity and fuel prices, as well as on freight costs. As a result, Bank staff have revised their projections for headline inflation to 10.6 per cent for 2022 mainly on the back of these external factors and second-round effects. Bank staff project inflation to recede in 2023 as pressures from outside to domestic price formation ease away. Consequently, inflation for 2023 is currently projected at around 5.0 per cent.

MPC Decision

16. The MPC took cognizance of the latest international and domestic developments that have emerged since the June MPC meeting and that are likely to impact on the growth and inflation outlook for 2022. While the global environment looks uncertain, significant progress has been made at the domestic level with normalisation of economic activities. The MPC took note of the positive outlook for the tourism sector for the year and of the positive momentum that the re-opening of borders has had across most sectors of the economy. The MPC also considered the risk factors to inflation in the light of developments taking place at the global level.

17. With economic recovery being back on track, the MPC has decided to pursue with the normalisation of monetary policy so as to avoid a de-anchoring of inflationary expectations. The MPC unanimously decided to raise the Key Repo Rate by 75 basis points to 3.00 per cent per annum.

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

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