Minutes of the 66th Monetary Policy Committee Meeting held on 14 December 2022

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The 66th meeting of the Monetary Policy Committee (MPC) was held on Wednesday 14 December 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 have taken place since the last MPC meeting held on 4 November 2022. MPC members were also apprised of the latest macroeconomic projections before deliberating on the policy rate.

Global Economic Developments

1. Global economic activity continues to be impacted by headwinds emanating from the Russia-Ukraine war and accompanying sanctions which have triggered supply-demand imbalances. The decisions by central banks worldwide to tighten their monetary policy to subdue inflationary pressures have also weighed on global growth. Leading economic indicators, such as the Purchasing Managers Indices (PMIs), are already pointing towards a slowdown in global economic

activity at the turn of the year. For instance, the J.P. Morgan Global Composite Output Index fell to 48.0 in November 2022 as order books and international trade flows weakened on the face of growing activity slowdown in the global manufacturing and services sectors.

2. The IMF has downgraded its global growth projection for 2022, from 4.4 per cent in January 2022 to 3.6 per cent in April 2022 and further to 3.2 per cent in July 2022. In October 2022, it maintained global growth at 3.2 per cent for the year. For 2023, global growth has been revised downwards four times since January 2022, from 3.8 per cent to 2.7 per cent, reflecting weakened performances for both advanced and emerging market developing economies. Major economies such as the US, the euro area and the UK are facing moderate growth, against a backdrop characterised by declining real disposable income, mounting inflationary pressures and tighter monetary and financial conditions. COVID-19 outbreaks and further lockdown periods in China are taking an important toll on the country's economy which has already begun to reel from setbacks associated with an ongoing property market crisis. India's economy is forecast to slow down due to subdued external demand.

3. Global inflation continues to linger in high territories. Year-on-year inflation in the euro area and in the UK remains on an uptrend, at 10.6 per cent and 11.1 per cent respectively, in October 2022. In contrast, inflation in the US has eased after reaching its highest point in June 2022. Similar trends were observed amongst emerging market developing economies, notably in Brazil and South Africa, with inflation peaking in April and July 2022, respectively. The IMF forecast global inflation to increase from 4.7 per cent in 2021 to 8.8 per cent in 2022, before declining to 6.5 per cent in 2023 amidst tighter monetary policy.

4. The tightening cycle amongst central banks, both in advanced and emerging economies, has gathered pace in the light of mounting inflationary pressures, with higher frequency and magnitude of the rate hikes. The US Federal Reserve increased the Federal Funds Rate by a cumulative 425 basis points to a target range of 4.25-4.50 per cent since March 2022. The European Central Bank first raised the policy rate to 0.50 per cent in July 2022, bringing the cumulative rate increase to 200 basis points by October 2022. The Bank of England also increased the policy rate by a cumulative 275 basis points to 3.00 per cent, since the beginning of the year. A notable exception was the Bank of Japan, which indicated that the accommodative monetary policy stance would be maintained until inflation in Japan exceeded its target.

5. Larger-than-expected monetary policy tightening in the US has propelled the US dollar to its highest level in the last 20 years. Safe-haven flows as a result of worries about a global recession lent further support to the US currency. The Dollar Index soared to new highs in October 2022, a level last seen in 2002, appreciating by around 17 per cent compared to January 2022. Central banks globally have followed suit by raising their policy rates to close negative interest rate differentials with the dollar, albeit the magnitudes of rate hikes have largely differed based on their domestic economic conditions. Other major currencies have weakened against the dollar. The euro depreciated, undermined by the ongoing energy crisis in Europe. The Pound sterling also lost steam against the dollar following the episodes of political and financial market turmoil hitting the UK economy.

6. Recent data indicate that inflation may have peaked in several countries. This can largely be attributed to the fact that factors that were previously contributing to the build-up in inflationary pressures are currently waning down, namely: subsiding energy and food prices, easing of supply chain disruptions and lower shipping costs. The Food and Agriculture Organisation's Food Price Index, which tracks the most globally traded food commodities, reached an all-time high of 159.7 in March 2022, before gradually declining to around 135.7 in November 2022, reflecting an easing of price pressures across the sub-indices. Crude oil prices, as gauged by the ICE Brent, have also declined in November 2022. ICE Brent averaged US$91.0 a barrel in November compared to a high of US$117.5 a barrel in June 2022. Similarly, the Baltic Dry Index, which measures the cost of shipping goods worldwide, has been on a declining trend over most of the second half of 2022, barring a brief uptick in September.

Domestic Economic Developments

7. The economic dashboard continues to show positive signals. The *'accommodation and food service activities'* sector registered triple-digit growth in the first semester of 2022. Tourist arrivals reached 755,655 for the period running from January to October 2022 and the momentum is picking up in the last quarter of 2022 due to the high season and additional airline seat capacity, suggesting that the target of attracting one million tourists for the year set by the authorities is attainable. The positive impetus to the tourism sector continues to generate favourable spillovers for other sectors, such as wholesale and retail trade, transportation, construction and real estate. The '*financial and insurance activities'* sector has remained resilient and continues to benefit from the reputational advantage gained with the country's exit from the Financial Action Task Force list of countries under enhanced monitoring, the UK's and the EU's lists of high-risk countries.

8. On the expenditure side, higher consumption spending and strong investment activity have largely supported the positive growth momentum. Household consumption expanded by 7.2 per cent, on average, during the first semester of 2022. Gross fixed capital formation surged, with growth of 20.2 per cent, underpinned by higher spending in both *'building and construction work'* and *'machinery and equipment'*. The pick-up in economic activity bodes well for labour market conditions which have so far improved during the first half of 2022. Unemployment rate fell to 8.1 per cent in the second quarter of 2022, from 8.7 per cent in the first quarter.

9. Exports of goods and services grew by 31.4 per cent in the first half of 2022 compared to a year ago, bolstered by the recovery in external demand and buoyant tourism activities. With household spending gathering pace and commodity prices picking up globally, imports of goods and services rose by 14.0 per cent during the same period. Tourism earnings, a major component of the services segment of the current account, amounted to Rs48,283 million from January to October 2022 – representing 96 per cent of the corresponding 2019 level. The increase in flight connectivity and forward bookings also point to a bright outlook for the tourism industry and are expected to contribute positively to the services segment. The current account deficit is nonetheless projected at 14.0 per cent of GDP in 2022 compared to 13.2 per cent of GDP in 2021. Financial flows are expected to strengthen in the light of recent initiatives at the national level aimed at strengthening the country's AML-CFT regime. Cross-border GBC investments are

projected to gain further traction. For non-GBC flows, the real estate sector is expected to continue to attract high influx of foreign direct investment in Mauritius. Gross Official International Reserves (GOIR) remained broadly adequate as a buffer against external shocks. As at end-November 2022, GOIR provided coverage for around 13.9 months of imports.

10. Headline inflation in Mauritius maintained its upward trajectory in November 2022 and closed the month at 10.3 per cent, up from 8.0 per cent in June 2022 and 4.6 per cent in January 2022. Year-on-year inflation, which reflects the inherent dynamics in the Consumer Price Index, stood at 12.1 per cent in November 2022, up from 9.6 per cent in June 2022 and 7.4 per cent in January 2022. The increase in inflation throughout 2022 can be attributed to international factors, namely the geopolitically-induced soaring global food and energy prices during the first half of 2022, while domestic factors, including weather-related disturbances also influenced prices of local food items. Core inflation, a measure which abstracts highly volatile items and which is a more reliable indicator of whether inflationary pressures are broad-based and permanent, took an ascending trend during the year.

11. The Bank pursued its open market operations to ensure orderly liquidity conditions and to align market rates with its policy rate, the Key Repo Rate (KRR). Accordingly, average excess liquidity dropped from Rs27.7 billion in January 2022 to Rs12.7 billion in November 2022. The four successive rounds of increases in the KRR by the Bank during the year largely influenced market rates. The 7-Day Bill yield, which stood at 0.66 per cent at the inaugural issuance in August 2022, increased to 2.00 per cent as at-end November 2022. The 91-Day Bill yield, the operational target under the current monetary policy framework, evolved within the lower bound of the interest rate corridor for most of the year. The upward hikes in KRR during the year impacted on the Prime Lending Rate and the Savings Deposit Rate, which rose from a range of 4.00-6.85 per cent and 0.15-0.60 per cent, respectively, in January 2022 to 6.15-9.00 per cent and 1.00-2.45 per cent, respectively, in November 2022. On a weighted average basis, the rupee lending rate and deposit rate of banks moved in line with their base lending and deposit rates.

12. Activity on the domestic foreign exchange (FX) market has been positive and resilient with the ongoing economic recovery and pick-up in tourism during the year. The peak season for tourist arrivals and end-of-year festivities at the turn of the year are expected to further catalyse the FX market. For the period running from January to November 2022, the Bank injected a total amount of USD982 million in the domestic market, including interventions to the tune of USD770 million in an effort to contain undue volatility in the exchange rate. The rupee continues to reflect domestic economic fundamentals as well as developments in the global currency market. The rupee strengthened in, both, nominal and real effective exchange rate terms during the period January to November 2022. Yield differentials adjusted for exchange rate movements of the rupee against the US dollar, albeit still negative, are closing as a result of the successive rounds of KRR hikes during the year.

13. The banking sector is assessed to be sound and resilient. The capital and liquidity positions of banks continue to be robust with comfortable levels of buffers. The Capital Adequacy Ratio stood at 19.0 per cent as at end-September 2022, well above the minimum regulatory requirements imposed by the Bank. Similarly, the aggregate Liquidity Coverage Ratio (LCR) stood at 252 per

cent in October 2022, exceeding the regulatory limit of 100 per cent. In an environment characterised by uncertainties coming from abroad, the resilience of the banking sector in Mauritius was underpinned by high levels of LCR in material foreign currencies which, at 174 per cent, provided comfortable buffers against possible liquidity strains from abroad and other external vulnerabilities.

14. The ongoing economic recovery has enabled banks to provide continuous support to the economy by ensuring constant flow of credit. Bank credit to the private sector grew, on an annual basis, by 2.4 per cent in October 2022 compared to 3.1 per cent in July 2022. The portfolio of the banking sector continues to be sound, as evidenced by the improvement in asset quality. The ratio of Non-Performing Loans (NPLs) to gross loans dropped to 4.4 per cent as at end-September 2022, from 4.6 per cent as at end-June 2022 and 4.9 per cent as at end-March 2022. This represents a marked improvement over the situation that prevailed in the two years prior to the pandemic, when the average NPL ratio hovered around 5.5 per cent. The coverage ratio of non-performing loans continues to be adequate. Latest stress test results confirm the resilience of the banking sector in Mauritius to severe but plausible hypothetical shocks. The successive rounds of increases in the KRR during the year, which have impacted on various interest rate structures, are not expected to undermine the soundness of the banking sector as a whole.

Staff Economic Outlook

15. As a small open island economy, the growth trajectory of Mauritius is scenario-based and is linked to the pace of global recovery. The positive momentum across all economic sectors appears well entrenched during 2022. Bank staff maintain the real GDP growth forecast at above 7.0 per cent for 2022. For 2023, growth is projected at around 5.0 per cent. The growth outlook, nonetheless, is subject to downside risks due principally to the aggressive global monetary tightening worldwide which may generate a slowdown in some advanced and emerging market developing economies in 2023. The ongoing geopolitical conflict, if prolonged, may also dampen the recovery in external demand and, by ricochet, impact the domestic growth impulse.

16. Inflation in Mauritius has been influenced by external factors, given the country's relatively high openness and high propensity to import. Bank staff project headline inflation at 10.6 per cent in 2022. Going forward, inflation is forecast to moderate progressively. Inflation expectations are anticipated to be anchored by the normalisation in monetary policy. Domestic price pressures are expected to ease away as the effects of commodity price declines during the second half of 2022 begin to seep in. The slowdown in global economic activity and the decisions by major trading partner countries to raise their interest rates will help keep a tab on foreign inflation. Consequentially, inflation in Mauritius is projected to take a downward trajectory in 2023 and is forecast within the range of 5.0–6.0 per cent for the year.

MPC Decision

17. The MPC was apprised of the latest international and domestic developments that have taken place since the last MPC meeting in November 2022.

18. The MPC noted that inflation continues to remain high in many countries, although there are signs that global inflationary pressures may recede in 2023, amidst a slowdown in global economic growth. On the domestic front, the recovery process is well under way, with positive performances across major economic sectors.

19. The MPC was of the view that the normalisation process should be pursued so as to ensure proper anchoring of inflationary expectations in the medium term. With major central banks pursuing their tightening stances, yield differentials may persist and, if unaddressed through appropriate policy locally, may contribute to further inflationary pressures.

20. The MPC decided that the positive growth performance provided room for manoeuvre for further normalisation. As a result, the Committee unanimously decided to raise the KRR by 50 basis points to 4.50 per cent per annum, bringing the cumulative rate hike to 265 basis points.

The date of the next MPC meeting will be communicated in due course.

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