Minutes of the 70th Monetary Policy Committee Meeting held on 3 April 2024

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The 70th meeting of the Monetary Policy Committee (MPC) was held on Wednesday 3 April 2024 at 08:30 hours at the Bank of Mauritius. The following members attended the meeting:

- Mr. Harvesh Kumar Seegolam G.C.S.K. (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
- 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 have taken place since the last MPC meeting held on 28 November 2023. MPC members were also apprised of the latest macroeconomic projections before deliberating on the policy rate.

Global Economic Developments

2. Global economic growth continues to be promising and robust. Strong private consumption and government spending, topped up with favourable supply-side developments, have provided impetus to the global growth momentum, despite headwinds coming from localised geopolitical uncertainties. The pace of growth has varied across various economies, largely reflecting their heterogeneous structures. Towards the end of 2023, the US economy showed resilience, catalysed by strong government spending and higher household income and consumption, mainly supported by higher wage growth. An economic contraction was avoided in the Euro area as firmer growth in countries such as Italy and Spain helped counteract the recession in Germany. The region continues to suffer from the offshoots of higher energy prices. The UK

economy contracted in the last quarter of 2023, mainly on the back of lacklustre retail sales. Outside Europe, the Japanese economy meanwhile managed to avoid a recession, despite declining consumption and investment. The Chinese economy remained resilient in 2023Q4, with consumption providing a fillip to the growth momentum, despite headwinds facing the property sector. Robust manufacturing and services sectors and enhanced purchasing power through declining inflation helped to solidify India's position as the world's fastest growing economy. The South African economy performed better in the last quarter of 2023, buoyed by its manufacturing and financial sectors, despite challenges confronting its electricity sector.

3. In its January 2024 World Economic Outlook (WEO) Update, the IMF projects global growth at 3.1 per cent in 2024 and at 3.2 per cent in 2025. Global growth forecast for 2024 was upgraded by 0.2 percentage point (pp) compared to October 2023 WEO projection and was attributed to greater-than-expected resilience in the US and several large emerging market and developing economies (EMDEs), as well as fiscal support in China. Growth projections for 2024 for both advanced economies and EMDEs were revised upwards by 0.1 pp to 1.5 per cent and 4.1 per cent, respectively.

4. Global inflation has been on the downtrend. The IMF, in its January 2024 WEO Update, forecast global inflation to fall from an estimated 6.8 per cent in 2023 to 5.8 per cent in 2024 and further to 4.4 per cent in 2025 on the back of lower food prices, softening labour market conditions and lower core inflation as a result of still-tight monetary policies. The effects of past monetary policy tightening, together with favourable evolution of global commodity prices, helped contain global inflationary pressures. The Food and Agriculture Organisation (FAO) Food Price Index fell from 120.8 in November 2023 to 117.3 in February 2024, mainly on the back of easing price pressures for cereals and vegetable oil due to favourable harvest which offset higher prices for a range of other commodities, including sugar. Going forward, the evolution of food prices remains fraught with uncertainty in the wake of the continued attacks in the Red Sea, the ongoing war in Ukraine and extreme weather shocks in certain parts of the world that may generate supply chain disruptions. Oil prices continue to remain subject to uncertainties with the increase in the number of ship attacks in the Red Sea, against heightened geopolitical tensions in the Middle-East. The announcement of further production cuts by the Organisation of Petroleum Exporting Countries and by Russia is expected to tilt the balance of risks for 2024 towards the upside.

5. As global monetary policy is still in the process of shifting cycles from hawkishness stance, as witnessed some time back in many countries to a more gradual dovish stance, some advanced economies are still leaving their rates unchanged to ensure that their past monetary policy decisions fully work through their economies and keep inflation firmly hooked. The US Fed has kept its policy rate unchanged since September 2023 in the range of 5.25-5.50 per cent, while the policy rate of the BoE has remained unchanged at 5.25 per cent since August 2023. The ECB also maintained its key policy rate unchanged at 4.50 per cent at its March 2024 meeting. Going forward, the US Fed and ECB are expected to start cutting rates as from 2024Q2 while the BoE is likely to cut rate as from 2024Q3. However, should geopolitical shocks persist, commodity prices could flare up and result in more persistent underlying inflation in many parts of the world. As a result, global monetary conditions could tighten and remain so for some time.

6. The IMF's January 2024 WEO Update underscored the moderation of risks to the global outlook. While factors such as disinflation, slower-than-expected fiscal support withdrawal and the prominence of productivity-enhancing Artificial Intelligence, could provide an impetus to growth, others could nonetheless constitute downside risks, if materialised. Prominent among such factors would be a further escalation of the conflict in the Middle East including continued attacks in the Red Sea that could result in renewed global supply chain pressures, higher shipping costs and commodity price spikes, triggering expectations for interest rates to remain elevated for longer. Extreme weather events could further accentuate the damage from domestic and global shocks.

Domestic Economic Developments

7. The domestic economy is well saddled on its growth trajectory, expanding by 7.3 per cent in 2023Q4, with growth for 2023 estimated at 7.0 per cent. This growth momentum was broad-based and was led by sectors including '*Construction', 'Accommodation and food service activities',* and *'Financial and insurance activities'*.

8. Strong global demand for travel and tourism helped support the robust expansion of the tourism sector in 2023. The Mauritian destination continues to be highly appealing internationally, especially in Europe, due to successful promotional campaigns and roadshows. Tourist arrivals reached 1,295,410 in 2023, representing 94 per cent of the level attained in 2019 and 30 per cent higher than in 2022. About 64 per cent of tourist arrivals hailed from European countries in 2023, with France being the trailblazer. Tourism earnings have been very encouraging, aggregating Rs85,993 million in 2023, higher by 36 per cent compared to 2019 and by 33 per cent compared to 2022. The average length of stay of tourists stood at 11.3 nights in 2023, well above 10.6 nights in 2019.

9. The growth momentum in 2023 could be attributed to a combination of domestic and external factors. On the domestic front, growth of domestic absorption was promising. Consumption, the highest weighted-element of aggregate demand, expanded by 1.7 per cent in 2023Q4. Investment, measured by Gross Fixed Capital Formation, expanded by 45.0 per cent, bolstered by large scale infrastructural and construction projects, both by the public and private sectors.

10. The broad-based growth momentum in different sectors bode well for the labour market. Favourable labour market policies during the year complemented the improved macroeconomic environment and helped improve fundamentals in the labour market. The unemployment rate continued to moderate, reaching a historical low of 6.1 per cent in 2023Q4. Youth unemployment rate clinched a new record low as well, standing at 17.3 per cent in 2023Q4. With buoyant economic activity, labour force participation rate improved further to 58.7 per cent in 2023Q4, the level that was attained prior to the pandemic on the back of higher supply of labour matching the increased demand. This signals continued progress in attracting former workers, unemployed and new entrants into the labour force to meet new demand. The strong demand for labour also resulted in a build-up in labour cost pressures across many sectors. However, short-term dynamics indicated

that, on a quarter-on-quarter basis, wage growth subsided from 4.1 per cent in 2023Q1 to 1.8 per cent in 2023Q4, indicating that wage pressures may be starting to ease.

11. Headline inflation in Mauritius continues to ease, declining from 7.7 per cent in November 2023 to 6.1 per cent in February 2024, due to favourable global commodity price developments. However, adverse weather conditions at the beginning of the year with repercussions on prices of vegetables, have resulted in a reversal in year-on-year (y-o-y) inflation which had been subsiding progressively throughout 2023 but which subsequently increased from 4.0 per cent to 6.2 per cent between November 2023 and February 2024. Core measures of inflation, which provide a better assessment of underlying demand pressures by controlling for volatile energy and food components, softened further. The lasting effects of previous monetary policy tightening continue to work through the economy, while keeping inflation expectations well-anchored.

12. A more granular analysis reveals that the proportion of pro-inflation items in the CPI basket has been gradually decreasing. In particular, the share of CPI items that were generating above target inflation of more than 5 per cent, halved from almost 70 per cent in February 2023 to around 35 per cent in February 2024 (e.g. other footwear and culinary herbs). At the same time, the share of items with inflation rates in the range of 0 to 5 per cent (e.g. flour and personal transport) worked out to nearly 47 per cent in February 2024, while the share of items (e.g. pre-primary education and other medical products) that were deflationary (less than 0 per cent) increased to roughly 18 per cent. These dynamics provide concrete evidence that inflation is gradually converging towards the Bank's target range for inflation. The latest survey of inflation expectations conducted in February 2024 indicated that inflation expectations remained well-anchored. Short-term inflation expectations are tilted to the downside, reflecting sustained moderation in headline inflation. Compared to the last survey conducted in November 2023, inflation expectations were revised down by 80 basis points, both for June 2024 and for one-year ahead.

13. The current account deficit improved considerably in 2023, reaching 4.5 per cent of GDP, down from 11.1 per cent of GDP in 2022, on the back of significantly healthy services and net income accounts that mitigated the widening trade deficit. The services account performance in 2023 reflected considerably higher gross tourism earnings, which reached Rs86 billion, compared to Rs64.8 billion a year earlier, and sharply lower freight costs on imports. Tourism earnings in January 2024 were estimated at Rs9.2 billion compared to Rs8.4 billion in January 2023, pointing to continued promising prospects in 2024.

14. The Mauritius International Financial Centre continues to attract robust financial flows as global cross-border investment activities remain resilient despite the challenging global economic landscape. With respect to the non-GBC financial flows, the country recorded substantial increases in gross foreign direct investment flows in 2022 and 2023. The Gross Official International Reserves of the country stood at US$7.2 billion as at end-March 2024, representing 11.1 months of import cover, and are considered more than adequate as buffers against potential external shocks. Going forward, the current account deficit is projected to narrow to around 4.0 per cent of GDP in 2024 on account of sustained healthy performance of the tourism sector as well as larger surplus on the primary income account.

15. The Bank continues to deploy its wide assortment of instruments for the conduct of open market operations in line with the new monetary policy framework. Since the last MPC meeting, 7-Day BoM Bills for an amount of Rs1.0 billion have been issued weekly to all banks on tender basis. As part of longer-term operations, the Bank issued BoM Bills for an aggregate amount of Rs25.1 billion in the 91-Day, 182-Day and 364-Day tenors between 28 November 2023 and 28 March 2024. Overnight Deposit Facility placed with the Bank averaged Rs23.7 billion over the same period. The Bank also issued two-year BOM Notes to the tune of Rs7.0 billion to mop up structural excess liquidity. The Bank has also mopped up a net amount of Rs1.9 billion through foreign exchange interventions since the previous MPC meeting. The overnight interbank rate, the new operating target under the new monetary policy framework, hovered closer to the lower bound of the corridor.

16. Robust tourist arrivals in 2023 contributed towards easing pressures in the domestic FX market. The Bank resumed its regular FX interventions in the last quarter of 2023 to ensure adequate supply of FX to the market. As a result of improved financial market conditions, the Bank did not intervene to sell FX on the market since 6 December 2023 till the end of 2024Q1, but rather purchased FX to the tune of USD238.9 million from the market. On 1 April 2024, the Bank intervened to sell USD5 million at Rs46.40/USD with a view to smooth excess volatility in the exchange rate of the rupee. The rupee continues to reflect demand and supply impulses and its evolution over the medium-term continues to be in line with economic fundamentals. Between 28 November 2023 and 2 April 2024, the rupee has depreciated by 4.9 per cent against the US dollar.

17. Financial stability concerns have eased substantially over the past year. Improved macroeconomic and macro-financial conditions in Mauritius and abroad have contributed to the stability and resilience of the financial system in general. The banking sector, which accounts for the lion's share of the entire financial system, continues to post strong performance. The relative level of indebtedness of the household and corporate sector, two counterparts of the banking sector, has fallen. The household sector has benefitted from improved conditions with the pick-up in domestic economic activity. In particular, the ratio of debt servicing cost to income and to GDP are now below pre-pandemic levels – at 16.8 per cent and 6.0 per cent, respectively, in December 2023.

18. Corporate indebtedness to banks relative to GDP has receded. The favourable macroeconomic environment helped support corporate earnings positively and lowered risks that banks face from their exposure to the corporate world. Both, the household and corporate sectors continued to benefit from continued expansion of credit from the banking sector. The asset quality of the banking sector improved in the last quarter of 2023. The overall non-performing loan (NPL) ratio dropped to 4.4 per cent in December 2023, from 4.8 per cent in September 2023. At 46.7 per cent in December 2023, the NPL coverage ratio is assessed to be adequate. The capital and liquidity buffers of the banking sector are assessed to be adequate. The Capital Adequacy Ratio of the banking sector rose to 21.0 per cent as at end-December 2023, well above the minimum regulatory requirement set by the Bank. The Liquidity Coverage Ratio (LCR) also stood well above the regulatory floor of 100 per cent, with aggregated LCR at 298.6 per cent and the LCR for material foreign currencies at 232.0 per cent in December 2023. Stress testing exercises continue to point towards continued resilience of the banking sector to large and plausible macroeconomic shocks.

Broad indicators measuring systemic resilience confirm a moderation of risks to the macro-financial landscape in Mauritius.

Staff Economic Outlook

19. The dynamism in domestic economic activity is projected to persist over the medium-term. The tourism sector is expected to continue to benefit from strong demand for holiday travel globally, improved flight connectivity and ongoing efforts to diversify the tourism base. The construction sector is expected to be buoyed by several large-scale infrastructure projects. The solid performance of the financial sector will be maintained, as authorities pursue timely efforts to consolidate the status of Mauritius as a trusted IFC. Solid growth in consumption, investment and net exports are expected to support domestic activity. In addition, fiscal impulse as a result of loose fiscal policy and the income effect emanating from the increase in national minimum wage and government allowances will raise aggregate demand and contribute to the positive output gap. Monetary conditions are expected to be stimulative in 2024. Real GDP growth is projected at around 6.5 per cent in 2024. The growth outlook, however, remains subject to potential downside risks which could emanate from a downturn in economies of trading partner countries, spill-overs from pronounced activity slowdown in China, as well as escalation of the conflict in the Middle East.

20. Inflation in Mauritius has maintained its downward trajectory on the back of favourable global commodity price developments. Going forward, pressures coming from the labour market may build up in the form of higher real wages. While these can positively support aggregate demand, they can also constitute a supply shock if unaccompanied by productivity rises. Despite this potential risk, inflation in Mauritius is expected to continue to ease on the back of normalisation in global food prices as well as the effects of past policy rate hikes engineered by the Bank which continue to work through the economy and to keep inflation hooked at levels consistent with the Bank's target. The Bank projects inflation to close the year at 4.9 per cent. However, the inflation outlook remains subject to potential upside risks due to adverse weather conditions which could keep domestic food prices elevated for longer and geopolitical tensions, which could generate adverse supply shocks with direct pressures on freight costs and by ricochet on commodity prices.

MPC Decision

21. The MPC took cognizance of the latest international and domestic developments that have taken place since the last MPC meeting held in November 2023.

22. Growth developments during year 2023 and at the beginning of 2024 have been very encouraging across all major economic sectors. Inflationary pressures are rapidly easing and look set to continue declining through 2024.

23. The MPC took note that, despite these positive macroeconomic developments, there are nonetheless important risk factors that could affect the outcomes in 2024, both on the inflation and on the growth side.

24. The MPC carefully balanced the risks to the growth and to the inflation outlook and considered that the Bank's decision to hike policy rates during 2022 still needed time to work through the economy, solidly anchor inflation expectations and ensure that the inflation target is attained in 2024.

25. Consequentially, the MPC decided that a change in the Key Rate is not warranted at this stage and unanimously decided to keep the Key Rate unchanged at its current level of 4.50 per cent per annum.

26. The next MPC meeting will be announced in due course.

27. The MPC will continue to monitor the economic situation closely and stands ready to meet in between its regular meetings, if the need arises.

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