Minutes of the 59th Monetary Policy Committee Meeting held on 04 August 2021

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The 59th meeting of the Monetary Policy Committee (MPC) was held on Wednesday 04 August 2021 at 10:30 hours at the Bank of Mauritius under the chairmanship of Governor Harvesh Kumar Seegolam. The following members attended the meeting: Mr. Mardayah Kona Yerukunondu (First Deputy Governor); Mrs. Hemlata Sadhna Sewraj-Gopal (Second Deputy Governor); Professor Sanjeev Kumar Sobhee; Mr. Lim Chan Kwong Lam Thuon Mine; Mr. Mohammad Mushtaq Namdarkhan; Dr Streevarsen Narrainen; and Mrs. Christine Marie Isabelle Sauzier (External Members).

Summary of Staff Report on Economic and Financial Developments

Bank staff briefed MPC members on global and domestic economic developments that took place since the 58th MPC meeting held on 04 February 2021. The MPC took note of staff's macroeconomic projections and assessed risks to the domestic economic outlook.

Global economic developments

1. The global economy is recovering, with several economies leading the way in re-opening their frontiers to international travel, and with ongoing efforts to accelerate vaccination programs. Most leading indicators of global economic activity indicated a robust upswing in global growth in 2021Q2. Nonetheless, uncertainty still looms since the pace of recovery, going forward, still depends on a number of factors, namely, how the health crisis is successfully managed, efficacy of vaccines, effectiveness of policy measures to weather the offshoots of the pandemic and to sustain the recovery efforts, financial market conditions and evolution of global commodity prices.

2. The International Monetary Fund (IMF) has, in its July 2021 World Economic Outlook (WEO) Update, maintained its 6.0 per cent global growth forecast for 2021. For 2022, the global economy is projected to grow by 4.9 per cent, up from the April 2021 WEO forecast of

4.4 per cent. Risks to the global growth forecast are tilted to the downside. Widespread disparities among countries and regions are expected to persist, depending on the pace of vaccination and emergence of new variants prompting renewed lockdowns in many countries.

3. Global inflation has been on the rise due to higher food and energy prices, and was assessed to be transitory in nature due to supply-side influences and statistical base effects. This was especially so among the main trading partners of Mauritius. In the US, inflation soared from 1.4 per cent in January 2021 to 5.4 per cent in June 2021 amid supply constraints and faster pace of economic activity. Consumer prices in the euro area rose from 0.9 per cent to 1.9 per cent over the same period as economies across the region started to lift COVID-19 restrictions and an upsurge in demand complemented existing supply bottlenecks. In the UK, inflation climbed from 0.7 per cent in January 2021 to 2.5 per cent in June 2021 owing to higher prices of food, fuel, second-hand cars, clothing and footwear. Inflation in China rose from -0.3 per cent in January 2021 to 1.1 per cent in June 2021 while inflation in India rose from 3.2 per cent in January 2021 to 5.3 per cent in May 2021.

4. Major central banks have maintained their accommodative monetary policy stance to support the economy. With economic recovery gathering pace and inflation picking up, major central banks have perceived high inflation witnessed in 2021Q1 and 2021Q2 as only temporary in nature and have looked beyond this uptick to maintain their accommodative monetary stance. Should the rise in inflation become more permanent with entrenched inflationary expectations, major central banks have indicated that they could contemplate monetary policy tightening as economic normalisation sweeps in.

Domestic economic developments

5. In 2021Q1, the domestic economy contracted, primarily due to effects of the second lockdown in March 2021. The negative effects were nonetheless contained due to the quick deployment of Work Access Permits which helped sustain a minimal level of economic activity. Although sectors such as agriculture, information and communication, real estate, construction, wholesale and retail trade and financial services contributed positively to economic activity, the protracted underperformance of the tourism sector continued to weigh negatively on activity, amidst subdued external demand. The contraction in real GDP at basic prices deepened to 8.4 per cent in 2021Q1, from 2.3 per cent in 2020Q1, but lower than that of 11.1 per cent in 2020Q4.

6. Domestic inflation gained further momentum in June 2021 on the back of upward price pressures emanating from both food items - which account for about 25 per cent of the CPI basket- and non-food products. The CPI increased from 106.1 in December 2020 to 111.4 in June 2021, with the rise emanating mostly from vegetables (1.3 index points), other food

products (0.9 index point), other goods and services (0.9 index point), cigarettes (0.5 index point), gasoline (0.5 index point) and alcoholic beverages (0.4 index point). Inflation accelerated in June, mainly on the back of budgetary measures pertaining to the increase in excise duties on goods such as alcoholic beverages and tobacco as well as unfavourable base effects associated with the downward adjustment in the price of vegetable items a year earlier. Y-o-y inflation, which fell from 2.7 per cent in December 2020 to a trough of 0.2 per cent in April 2021, rose to a three-year peak of 5.9 per cent in June 2021. In parallel, headline inflation eased from 2.5 per cent in December 2020 to 1.8 per cent in May 2021 but subsequently rose to 2.2 per cent in June 2021.

7. Labour market conditions deteriorated in 2021Q1 in the midst of the second national lockdown in March 2021, with the unemployment rate rising from 6.9 per cent in 2020Q1 to 9.8 per cent in 2021Q1.

8. The current account deficit worsened in 2021Q1, stemming mainly from a deficit in the services account and widening goods account deficit. The former resulted from the significant drop in tourism receipts while the latter reflected higher contraction in nominal exports relative to nominal imports. Exports of goods declined to Rs17.4 billion in 2021Q1, driven by contractions in exports of '*ship stores and bunkers*' and '*fish and fish preparations*'. Imports of goods declined to Rs40.4 billion in 2021Q1, from Rs41.6 billion in 2020Q1. As a percentage to GDP, the current account deficit rose from 6.8 per cent in 2020Q1 to 16.1 per cent in 2021Q1.

9. The Gross Official International Reserves (GOIR) as at end-June 2021 remained at a comfortable level as a buffer against external shocks. As a ratio of imports of goods and services, the GOIR represented 18.1 months of imports, compared to 16.9 months as at end-June 2020.

10. The level of rupee excess liquidity in the banking system declined on the back of active open market operations. The Bank continued to mop up excess rupee liquidity in line with its monetary policy stance. Short-term yields moved back within the interest rate corridor. Excess rupee liquidity, which averaged Rs40.9 billion over the period 22 September 2020 to 04 February 2021, declined to an average of around Rs28.4 billion over the period 05 February to 23 July 2021, mainly as a result of net issuances of both Government and BoM securities, to the tune of Rs46.5 billion. A further amount of Rs21.7 billion was removed through FX operations conducted by the Bank over the same period. The Bank continued to ensure an adequate supply of foreign exchange to the market at exchange rates based on bids received from banks at its FX auctions.

Staff economic outlook

11. Price dynamics are expected to be influenced by supply-side factors. The recently announced budgetary measures to impose higher excise duties on alcoholic beverages and tobacco and adjustments to the price of petroleum goods are examples of such factors. In parallel, inflation dynamics may also be influenced by the weakening of the rupee against major currencies, coupled with higher freight charges. Demand side factors are expected to have minimal effects on inflation due to the dampening effects of the pandemic on demand which will nevertheless recede. Going forward, risks to the inflation outlook remain tilted to the upside. Domestic inflation could well be affected by upsurges in global oil and commodity prices, as well as by stronger pass-through of exchange rate effects on prices of imported items. The Bank projects inflation at about 3.5 per cent in 2021.

12. The ongoing vaccination campaign and recovery in global demand are expected to support the domestic economy and mitigate the negative impact of the second lockdown in March 2021. Key sectors of the economy, notably construction, manufacturing, financial services and information and communication are expected to contribute positively to growth. The re-opening of the Mauritian borders to international travel, together with the vaccination campaign, are expected to give a fillip to the tourism sector and all supporting sectors. On the demand side, household consumption – the largest component of aggregate demand – is expected to contribute positively to output, as economic activity moves towards *'normalisation'* mode. Public spending in infrastructure projects is also expected to sustain activity. The Bank projects real GDP growth at about 5.5 per cent in 2021.

Monetary Policy Decision

13. The MPC discussed the global economic context and took note that, while economic recovery was under way globally, the pace somewhat differed among economies, due to differences in vaccination campaigns and emergence of new variants. Global trade and global tourism have been recovering from pandemic-related disruptions. Global inflation has been picking up, but reflected mostly supply-demand mismatches which are expected to fade away. Major central banks have been maintaining their accommodative stance to support their economies, looking beyond the temporary uptick in inflation.

14. Turning to the domestic economy, members took note that economic activity in 2021Q1 suffered from the imposition of a second lockdown in March 2021. With the ongoing mass vaccination campaign, recovery is under way. The re-opening of borders is expected to support the tourism sector, with positive repercussions on other sectors, in the second half of 2021 and boost confidence. Members also noted that a rebound in domestic demand appears to be underway.

15. With regards to the inflation outlook, members took cognizance that inflation pressures have emerged in Mauritius but that the rise in headline inflation, like in many countries around the world, was mostly transient in nature.

16. Members also took note of the latest measures under the Bank of Mauritius COVID-19 Support Programme and its extension up to June 2022. These measures have complemented the accommodative monetary policy stance of the Bank.

17. The MPC unanimously decided to keep the Key Repo Rate (KRR) unchanged at 1.85 per cent per annum. The MPC considers that the current monetary policy stance is appropriate and supportive of economic recovery. The MPC will continue to monitor the economic situation closely and stands ready to meet in between its regular meetings, if the need arises.

18. The next MPC is scheduled on 06 October 2021.

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Editor's Note

According to the Bank of Mauritius Act 2004, the primary object of the Bank shall be to maintain price stability and to promote orderly and balanced economic development. The Act gives the Monetary Policy Committee (MPC) responsibility to formulate and determine the monetary policy to be conducted by the Bank.

Headline inflation is measured by the change in the average CPI over a twelve-month period compared with the corresponding previous twelve-month period.

Year-on-year (y-o-y) inflation is measured by the change in the CPI for a given month compared with the corresponding month of the preceding year.