BANK OF MAURITIUS

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Minutes of the 35th Monetary Policy Committee Meeting of 27 October 2014

The 35th meeting of the Monetary Policy Committee was held on 27 October 2014 at 09:30 hours at the Bank of Mauritius and was chaired by Mr Rundheersing Bheenick, Governor of the Bank.

Members present: Mr Yandraduth Googoolye, First Deputy Governor; Mr Issa Soormally, Second Deputy Governor, Mr Nishan Degnarain, Mr Pierre Dinan, and Mr Hemraz Oopuddhye Jankee, External Members.

Professors Silvana Tenreyro and Jeffrey Frankel, External Members, attended the meeting via video-conference.

Observers: Dr Streevarsen Narrainen, Senior Economic Adviser, Ministry of Finance and Economic Development, and Mr Neetyanand Kowlessur, Chief-Economic Research Division, Bank of Mauritius.

Summary of Staff Reports on Economic and Financial Developments

The Staff reported on economic and financial developments since the 34th MPC meeting held on 14 July 2014.

International Economic Environment

1. **The MPC was briefed on the latest projections put up by the IMF in its October 2014 World Economic Outlook, which forecast global growth to increase from 3.3 per cent in 2014 to 3.8 per cent in 2015**. Albeit, it was pointed out that global growth would remain modest and uneven; as evidenced by the renewed threats of recession in the Eurozone, persistent economic and financial weaknesses in some large emerging economies, and dampening confidence arising from geopolitical tensions. However, growth in the US, UK, Canada, Sweden, and Norway would be firm and India would sustain rapid growth.

2. **Subdued world output growth, domestic demand and stable commodity prices have thus far contained inflationary pressures, keeping global inflation at moderate levels.** The October 2014 WEO projected consumer price inflation in advanced economies to increase

from 1.6 per cent in 2014 to 1.8 per cent in 2015. In emerging market and developing economies, inflation is estimated to edge up from 5.5 per cent in 2014 to 5.6 per cent in 2015. Upside risks to inflation would emanate from geopolitical events.

3. **Central banks are facing varying challenges on account of unevenness of economic recovery across economies and inflation outcomes vis-à-vis targets**. In the US and the UK, recovery is strong and inflation rising and the challenge is thus to manage exit from the accommodative monetary policies, which have built up financial sector excesses. Japan and the Eurozone are expected to maintain a loose monetary policy stance so as to boost economic activity and fight the threat of deflation. Some emerging and developing economies have changed their policy stance lately while others have left it unchanged.

4. **Global share prices have maintained their uptrend in recent months, but remained volatile to news**. Gains have occurred mainly due to the widespread view that the US economy improved further and the official interest rates in some major economies would remain exceptionally low for some time.

5. **The strength of the US dollar in recent months has reflected better-than-expected US economic data releases, the Fed's conviction to discontinue with its bond purchases and risk aversion due to geopolitical tensions**. The euro fell against other major currencies on the back of weaker-than-expected economic data releases and the threat of deflation. The Pound sterling gained momentum on the back of better-than-expected data on industrial output and on growing expectations that the Bank of England would tighten monetary policy sooner than later.

Domestic Economic Developments

6. **The MPC noted that in 2014H1, the domestic economy expanded by 3.7 per cent, slightly higher than the 3.6 per cent growth recorded in 2013H1**. Growth reflected brisk activity in the services sector, especially in public administration, accommodation and food service, financial and insurance, and other services. While the construction sector has contracted, the manufacturing sector improved further, echoing increased exports to US, Asia, France and United Arab Emirates. In its update of national accounts in September 2014, Statistics Mauritius (SM) maintained its June forecast of annual GDP growth of 3.5 per cent in 2014, although sectoral contribution to growth changed between the two forecasts.

7. **External demand and final consumption contributed positively to real GDP growth in 2014H1, while growth of gross domestic fixed capital formation has remained negative**. The growth of net external demand reflected the strong growth of exports of goods and services (+3.1 per cent) whereas imports of goods and services grew at a significantly lower rate (+0.6 per cent). Final consumption grew at an average rate of 2.3 per cent in 2014H1 compared to 2.4 per cent in 2013H1.

8. **Labour market conditions have remained broadly stable so far and the unemployment rate went down to 7.8 per cent in 2014Q2, from 8.0 per cent in 2014Q1**. On a seasonally-adjusted basis, the unemployment rate stood unchanged at 7.4 per cent in 2014Q2. Total employment rose by 5,900 in the year to 2014Q2, compared with an increase of 6,900 for the corresponding period of 2013.

9. **Broad money liabilities continued to grow moderately in tandem with the growth of the economy**. Broad money increased by 7.9 per cent y-o-y in August 2014 due to a rapid increase in savings and transferable deposits, while the growth of time deposits lagged behind. The growth rate of bank credit to the private sector (excluding credit to GBCs) declined from 3.6 per cent as at end-June 2014 to 0.5 per cent as at end-August 2014. The slowdown mainly reflected a deceleration in the growth of both corporate and household credit.

10. **The current account deficit narrowed from 8.5 per cent of GDP in 2013H1 to 8.2 per cent to GDP in 2014H1 on the back of a lower trade deficit and higher surplus on the services account that more than offset a marked deterioration in the income account balance**. The improvement in the trade balance mirrored a restricted growth in imports of intermediate and final consumption goods.

11. **Prudent macroeconomic management continued to underpin fiscal performance in 2014**. Trends in the overall fiscal deficit and primary balance pointed that they would be broadly on target, with the attainment of an overall fiscal deficit of 3.2 per cent of GDP and a primary deficit of 0.4 per cent of GDP in 2014. Revenue performance remained strong while total government expenditure has remained constant (as a share of GDP) during the first and second quarters of 2014.

12. **Short-term interest rates remain influenced by the excess liquidity prevailing in the banking system, despite joint coordination efforts by the Bank and MoFED to address the issue**. Despite the sizeable frontloading of government papers and the issue of BoM instruments, for the three consecutive monitoring periods ended 02 October 2014, banks' excess reserves averaged Rs10.6 billion. The Bank's interventions in the foreign exchange markets have led to an increase in official reserves from about US$3.5 billion by the end of December 2013 to US$3.9 billion by the end of September 2014.

13. **Since the July 2014 MPC meeting, the rupee has been quite stable in nominal effective terms.** The trade-weighted nominal exchange rate of the rupee remained almost flat whereas the currency-weighted nominal exchange rate (MERI1) depreciated by 0.6 per cent, reflecting the strength of the US dollar. On a point-to-point dealt basis, the rupee depreciated by 3.7 per cent against the US dollar but appreciated by 3.6 per cent and 2.5 per cent against the euro and Pound sterling, respectively.

14. **Y-o-y CPI inflation and various derived inflation indicators have shown either relative stability or maintained a downtrend so far in 2014.** Since March 2014, headline inflation has been virtually flat at about 4.0 per cent, while y-o-y inflation dropped systematically from 4.5 per cent in March 2014 to 3.1 per cent in July 2014 before rising to 3.8 per cent in August 2014. It dropped to 2.9 per cent in September 2014. This decline is mainly attributed to subsiding food and transport inflation. Y-o-y core inflation measures mirrored more or less CPI inflation trends.

15. **Inflation expectations appeared to be well anchored**. The Bank's August 2014 Inflation Expectations Survey pointed to lower inflation outcomes in periods going up to a year ahead, compared to the previous survey. The mean headline inflation rates expected by respondents were 4.1 per cent, 4.3 per cent and 4.5 per cent, respectively, for December 2014, June 2015 and a year ahead compared to 4.4 per pent, 4.6 per cent and 4.7 per cent respectively, for December 2014, June 2015 and a year ahead for the survey month of May 2014.

Staff Economic Outlook

16. **Based on the Bank's short-term forecasting model[1], staff noted that y-o-y CPI inflation was expected to decline marginally during 2014Q4 and would stand at about 3.0 per cent for December 2014.** Looking ahead, Staff projected y-o-y CPI inflation to remain low in 2015Q1 but would thereafter pick up against the premise of cost-push factors, potentially the outcome of seasonal and other exogenous factors that would affect the price of certain goods and services in the CPI basket. The projected inflation dynamics would reflect trends of food and non-food inflation, resulting from modest growth of domestic absorption, moderate global growth and inflation (that would lower imported inflation), and an improvement in Mauritius' terms of trade on account of the stability of international commodity prices.

17. **Staff noted that domestic growth bounced above potential in 2014Q2 on account of the significant performance of the economy during that quarter but over the short term, the domestic output gap, also estimated using the Bank's forecasting macro model, is projected to remain in negative territory**. Staff expected that the underlying growth momentum looked set to remain positive during 2014H2 and maintained the growth forecast for 2014 in a range of 3.4 to 3.6 per cent.

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[1] *The Bank's model is a New Keynesian Model for an open economy, formulated in terms of differences between the actuals or projected macro variables against the value of those variables in the "steady state".*

External Presentations to the MPC[2] [3]

18. **The MPC listened to the Acting Deputy Financial Secretary, Mr Patrick Yip, who conveyed the views of the Ministry of Finance and Economic Development (MOFED)**. Mr Yip mentioned that the MOFED took note of the guidance adopted by the MPC at its July 2014 meeting to reduce uncertainty among economic operators. Given that the next MPC meeting would most likely take place after the forthcoming legislative elections and after the presentation of the budget by the next Minister of Finance, he added that new considerations may arise. He stated that coordination of macroeconomic policies between the Bank and MOFED was on course and a Memorandum of Understanding on liquidity management and policy coordination would soon be finalised. Given that both headline and y-o-y inflation were below the 4 per cent threshold set by the MPC in July 2014 and that global growth outlook still remained uncertain, he argued for maintaining the current accommodative stance of monetary policy and thus, keeping the KRR unchanged.

19. **Mr Suttyhudeo Tengur communicated the views of the Association for the Protection of the Environment & Consumers (APEC) and requested the MPC to protect the rights and interests of consumers in its decision-making process**. He reminded that APEC has always taken a stance to increase the KRR so as to encourage savings and build up purchasing power. He noted more downside risks to inflation arising from subdued global commodity prices compared to upside risks from the recent strength of the US dollar against the rupee and taking into account the current situation, he argued for maintaining the KRR unchanged.

20. **Dr Ashok Aubeeluck, Head of the Economic Analysis & Publications Division of the Bank, delivered the third presentation to the MPC on "the risks and vulnerabilities in the domestic banking system"**. He claimed that the domestic banking sector is facing certain risks and challenges: issues of non-performing loans, loan concentration, excess liquidity and technology risk. He mentioned that excess liquidity led to the distortion of the interest rate structure; stifled the transmission mechanism; and affected market efficiency. It was thus imperative to address this issue as well as to monitor closely the rising non-performing loans in a low interest rate environment for financial stability considerations.

21. **Mr Nishan Degnarain, member of the MPC, gave a presentation on "*Mauritius: Africa's first Renminbi Trading Hub: A new growth frontier and monetary policy implications*"**. Mr Degnarain explained that trade between China and Africa has increased ten-fold over the last ten years and is forecast to double by 2020 from US$200 billion to US$400 billion. There thus arose more opportunity for RMB-denominated transactions in Africa; such that by 2020 it is expected that 6 per cent of China's commodity trade will be in RMB. The RMB is also

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[2] *The MPC is required by law to take into account the views of the Bank, the Finance Ministry and such institution or organisation as it considers appropriate in the discharge of its functions.*

[3] *The full set of presentations is available on the Bank's website at https://www.bom.mu.*

expected to be the 4th most traded currency behind the USD, EUR and GBP by 2020. In this respect, he viewed that Mauritius could position itself to become the first RMB hub in Africa, but he noted that Mauritius would face competition from several other African financial centres. The potential advantages to the financial services sector of the Mauritian economy were also discussed.

The Governor remarked that the Bank had already initiated actions with regard to trading in RMB bonds as well as on trade settlement in Renminbi since some time, including organising a Mandarin course for some of the Bank's staff.

The Monetary Policy Decision

22. **Members debated on the recent international developments and projections and noted that despite global output recovery from 3.3 per cent in 2014 to 3.8 per cent in 2015, as indicated in the IMF's October 2014 WEO, growth would remain uneven across countries and regions**. They noted that growth was projected to strengthen in the US and UK but would be weak in the Eurozone. However, several emerging market economies would sustain their growth outlook.

23. **The MPC took note of the apprehension of build-ups in financial sector excesses in advanced economies and the risks that such excesses posed**. They reflected on the potential outcome of exits from accommodative monetary policies and observed that global inflation remained benign amidst stable international oil and food prices.

24. **Members noted that the IMF has downgraded global growth for the third time this year and that the domestic economic environment is mired with uncertainty over the next 4 to 5 months on account of the political developments**. The danger of deflation in Europe is serious given that some of the European countries are our main markets. They also raised the alarm bell on the low savings to GDP ratio, which has maintained a continuous decline, from over 20 per cent in the early 2000s to an estimated 11.6 per cent in 2014. Some members viewed that domestic savings are not growing enough to service the economy and that fiscal policy ought to be the solution, and not monetary policy.

25. **In their discussion of the domestic economic situation and outlook, the Committee noted that domestic economy was resilient, expanding at a reasonable pace, albeit remaining below potential in 2014H1**. Members noted the strong performance of the economy during 2014Q2, which was partly led by a higher than expected performance in '*public administration'*. A higher growth of 4.6 per cent was estimated for 2014Q2. They argued that the economy was showing some notable resilience in spite of the potential drags from Europe for exports of manufactures and tourism services. Some members viewed that growth could

even be better for 2014 because of revival noted in some specific sectors and also on account of positive data developments relating to exports and tourist arrivals in 2014Q3.

26. **The Committee noted that labour market conditions remained more or less unchanged while the unemployment rate dropped from 8.0 per cent in 2014Q1 to 7.8 per cent in 2014Q2.** Albeit additional foreign labour joining the labour force, the unemployment rate is forecast to be slightly lower for 2014 compared to 2013. Some members highlighted the need for job-rich growth as well as structural and labour market reforms.

27. **Members noted that CPI inflation was modest**. The Committee acknowledged that there were little inflationary pressures that would pose risks to the CPI inflation until the end of 2014. Members viewed that the build-up in domestic wage pressures ought to be contained; otherwise domestic inflation would outstrip imported inflation very rapidly. At this current juncture, both food and energy prices are contained due to stable global commodity prices. The impact of a lower y-o-y CPI inflation in September 2014 would lead to a rise in the real rate of interest on savings deposits.

28. **Some members expressed their concern about the low level of investment, productivity and competitiveness**. They remained apprehensive of the negative rates of return savers continue to receive. The declining savings rate of the economy remained the dark spot. It was noted that the savings rate had fallen from 13.0 per cent in 2011 to 11.8 per cent in 2013 and would go down further to 11.6 per cent in 2014. Some members also reflected on rising income inequality and the distribution of growth in the economy.

29. **Among some challenges noted by certain members on the corporate sector was the excessive leverage of a few domestic companies**, **which could be resolved through debt restructuring and injection of additional capital**. The global growth outlook, which indicated different paths for countries and regions, could lay the basis for a revised domestic export strategy for merchandise goods, as had been the case for the services sector. The country ought to gear its approach towards diversifying its markets and export base.

30. **Some members maintained that interest rates will need to be normalised over time to guard against risks to financial stability and to address the low domestic savings rate.** To partly address the latter and to deal with the excess liquidity situation, the Bank has been issuing 3-Year Government of Mauritius Savings Notes at a fixed coupon rate of 5.25 per cent per annum and 5-Year Government of Mauritius Savings Bonds at a fixed rate of 6 per cent per annum to retail investors. Some members agreed that the timing of the normalisation process would rest on future price and real sector developments.

Voting Pattern

31. **All members unanimously voted to keep the KRR unchanged at 4.65 per cent per annum, in line with the approach adopted at the July 2014 MPC meeting**.

32. **The MPC continues to monitor economic and financial developments** and stands ready to meet in between its regular meetings, if the need arises.

33. **The next meeting is scheduled on Monday 9 February 2015**.

Bank of Mauritius ***10 November 2014***

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. The MPC meets on a regular quarterly basis.

In line with amendments brought to the Bank of Mauritius Act 2004 in December 2012, the MPC was reconstituted in March 2013. Members of the MPC comprise the Governor (Chairperson), the 2 Deputy Governors, 2 other persons appointed by the Prime Minister and 3 other persons, not being Directors or employees of the Bank, appointed by the Finance Minister.

When the MPC met on 27 October 2014, the last available data on national accounts, employment and external trade were for 2014Q2. The last data available on CPI and inflation were for September 2014.

Abbreviations and Definitions

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

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.

CORE1 inflation excludes food, beverages and tobacco and mortgage interest on housing loan from the CPI basket. Both headline and y-o-y CORE1 inflation measures are available.

CORE2 inflation excludes food, beverages and tobacco, mortgage interest, energy prices and administered prices from the CPI basket. Both headline and y-o-y CORE2 inflation measures are available.

Dealt exchange rate is the weighted average rupee selling rate derived from transactions of US$30,000, and above, or equivalent.

KRR refers to the Key Repo Rate.

MERI1 is the Mauritius Exchange Rate Index, a nominal effective exchange rate introduced in July 2008, based on the currency distribution of merchandise trade.

Y-o-y refers to year-on-year changes.

Q-o-q refers to quarter-on-quarter changes.