Monetary Policy Committee Meeting – 3 June 2022

Press Statement by the Governor

1. Ladies and gentlemen, members of the media, good morning.

2. Welcome to our second post-MPC Press Briefing for this year.

3. At its meeting today, the MPC extensively discussed the outlook for the domestic economy in the light of the latest global developments and has considered these elements in its decision.

International Economic Developments

Inflation globally

4. On the international front, the key concern of central banks currently is inflation.

5. Economic activity has been picking up globally after being severely disrupted by the pandemic, though the Russia-Ukraine war has inhibited global growth prospects for 2022. But inflation – especially high inflation as we see today – can derail the growth momentum, by impacting demand for goods and services.

6. High inflation is primarily caused by war-induced food and fuel price increases, which have added to the pandemic-related supply-side strains. However, in many countries there are indications that inflation may have reached a peak or may do so in the near term. Policymakers worldwide anticipate inflation to remain at around current levels before subsiding.

7. As the IMF has put it, we are facing a '*crisis upon a crisis'*, with the Russia-Ukraine war compounding the pandemic and '*dragging down growth and pushing up inflation'*.[1]

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[1] "*Why We Must Resist Geoeconomic Fragmentation—And How"*, IMF Blog, Kristalina Georgieva, Gita Gopinath and Ceyla Pazarbasioglu, 22 May 2022.

8. In its April 2022 World Economic Outlook, the IMF has revised upward its inflation projections to 5.7 per cent for advanced economies and 8.7 per cent for emerging market and developing economies – i.e., 1.8 and 2.8 percentage points higher than projected in January 2022, respectively. Inflation went up to as high as 8.3 per cent in the US and to 7.4 per cent in the eurozone in April 2022. The Eurostat expects inflation at 8.1 per cent in May 2022 for the eurozone. For the UK, inflation reached 9.0 per cent in April 2022, a 40-year high.

9. Prices of energy commodities continued to rise through April and May. Brent crude oil prices exceeded $115 per barrel in May 2022. The Food and Agriculture Organisation (FAO) Food Price Index remained 29.8 per cent higher in April 2022 than a year earlier.

10. Central banks are wary of persisting inflation feeding into elevated inflation expectations and high inflation becoming more entrenched. Accordingly, many central banks have been raising interest rates to curb inflation expectations over the medium term.

11. The US Federal Reserve raised its policy interest rate further by 50 basis point in May 2022. The Bank of England has also hiked its policy rate by 25 basis points in May 2022. Responding to growing inflationary pressures, central banks in India and Brazil have also raised rates while the European Central Bank confirmed a forthcoming end to negative rates.

12. Altogether, some 138 interest rate increases by central banks have been observed since the beginning of 2022 to tackle high inflation, with the quantum of the hikes depending on the economic context and the inflation outlook.

Global growth

13. In light of these developments, the IMF, in its April 2022 World Economic Outlook, revised downwards its global growth projections by 1.3 percentage point to 3.6 per cent for 2022, relative to its October 2021 projections. The economic effects of the war were spreading mainly through the commodity markets, trade, and financial linkages.

Domestic Economic Developments

Inflation

14. I will now brief you on domestic developments.

15. Inflation dynamics in Mauritius have changed considerably with the effects of the Russia-Ukraine war on food and energy prices.

16. Inflation has picked up pace in March and April 2022, with price pressures sparked by higher food and fuel prices. Headline inflation went up to 7.0 per cent in April 2022, a level not seen since the Global Financial Crisis. Year-on-year inflation rose to 11.0 per cent. Core inflation measures have also gone up.

17. It is important to highlight that, despite the significant external price shocks, inflation in Mauritius remains below peaks reached during the 2008 Global Financial Crisis or even in the last two decades. It may be recalled that inflation attained a peak of 10.7 per cent in 2007.

18. I will elaborate on the inflation outlook when I share with you the decision of the MPC today.

Economic developments

19. The domestic economy continues to recover, with most key sectors contributing positively to growth. Several economic sectors have already attained pre-pandemic levels of activity.

20. The revival of the tourism industry in 2021Q4 had positive spill-over effects to other sectors of the economy and played a substantial role in sustaining consumer and business confidence. Relaxation of some of the sanitary measures in April 2022, facilitating access for inbound travellers, is expected to further support the tourism industry. The flight connectivity has also increased and will add to the positive outlook for the sector. Forward bookings for coming months are encouraging signs for the tourism industry and the economy.

21. Since the beginning of this year up to 31 May 2022, the country has welcomed around 330,000 tourists. In May 2022, a total of around 87,000 tourists visited Mauritius, well above the target set by the authorities. Gross tourism earnings

went up by around 30 per cent in March 2022 to Rs4.6 billion, from Rs3.6 billion in February 2022. The average length of stay has gone up further to 13.5 nights in 2022Q1, compared to around 10 nights during the pre-pandemic period. A significant rise of 73 per cent in average spending per tourist was noted in the first quarter of 2022, compared to the pre-pandemic period.

22. The manufacturing sector remains on a sustained recovery track. Operators in the textile sector have shown optimism, with strong order books and a re-routing of some activities to Mauritius. The outlook for other segments of the manufacturing sector has also improved.

23. Activity in the other key economic sectors – notably financial services, construction and information technology – are expected to be sustained this year and favourably impact economic growth.

24. The recovery in economic activity has improved labour market conditions. The unemployment rate fell to 8.1 per cent in 2021Q4, from 9.5 per cent in 2021Q3. Further favourable developments are expected in labour market conditions during 2022 as economic activity moves closer to pre-pandemic level.

External sector

25. With stronger performance of the export sector in 2022, the current account deficit is projected to narrow to around 12 per cent of GDP, from a revised estimate of 13.7 per cent of GDP in 2021. Financial flows are expected to strengthen as global economic activities pick up and investment increases. Financial flows – both GBC and non-GBC – are expected to continue strengthening and contribute to maintaining the balance of payments in surplus as in 2021.

Money market

26. I will now move on to money market developments.

27. The 15 basis points hike in the Key Repo Rate (KRR) at the March 2022 MPC meeting was well transmitted to market interest rates, both in terms of timeliness and magnitude. The Bank's current operating target – the 91-day Treasury Bill – adjusted by the same scale. It stayed at the lower bound of the interest rate corridor.

28. Excess liquidity in the banking system is closely managed to ensure that the monetary policy stance of the Bank is transmitted to market interest rates. The level of excess liquidity has fallen to an average of Rs25.8 billion in the period 1 April to 31 May 2022.

29. The outstanding Bank of Mauritius securities stood at Rs113 billion as at 31 May 2022, down from Rs129.5 billion as at 9 March 2022. Concurrently, foreign exchange interventions by the Bank absorbed a Rupee equivalent of around Rs15.6 billion.

Foreign exchange market

30. Activity on the FX market has gained further momentum, supported by greater dynamism in the export and tourism sectors.

31. FX inflows in the first five months of 2022 amounted to USD1.6 billion, an increase of 9.2 per cent compared to the last five months of 2021. Based on its regular interactions with economic operators, the Bank expects the inflow of FX to continue growing in coming quarters.

32. As conditions on the FX market improved, the Bank has reduced the frequency of its interventions. In the first five months of 2022, the Bank sold a total of US$337 million to the banking sector, compared to USD525 million in the corresponding period of 2021. As conditions improve, the STC is meeting part of its FX requirements from the market.

33. The evolution of the exchange rate continues to reflect domestic economic fundamentals as well as market conditions.

34. I have to highlight that the Bank is working on a new FX intervention strategy. As market conditions normalise, the Bank will move towards this new intervention framework which will focus on smoothing excessive volatility in the exchange rate.

35. This initiative is in line with modernising and introducing new frameworks at the Bank. You would recall in September 2020, I had announced that the Bank will work on its new monetary policy framework. In the same vein, we are now embarking on introducing a new framework for our FX intervention strategy.

36. The Gross Official International Reserves (GOIR) remains at a level sufficient to provide a buffer against adverse external conditions. The GOIR stood at US$7.1 billion as at end-May 2022, representing 14.5 months of imports.

Financial stability

37. I will now brief you on financial stability.

38. The banking sector remains sound and stable, supported by strong capital and liquidity buffers. The aggregate Capital Adequacy Ratio rose to 20.0 per cent in March 2022. The Liquidity Coverage Ratio (LCR) went up to 261.5 per cent in March 2022, well above the minimum regulatory limit of 100 per cent. The LCR in FX was 190.3 per cent, providing a buffer against external vulnerabilities.

39. The Bank is progressively unwinding the COVID-19 support measures, as economic recovery gathers momentum. This process is regularly discussed at meetings of the Task Force on Banking Sector Resilience. For instance, the Capital Conservation Buffer has been restored to 2.5 per cent with effect from 1 April 2022.

40. With respect to the moratorium on loans granted to economic operators, SMEs, households and individuals impacted by Covid-19, the banking sector has already embarked on a targeted approach instead of blanket approach in granting moratoriums to borrowers. Overall, the amount of credit facilities under moratorium and restructuring continues to decline.

41. Bank credit continued to flow to the private sector, expanding by an annual rate of 1.8 per cent in April 2022. Credit to households grew at a strong annual rate of 11.8 per cent, mostly driven by facilities allotted for residential property purposes. Bank credit to the corporate sector contracted by 3.9 per cent, primarily due to deleveraging by the *Accommodation and food service activities, Manufacturing* and *Construction* sectors.

42. The asset quality of banks remains sound and has been well sustained by the COVID-19 support measures. The ratio of non-performing loans to total loans was 4.9 per cent in March 2022, unchanged from the previous quarter.

MPC Decision

43. I will now elaborate on the decision of the MPC.

44. The MPC reviewed recent global economic developments and discussed their potential implications for the domestic economy. The global growth downgrade by the IMF in April 2022 and above-target inflation for many central banks could weigh on the domestic economic outlook.

45. Bank staff weighed the risks to the domestic growth outlook and maintained the growth projection for 2022 between 7 to 8 per cent. The target of 1,000,000 tourists visiting Mauritius, renewed export sector dynamism and favourable prospects for other key sectors are expected to support domestic economic activity.

46. The MPC concurred with the growth outlook, but recognised the downside risks due principally to the repercussions of the ongoing Russia-Ukraine conflict on our major trading partners, especially the Euro area.

47. The inflation trajectory will depend upon the evolving geopolitical situation and its impact on global commodity and fuel prices, supply chain disruptions, as well as freight and other input costs. Considering all these elements, Bank staff revised the forecast of headline inflation to around 8.6 per cent in 2022.

48. The MPC weighed the downside risk to the growth outlook versus the impact of persistently high inflation. The MPC unanimously agreed to pursue the normalisation of monetary policy to foster price stability over the medium term and create macroeconomic conditions conducive to sustaining growth. The withdrawal of accommodative monetary policy will concurrently contribute towards containing inflation expectations.

49. In the light of its deliberations and given the heightened risk to the inflation outlook, the MPC has today unanimously decided to raise the Key Repo Rate by 25 basis points to 2.25 per cent per annum.

50. The MPC agreed that the timing and pace of the further normalisation of the monetary policy stance would depend on the inflation and growth outlook over the policy horizon.

Cash Reserve Requirement

51. As part of the COVID-19 support measures, the Bank had reduced the Cash Reserves Requirement (CRR) on Rupee deposits in March 2020, from 9 per cent to 8 per cent. This reduction released liquidity that allowed banks to extend additional credit facilities to assist economic operators impacted by the pandemic.

52. In addition to the decision of the MPC today, the Bank has decided to restore the CRR on rupee deposits to 9 per cent effective 1 July 2022, as part of the

unwinding of its COVID-19 support measures. This measure is estimated to reduce the level of excess liquidity by around Rs5 billion.

New monetary policy framework

53. The consultation process on the new monetary policy framework is continuing. A series of discussions and working sessions are planned this month and next month with treasurers of banks in this respect.

54. One of the key features of the framework is the issuance of a 7-day Bank of Mauritius instrument to improve the transmission mechanism of monetary policy signals. This instrument will also help anchor short-term money market rates.

55. I am pleased to announce that, as a phased introduction of the new monetary policy framework, we will start the issuance of our 7-day instrument as from August 2022. The current operational target – the 91-Day Treasury Bill yield – will continue to be used until the full implementation of the new framework.

56. The next meeting of the MPC is scheduled in September 2022. The MPC will continue to monitor the economic situation closely and stands ready to meet in between regular meetings if the need arises and depending on the evolution of the situation.

57. I reiterate the commitment of the Bank of Mauritius to deliver on its mandate of maintaining price stability, promoting orderly and balanced economic development, whilst ensuring the stability and soundness of the financial system of Mauritius.

58. I thank you for your attention.