Press Statement by the Governor

Monetary Policy Committee Meeting - 9 March 2022

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

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

3. This year started with a brighter outlook for our economy, as the effects of the pandemic were gradually receding and key sectors of the economy were regaining dynamism. But the war between Russia and Ukraine is a new challenge that we have to cope with. This conflict brings new risks to global growth as well as pressures on global inflation. The MPC deliberated extensively on the potential implications of the war for the Mauritian economy.

4. I shall now provide you with an overview of the international and domestic economic developments which are having a bearing on inflation and growth outlook for 2022. The MPC has considered these elements to reach its decision on the monetary policy stance.

INTERNATIONAL ECONOMIC DEVELOPMENTS

5. I shall begin with the international economic developments.

6. Before the war between Russia and Ukraine unfolded, global recovery was already well under way. Countries were grappling with the pandemic with good progress made in the rollout of vaccination programmes globally, which helped support the positive momentum in economic activity. The war between Russia and Ukraine has now added layers of uncertainty to the global growth outlook. Although official figures are yet to be released, some high frequency indicators are pointing towards slower recovery at the start of 2022 based on the ongoing geopolitical tensions. Higher prices and shortages of inputs are also constraining global economic recovery.

7. The IMF, in its January 2022 World Economic Outlook (WEO) Update, estimated global economic growth at 4.4 per cent in 2022, a downgrade of 0.5 percentage points from its October 2021 projections, mainly on grounds of the withdrawal of accommodative monetary policy stances in many parts of the world and supply bottlenecks. However, these growth forecasts by the IMF do not factor in the latest geopolitical developments in Russia and Ukraine and, as such, may be subject to further downward revision. In its *Statement on the Economic Impact of War in Ukraine* released on 5 March 2022, the IMF has already indicated that the "*ongoing war and associated sanctions will also have severe impact on the global economy*."

8. With the new layers of uncertainty that the Russia-Ukraine war may pose to global recovery, the balance of risks to growth now appears to weigh relatively more on the downside while global inflation risks appear to be more entrenched. The path of the global economic recovery will also be dependent on the evolution of the pandemic. While improved health systems and vaccination programmes have enhanced various countries' capacity and preparedness in effectively tackling the challenges of the pandemic, the risk of further mutations of the virus prevails and may affect the pace of economic recovery further.

9. The near-term consequences of the Russia-Ukraine war are inevitably higher commodity and energy prices. The price of Brent crude oil reached an intra-day high of USD139.13 per barrel on 7 March, its highest since 2008, before settling down to USD129.5 per barrel as at close of business on 8 March. The price of gas is also expected to rise markedly due to the ongoing conflict. Food prices, as measured by the FAO Food Price Index, rose by around 5 per cent in February 2022 compared to December 2021. Shipping costs continue to remain elevated.

10. In its January 2022 WEO Update, the IMF had revised upward its inflation projections for both advanced economies and emerging market and developing economies (EMDEs). Inflation is expected to reach 3.9 per cent in advanced economies and 5.9 per cent in EMDEs in 2022, up by 1.6 percentage points and 1.0 percentage point, respectively, from the October 2021 forecasts. These inflation numbers will likely be higher after considering the impact of the war on commodity and energy prices. Inflation in several countries are at high levels already, such as at 7.8 per cent in the US, 5.4 per cent in the UK, 5.1 per cent in the Euro area and 5.8 per cent in India.

11. The Russia-Ukraine war is impacting on global financial markets as well. Equity markets have plunged over recent days. The VIX index, a measure of volatility in stock markets, has risen to a one-year high. A rush towards safe haven assets has also been noted over the past weeks. For instance, the price of gold reached an all-time high of USD2,070 an ounce on 8 March.

12. Prior to the war, many central banks have been tightening their monetary policy stance so as to stem inflationary pressures, which were expected to persist into 2022. These central banks include the Bank of England and the South African Reserve Bank. With the onset of the Russia-Ukraine war at the end of February 2022, some central banks may be inclined to adopt a more cautious stance in their approach towards policy rate hikes, with growing uncertainty to the growth outlook. Other central banks may continue focussing on containing inflationary pressures by pursuing the tightening of monetary policy. Several central banks have started or continued to hike interest rates even after the conflict began.

DOMESTIC ECONOMIC DEVELOPMENTS

13. The domestic economy remains on its recovery path. Policy support coupled with the vaccination programmes and deployment of booster doses continue to strengthen business and consumer confidence and to sustain aggregate demand.

14. The full reopening of national borders in October 2021 and the deployment of comprehensive health protocols to safely welcome vaccinated travellers in Mauritius have provided the much-needed impetus to the tourism sector. The revival of the tourism sector is having positive spillover effects on other sectors such as retail trade and construction.

15. The country has welcomed around 262,000 tourists since the full re-opening of borders up to end-February 2022. In February 2022, around 53,000 tourists visited Mauritius in line with what was targeted by the authorities. Average spending per tourist in the last quarter of 2021 has gone up by around 40 per cent compared to the pre-pandemic level. In addition, the average length of stay has increased to around 12 nights, from 10 nights during the pre-pandemic period. Forward bookings for the next three months are encouraging. France has upgraded Mauritius from the *'Orange list'* to the *'Green list'*, implying a lifting of all travel restrictions. This is expected to give further support to the sector, given the importance of France as a source country for the tourism industry in Mauritius. More recently, the full re-opening of travel between Reunion and Mauritius is expected to contribute positively to the tourism industry.

16. Moreover, it is important to underline that tourism remains a key pillar of the economy and is thus closely linked with its performance. It is, therefore, crucial to deploy additional efforts to ensure the good performance of the tourism sector and to achieve the objective of 1 million tourists in 2022.

17. The manufacturing sector is already showing positive signs. Orders continue to increase even though supply disruptions and labour shortages are still weighing on production capacity.

18. Other key economic sectors, notably financial services, construction and information technology are expected to gain further traction this year and continue to contribute positively to growth.

19. The external sector is expected to improve further this year with the current account deficit to GDP ratio projected to decline to around 12 per cent in 2022 compared to a revised estimate of 13.8 per cent in 2021.

INFLATION

20. Domestic inflation gathered momentum in January and February 2022 due to upward price pressures stemming from fuel prices and food products, in particular fresh vegetables. Headline inflation stood at 5.2 per cent in February 2022 and the year-on-year inflation was at 9.0 per cent.

21. I wish to underline that for monetary policy purposes, the Bank of Mauritius focusses on the headline inflation. The year-on-year inflation is more volatile and, as such, may not be a reliable indicator of sustained price pressures in the economy for the formulation of monetary policy.

22. Inflation in Mauritius continues to be influenced by supply-side disturbances emanating mostly from external sources, notably higher freight costs and rising prices of energy and of commodities. In line with global inflation developments, inflationary pressures in Mauritius in the short to medium terms will continue to be impacted by ongoing Russia-Ukraine war, global supply-chain disruptions and ongoing concerns over the Omicron variant. Domestic factors may also contribute to inflation. I will elaborate more on the inflation outlook for Mauritius when I wrap up on the MPC discussion today.

MONEY MARKET

23. Let me now move to an update on financial market developments.

24. The Bank has been managing the excess rupee liquidity situation in line with its monetary policy stance and to ensure that short-term yields remain within the interest rate corridor.

25. The Bank remains committed to pursue active liquidity management to ensure appropriate liquidity conditions as economic recovery gathers momentum. Since the last MPC in December 2021 to date, the Bank has issued securities aggregating Rs45 billion. Since the beginning of 2022, the Bank has issued a total of Rs29 billion securities. The level of excess liquidity was at Rs28.5 billion on 8 March 2022. Following active open market operations conducted by the Bank since January 2022, outstanding Bank of Mauritius securities attained an all-time high of Rs129.5 billion as at 4 March 2022.

FOREIGN EXCHANGE MARKET

26. Conditions on the FX market have been improving. The Bank has continued to conduct FX interventions to ensure adequate supply of FX on the market and to contain excessive exchange rate volatility.

27. Since the start of 2022, it has been noted that banks have been frequently purchasing more FX from the market than what they have been selling. Consequently, the Bank has been intervening at lower frequency and the aggregate amount of FX sold has gone down significantly. The Bank has sold a total of USD45 million to banks and a total amount of USD80.5 million to the State Trading Corporation. Since the beginning of the pandemic in March 2020, the Bank has sold an aggregate of USD2.8 billion to the market.

28. The gross official FX reserves of the country remained at comfortable levels, standing at around USD7.8 billion as at end-February 2022, representing 20 months of imports. The reserves have remained at a level that satisfies various stringent international adequacy assessment metrics, indicating that the current level of reserves is still adequate to shield the economy against external vulnerabilities.

29. The Bank remains committed to maintaining a floating exchange rate regime. The exchange rate will continue to reflect movements of major currencies in international markets as well as domestic market conditions.

FINANCIAL STABILITY

30. I will now brief you on financial stability, with specific focus the banking sector.

31. The banking sector continues to remain sound and stable, with strong capital and liquidity buffers. The aggregate Capital Adequacy Ratio and the Liquidity Coverage Ratio (LCR) were at 19.5 per cent and 247.7 per cent at the end of December 2021, respectively, well above the minimum regulatory limits. The LCR in FX was around 177.1 per cent, representing a buffer against external vulnerabilities.

32. Banks' robust buffers continue to sustain credit flows to the economy. The annual growth of bank credit to the private sector remained in positive territory at 0.6 per cent as at end-January 2022, compared to 4.2 per cent as at end-September 2021. Bank credit to the corporate sector registered an annual contraction of 3.8 per cent as at end-January 2022, mainly due to a 10.5 per cent drop in credit denominated in foreign currency while credit in terms of rupees remained sustained. The growth of bank credit to households reached a high of 8.3 per cent in January 2022, from 6.3 per cent in September 2021.

33. The Bank is continuously engaging with bankers, through the two Task Forces it established in 2020, to encourage them to extend further credit facilities to the corporate sector, specially in growth-enhancing and future-oriented sectors, such as renewable energy.

34. The asset quality of banks remains sound, though there was a rise in the ratio of non-performing loans to total loans to 4.9 per cent in December 2021, from 4.5 per cent in September 2021, mainly due to an increase in impaired credit in the global business sector. This ratio is still below the 5.0 per cent recorded in March 2021.

35. The extension of the moratoria and some of the COVID-19 relief measures up to June 2022 have continued to alleviate the financial burden of heavily-impacted borrowers by the pandemic. The total outstanding amount of loans to economic operators, SMEs, households and individuals which have been granted moratorium due to COVID-19 declined to stand at around Rs29 billion at end-December 2021, from Rs34 billion at end-September 2021.

36. The decline in the outstanding value of moratoria is a positive indication that the economic recovery is well under way. A further sign of recovery is the drop in the amount of restructured loans since December 2020. Businesses and households are in a better position to service their debts, reducing risks to financial stability.

37. The banking sector remained resilient despite the real economic shocks caused by the pandemic. The results of the latest stress test exercise, based on December 2021 data, indicate that the banking sector maintains adequate buffers to absorb plausible macroeconomic shocks. The financial stability implications of the ongoing Russia-Ukraine war are being closely monitored.

38. I wish to highlight that the Bank conducted a survey with all banks to assess their exposures to Russia and Ukraine. The results show that the direct exposure of the banking sector to these economies is not significant.

MPC DECISION

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

40. The MPC reviewed the latest developments taking place in the global economic landscape and assessed their potential impact on the domestic front. While the Russian-Ukraine war may affect cross-border trade and investment flows across countries, its impact on Mauritius will depend on the duration of the conflict and on its effects on our main trading partners.

41. The elevated level of uncertainty around the outlook for global growth and the implications of the war on tourism compelled Bank staff to evaluate various economic growth scenarios for Mauritius. Bank staff has projected growth to be between 7 to 8 per cent for 2022, depending on the number of tourist arrivals as well as the performance of the export sector. The MPC also noted that the war poses downside risks to the various growth scenarios.

42. The relative openness of the Mauritian economy and the fact that Mauritius imports a large proportion of what it consumes, mean that domestic price developments are affected by international events. As such, pandemic-related disturbances and the Russia-Ukraine war may result in higher freight costs and higher prices of energy, food and commodities. Global financial market developments, especially in currency markets, may result in higher volatility.

43. In addition to these external factors, domestic disturbances such as seasonal factors in influencing prices of fresh food items may weigh on inflation dynamics. The second-round impact of latest price increases, especially the recent hikes in retail petroleum prices, could sustain inflationary pressures during the year. Taking all potential factors into consideration, Bank staff estimate headline inflation at about 6.7 per cent for 2022, which is well above the past trends in inflation.

44. At today's meeting, the MPC has carefully assessed those international and domestic developments that are currently impacting and are likely to affect the growth and inflation outlook for 2022. The MPC weighed the downside risk to the domestic growth prospect and the upside risk to the inflation outlook over the short to the medium term.

45. The MPC acknowledged that monetary policy should continue to support economic recovery, but at the same time it should respond to growing inflationary pressures. The MPC agreed that the accommodative monetary policy stance should gradually and carefully be removed in order to continue to promote macroeconomic conditions conducive to sustained growth. In particular, members were of the view that the risk to the inflation outlook called for a gradual normalisation of monetary policy to foster price stability and anchor inflation expectations over the medium term, without slowing down economic recovery.

46. In the light of today's discussions and in the face of heightened risks to inflation while continuing to promote conducive macroeconomic conditions for economic recovery, the MPC has unanimously decided to raise the Key Repo Rate by 15 basis points to 2.00 per cent per annum.

47. The MPC has been and will remain cautious in its approach towards the normalisation of monetary policy. The timing and pace of the withdrawal of the accommodative monetary policy stance would depend on the assessment of the inflation and growth outlook over the policy horizon, given the high degree of uncertainty caused by the Russia-Ukraine war and the pandemic which is still disrupting global supply chains.

48. The next meeting of the MPC is scheduled in June 2022. The MPC will continue to monitor the economic situation closely and, therefore, stands ready to meet before June 2022 if the need arises and depending on the evolution of the situation.

49. As usual, I would like to 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.

50. I thank you for your attention.

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Port Louis
9 March 2022