BANK OF MAURITIUS

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Minutes of the 52nd Monetary Policy Committee Meeting held on 9 August 2019

The 52nd meeting of the Monetary Policy Committee (MPC) was held on Friday 9 August 2019 at 10:00 hours at the Bank of Mauritius and was chaired by Mr. Yandraduth Googoolye, Governor.

Members present: Dr Renganaden Padayachy (First Deputy Governor); Mr. Mahendra Vikramdass Punchoo (Second Deputy Governor); Mr. Lim Chan Kwong Lam Thuon Mine; Mr. Mohammad Mushtaq Namdarkhan; Dr Streevarsen Narrainen; Ms. Marie Rosy Priscilla Pattoo; and Professor Sanjeev Kumar Sobhee (External Members).

Summary of Staff Report on Economic and Financial Developments

The Bank's staff reported on economic and financial developments, which took place since the 51st MPC meeting held on 17 May 2019. The MPC also assessed staff's macroeconomic projections and evaluated risks to the domestic economic outlook.

Global economic and financial developments

1. **Bank staff briefed the MPC on the revised global growth projections, including those of the main trading partners of Mauritius.** Bank staff highlighted that the prospects for the world economy have softened further on account of the following: (i) increasing risks stemming from the ongoing global trade tensions between the two largest economies; (ii) rising uncertainties associated with Brexit and (iii) geopolitical tensions. Weaker manufacturing and trade activity in advanced economies, subdued investment and lower external demand in emerging economies weighed on global economic activity. The downward revision in global growth was mitigated somewhat by a better-than-expected performance of advanced economies, attributed mainly to solid US growth. However, economic conditions in some emerging and developing economies (EMDEs) continued to deteriorate.

2. **The major multilateral organisations have all scaled down their global growth projections for 2019 while expressing caution for 2020**. In its July 2019 World Economic Outlook Update, the IMF revised down global growth further for 2019 from 3.3 per cent to 3.2 per cent, half a percentage point lower compared to its October 2018 projections. It expected the global economy to recover to 3.5 per cent in 2020, on account of supportive financial market sentiment, further monetary policy accommodation, an abating of trade tensions and dissipating drags in the euro area. In the June 2019 issue of its Global Economic Prospects, the World Bank downgraded its global growth forecast for 2019, from 2.9 per cent to 2.6 per cent but projected global growth at 2.7 per cent for 2020. In its May 2019

Economic Outlook, the OECD set world growth at a below-trend rate of 3.2 per cent in 2019, down by 0.1 percentage point from its March 2019 projections. It, however, maintained global growth performance at 3.4 per cent for 2020. In its Mid-2019 World Economic Situation and Prospects published in May 2019, the UN expected the world economy to moderate to 2.7 per cent and 2.9 per cent in 2019 and 2020, down by 0.3 and 0.1 percentage point, respectively, from the January 2019 projections.

3. **Globally, inflation continued to be subdued and remained below major central banks' targets.** Core inflation has remained mild amidst broadly contained inflation expectations in major advanced economies. The following changes were observed in June 2019. Inflation in the US dropped to 1.6 per cent from 1.8 per cent in May 2019 amid cheaper gasoline and food prices. Inflation in the euro area settled at 1.3 per cent, thus staying below the 2 per cent level since November 2018. Inflation in the UK stood at 1.9 per cent and remained almost range bound since March 2019. From 2.3 per cent in March 2019, inflation in China increased to 2.7 per cent but remained low. In India, inflation rose from 7.7 per cent in March 2019 to 8.6 per cent in June, reflecting higher food prices. Overall, inflation remained broadly unchanged on an aggregated basis for the main trading partners of Mauritius.

4. **Crude oil prices have reversed course since the last MPC meeting, due to weakening demand, strong supply growth in the US and a build-up in global oil inventories.** Brent crude oil declined from US$71.6 per barrel in April 2019 to US$64.2 per barrel in July 2019. NYMEX WTI fell from US$63.9 per barrel in April 2019 to US$57.5 per barrel in July 2019. OPEC's extended agreement until 2020Q1; US sanctions on Iran's and Venezuela's crude oil exports; and Saudi Arabia's continued over-compliance with the existing OPEC's agreement supported oil prices.

5. **Amidst the fast-changing trade environment, international agricultural food commodity prices were broadly contained.** The FAO Food Price Index declined for a second consecutive month from 172.7 in June 2019 to 170.9 in July 2019, due to the lower prices of dairy products, cereals and sugar, which more than offset increases in the prices of meat and oil. The International Grains Council's Grains and Oilseed Index fell to 190 points in July 2019, from 193 points in June 2019, due to an increase in supply and higher competition for exports of grains. The April 2019 World Bank Commodity Markets Outlook projected prices of food commodities to decline by 2.6 per cent in 2019.

6. **Major advanced and EMDEs have been easing their monetary policy stances to support growth prospects amidst muted inflationary pressures.** With weakening global economic activity and the adverse impact of the trade tensions; and amidst soft business investment and contained inflationary pressures, the US Federal Reserve cut the Federal Funds rate by 25 basis points to a range of 2.00-2.25 per cent at its July 2019 meeting. The European Central Bank (ECB), at its July 2019 meeting, emphasised that a highly accommodative monetary policy stance for a prolonged period of time would be necessary given persistently below target inflation. The ECB expected interest rates to remain unchanged or lower until at least 2020H1 due to the risks to the euro area economic outlook and cited the need for new asset purchases. At its August 2019 MPC meeting, the Bank of England kept the Bank Rate unchanged at 0.75 per cent and voted to maintain its asset purchase target at £435 billion, despite higher downside risks to growth and the likelihood of a no-deal Brexit. In Brazil, South Africa, India, New Zealand and Philippines, amongst others, central banks also reduced their policy rates.

Domestic economic developments

7. **Domestic inflation dropped to levels last seen in 2016, reflecting the low global inflationary environment and the persistence of slack in the domestic economy.** Headline inflation continued its downtrend, while year-on-year (y-o-y) inflation exhibited its typical volatility but remained low. Headline inflation declined to 0.9 per cent in July 2019, 0.3 percentage point lower than in April 2019 while y-o-y inflation edged up to 0.8 per cent in July 2019, from 0.6 per cent in April 2019. The core inflation measures also declined. The 12-month average CORE1 inflation fell from 1.9 per cent in April 2019 to 1.3 per cent in July 2019 whereas CORE2 inflation dropped to 1.8 per cent, from 1.9 per cent.

8. **The domestic economy lost some momentum in 2019Q1, mainly due to weak performance of the manufacturing and tourism sectors**. Growth remained largely supported by continued strong performance of the construction and key services sectors. The 'construction' sector grew by a commendable 8.7 per cent, benefitting mostly from ongoing public infrastructure projects. Among the key services sectors, the 'information and communication' and 'financial and insurance activities' registered solid growth rates of 5.7 per cent and 5.0 per cent, respectively. Activity in the 'manufacturing' sector moderated amidst closure of some textile firms, registering a mild growth of 0.4 per cent. The 'textile' sub-sector contracted for the seventh consecutive quarter, by a further 7.5 per cent in 2019Q1 while the 'sugar' sub-sector rebounded by a positive growth rate of 7.5 per cent. The 'accommodation and food service activities' sector underperformed with a negative growth of 1.1 per cent, mainly explained by the substantial drop in tourist arrivals and earnings.

9. **In 2019Q1, investment activity was sustained; growth in final consumption spending moderated whereas net external demand faltered**. Gross Fixed Capital Formation grew by 8.3 per cent compared to 2.6 per cent in 2018Q1, backed by robust investment growth of 9.2 per cent and 6.4 per cent in '*Building and construction work*' and '*Machinery and equipment*', respectively. Growth in final consumption expenditure dropped to 3.2 per cent in 2019Q1, from 3.4 per cent in 2018Q1. Household consumption expenditure growth was almost flat at 3.3 per cent while general government consumption expenditure grew lower at 2.5 per cent. Exports of goods and services dropped by 3.1 per cent, owing to the contraction in exports of services of 8.3 per cent which more than offset the increase in exports of goods of 5.1 per cent. Imports of goods and services surged by 10.1 per cent.

10. **Preliminary estimates of the balance of payments pointed to a higher current account deficit in 2019Q1 relative to 2018Q1 that reflected a larger deficit on the goods account combined with a lower surplus on the services account**. The current account is estimated to have recorded a deficit of Rs5.0 billion (or 4.2 per cent of GDP) in 2019Q1 compared to Rs1.9 billion (or 1.7 per cent of GDP) in 2018Q1. The deficit on the goods account widened from Rs19.3 billion (or 17.1 per cent of GDP) in 2018Q1 to Rs24.4 billion (or 20.6 per cent of GDP) in 2019Q1. The services account posted a surplus of Rs7.4 billion in 2019Q1 compared to Rs10.4 billion in 2018Q1, mainly due to a lower net surplus on the 'travel' sub-account. Net surplus on the financial account, inclusive of reserve assets, was estimated at Rs8.4 billion in 2019Q1 compared to Rs3.5 billion in 2018Q1. The country recorded an overall balance of payments surplus of Rs7.4 billion in 2019Q1 compared to a surplus of Rs6.8 billion in 2018Q1.

11. **Between 2018Q1 and 2019Q1 the rise in employment outpaced the increase in the labour force**. The labour force expanded by 5,400 while employment rose by 6,000. As a result, the number of unemployed declined by 600, lowering the unemployment rate from 7.1 per cent in 2018Q1 to 6.9 per cent in 2019Q1. Wages grew at less than 3 per cent for the majority of sectors. Private sector wages rose at a faster pace of 4.9 per cent in 2019Q1, compared to 2.3 per cent for the public sector.

12. **The Bank continued its open market operations to contain excess liquidity and intervened on the domestic foreign exchange market**. Banks' average rupee excess liquidity rose to Rs12.5 billion between 17 May and 26 July 2019, from an average of Rs11.3 billion between 22 February and 16 May 2019. The Bank issued its own securities for a total amount of Rs37.6 billion while maturing BoM securities amounted to Rs30.6 billion. The Bank intervened on the domestic foreign exchange market to purchase a total of US$243.1 million[1], injecting an amount of Rs8.7 billion in the banking system, of which an amount of Rs4.8 billion was sterilised for a period of one year. The Bank also sterilised a total of Rs2.5 billion by way of 2-year Special Deposits. Short-term yields remained generally within the interest rate corridor of the operational framework for monetary policy.

13. **Movements in the rupee exchange rate reflected the evolution of major currencies on the international market and domestic demand and supply conditions.** On a nominal effective exchange rate basis, as gauged by MERI1, the rupee depreciated further by 1.3 per cent in June 2019 on a month-on-month (m-o-m) basis. On a real effective exchange rate basis, the rupee depreciated further by 0.8 per cent m-o-m in June 2019.

14. **Broad Money Liabilities (BML) continued to expand at a stable pace and both household and corporate deposits remained sustained.** The annual growth rate of BML remained unchanged at 6.4 per cent in June 2019, compared to March 2019. The contribution of rupee deposits in the y-o-y growth of BML increased from 2.4 percentage points in March 2019 to 3.6 percentage points in June 2019. Excluding foreign currency deposits, the y-o-y growth rate of BML rose from 5.2 per cent in March 2019 to 6.0 per cent in June 2019. Household deposits held with Depository Corporations went up by 1.9 per cent to Rs357 billion as at end-June 2019 compared to end-March 2019 and corporate deposits ticked up by 0.3 per cent to Rs158 billion.

Staff economic outlook

15. **With regard to factors that may influence the outcome of future inflation and real GDP growth in Mauritius, Bank staff have assumed that** the prices of domestic petroleum products will remain unchanged over the forecast horizon based on global projections of food and oil prices for the rest of 2019 and for 2020. The prices of other administered products are also expected to remain unchanged while the implementation of public sector infrastructure projects as per the Public Sector Investment Programme will continue as per the set target. Inflation expectations should remain broadly anchored.

[1] *Data up to 26 July 2019.*

16. **Headline inflation is expected to maintain its downtrend till the end of 2019**. Based on the assumption that the prices of fresh vegetables will continue to moderate in the near future and coupled with the downward adjustment in domestic petroleum prices in 2019Q2, the previously announced inflation projection of 1.5 per cent for 2019 has been revised down to about 0.5 per cent for 2019 and at about 1.5 per cent for 2020. The combination of a relatively weaker exchange rate pass-through to CPI and subdued imported inflation has contained domestic price pressures. On the demand side, the contribution of a negative output gap continues to weigh on prices. Staff view that the balance of risks to the inflation outlook appears marginally tilted on the downside in the absence of major supply shocks.

17. **The domestic economic growth momentum is anticipated to persist in 2019**. Positive domestic conditions continue to favourably influence domestic economic activity. The contribution of key sectors such as construction, financial and insurance activities, real estate activities and accommodation and food service activities to real GDP growth remains key to sustaining economic activity. The recently announced pro-growth fiscal measures, together with accommodative monetary policy stance are expected to sustain a conducive macroeconomic environment. The economic impetus arising from major infrastructure projects continues to positively support domestic output. At the sectoral level, domestic economic activity remains supported by the services sector, notwithstanding that the 'financial and insurance activities' sector is expected to moderate to 5.2 per cent and the 'accommodation and food service activities' sector will underperform. The dynamism in the 'construction' sector would be sustained, growing at around 8.5 per cent in 2019 owing to ongoing major infrastructure projects. Overall, the domestic economy continues to operate below its potential, albeit at a sectoral level, a few sectors have recently been operating below trend.

18. **Conditional on the set of assumptions outlined above, Bank staff have maintained real GDP growth rate of about 3.9 per cent in 2019 and around 4 per cent in 2020**. Amid protracted global uncertainty, the growth performance of our main trading partners may impact on external demand. Domestic sectoral issues can dent growth momentum if they remain unaddressed. Thus, the balance of risks for GDP growth appears to be tilted somewhat on the downside and the main events that could divert the evolution of real GDP growth from its baseline forecast are lower-than-expected global growth, due to weak economic activity in some of our major trading partners, among others. On the domestic front, the sectoral issues that could weigh on growth performance remain the challenges faced by the textile and sugar sectors, and lower growth in tourist arrivals. Private sector investment also remains a source of apprehension.

Monetary Policy Decision

19. **The MPC perceived that the global economic environment would remain fraught with uncertainty over the near-term and warranted careful monitoring.** The MPC remarked that global economic conditions have weakened since their last meeting. Mauritius, being a small open economy, is exposed to quite a significant extent to external developments. The slowdown in some of the largest emerging market economies also raised some worries. There was uncertainty about the prospects for a sustained recovery in the world economy, with important downside risks seen in the medium-term. It noted the recent monetary policy actions across the world and, in the current global economic environment, monetary policy in a number of advanced and EMDEs was loosening further. Concurrently,

the global inflation outlook was subdued as demand pressures and commodity prices remained under control.

20. **MPC Members viewed that domestic economic activity was expected to remain resilient in the short-term, despite a highly uncertain global economic environment**. Private consumption expenditure and public sector investment activity would remain supportive of aggregate demand. The MPC Members discussed the lower domestic GDP growth in 2019Q1 and the potential impact of slowing global demand on the domestic economy through the trade and confidence channels.

21. **The MPC viewed that inflation was currently being projected to remain low over a 12-to-18 months' horizon**. Members noted the continued downward trend in recent inflation outcomes and the moderation in inflation expectations. Demand side pressures remained subdued. Members also noted that central banks have been easing monetary policy to support their economies. The inflation outlook would, thus, provide room for a reduction in the policy rate as a pre-emptive move against the risks associated with weakening global growth.

22. **The MPC assessed the risks to the growth forecast to be almost balanced in the near-term but remained cautious on short-to-medium-term risks**. Members agreed that the implementation of prudent macroeconomic policies together with structural reforms that would raise potential growth would remain a priority. The benign inflation outlook would, thus, provide some space for policy action to reinforce domestic growth momentum.

23. **Out of the 8 MPC Members, 7 Members agreed that a reduction in the Key Repo Rate was warranted, reflecting on the need to support growth and business financing.** At the conclusion of the discussions, 6 Members voted to cut the Key Repo Rate by 15 basis points to 3.35 per cent per annum. One Member voted for a 25 basis points cut in the Key Repo Rate so as to consolidate the economy further. Members agreed that there was some room to adjust monetary policy to send the right signal to the market about the softer economic conditions abroad and their potential repercussions on the domestic economy and to promote balanced and orderly economic development. One Member opted to leave the Key Repo Rate unchanged. He underscored that domestic economic fundamentals were still resilient with robust consumption spending and the unemployment rate projected to decline further. He argued that Mauritius is a diversified economy and not all sectors were expected to perform strongly all the time. What matters was that overall, the economy was still growing at a solid pace. Interest rate policy cannot be used to address sectoral issues. Given that the estimated real output gap was close to zero amid looser real monetary conditions on account of the domestic currency depreciation since the last MPC Meeting in May 2019, it was not opportune to reduce the Key Repo Rate and if the KRR was indeed reduced, it could send confusing signals to the Market

Voting Pattern

24. **Voting for a cut of 15 basis points in the Key Repo Rate:** Mr. Yandraduth Googoolye; Dr Renganaden Padayachy; Mr. Mr. Lim Chan Kwong Lam Thuon Mine; Mr. Mohammad Mushtaq Namdarkhan; Dr Streevarsen Narrainen; and Professor Sanjeev Kumar Sobhee.

25. **Voting for a cut of 25 basis points in the Key Repo Rate:** Ms. Marie Rosy Priscilla Pattoo.

26. **Voting to keep the Key Repo Rate unchanged:** Mr. Mahendra Vikramdass Punchoo.

27. **The Committee stands ready to meet in between its regular meetings, if the need arises**.

28. **The next MPC meeting is scheduled on 20 November 2019.**

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.

When the MPC met on 9 August 2019, the last available data on national accounts, employment, external trade and balance of payments were for 2019Q1. The last data available on Consumer Price Index (CPI) and inflation were for July 2019.

Headline inflation is measured by the change in the average 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.

CORE2 inflation excludes food, beverages and tobacco, mortgage interest, energy prices and administered prices from the CPI basket.

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

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

GMTBs refer to Government of Mauritius Treasury Bills.