BANK OF MAURITIUS

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Minutes of the 48th Monetary Policy Committee Meeting held on 20 August 2018

The 48th meeting of the Monetary Policy Committee (MPC) was held on Monday 20 August 2018 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; Ms Marie Rosy Priscilla Pattoo; Mr Mohammad Mushtaq Namdarkhan; and Professor Sanjeev Kumar Sobhee (External Members).

Member absent with apologies: Dr Streevarsen Narrainen (External Member).

Summary of Staff Report on Economic and Financial Developments

The Bank's staff reported on economic and financial developments which took place since the 47th MPC meeting held on 30 May 2018.

Global economic and financial developments

1. **Global economic growth remains on track, although risks to the outlook had shifted to the downside.** The International Monetary Fund (IMF) left its global growth forecast for both 2018 and 2019 unchanged at 3.9 per cent in its July 2018 World Economic Outlook Update. While economic growth in advanced economies would be broadly unchanged at 2.4 per cent in 2018 compared to their 2017 level; real output of Emerging Market and Developing Economies (EMDEs) would rise to 4.9 per cent in 2018. The IMF noted that world growth was becoming less synchronised, with diverging growth path between the US, on the one hand, and Europe and Japan, on the other. Even among EMDEs, such differences were being noticed.

2. **Major survey indicators had pointed to a moderation of economic activity in July 2018.** The J.P.Morgan Global All-Industry Output Index, a lead indicator for global output, declined to a four-month low of 53.7 in July 2018, from 54.2 in June 2018. Manufacturing sector activity growth has steadily declined throughout 2018, reaching a one-year-low in July 2018, while growth in the global services sector decelerated in July 2018 after increases for three months in a row.

3. **Global inflation gradually increased due to higher global energy prices, but has yet to return to its pre-crisis level.** Core inflation measures continued to remain subdued. The July 2018 WEO Update projects consumer prices to rise to 2.2 per cent in advanced economies and 4.4 per cent in EMDEs in 2018.

4. **Crude oil prices declined further in July 2018 on account of higher production.** ICE Brent dropped from US$77.0 per barrel in May 2018 to US$75.9 per barrel in June 2018 and, further, to US$75.0 per barrel in July 2018. While US oil production neared record levels, OPEC's production also increased to meet for the shortfall from reduced Iranian exports.

5. **Global agricultural commodity and grains prices also went down in July 2018 due to excess supply.** The Food and Agriculture Organisation's Food Price Index dropped by 6.5 index points to 168.8 in July 2018. All of its sub-indices declined, with the highest fall registered in dairy, followed by sugar and cereals. Besides over-production, food prices have been affected by heightened trade tensions.

6. **After the US Federal Reserve System (US Fed), the Bank of England became the second major central bank to raise interest rates in August 2018.** At its June meeting, the US Fed increased its benchmark rate by 25 basis points to 1.75-2.00 per cent and hinted at two additional hikes by the end of 2018. At its meeting of 2 August 2018, the Bank of England voted to hike the benchmark rate by 25 basis points to 0.75 per cent, while keeping its asset purchase target at £435 billion. The European Central Bank was expected to end its massive bond purchase scheme by year-end and to keep interest rates unchanged well into 2019.

Domestic economic developments

7. **The domestic economy advanced at a higher year-on-year pace of 3.6 per cent in 2018Q1 compared to 2017Q4, supported by almost all sectors and by domestic demand.** Final consumption expenditure was sustained, with a strong acceleration in government consumption expenditure. However, investment contracted in 2018Q1, reflecting lower expenditure on machinery and equipment. Net exports remained a drag on growth. On the supply side, the services and construction sectors remained the key drivers of growth in 2018Q1. Statistics Mauritius has maintained its projected GDP growth rate at market prices at 3.9 per cent for 2018.

8. **Domestic inflation receded after the adverse shocks to food prices subsided and the downward adjustment in the prices of some administered goods.** Headline inflation dropped to 4.0 per cent in July 2018, from 5.0 per cent in April 2018. Year-on-year inflation slowed to 1.0 per cent in June 2018, mostly due to the sequential decline in fresh food prices before rising to 1.7 per cent in July partly reflecting unfavourable base effects. Core measures, both on a 12-month average and year-on-year basis, have remained broadly contained below 3.0 per cent.

9. **Labour market conditions have continued to improve.** Year-on-year, employment increased for the sixth consecutive quarter in 2018Q1, pushing the unemployment rate down to 7.1 per cent. In 2018, the unemployment rate is expected to decline to 6.9 per cent, falling below the 7.0 per cent mark for the first time since 2001.

10. **The current account deficit was projected to narrow from 6.6 per cent of GDP in 2017 to 5.7 per cent of GDP in 2018, reflecting improving services and income account surpluses despite a further deterioration of the deficit on the goods account**. This worsening in the

goods account was projected to result from higher oil prices as well as higher imports meant for infrastructure projects. The services account was expected to post a higher surplus, benefitting principally from the positive momentum in the tourism sector. The capital and financial flows in 2018 was projected to be more than adequate to finance the current account deficit, thereby resulting in an estimated balance of payments surplus of Rs29 billion in 2018 compared to Rs26 billion in 2017.

11. **On both a nominal and real effective exchange rate basis, the rupee depreciated in 2018Q2.** On a nominal effective exchange rate basis, as measured by MERI1, the rupee depreciated by about 1.4 per cent in 2018Q2 after an appreciation of 0.6 per cent in 2018Q1. On a real effective exchange rate basis, the rupee reversed its appreciation of 2018Q1 in 2018Q2.

12. **Broad money supply continued to expand at a robust pace of 9.4 per cent in June 2018, from 9.1 per cent in March 2018.** Growth of bank credit to the private sector also gained momentum, rising by 9.0 per cent in June 2018, up from 8.0 per cent in March 2018, supported by corporate credit, benefitting from demand from Financial and Business Services, Construction and Tourism sectors. Mortgage credit continued to drive the growth in household credit.

13. **The Bank maintained its open market operations so as to remove the structural excess liquidity from the system and bring money market rates in line with the policy rate, i.e. the Key Repo Rate (KRR), besides conducting sterilised foreign exchange intervention**. Whilst liquidity over and above the cash reserve ratio requirement fluctuated between Rs8-9 billion in the first semester of 2018, it was estimated that a large part of this liquidity represented voluntary reserves kept by banks. The evolution of the 91-day Bill yield could be viewed as a measure of the efficiency of the Bank's open market operations to implement its monetary policy stance. Since the low of 1.65 per cent in October 2017, the yield on the 91-day Bill had consistently risen to 3.41 per cent at the end of February 2018. Thereafter, the Bank had successfully been able to manage liquidity in the system to keep the 91-day Bill yield at a level consistent with the monetary policy stance, hovering close to the KRR.

14. **The banking sector remained buttressed by strong capital positions, with an aggregate capital adequacy ratio of 17.2 per cent as at end-June 2018.** Both Tier 1 capital and CET 1 capital were almost unchanged at 16.3 per cent and 15.6 per cent, respectively. Banks had also been building up their Capital Conservation Buffers, which rose by Rs2.6 billion. As at end-March 2018, asset quality improved compared to a year ago. The gross non-performing loan ratio hovered at around 6.7 per cent, somewhat lower compared to end-March 2017.

Staff economic outlook

15. **Bank staff have lowered inflation projections for 2018, reflecting the combined disinflationary impulses arising out of normalising fresh food prices and downward adjustment in the prices of some administered goods.** Headline inflation was being projected at 3.5 per cent in 2018, instead of a previous estimate of 4.2 per cent. For 2019, it was forecast at 3.0 per cent.

16. **Domestic growth momentum was expected to remain sustained over the medium term amid current accommodative monetary and fiscal conditions.** Bank staff had kept projections of real GDP growth at market prices at about 4.0 per cent in both 2018 and 2019. The implementation of key public investment projects remained on track and was projected to give a fillip to domestic output over the projection horizon. Other factors supporting growth were robust performances of a number of sectors, buoyant household and corporate credit, favourable adjustments to the income tax brackets of the middle-income group as well as the continued implementation of the negative income tax.

Monetary Policy Decision

17. **MPC members discussed international economic and financial developments and observed that the global economic outlook was subject to rising uncertainty.** Indicators of growth such as PMIs had decreased during 2018Q2 and tightening of financial conditions were expected to weigh on growth further ahead. Trade frictions had been weighing on investment. Brexit remained a concern with looming uncertainty on whether the UK and EU could sort out their future economic and financial relationships by March 2019. Chinese growth also slipped, echoing the impact of the deleveraging campaign on infrastructure investment.

18. **Members viewed that the performance of the domestic economy was sustained and the forecasts for the Mauritian economy were broadly unchanged.** Pro-growth budgetary measures, household consumption and capital spending on infrastructural projects had been supporting growth. Business conditions remained positive. They opined that the domestic economy's outlook had not changed materially since the May 2018 MPC meeting. The outlook on the domestic economy remains quite upbeat, taking into account that the economy is operating with some spare capacity. The unemployment rate remained on a downtrend. They highlighted that domestic inflation was under control and would move within a tolerable range in the near term in the absence of adverse supply shocks.

19. **The MPC remarked that, since climbing within the corridor of the KRR in February 2018, short-term money market rates generally hovered in tight range and close to the KRR.** The Bank kept its commitment to the market that it would undertake open market operations as required to achieve the desired monetary policy stance. The restored credibility of the Bank with regard to the implementation of monetary policy was expected to reinforce the monetary policy transmission mechanism.

Voting Pattern

20. **After their deliberations and analysing various economic scenarios, members unanimously voted to keep the KRR unchanged at 3.50 per cent per annum.** The MPC weighed the risks to the growth and inflation outlook and concluded that the current monetary policy stance was supporting growth in an environment where inflationary pressures were contained. The Bank's monetary policy operations had stabilised the short-term interest rates around the KRR.

21. The Committee will continue to exercise vigilance should there be a resurgence of inflationary pressures in the economy and stands ready to meet in between its regular meetings, if the need arises.

22. The next MPC meeting is scheduled on 9 November 2018.

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 20 August 2018, the last available data on national accounts, employment and external trade were for 2018Q1. The last data available on Consumer Price Index (CPI) and inflation were for July 2018.

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.