BANK OF MAURITIUS

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Minutes of the 42nd Monetary Policy Committee Meeting held on 20 February 2017

The 42nd meeting of the Monetary Policy Committee (MPC) was held on Monday 20 February 2017 at 10:30 hours at the Bank of Mauritius and was chaired by Mr. Rameswurlall Basant Roi GCSK, Governor.

Members present: Mr. Yandraduth Googoolye (First Deputy Governor); Mr. Mahendra Vikramdass Punchoo (Second Deputy Governor); Mr. Pierre Dinan, Mr. Mohammad Mushtaq Namdarkhan, Dr Streevarsen Narrainen and Mr. Guy Wong So (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 41st MPC meeting held on 10 November 2016.

Global economic and financial developments

1. **The MPC noted that growth in major advanced economies would likely strengthen in 2017.** The IMF's World Economic Outlook Update released in January 2017 kept global growth forecasts for 2017 and 2018 unchanged from projections made in October 2016. Global economic growth would be expected to increase from 3.1 per cent in 2016 to 3.4 per cent in 2017 and further to 3.6 per cent in 2018. Growth projections have been upgraded for the US, Germany, Japan, Spain and UK. Emerging Market and Developing Economies (EMDEs) are also forecast to record an increase in real activity as macroeconomic conditions revert to normal in a number of large economies currently under stress. Growth for the EMDEs is forecast to increase from 4.1 per cent in 2016 to 4.5 per cent in 2017, and further to 4.8 per cent in 2018.

2. **Global inflationary pressures are expected to be relatively stronger in 2017, partly reflecting the recent increases in commodity prices.** Inflation in advanced economies is forecast to increase from 0.7 per cent in 2016 to 1.7 per cent in 2017. Inflation in EMDEs is projected to remain unchanged at 4.5 per cent in 2017.

3. **Commodity prices have firmed up somewhat since the November 2016 MPC meeting, mostly on account of supply considerations.** The uptick in oil prices reflected, amongst others, the agreement between the 14 member countries of Organisation of Petroleum Exporting Countries to curtail oil production, for the first time since 2008, to 32.5 million barrels a day. The monthly average oil price of NYMEX WTI gradually increased from US$46.1 per barrel in November 2016 to US$52.6 per barrel in January 2017. The price of ICE Brent also rose from US$47.4 per barrel to US$55.4 per

barrel over the same period. The rebound in the Food and Agriculture Organisation's Food Price Index in January 2017 reflected the surge in international sugar quotations and sharp increases in export prices of cereals as well as vegetable oils. Meat and dairy markets remained more or less stable.

4. **Since the last MPC meeting, which was held in November 2016, global stock markets posted healthy gains as equities rose following supportive investor sentiment, amongst others.** US equity markets hit record highs as the newly elected US President indicated that he would spend massively on infrastructure and streamline business regulations.

5. **The US dollar strengthened against major currencies, amidst the rise in US Treasury yields which posted their largest gains in more than five years and expectations of an expansionary fiscal policy in the US, which would trigger higher inflation**. The US dollar's strength took a toll on the euro, which was also influenced by widening interest rate differentials, expectations of lingering accommodative monetary policy, and political uncertainty in the euro area. The currencies of main commodity exporters strengthened amid an increase in commodity prices.

Domestic economic developments

6. **Real GDP growth was strong in 16Q3, well-supported by domestic demand and is estimated to have kept the same momentum in 16Q4**. On a y-o-y basis, Real GDP expanded by 4.0 per cent y-o-y in 16Q3, higher than the 2.5 per cent and 2.8 per cent growth rate recorded in 16Q2 and 15Q3, respectively. The build-up in growth momentum was also reflected in the seasonally-adjusted q-o-q growth rate, which rose by 3.1 per cent in 16Q3 as against a decline of 0.4 per cent in 16Q2. Domestic economic growth is posited to increase in 2017, with major sectors registering positive growth. Statistics Mauritius expects real GDP growth to pick up to 3.8 per cent in 2017, from 3.6 per cent in 2016. The main assumptions underpinning the higher growth rate are strong rebound in building and construction activities, higher sugar output and a further increase in tourist arrivals.

7. **Domestic inflation has remained contained at relatively low levels, thanks to muted domestic demand pressures and the absence of major supply shocks.** Headline inflation edged up to 1.1 per cent in January 2017. The various other inflation measures also remained at moderate levels, reflecting transient price pressures in some selected products, coupled with favourable base effects. Inflation expectations assessed in the Bank's November 2016 Survey stayed skewed to the downside and were consistent with the prevailing low headline inflation.

8. **Labour market conditions deteriorated somewhat during 16Q3, with a rise in the unemployment rate**. The unemployment rate rose from 7.4 per cent in 15Q3 to 7.6 per cent in 16Q3 and the seasonally-adjusted rate went up from 7.6 per cent to 7.8 per cent. Nonetheless, the unemployment rate is estimated at 7.4 per cent in 2016, down from 7.9 per cent in 2015.

9. **The wage rate index (WRI) continued to increase at the expense of productivity gains**. Between 16Q2 and 16Q3, the WRI rose by 1.0 per cent but compared to 15Q3, it went up by 5.3 per cent. This nominal increase largely exceeded the y-o-y inflation rate over the same period.

10. **Preliminary data on Mauritius' balance of payments for 16Q3 pointed to a widening of the current account deficit, albeit lower in 2016 compared to 2015.** The current account deficit increased from about 6.2 per cent of GDP in 15Q3 to about 6.4 per cent of GDP in 16Q3. The deepening of the current account deficit chiefly reflected the broadening of the deficit on the goods account, from 15.5 per cent of GDP to 17.6 per cent of GDP, resulting from a decline in exports of goods. Y-o-y, exports of goods fell by 12.6 per cent in 16Q3, while imports (f.o.b.) rose marginally by 0.1 per cent. For the year 2016, the current account deficit is forecast at about 4.2 per cent of GDP, lower than the 5.0 per cent of GDP estimated for 2015. The current account deficit has been estimated at 4.2 per cent of GDP for 2017.

11. **The rupee remained influenced by movements of major currencies on the international markets and by domestic demand and supply conditions, but was accompanied by relatively less volatility**. During 16Q4, the rupee was broadly stable, appreciating by 0.9 per cent on a nominal effective exchange rate basis and by 0.2 per cent on a real effective exchange rate basis.

12. **The Bank pursued its effort to contain the level of excess liquidity with the conduct of active open market operations.** Excess reserves gradually rose from Rs4.5 billion on 10 November 2016 to peak at Rs17.4 billion on 26 January 2017 but dropped to Rs6.9 billion on 14 February 2017 partly due to the issue of the Bank's own instruments. As at close of business on 17 February 2017, total outstanding instruments issued for liquidity management were nearly Rs59 billion.

13. **The level of excess reserves influenced heavily the movements of yields of securities issued at auctions**. The weighted yield for the 91-Day Bills dropped from 2.55 per cent on 11 November 2016 to 1.82 per cent on 10 February 2017; that on 182-Day Bills declined from 2.71 per cent to 2.18 per cent and that on 364-Day Bills fell from 2.82 per cent to 2.18 per cent. Broadly, a similar decline was noted for medium- and long-term securities.

14. **Broad money supply maintained a healthy pace of expansion since the last MPC meeting in contrast to private sector credit growth which remained subdued**. The annual growth rate of Broad Money Liabilities (BML) increased from 8.9 per cent in September 2016 to 9.1 per cent in December 2016 backed by positive contributions of 4.6 percentage points in net foreign assets and of 3.8 percentage points in domestic credit. BML was supported chiefly by its most liquid components. The annual growth rate of banks' credit to the private sector (excluding credit to GBC entities) fell from 2.1 per cent in September 2016 to -0.2 per cent in December 2016, reflecting on-going deleveraging by the corporate sector.

15. **As at end-September 2016, the banking sector remained sound and well-capitalised, while the ratio of non-performing loans (NPL) to total loans was unchanged for the third quarter running.** The aggregate capital adequacy ratio stood at 17.4 per cent as at end-September 2016, marginally down from 17.5 per cent as at end-June 2016, mostly reflecting a rise in total risk-weighted assets held in banks' portfolio. The ratio of NPL to total loans remained unchanged at 7.1 per cent, for the third consecutive quarter, as at end-September 2016.

Staff economic outlook

16. **Bank staff have estimated that, based on current domestic and global economic conditions, headline inflation is expected to remain moderate in the near term.** Headline inflation is projected at around 2.5 per cent for calendar year 2017. The uptick in international commodity prices, especially energy prices, if persistent, would remain the key upside risk to domestic inflation.

17. **Bank staff forecast that domestic economic growth is projected to sustain momentum in 2017.** Supportive monetary conditions, rising business confidence and considerable public investment programmes are expected to back domestic output in 2017. Overall, Bank staff have maintained domestic output growth projection for 2017 ranging between 3.8 per cent and 4.0 per cent. Nonetheless, headwinds to domestic growth prospects still prevail, as the materialisation of the real GDP growth forecasts depends much on the implementation of announced public investment projects.

Monetary Policy Decision

18. **The Chairperson noted that there had not been a marked departure from economic and financial developments since the November 2016 MPC meeting.** Domestic monetary conditions remained broadly stable and the economy performed above trend in 16Q3. The economy was expected to have had an improved performance in 16Q4. The Bank was somewhat aggressive since the beginning of the year in its effort to bring down the level of excess liquidity in the banking system and issued BoM securities as part of open market operations. The Chairman viewed that the rising business confidence would comfort investor optimism and expected the kick-off in public sector investment programmes to support the domestic growth momentum. In addition, the banking sector remained safe and resilient.

19. **Members commented on export performance and emerging trends in the banking sector.** In particular, they highlighted the importance of export receipts for financing the current account deficit and took note of Government's decision to set up a Ministerial committee to look into the challenges pertaining to the export sector. They also requested vigilance in monitoring domestic price developments given the potential uptick in global inflation.

20. **The MPC took note of the measures taken by the Bank to bring down the level of excess liquidity in the banking system to tolerable limits.** In this respect, members viewed that the Bank should continue its efforts to achieve the necessary conditions prior to the implementation of the new monetary policy framework for an effective transmission of monetary policy to the real sector of the economy.

21. **On the external front, the MPC noted that there might be downside risks to global growth as the external environment continued to be characterised by heightened risks and uncertainties.** Downside risks to global growth could emanate from the policy stance of the new US administration and its global consequences and the sequencing of UK-EU Brexit negotiations.

22. **The MPC viewed that holding the Key Repo Rate unchanged was consistent with domestic economic conditions in the foreseeable future**. Members argued that maintaining the current policy stance would support domestic economic growth effort.

Voting Pattern

23. **At the conclusion of the discussions, the Committee unanimously voted to keep the Key Repo Rate unchanged at 4.00 per cent per annum**.

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

25. **The next MPC meeting is scheduled on Friday 5 May 2017**.

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 February 2017, the last available data on national accounts, employment and external trade were for 16Q3. The last data available on CPI and inflation were for January 2017.

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.

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

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

GMTBs refer to Government of Mauritius Treasury Bills.