BANK OF MAURITIUS

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Minutes of the 46th Monetary Policy Committee Meeting held on 28 February 2018

The 46th meeting of the Monetary Policy Committee (MPC) was held on Wednesday 28 February 2018 at 10:30 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. 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 45th MPC meeting held on 29 November 2017.

Global economic and financial developments

1. **Global growth has continued to strengthen and is currently at its highest since 2010.** The IMF, in its January 2018 World Economic Outlook (WEO) Update, estimated world output to have grown by 3.7 per cent in 2017, 0.5 percentage point higher than in 2016. Forecasts for world growth for 2018 and 2019 have been revised further up by 0.2 percentage point to 3.9 per cent, respectively. Economic recovery is becoming more balanced, with higher activity noted in both advanced and developing economies. Advanced economies are projected to grow by 2.3 per cent and 2.2 per cent in 2018 and 2019, respectively. Emerging Market and Developing Economies (EMDEs) are forecast to record higher growth of 4.9 per cent in 2018 and 5.0 per cent in 2019.

2. **Survey indicators have been pointing towards sustained global growth momentum.** The Global Purchasing Managers' all-industry output index, leading global output indicators, has increased to a 40 months' high in January 2018. The recent movements in the index are also broadly in line with indications of an on-going broad-based and synchronised global economic recovery. Manufacturers and service providers are expected to gain from the upswing in global market conditions.

3. **Global inflation increased in 2017H2 due to higher global energy prices, but remained contained while inflation expectations have been well anchored.** The WEO Update projects consumer prices to rise in advanced economies, from 1.7 per cent in 2017 to 1.9 per cent in 2018 due to further increases in energy prices. Inflation in EMDEs is forecast to rise from 4.1 per cent in 2017 to 4.5 per cent in 2018, owing to inflationary impulses arising from both demand and supply.

4. **Oil prices have moved higher, due to OPEC's agreement to extend production cuts until the end of 2018, declines in US crude oil inventories and geopolitical tensions in the Middle East**. The monthly average oil price of NYMEX WTI gradually rose from US$56.7 per barrel in November 2017 to US$57.9 per barrel in December 2017 and further to US$63.7 per barrel in January 2018. Prices, however, declined to US$61.9 per barrel in February 2018[1].

5. **Reflecting favourable supply conditions, food prices maintained a downtrend.** The FAO Food Price Index retreated from 175.7 in November 2017 to 169.5 in January 2018, easing pressure on food commodities' prices. Grains prices ticked up mildly, with the International Grains Council's Grains and Oilseed Index rising by 0.3 per cent, from 193.1 to 193.7, while good supply conditions would keep prices stable.

6. **Equity prices dipped in the first week of February 2018 amid a global equity sell-off but recovered somewhat later.** Fears of rising inflation and higher interest rates brought about a rebalancing of portfolio by investors. Though markets have recouped some losses, they remain subject to bouts of volatility. On a point-to-point basis, between 29 November 2017 and 20 February 2018, the MSCI World and MSCI Emerging Markets indices were higher by 2.9 per cent and 4.7 per cent, respectively.

7. **The US Federal Reserve System increased interest rates by 25 basis points in December 2017, while other major central banks maintained their monetary policy stances unchanged.** The US Fed signaled that it could hike the Federal funds rate at its March 2018 meeting, keeping its forecast for three additional rate increases in 2018. The ECB kept its benchmark refinancing rate unchanged at zero per cent and confirmed that it intended to run its monthly asset purchase programme of EUR30 billion until the end of September 2018. However, the ECB saw the strength of the euro and its implications for inflation as impeding its path out of its massive stimulus programme. The Bank of England kept its policy rate constant at 0.5 per cent but announced that the bank rate could increase, if the economy were to maintain its robust growth.

Domestic economic developments

8. **The domestic economy posted a commendable growth performance in 2017Q3, well supported by investment activity.** Real GDP grew by 3.6 per cent in 2017Q3, following growth of 3.7 per cent in 2016Q3. On a quarter-on-quarter seasonally-adjusted basis, real GDP increased by 1.5 per cent in 2017Q3, up from 1.0 per cent in the previous quarter. Gross fixed capital formation expanded by 6.3 per cent in 2017Q3, compared to 9.8 per cent in 2016Q3. Consumption expenditure was up by 2.8 per cent in 2017Q3, compared to 2.6 per cent in 2016Q3. Economic activity was supported by all key sectors of the economy, including manufacturing, accommodation and food service activities, distributive trade, financial and insurance services and construction. Statistics Mauritius projects real GDP at market prices to grow by 4.0 per cent in 2018, with the improvement in domestic demand that should benefit the different sectors of the economy.

[1] *Average from 1 February to 20 February 2018.*

9. **Both headline and year-on-year (y-o-y) inflation increased in January 2018, largely reflecting the spike in prices of vegetables that resulted from adverse climatic conditions**. Y-o-y inflation rose from 3.5 per cent in October 2017 to 6.2 per cent in January 2018 while headline inflation went up from 3.4 per cent to 4.0 per cent over the same period. However, underlying inflation measures remained somewhat contained. CORE1 and CORE2 inflation measures were confined within a range of 2.0 per cent and 2.9 per cent. CORE2, which excludes food, beverages, tobacco, mortgage interest, energy prices and administered prices from the CPI basket, has been broadly stable and contained over the past 2 years.

10. **Survey indicators showed that both business and consumer optimism have increased**. Car registration, an important consumption indicator, was buoyant in 2017 and exceeded expectations. The abridged financial statements of a majority of companies listed on the Stock Exchange of Mauritius pointed to higher profits before tax in 2017Q4 compared to 2016Q4.

11. **Labour market conditions improved in 2017Q3, with further decline in the unemployment rate.** Employment rose by 6,100 between 2016Q3 and 2017Q3, more than offsetting the increase in the labour force by 2,300, thereby reducing the number of unemployed by 3,800. The unemployment rate decreased from 7.6 per cent in 2016Q3 to 7.0 per cent in 2017Q3. On a seasonally-adjusted basis, the unemployment rate dropped from 7.8 per cent to 7.2 per cent. The unemployment rate for 2017 is expected to fall to 7.1 per cent, from 7.3 per cent in 2016.

12. **The wage rate index increased during 2017Q3 and is projected to remain firm due to the introduction of the minimum wage.** The index rose from 103.2 in 2017Q2 to 104.2 in 2017Q3, as almost all industry groups registered higher wages, with the exception of 'human health and social work activities'. The highest increase was noted in the 'agriculture, forestry and fishing' sector due to higher wages and regular allowances paid in the crop season which falls mainly in the third quarter of the year.

13. **The current account deficit worsened in 2017, both in absolute terms and as a percentage to GDP, hit by adverse performance of exports of goods and deteriorating terms of trade.** The current account deficit has been estimated at Rs26.7 billion (or 5.8 per cent of GDP) in 2017 compared to Rs19.7 billion (or 4.5 per cent of GDP) in 2016. The deficit on the goods account widened from Rs72.8 billion in 2016 to Rs88.6 billion in 2017, reflecting largely the combination of higher imports and lower exports of goods. The services account surplus is expected to rise from Rs27.2 billion in 2016 to Rs27.8 billion in 2017 and the income account surplus from Rs35.8 billion to Rs42.5 billion. The capital and financial account, inclusive of reserve assets, recorded net inflows estimated at Rs23.5 billion in 2017 compared to net inflows of Rs21.8 billion a year ago.

14. **As a result of the Bank's active open market operations, the rupee excess liquidity declined and money market rates moved within the corridor of the Key Repo Rate (KRR).** Rupee excess liquidity, which averaged Rs8.0 billion in November 2017, increased to Rs11.2 billion in December 2017, mostly due to seasonal considerations, but dropped to Rs7.7 billion between 1 and 19 February 2018. These were reflected in the increase in yields on T-Bills which moved within the corridor of the KRR in early December 2017 and have, since, crept closer to the KRR. Yields on T-

Bills auctions gained 1.42, 1.31 and 1.35 percentage points, on the 91-Day, 182-Day and 364-Day tenors, respectively, since the last MPC meeting to stand at 3.41 per cent, 3.35 per cent and 3.49 per cent, respectively, as at 23 February 2018. The overnight interbank rate also increased over the period under review and was equally within the corridor of the KRR.

15. **Broad money growth remained expansionary while private sector credit growth continued its recovery.** The annual growth rate of Broad Money Liabilities increased from 8.8 per cent in October 2017 to 9.3 per cent in December 2017. Y-o-y, bank credit to the private sector expanded by 8.0 per cent in December 2017, up from 5.7 per cent in October 2017.

16. **The banking sector remains sound and adequately capitalised, while asset quality of banks improved.** The aggregate capital adequacy ratio (CAR) stood at 17.6 per cent as at end-December 2017, up from 17.5 per cent as at end-December 2016. The improvement in the overall CAR is explained by an increase of the capital base due to further strengthening of Tier 1 capital. The ratio of non-performing loans (NPLs) to total loans fell to 6.2 per cent as at end-December 2017, from 6.8 per cent as at end-December 2016, led by lower NPL ratios both in and outside Mauritius. Banks' coverage of NPLs, measured by the ratio of specific provisions to impaired credit, stood comfortably at 49.7 per cent as at end-December 2017, up from 48.8 per cent a year earlier.

Staff economic outlook

17. **Conditional on the absence of supply shocks and assuming no future increases in domestic petroleum prices, Bank staff project headline inflation at about 4.0 per cent in 2018 and 3.7 per cent in 2019.** Supply shocks reflecting the impact of adverse climatic conditions would influence domestic prices during 2018Q1. The transitory shocks to the CPI are, however, expected to dissipate over the coming months. The headline inflation forecast for 2018 has been revised up, mostly on account of the supply disruptions to the production of fresh vegetables following adverse climatic conditions during January and February 2018. The introduction of negative income tax and minimum wage policy are not expected to generate inflationary impulses, given that the economy continues to operate below its potential.

18. **Bank staff have lowered their forecasts for real GDP growth at market prices to 4.0 per cent for 2018 and expect growth at 4.2 per cent for 2019.** The impact of adverse climatic conditions during the first two months of the year and delay in a couple of infrastructure projects would weigh on the domestic growth performance. As a result, growth projections have been scaled down. Accommodative monetary conditions, favourable business conditions, and timely implementation of public and private investment projects, amongst others, are expected to support the domestic growth momentum.

Monetary Policy Decision

19. **The Chairperson remarked that adverse climatic factors have directly affected domestic agricultural output and indirectly some economic activities**. Inflationary pressures crept in because of a fall in the supply of fresh vegetables caused by weather-related events. Consequently, the CPI rose by 3.0 index points in January 2018, of which fresh vegetables accounted for slightly over two-third of the net increase. Based on past trends, the prices of vegetables are expected to adjust back to their market levels by 2018Q2. With regards to domestic growth performance for 2018, he noted that some delays in the implementation of public infrastructural projects would impact on the growth outcome.

20. **The Chairperson pointed out that, since December 2017, the Bank has been aggressive in its conduct of open market operations, which culminated in money market rates drifting within the corridor of the KRR.** The Bank has been issuing its own securities with the intention to address the excess liquidity issue in the banking system. These operations also had the added objective to align money market rates with the policy rate. The weekly issuance of BoM Bills was increased to a range of Rs1.8-2.5 billion in February 2018 so as to mop up excess liquidity. Accordingly, rupee excess liquidity was contained and concentrated within a few banks. The Bank's operations brought about an increase in the overnight interbank rates, which moved closer to the KRR.

21. **The Governor mentioned that the Bank would be monitoring developments on the interbank money market as well as the 91-Day Bills yields till the next MPC meeting.** The Bank would assess whether the rates, which have moved, within the corridor of the KRR, are sustainable or not. The Bank would then formalise the choice of the operational target.

22. **Members of the MPC reviewed recent macroeconomic developments abroad and assessed their implications for the Mauritian economy.** They noted that the global economic recovery remained firm. In particular, GDP data confirmed higher economic activity in major trading partner economies of Mauritius. Favourable economic conditions supported by improving labour market conditions and rising business confidence continued to underpin growth in major advanced and emerging economies.

23. **With regards to price developments in the world economy, members remarked that despite the global recovery, inflation abroad remained moderate and core inflation in many developed economies was still subdued**. They observed that oil prices had increased recently, mainly due to reductions in output and inventories of oil, and rising demand emanating from recovery in global economic growth.

24. **While discussing the developments in the domestic economy, MPC members viewed that the economy has delivered a commendable broad-based performance in 2017, accompanied by a balanced structure of economic growth**. It was highlighted that growth remained driven by domestic demand, including consumer demand, supported by rising employment and wages, and higher business and consumer confidence. However, the performance of exports of goods remained a cause for concern, given the deepening trade deficit and its implications for the balance of payments.

25. **While analysing inflationary developments, members pointed out that CORE2 inflation had remained broadly stable and contained**. The majority of members were of the opinion that inflationary pressures remained rather limited, while one member, in the light of the recent inflation outcome and of its impact on deposit interest rates, considered that the time had come to start normalising interest rates. The majority of the members judged that, based on available information, inflation in the near term would be rather moderate, in the absence of major supply shocks. The current inflation rate reflected supply disruptions and once production of fresh vegetables would normalise, their prices would reverse course and induce dampening pressures on the CPI. They argued that the policy rate should remain unchanged, as its current level would keep the economy on a sustainable growth path and maintain macroeconomic stability.

Voting Pattern

26. **At the conclusion of the discussions, and after considering various economic scenarios and policy options, the Committee voted with a majority of 6 to 1 to keep the KRR unchanged at 3.50 per cent per annum.** The dissenting member voted to increase the KRR by 25 basis points. Mr. Yandraduth Googoolye, Dr Renganaden Padayachy, Mr. Mahendra Vikramdass Punchoo, Mr. Mohammad Mushtaq Namdarkhan, Dr Streevarsen Narrainen and Mr. Guy Wong So voted to leave the KRR unchanged, while Mr. Pierre Dinan voted to increase the KRR by 25 basis points due to expected higher inflation outturn and impending changes in the accommodative monetary policy stances abroad.

27. **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**.

28. **The next MPC meeting is scheduled on 18 May 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 28 February 2018, the last available data on national accounts, employment and external trade were for 2017Q3. The last data available on Consumer Price Index (CPI) and inflation were for January 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.

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

GMTBs refer to Government of Mauritius Treasury Bills.