BANK OF MAURITIUS

Released on 22 July 2020

Minutes of the 56th Monetary Policy Committee Meeting held on 8 July 2020

The 56th meeting of the Monetary Policy Committee (MPC), which was chaired by Governor Harvesh Kumar Seegolam, was held on Wednesday 8 July 2020 at 10:30 hours at the Bank of Mauritius.

Members present: Mr. Mardayah Kona Yerukunondu (First Deputy Governor); Mrs. Hemlata Sadhna Sewraj-Gopal (Second Deputy Governor); Mr. Lim Chan Kwong Lam Thuon Mine; Mr. Mohammad Mushtaq Namdarkhan; Dr Streevarsen Narrainen; Professor Sanjeev Kumar Sobhee; and Mrs. Christine Marie Isabelle Sauzier (External Members).

Summary of Staff Report on Economic and Financial Developments

The MPC was briefed by Bank staff on international and domestic economic developments that took place since the 55th MPC meeting held on Thursday 16 April 2020. The MPC took note of staff's macroeconomic projections and assessed risks to the domestic economic outlook.

Global economic and financial developments

1. **Bank staff reported that the global economic landscape remained fraught with uncertainty as countries continued to be subject to the adverse effects of the COVID-19 pandemic.** The unprecedented shock to the global economy has led several multilateral organisations (e.g. IMF, World Bank and the OECD) to revise down their initial growth projections for 2020. The IMF, in its June 2020 update to the World Economic Outlook, has downgraded most countries' growth forecast for 2020. It has projected that global growth could contract by 4.9 per cent in 2020, compared to its projection of -3.0 per cent made in April 2020 forecast.

2. **Volatility in international financial markets soared to record highs through March 2020 amid the impact of COVID-19 pandemic and global oil-price war.** Volatility in US stocks, as measured by VIX, peaked at 82.7 on 16 March 2020 before declining over subsequent weeks. Following a periodic respite, VIX increased amid growing fears of a second wave of COVID-19 and a gloomy economic outlook projected by the US Fed.

3. **Crude oil prices rebounded strongly from their low levels of April 2020, as market fundamentals improved significantly following the adverse demand shock created by the pandemic.** Crude oil prices dropped sharply in April 2020 as oil inventories increased considerably. However, additional production cuts in May and June 2020 by the Organisation of the Petroleum Exporting

Countries reversed this trend. With the gradual lifting of national confinement measures across major economies, oil demand prospects improved and contributed positively to oil prices, which crossed the US$40/barrel mark in early June. By end-June 2020, concerns over a resurgence in COVID-19 cases that may undermine fuel demand, capped gains in oil prices.

4. **Prices of major food commodities declined, induced by demand shock-related to the pandemic.** The FAO Food Price Index declined to 162.5 in May 2020, from 165.6 in April 2020, as all except its sugar sub-indices dropped. The fall reflected lower demand from out-of-home consumption linked to the confinement measures imposed by many countries, and lower demand from ethanol producers due to the steep fall in crude oil prices. The International Grains Council's Grains and Oilseed Index fell to 186.9 points in May 2020, down from 189.2 points in April 2020, driven by declines in most of the sub-indices.

5. **Weaker domestic demand arising from national lockdowns and low commodity prices pushed global inflation down.** In the US, inflation fell to 0.1 per cent in May 2020 after remaining above the US Fed's target rate of 2.0 per cent from November 2019 to February 2020. The fall in prices was attributed to lower demand for transport, energy, apparel and airline fares. Inflation in the UK fell from 1.8 per cent in January 2020 to 0.5 per cent in May 2020 amid falling prices for fuel and various recreational services. In the Euro area, inflation dropped to 0.1 per cent in May 2020, its lowest since June 2016, on the back of subdued energy prices. In China, inflation moderated to 2.4 per cent in May 2020, after recording a high of 5.4 per cent in January 2020, mostly on account of lower food prices.

6. **To counter the impact of the COVID-19 pandemic, central banks have taken decisive actions to support the economy.** Since January 2020, most central banks in advanced and emerging economies have lowered their interest rates and up till 30 June 2020, 153 rate cuts were noted. The US Fed reduced its policy rate twice in March 2020 to 0.00-0.25 per cent. The Governing Council of the European Central Bank decided to keep key policy rates unchanged at its March, April and June 2020 meetings and launched a €1,350 billion pandemic emergency purchase programme that aimed to lower borrowing costs and increase lending in the euro area. The Bank of England also applied two rate cuts at its two MPC meetings in March 2020, bringing the Bank Rate to 0.10 per cent.

Domestic economic developments

7. **Reflecting the seasonal hike in the prices of vegetables, coupled with concerns over the supply of necessities during the confinement period, headline inflation went up but y-o-y inflation was rather volatile.** Y-o-y inflation rose systematically from 2.0 per cent in January 2020 to 4.2 per cent in April 2020, before declining to 1.7 per cent in June 2020. On the other hand, headline inflation rose consistently from 0.6 per cent in January 2020 to 1.8 per cent in June 2020.

8. **The economy is estimated to have contracted in 2020Q1, recording the steepest pace of contraction in GDP since 2009Q1**. Real GDP shrank by 1.4 per cent in 2020Q1, mainly reflecting the adverse impact of measures taken to contain the spread of COVID-19, including the imposition of the national confinement. On a q-o-q seasonally-adjusted basis, real GDP contracted by 3.6 per cent compared to a growth of 1.5 per cent in the previous quarter. On the expenditure side, domestic demand

and exports of goods and services recorded sharp declines. On the supply side, economic activity in major sectors experienced a sharp downshift in 2020Q1. The closure of borders and national confinement ultimately affected business activity, tourism and consumer spending. Growth in the *'manufacturing'* sector remained in negative territory, while the *'construction'* sector also contracted, mainly reflecting the halt in activities during the lockdown.

9. **Labour market conditions deteriorated in 2020Q1, reflecting a pick-up in the unemployment rate.** The y-o-y increase in the labour force (+5,400) outweighed the rise in employment (+3,900). As a result, the number of unemployed rose by 1,500, which translated into a higher unemployment rate of 7.1 per cent. The seasonally-adjusted unemployment rate stood at 6.6 per cent and the activity rate at 59.2 per cent of the working age population in 2020Q1. In 2020, significant uncertainty is expected to prevail in the labour market due to the economic fallout of the COVID-19 pandemic.

10. **Preliminary estimates for Mauritius of the balance of payments for 2020Q1 have pointed to a higher current account deficit relative to 2019Q1, emanating from lower surpluses on the services and primary income accounts**. As a ratio to GDP, the current account deficit has been estimated at about 4.2 per cent in 2020Q1 compared to 3.2 per cent in 2019Q1. The external sector outlook for 2020 remains grim with the considerable decline in tourist earnings amidst travel restrictions, and expected lower surplus on the income account. As a ratio to GDP, the current account deficit is projected to widen from 5.5 per cent in 2019 to 13.5 per cent in 2020.

11. **The rupee exchange rate moved in tandem with developments on the global foreign exchange market as well as domestic demand and supply conditions.** On a nominal effective exchange rate basis, MERI1 shed 0.8 per cent m-o-m in May 2020 compared to an average depreciation of 2.2 per cent over the last three months. On a real effective exchange rate basis, the rupee lost ground for the third successive month.

12. **Broad money supply gained further momentum since the April 2020 MPC meeting, reflecting ample liquidity in the banking system.** Broad Money Liabilities grew by 13.5 per cent y-o-y in May 2020, up from 8.9 per cent in January 2020, partly reflecting accommodative monetary policy measures. Y-o-y, bank loans to the private sector lost some momentum in May 2020 compared to February 2020, driven by lower expansion in bank lending to households.

Staff economic outlook

13. **Risks to global growth are fully tilted to the downside while the full economic impact of COVID-19 remains uncertain at this juncture.** Global financial conditions have tightened in recent months with significant bouts of volatility. Major stock markets have seen increasing sell-offs and many Emerging Market and Developing Economies (EMDEs) have witnessed a depreciation of their currencies. If such conditions persist or intensify further, the tightening of financial conditions, especially in EMDEs, could cause adverse spillovers that would exacerbate the current weaknesses in the real economy. The global economic environment also remains susceptible to risks that were present before the outbreak of COVID-19, including lingering trade disputes and Brexit.

14. **Global inflationary pressures were expected to remain contained even though major central banks are dramatically boosting the size of their balance sheets to support economic activity.** Demand has fallen substantially and most economies were expected to face significant output gaps over the medium term. Thus, it is not likely that there would be pressure on prices due to excess demand. Moreover, once the crisis ends, central banks are expected to reverse the monetary easing as they did after the global financial crisis. The significant decline in the prices of oil and other commodities would also keep a lid on inflation. Brent crude oil prices are projected to average US$37 a barrel during the second half of 2020 and rise to an average of US$48 a barrel in 2021. In addition, higher unemployment would likely lead to downward pressure on wages and prices.

15. **In Mauritius, inflationary pressures have been projected to remain contained in 2020.** While prices of fresh vegetables have been subject to significant increases during the confinement period, they are expected to normalise and decline because of excess supply. In addition, the negative output gap is expected to keep inflation muted. In the absence of exogenous shocks, headline inflation is forecast at 2.5 per cent in 2020. For 2021, barring major economic shocks, headline inflation is forecast at around 2 per cent.

16. **The COVID-19 pandemic has led to severe deterioration in global economic conditions, with serious ramifications for the Mauritian economy.** While the tourism and manufacturing sectors would be most affected, other sectors would not remain unscathed even though the magnitude of the effect would vary across sectors. On the expenditure side, consumption and investment would likely remain subdued. The baseline projection is for real GDP to contract by 12.5 per cent in 2020, on expectations of a synchronised slowdown in both external and domestic demand. For 2021, however, the economy is expected to rebound to a positive growth of around 7.0 per cent.

Monetary Policy Decision

17. **MPC Members have noted that domestic economic activity has been impacted by the lockdown and that the macroeconomic impact of the pandemic would be considerable.** They commented on the extent of prevailing uncertainty over the outcome of the pandemic. The Mauritian economy, in particular key sectors such as tourism and manufacturing, is already being buffeted by the pandemic. The MPC discussed the implications of the pandemic on the domestic economy and the previous cumulative 150 basis points cut in the Key Repo Rate. Members viewed that the cuts were still working through the economy. Moreover, they noted that household consumption and private investment would remain subdued in 2020.

18. **MPC Members also discussed about the implications of low interest rates on the economy and the need to keep policy buffers**. They also noted that domestic inflation has remained low and stable and is projected to remain broadly contained, barring exogenous shocks. The low interest rate environment was expected to support the domestic economic growth and development agenda. Members agreed that there may be a paradigm shift in the way monetary policy has been operating and discussed on the role of monetary policy, including unorthodox measures taken to support the economy during the health crisis.

19. Members agreed that the current monetary policy stance was deemed appropriate as it would help to revive growth and mitigate the impact of COVID-19 on the economy,

Voting Pattern

20. At the conclusion of the discussions, the Committee unanimously voted to maintain the Key Repo Rate unchanged at 1.85 per cent per annum.

21. The next MPC meeting is scheduled on Wednesday 23 September 2020.

22. The MPC maintains its vigilance in monitoring the economic situation and stands ready to meet in between its regular meetings, if the need arises.

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 8 July 2020, the last available data on national accounts, employment, external trade and balance of payments were for 2020Q1. The last data available on Consumer Price Index (CPI) and inflation were for June 2020.

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.

M-o-m refers to month-on-month.