BANK OF MAURITIUS

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Minutes of the 43rd Monetary Policy Committee Meeting held on 5 May 2017

The 43rd meeting of the Monetary Policy Committee (MPC) was held on Friday 5 May 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 42nd MPC meeting held on 20 February 2017.

Global economic and financial developments

1. **The MPC noted that major international institutions like the IMF, World Bank and OECD, were projecting a brighter outlook for global economic growth in 2017 and 2018.** The April 2017 IMF's World Economic Outlook forecasts global growth to pick up from 3.1 per cent in 2016 to 3.5 per cent in 2017 and further to 3.6 per cent in 2018. The IMF's more optimistic outlook reflects the improved performance of advanced economies, which are expected to grow from 1.7 per cent in 2016 to 2.0 per cent in 2017. Emerging market and developing economies (EMDEs) would also support the global growth momentum and are projected to record an increase in real activity from 4.1 per cent in 2016 to 4.5 per cent in 2017.

2. **Global consumer and producer price inflation rates had begun an uptrend, reflecting higher commodity prices.** Inflation in advanced economies is forecast to increase from 0.8 per cent in 2016 to 2.0 per cent in 2017, mirroring a rise in energy prices and lowering of the output gap. Inflation in EMDEs is expected to increase from 4.4 per cent in 2016 to 4.7 per cent in 2017.

3. **Movements in oil prices have been somewhat mixed since the start of 2017.** OPEC's decision towards the end of 2016 to curtail oil production sent oil prices higher in January and February 2017, but concerns over whether this would restore balance in an oversupplied market sent prices down in March 2017. The monthly average oil price of NYMEX WTI gradually rose from US$52.2 per barrel in December 2016 to US$52.6 per barrel in January 2017 and further to US$53.5 per barrel in February 2017, but dropped to US$49.7 in March 2017. The FAO Food Price Index more or less mirrored the trend in oil prices, mostly on account of supply factors.

4. **Global trade growth is projected to recover from 2.2 per cent in 2016 to 3.8 per cent in 2017, reflecting a pick-up in trade flows for both advanced economies and EMDEs.** The volume of goods and services traded by advanced economies is forecast to increase in 2017 amid a pick-up in economic activity in these economies. Trade for EMDEs is also expected to accelerate, supported by an expected rebound in demand for imports from large EMDEs.

5. **Global stock markets were quite volatile since the last MPC meeting, but did not post any marked gain.** US stock markets were supported by upbeat economic data and an unexpectedly less hawkish stance on monetary policy by the US Fed. European equity markets remained strongly linked to the performance of American peers.

6. **The US dollar retreated after the US Fed rate guidance proved to be less hawkish than anticipated.** Lower prospects for the proposed US fiscal stimulus in the wake of the failure to approve a key healthcare reform bill also took a toll on the US dollar. The euro gained ground against the US dollar after some European Central Bank policymakers raised the possibility of tightening monetary policy before the end of the bond purchase programme. The Pound sterling strengthened against a broadly weaker US dollar after the British Prime Minister surprisingly decided to call for an early general election scheduled for 8 June 2017.

Domestic economic developments

7. **The domestic economy recovered in the second half of 2016 after moderate growth in the first two quarters, driven mainly by on-going support from domestic demand and better performance of the manufacturing and construction sectors.** Real GDP advanced by 4.1 per cent y-o-y in 16Q4, up from 3.7 per cent and 3.8 per cent in 16Q3 and 15Q4, respectively. The domestic economy is projected to grow faster at a close-to-trend rate in 2017. Statistics Mauritius expects GDP growth to pick up to 3.8 per cent in 2017, from 3.5 per cent in 2016.

8. **Domestic inflation remained low notwithstanding the upward dynamics in headline inflation, from 1.0 per cent in December 2016 to 1.3 per cent in March 2017.** Y-o-y inflation dropped from 2.3 per cent in December 2016 to 1.3 per cent in March 2017, reflecting somewhat volatility in the prices of some products. Both core and variously defined inflation measures remained subdued. However, the import price index rose during 16Q4 and warrants monitoring. Inflation expectations assessed in the Bank's February 2017 Survey remained broadly anchored in line with the prevailing low headline inflation.

9. **Labour market conditions improved during 16Q4, with a significant drop in the unemployment rate**. The unemployment rate fell from 7.9 per cent in 15Q4 to 6.6 per cent in 16Q4 and the seasonally-adjusted rate went down from 8.6 per cent to 7.3 per cent. The unemployment rate has been estimated at 7.3 per cent in 2016, down from 7.9 per cent in 2015.

10. **The wage rate index (WRI) continued to increase.** Between 15Q4 and 16Q4, the WRI rose by 5.4 per cent, gaining 7.0 points. This change was driven mainly by increasing wages in sectors such as public administration, education, financial activities and manufacturing. The increase in the WRI outpaced inflation rate by more than 5 times.

11. **Preliminary data on Mauritius' balance of payments for 16Q4 indicate a deterioration in the external current account deficit.** The current account deficit almost doubled from about 2.1 per cent of GDP in 15Q4 to about 3.9 per cent of GDP in 16Q4. The deepening of the current account deficit resulted from a higher deficit on the goods account, which was partly offset by a higher surplus on the services account. The country is projected to record a lower current account deficit of 4.3 per cent of GDP in 2016 compared to 5.0 per cent in 2015, due to a lower goods account deficit and a higher surplus on the services account.

12. **The rupee continued to reflect the outcome of movements of major currencies in international markets, as well as domestic demand and supply conditions, but remained broadly stable in nominal effective exchange rate terms.** On a real effective basis, however, the rupee was somewhat on an appreciating path in 17Q1.

13. **The Bank maintained its open market operations to absorb the excess liquidity in the system.** Excess reserves peaked at Rs13.6 billion on 25 April 2017 and total outstanding instruments issued for liquidity management purposes stood at Rs64.5 billion as at 3 May 2017.

14. **The annual growth rate of Broad Money Liabilities increased from 9.1 per cent in December 2016 to 9.6 per cent in March 2017.** The annual growth rate of bank credit to the private sector (excluding credit to the GBC sector) remained weak.

15. **As at end-December 2016, the banking sector remained adequately capitalized and the ratio of non-performing loans (NPL) to total loans declined from 7.1 per cent as at end-September 2016 to 6.8 per cent as at end-December 2016.** The aggregate capital adequacy ratio maintained by banks fell to 17.5 per cent as at end-December 2016, from 17.9 per cent as at end-December 2015, mostly reflecting a higher increase in risk-weighted assets.

16. **The MPC was also briefed about the Forecasting and Policy Analysis System (FPAS), used by the Bank for assessing macroeconomic conditions and for projecting real GDP growth and inflation.** The FPAS process is predominantly based on a description of the transmission mechanism of the two main instruments: the interest rate and the exchange rate, to the rest of the economy and to inflation. It is based around a forward-looking New-Keynesian structural forecasting model, which provides for consistency in macroeconomic forecasts. The model is complemented by a range of short-term forecasting tools.

Staff economic outlook

17. **Bank staff have estimated that headline inflation is expected to rise moderately from its current level but would remain low in 2017, barring exceptional shocks.** The headline inflation forecast for 2017 has been lowered to around 2.0 per cent, as compared to the previous forecast of 2.5 per cent, on account of the absence of food price shock in 17Q1 and the unanticipated stabilisation of global oil prices over the projection horizon.

18. **Bank staff maintain their real GDP growth projections in the range of 3.8 to 4.0 per cent for 2017.** Domestic economic growth is expected to remain sustained in 2017, dependent on the implementation of public and private investment projects. Accommodative monetary conditions and business optimism as revealed in private sector confidence surveys are expected to support

domestic economic activity over the forecast horizon. However, downside risks to growth would include, inter alia, delays in launching public investment projects, longer-than-expected corporate deleveraging, rising protectionism, declining productivity trends and geopolitical tensions.

Monetary Policy Decision

19. **The Chairperson mentioned that domestic macroeconomic conditions have little changed since the last MPC meeting, while external conditions have brightened somewhat despite political and policy uncertainties.** Global growth projections have been scaled upwards and the outlook remains positive for the near term. While global trade growth is projected to be higher in 2017, its growth rate would remain short of global GDP growth. The domestic economy performed better in 16Q4 and is expected to keep pace in 2017. However, it is imperative that various public sector investment programmes are adequately and timely implemented. The current account deficit is projected to deteriorate in 2017 due to a higher deficit in the goods account. Domestic inflationary pressures have remained contained so far, and there do not appear to be any significant build-up in underlying inflationary pressures. The nominal and real effective exchange rates of the rupee have remained broadly stable since the last MPC meeting.

20. **Members reviewed domestic economic conditions and remained concerned with the export performance.** They also discussed lengthily on the implications of rising wage growth and labour productivity in the economy.

21. **The MPC reviewed the level of excess liquidity in the banking sector and considered the measures taken by the Bank to be appropriate.** Members noted that the Bank would pursue its efforts to bring down the level of excess liquidity to a tolerable level prior to the implementation of the new monetary policy framework.

22. **On the external front, the MPC noted that the global economic environment would continue to remain fraught with uncertainty over the near term.** Downside risks to global growth could emanate from a number of factors, namely potential slowdown in global trade flows, tighter global financial conditions and heightened geopolitical strains. Mauritius, being a small open economy, is exposed to quite a significant extent to external developments. Strengthening macroeconomic fundamentals and reducing imbalances remain a primary concern.

23. **The MPC viewed that leaving the Key Repo Rate unchanged at 4.00 per cent was consistent with domestic economic conditions in the foreseeable future and that monetary conditions remain accommodative**. The current policy stance remain conducive to economic growth amid a low inflation environment.

Voting Pattern

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

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

26. **The next MPC meeting is scheduled on 6 September 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 5 May 2017, the last available data on national accounts, employment and external trade were for 16Q4. The last data available on CPI and inflation were for March 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.