BANK OF MAURITIUS

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Minutes of the 49th Monetary Policy Committee Meeting held on 09 November 2018

The 49th meeting of the Monetary Policy Committee (MPC) was held on Friday 09 November 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); Dr Streevarsen Narrainen; Mr Lim Chan Kwong Lam Thuon Mine; Ms Marie Rosy Priscilla Pattoo; Mr Mohammad Mushtaq Namdarkhan; and Professor Sanjeev Kumar Sobhee (External Members).

Summary of Staff Report on Economic and Financial Developments

The Bank's staff reported on economic and financial developments since the 48th MPC meeting, which was held on 20 August 2018.

Global economic and financial developments

1. **Both the IMF and the OECD had downgraded global growth forecasts since the last MPC meeting and noted that growth was turning more asynchronous and diverging across major economies.** In its October 2018 World Economic Outlook (WEO), the IMF revised down its growth projection for 2018 by 0.2 percentage point to 3.7 per cent, reflecting moderation in activities in advanced economies and economic turbulences in some Emerging Market and Developing Economies (EMDEs), arising notably from higher financial market pressures, escalating trade tensions and higher energy costs. The OECD, in its September 2018 Interim Economic Outlook, downgraded the global growth projection for 2018 by 0.1 percentage point from its May 2018 forecast, to 3.7 per cent. Both institutions pointed to the possibility that global economic growth might have attained its highest level.

2. **Survey indicators of economic activity had been hinting that the pace of global economic activity could be decelerating.** J.P.Morgan's Global All-Industry Output Index, a lead indicator for global output, dropped to a two-year low of 52.8 in September 2018, from 53.7 in July 2018. Manufacturing sector activity would also appear to be growing at a slower pace. J.P. Morgan's Global Manufacturing PMI had fallen to a 22-month low of 52.2 in September 2018, from a peak of 54.5 in December 2017. Growth in the global services sector also eased to a two-year low of 53.0 in September 2018.

3. **Global inflation had, so far, remained broadly subdued and almost in line with targets**. The October 2018 WEO was projecting inflation in advanced economies to drop from 2.0 per cent in 2018 to

1.9 per cent in 2019, while for EMDEs, inflation is forecast to rise from 5.0 per cent in 2018 to 5.2 per cent in 2019. Inflation in the main trading partner countries of Mauritius is forecast to remain broadly contained.

4. **Crude oil prices had reversed course since the August MPC meeting, largely influenced by supply concerns.** After declining from US$75.0 per barrel in July 2018 to US$73.8 per barrel in August, ICE Brent increased sharply to US$79.1 per barrel in September and further to US$81.3 per barrel in October[1]. Prices had been largely driven by fears over supply shortages, amidst declining US stockpiles and the imminent enactment of US sanctions on Iran.

5. **International agricultural food commodity prices retreated further in September 2018, mirroring an increase in supply.** The Food and Agriculture Organisation's Food Price Index decreased from 167.6 in August 2018 to 165.4 in September 2018, representing a month-on-month decline of 1.3 per cent, underpinned by lower prices in the markets for dairy products, cereals, vegetable oils and meat, despite a recovery in sugar prices. The International Grains Council's Grains and Oilseeds Index eased further to 199.3 in September 2018, from 201.7 in August 2018.

6. **The US Federal Reserve System pursued its interest rate norrmalisation process, thereby accentuating the policy divergence against other major advanced economies**. The US Fed increased its benchmark federal funds rate to 2.00-2.25 per cent at its September 2018 meeting. Both the European Central Bank and the Bank of England had kept their policy rates unchanged. Among emerging economies, central banks of Indonesia, Russia, Turkey and Philippines had tightened monetary policy in an attempt to tame persistent increases in inflation or avert a currency crisis.

Domestic economic developments

7. **Economic activity in the domestic economy had been generally positive, supported by public infrastructure projects, buoyant tourism activity and steady consumption growth.** According to Statistics Mauritius, the domestic economy grew by 3.7 per cent, y-o-y in 2018Q2, somewhat checked by subdued activity in the manufacturing sector and lower agricultural production.

8. **Consumption expenditure remained upbeat and investment rebounded, whereas exports of goods and services contracted for the fourth consecutive quarter in 2018Q2.** Final consumption expenditure increased by 4.0 per cent y-o-y in 2018Q2 compared to 3.0 per cent in 2017Q2. Household consumption kept pace with 3.2 per cent growth; boosted by continued strength in income and employment. General Government consumption expenditure increased by 8.1 per cent in 2018Q2. Gross Fixed Capital Formation (GFCF) grew by 5.7 per cent, after a contraction of 0.7 per cent in 2018Q1; well supported by a robust increase in '*building and construction work*', on account of ongoing infrastructure projects. Statistics Mauritius was expecting final consumption expenditure growth of 3.4 per cent in 2018 and GFCF growth of 5.5 per cent, as a result of a marked rise in public investment. Private sector investment was estimated to remain flat in 2018.

[1] *Average till 26 October 2018.*

9. **Exports of goods and services contracted for the fourth consecutive quarter in 2018Q2, remaining a drag on growth performance.** Exports of goods and services contracted by 0.2 per cent in 2018Q2; with goods exports falling by 1.5 per cent while exports of services improving by 0.9 per cent. Imports of goods and services increased by 5.4 per cent in 2018Q2, compared to a contraction of 12.4 per cent in 2018Q1. Statistics Mauritius was expecting exports and imports of goods and services to increase by 1.7 per cent and 1.1 per cent, respectively, in 2018.

10. **Domestic inflation continued to ease in an environment characterised by a moderation in fresh food prices and subdued price pressures in other miscellaneous components of the CPI basket, which imparted a disinflationary bias in 2018Q3.** Headline inflation dropped to 3.5 per cent in September 2018, from 4.0 per cent in July 2018. Year-on-year inflation decelerated from 1.7 per cent in July 2018 to 0.9 per cent in August, driven mostly by the downward momentum of fresh food prices, before picking up to 1.9 per cent in September, largely due to base effects. Core inflation had remained somewhat muted and could be indicative of weaker underlying inflationary pressures.

11. **The unemployment rate declined further; while wages continued to firm in almost all sectors of the economy**. The unemployment rate dropped from 7.1 per cent in 2018Q1 to 7.0 per cent in 2018Q2. Based on latest trends, the unemployment rate was expected to edge down from 7.1 per cent in 2017 to a 17-year low of 6.9 per cent in 2018. The wage rate index rose by 4.6 per cent, y-o-y, backed by the manufacturing sector, which contributed 1.5 percentage points (pp), followed by financial and insurance activities and General Government (0.6 pp each).

12. **The current account deficit was projected to improve in 2018 due to an improved performance of the services account, notwithstanding a widening goods account deficit.** The current account deficit would thus drop from 5.7 per cent of GDP in 2017 to 5.4 per cent of GDP in 2018. The deficit on the goods account would essentially emanate from higher international energy prices, coupled with imports associated with infrastructure-linked investment projects. The higher expected surplus on the services account would rest on the buoyant tourism industry. The financial account was expected to record net inflows of Rs26 billion in 2018 while a balance of payments surplus of about Rs17 billion was being forecast.

13. **The rupee exchange rate continued to be influenced by developments on the global currency markets and domestic demand and supply conditions**. Between 20 August and 26 October 2018, on a weighted average dealt selling rate basis, the rupee was almost flat against the US dollar and appreciated slightly against the euro. On a nominal effective exchange rate basis, as measured by MERI1, the rupee appreciated marginally by 0.1 per cent in September 2018. Since the August 2018 MPC meeting, the Bank intervened on the domestic foreign exchange market twice, purchasing a total of USD25 million.

14. **Broad money supply and credit growth slowed somewhat since the last MPC meeting.** Broad Money Liabilities (BML) grew by 4.4 per cent y-o-y in September 2018, down from 9.4 per cent in June 2018, reflecting decreases in both of its major components and base effects. Bank credit to the private sector (excluding credit to the GBC sector) dropped to 7.9 per cent y-o-y in September 2018, from 9.0 per cent in June 2018. Corporate credit grew by 7.6 per cent, mainly led by Financial and Business Services,

Construction and Tourism. Mortgage credit continued to drive growth in household credit, with y-o-y growth of 9.1 per cent.

15. **The banking sector remained sound and well-capitalised with an aggregate capital adequacy ratio of about 17 per cent as at end-June 2018.** Over the quarter ended June 2018, the ratio of non-performing loans to total loans edged down from 6.7 per cent as at end-March 2018 to 6.5 per cent as at end-June 2018. Specific provisions set aside by banks against non-performing loans have improved, as the coverage ratio rose to 56.4 per cent as at end-June 2018, from 54.1 per cent as at end-March 2018.

16. **The Bank's open market operations had contributed to keep an appropriate level of rupee excess liquidity in the banking system such that short term yields remained within the interest rate corridor of the Operational Framework for Monetary Policy.** The scaling up of open market operations by the Bank increased the amount of outstanding BoM securities from Rs89 billion as at 10 August 2018 to Rs93 billion as at 26 October 2018. The average overnight interbank interest rate dropped from 3.34 per cent in August 2018 to 3.32 per cent in September 2018 before rising to 3.50 per cent in October 2018 as rupee excess reserves fell. The average weighted yields for the 91-Day and 182-Day Bills which stood at 3.57 per cent and 3.63 per cent, respectively, at end of August 2018, decreased by 12 and 3 basis points to 3.45 per cent and 3.60 per cent, respectively, as at 26 October 2018.

Staff economic outlook

17. **Domestic inflationary dynamics had remained somewhat benign, reflecting the combined influence of weak demand-pull and cost-push factors on CPI inflation**. Cost-push pressures arising from adverse weather conditions and which contributed to volatile inflation during 2018H1 had dissipated. The fiscal measures announced in the June 2018 Budget had also enabled to wane inflationary impulses. Our trading partners' inflation remained subdued and imported inflation was expected to be modest in the near-term. Pressures from global food prices were expected to remain mild, while the volatility in global oil prices would be expected to add to the uncertainty in predicting its future path. Headline inflation was expected at 3.2 per cent for 2018, down from the previous estimate of 3.5 per cent. In 2019, headline inflation was projected at 3.0 per cent, conditional on the absence of a major supply shock and changes to administered prices.

18. **Domestic demand would remain the key driver of real GDP growth.** The massive public spending in infrastructural projects would continue to sustain the growth momentum, supported by final consumption expenditure, upheld by the fiscal incentives such as the negative income tax and minimum wages. Strong contribution from tourism, construction and financial services sectors would enable to boost domestic output. The prevailing accommodative monetary conditions would continue to favourably influence domestic economic activity. The Bank had maintained real GDP growth at 4.0 per cent for 2018 on account of stronger economic activity in key sectors of the economy. Bank staff had also kept real GDP growth projection at 4.0 per cent for 2019. Notwithstanding the robustness of domestic macroeconomic fundamentals, downside risks to real GDP growth could creep, as the materialisation of real GDP growth forecast would rest upon the timely completion of key public infrastructure projects and dynamics of private investment.

Monetary Policy Decision

19. **Members began their discussions by noting that global economic growth had been revised down and underlined the uncertainty factors surrounding economic developments abroad**. They acknowledged that developments in trade policies as well as issues surrounding the Brexit negotiations and other geopolitical matters of concern had continued to pose risks to the growth outlook. In the United States, GDP growth had remained strong in the first half of 2018, reflecting the fiscal stimulus, which had more than offset any effect of higher tariffs. GDP growth had remained above trend in the euro area. They observed that inflation developments across the world, including our main partner economies, had remained moderate. Members viewed that global economic conditions would remain challenging, with the outlook being subject to a number of risks. In addition, oil prices had generally been volatile and remained quite elevated.

20. **Members emphasised that economic activity in Mauritius remained commendable amidst an environment of subdued inflationary pressures.** Since the August 2018 MPC meeting, macroeconomic developments had, for the most part, been as expected and the forecasts remained largely unchanged. The outlook on the domestic economy remained upbeat, taking into account that the economy was operating with some spare capacity. Public sector projects were providing the necessary impetus to the growth momentum. The unemployment rate remained on a downtrend. They highlighted that domestic inflation was under control and would be around 3 per cent in the near term in the absence of adverse supply shocks. Underlying inflation had remained low and stable.

21. **Members reviewed the Bank's monetary policy operations and discussed extensively on the level of excess liquidity**. They noted that short-term interest rates continued to be around the Key Repo Rate following the implementation of appropriate measures. The Bank remained committed to undertake open market operations as required to achieve the desired monetary policy stance.

Voting Pattern

22. **At the conclusion of the discussions, the Committee unanimously voted to maintain the Key Repo Rate at 3.50 per cent per annum.** Members assessed that the current stance of monetary policy would continue to support economic growth, while maintaining price stability.

23. **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**.

24. **The next MPC meeting is scheduled on 22 February 2019.**

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 09 November 2018, the last available data on national accounts, employment and external trade were for 2018Q2. The last data available on Consumer Price Index (CPI) and inflation were for October 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.