BANK OF MAURITIUS COMMUNIQUÉ

Released on 13 December 2006

A New Framework for the Conduct of Monetary Policy by the Bank of Mauritius

The Bank of Mauritius Act 2004 stipulates "*The primary object of the Bank shall be to maintain price stability and to promote orderly and balanced economic development*".

2. To achieve its objective of maintaining price stability, the Bank of Mauritius needs to formulate and implement a number of measures affecting the supply of reserve money, the money supply and the level of interest rates in the economy. The set of measures designed by a central bank to attain its objective is termed monetary policy.

3. The Bank of Mauritius is introducing a new framework for the conduct of monetary policy. The Bank of Mauritius will pursue a monetary policy strategy based on a more comprehensive set of indicators in a two-pillar approach. Pillar 1 focuses on economic analysis that measures short and medium term risks to price stability. Pillar 2 evaluates monetary developments and the associated long term risks to price stability. Used in combination, the two pillars provide a crosscheck of the risks to price stability stemming from shorter-term economic developments with those resulting from longer-term monetary developments, thereby ensuring that monetary policy does not overlook important information relevant for assessing future price trends.

4. This monetary policy framework will enhance the internal decision-making processes at the Bank of Mauritius in responding effectively to the maintenance of low and stable inflation. It needs to be highlighted that the implementation of monetary policy measures normally impacts on the general price level after a time lag of around eighteen months.

5. In the new framework, the Bank of Mauritius will use the Repo Rate instead of the Lombard Rate as the key policy rate to signal changes in its monetary policy stance. The Bank of Mauritius will set the Repo Rate and will regulate the supply of reserve money such that the overnight interbank money market interest rates move close to the Repo Rate. As has been the practice with the Lombard Rate, the Bank of Mauritius will issue a communiqué to explain its decision on the Repo Rate.

6. As in the past, policy announcements by the Bank of Mauritius would alter the behaviour of economic agents. However, because of shocks to the general price level emanating from the supply side – such as increases in the prices of petroleum products and rises in tax rates – it may not be possible for the Bank of Mauritius to achieve price stability at all time. To that effect, the Bank also monitors movements in the "core" inflation rate which focuses on persistent sources of inflation and serves as a guideline for the conduct of monetary policy.

A. The Repo Rate

7. Effective 18 December 2006, the Repo Rate is set at 8.50 per cent per annum.

8. In order to manage the overnight interbank interest rate in an effective manner, the Bank of Mauritius will supply or absorb liquidity against collateral at its discretion and in whatever volume required to hold the overnight interbank interest rates close to the Repo Rate. For this purpose, the Bank of Mauritius is establishing a "corridor" that will effectively provide a ceiling and a floor for overnight interbank interest rates. The Bank of Mauritius will lend money to banks at the ceiling of the "corridor" which is set at 50 basis points above the Repo Rate. In a similar manner, the Bank of Mauritius will absorb excess funds at the floor of the "corridor" which is set at 50 basis points below the Repo Rate. Thus, with a Repo Rate of 8.50 per cent per annum, the Bank of Mauritius will lend funds to banks at 9.00 per cent per annum and sterilise excess funds at 8.00 per cent per annum. The ceiling and the floor of the "corridor" will move in the same direction and magnitude as the Repo Rate. Depending on the evolution of the market, the Bank of Mauritius may vary the width of the "corridor" with a view to achieving its objective.

B. The Minimum Cash Reserve Ratio Requirement

9. In terms of Section 49 (1) of the Bank of Mauritius Act 2004, the minimum cash reserve ratio requirement on a bank's deposits and other liabilities has been set at 4.0 per cent. Banks are currently required to maintain minimum weekly average reserve balances at the Bank equivalent to 4.0 per cent of their average deposit liabilities held in the preceding week.

10. With a view to providing more flexibility to banks, the Bank of Mauritius is lengthening the maintenance period from one week to two weeks as from 19 January 2007. Accordingly, banks will be required to maintain two-week average reserve balances at the Bank equivalent to a minimum of 4.0 per cent of their average deposit liabilities held over the two-week period preceding the maintenance period. However, on any particular day during

the maintenance period, the minimum cash reserve ratio shall not fall below 2.0 per cent of average deposit liabilities. The first maintenance period will run from 19 January 2007 through 1 February 2007 and during that two-week period banks will have to maintain minimum average cash balances equivalent to 4.0 per cent of their average deposit liabilities for the period 5 through 18 January 2007.

C. The Standing Facility

11. With effect from 18 December 2006, the Lombard Facility and the Lombard Rate are abolished.

12. As lender of last resort, the Bank will continue to provide a collateralised overnight facility to banks under a new Standing Facility without any borrowing quota. The interest rate chargeable on the Standing Facility is set at 400 basis points above the Repo Rate and will be 12.50 per cent per annum with effect from 18 December 2006.

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