BANK OF MAURITIUS

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Communiqué
Inflation Forecasts

Released at 18.45 hours on 8 February 2014

It has been reported in the press this morning that the Ministry of Finance and Economic Development (MOFED) had released a press communiqué late yesterday (which was not available on its website at the time of writing), in which, among others, it was stated that "*inflation was at a record low in 2013 and is expected to remain relatively low for the whole year*" and "*the Bank of Mauritius has continuously overstated expected inflation, and should review its forecasting procedures*".

Our own staff's year-on-year inflation forecast communicated to the Monetary Policy Committee (MPC) for the February 2014 meeting was 4.0 per cent for year-end. Staff arrived at their forecast after a thorough assessment of past and future external and domestic developments and consideration of a small subset of the many macroeconomic variables that potentially affect the inflation path.

Inflation forecasts are also obtained from different modelling frameworks developed under technical assistance (TA) from the International Monetary Fund (IMF). As part of its on-going TA work on macro-modelling and forecasting, an IMF mission visited the Bank in January 2014 to assist with building medium-term forecasting and policy analysis capabilities. Further TA missions are forthcoming during the year.

Among the different inflation forecasts available, staff comes up with the final inflation forecast based on best judgement. Staff usually provides scenario-based forecasts to the MPC.

First forecasts of inflation for the year 2013 – which projected year-on-year and 12-month average inflation rate for 2013 at 4.8 per cent and 5.1 per cent respectively - were released to the MPC in November 2012. The main upside risk factored in the inflation forecast was the PRB wage award in the public sector, which was expected to be followed by higher wage demands in the private sector. Historical data on past PRB award had shown some lagged effect on inflation.

The medium-term macroeconomic projections released by MOFED in November 2012 forecast headline inflation rate for 2012 and 2013 at 4.1 per cent and 6.0 per cent respectively. The actual headline inflation rate turned out to be 3.9 per cent for 2012 and 3.5 per cent for 2013.

In its Article IV Mission Report 2013, the IMF had highlighted the likely impact of emerging inflationary pressures in 2013 arising from "*wage increases in the public and private sectors and adjustments to some administrated prices*". IMF had forecast headline inflation to reach 5.7 per cent and year-on-year inflation to reach 6.0 per cent in 2013. The report is available on the IMF's website http://www.imf.org.

The Bank's staff forecasts for headline inflation and year-on-year inflation for the year 2013 were subsequently revised upward in March 2013, in line with the IMF's inflation assessment, to within a range of 4.7-4.9 per cent and 5.5-5.9 per cent respectively.

In June 2013, staff's inflation forecasts were adjusted downward mainly on technical factors as in their opinion, the new 2012 consumer basket appeared to have introduced a downward bias stemming from consumer substitution for lower-priced products following the rise in the cost of living.

In the September 2013 MPC meeting, staff argued that the cumulative decline in the CPI from May to August 2013 was mainly due to the change in market microstructure and price-setting behaviour, which had significantly altered the price dynamics.

Staff put forward two inflation forecast scenarios for year-end 2013. Based on past data, it was estimated that the Budget 2014 would be adding between 1.3 and 1.5 index points to the CPI, which would have brought the year-on-year inflation to a range of 4.5-4.9 per cent. On a zero-Budget impact scenario, the year-on-year inflation was revised down to a range of 3.7-4.0 per cent. The Budget 2014 direct impact on the CPI turned out to be around 0.5 index points based on staff's calculations and the actual year-on-year inflation for 2013 was 4.0 per cent.

"*Inflation is hard to forecast…. there is considerable evidence that Phillips curve forecasts do not improve upon good univariate benchmark models…. there are times, such as the late 1990s, when Phillips curve forecasts improved upon univariate forecasts, but there are other times (such as the mid-1990s) when a forecaster would have been better off using a univariate forecast.*" Professor James H. Stock, Department of Economics, Harvard University, and NBER and Professor Mark W. Watson, Woodrow Wilson School and Department of Economics, Princeton University

Statistics Division

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