BANK OF MAURITIUS

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MONETARY POLICY STATEMENT

The Board of Directors of the Bank of Mauritius at its meeting on 30 June 2007 considered the recommendations of the Monetary Policy Committee which met earlier on the same day. The Board decided to raise the key Repo Rate by 75 basis points from 8.50 per cent to 9.25 per cent per annum effective today, Monday 2 July 2007. Concurrently, the interest rate chargeable on the Standing Facility of the Bank of Mauritius has also been increased from 12.50 per cent to 13.25 per cent per annum.

The MPC assessed the latest economic developments and trends. Its recommendations were motivated by the prevailing upside risks to inflation over the next 18 to 24 months and the potential build-up of entrenched inflationary expectations against a backdrop of global interest rate tightening and rising inflation driven by high oil and commodity prices.

Background

Headline consumer price inflation hit 10.5 per cent in May 2007 and is estimated at 10.7 per cent in June 2007 – the highest in over a decade. The Bank of Mauritius's own measures of underlying trend inflation or core inflation[1] also point towards a rising inflation rate, closely tracking headline inflation. High oil and commodity prices, the depreciation of the rupee in the second half of last year, price rises in some basic foodstuffs and the increase in excise duties had second-round effects which pushed the inflation rate to higher levels. Looking ahead, risks to inflation appear to be on the upside.

Recent data seem to indicate that the economy will continue to expand at a reasonable pace, supported by a recovery in the main economic sectors. However, inflationary pressures and a widening deficit in the merchandise account of the balance of payments could potentially threaten the growth outlook in the medium term. Given the current level of real interest rates, the downward trend in the saving rate is likely to accentuate thereby increasing consumption expenditure and reducing domestic resources available for investment.

[1] Details of the Bank of Mauritius's core inflation measures are available at http://bom.intnet.mu/publicat_r.htm.

The exchange rate has been relatively stable this year partly on account of sustained inflows of foreign direct investment and portfolio investment in stocks and Government securities. However, there are expectations that the central banks of major trading and investment partner countries of Mauritius are set to tighten their policy interest rates in the near future. This may create downward pressures on the exchange rate should the currently favourable interest rate differential tilt against the rupee and may in turn translate into higher inflation via the exchange rate pass-through.

On the monetary side, latest data show rather subdued money and credit growth compared to nominal GDP growth thereby pointing to the containment of risks to price stability emanating from monetary developments.

Nonetheless, the near-term economic outlook is underpinned by prudent monetary and fiscal policies, and a sound banking system. The MPC will continue to monitor closely developments and take whatever action is necessary in future to ensure price stability in the medium term, a prerequisite for sustainable growth.

Voting pattern

The Board took note of the recommendations of the MPC for an increase in the key Repo Rate, which was supported by all MPC members except one who argued for a reduction. The remaining MPC members were split evenly, 3-3, between an increase of 50 basis points on the one hand and an increase of 75 basis points on the other, with the Chairman choosing not to exercise his casting vote. The Board weighed the merits of the two options and voted by a majority of 6-3 in favour of raising the key Repo Rate by 75 basis points from 8.50 per cent to 9.25 per cent per annum.

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Annexe on Core Inflation

Core inflation is the trend component of headline inflation and reflects the persistent sources of inflationary pressures. The Bank of Mauritius calculates three measures of core inflation using the exclusion and statistical approaches. The exclusion-based approach excludes certain items from headline inflation while the statistical approach trims from the distribution of price changes the extreme movements.

The first exclusion method, CORE1, strips the two divisions of the consumer basket: "Food and Non-Alcoholic Beverages" (Division 01) and "Alcoholic Beverages and Tobacco" (Division 02) from the computed series while the second exclusion method, CORE2, apart from excluding Divisions 01 and 02, also removes energy and administered prices as these prices are subject to different kinds of regulation and government tax policies. The third measure of core inflation, TRIM10, uses the trimmed mean approach, which excludes 5 per cent of the most positive and 5 per cent of the most negative price changes. Core inflation is then computed by taking the weighted average of price changes for the remaining components.

The Bank of Mauritius monitors core inflation as part of broad inflationary indicators in the economy. Core inflation is intended to be used as a complementary indicator of the general movement in prices of goods and services.

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