BANK OF MAURITIUS

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MONETARY POLICY STATEMENT

The Monetary Policy Committee (MPC) of the Bank of Mauritius convened a special meeting on 21 July 2008 and decided to raise the key Repo Rate by 25 basis points to 8.25 per cent per annum effective same day. The interest rate chargeable on the Special Deposits Facility, set at 100 basis points below the key Repo Rate, increases to 7.25 per cent per annum while that on the Overnight Facility, introduced at 150 basis points above the key Repo Rate, rises to 9.75 per cent per annum. The interest rate payable on the Standing Facility, at 400 basis points above the key Repo Rate, increases to 12.25 per cent per annum.

The MPC reviewed latest international economic developments to assess the global outlook for inflation and growth. Global inflation has continued to gather momentum, hitting record highs in several countries, particularly in emerging and developing economies, against the backdrop of persistently high oil and commodity prices. According to the United Nations Food and Agricultural Organisation (FAO), food prices are likely to remain elevated over the next decade mainly due to high biofuel demand, mounting energy costs and commodity speculation. Asia's rising inflation is having major implications for the global economy as increasingly higher prices for Asian exports feed into the price structure of importing countries. Concern on second-round effects of food and oil price shocks as well as on inflation expectations becoming entrenched has prompted central banks around the world to shift the focus from growth to inflation. The MPC took note of a recent survey by JP Morgan from which it was observed that most central banks are in a tightening mode in respect of monetary policy.

Since the last MPC meeting, the forecast for global growth for 2008, according to the July 2008 World Economic Outlook (WEO) update of the International Monetary Fund, has been revised upward to 4.1 per cent, from 3.7 per cent made in April 2008, following a better-than-expected performance in the early part of 2008. Global growth was 5.0 per cent in 2007. It is forecast to decelerate significantly in the second half of 2008 before recovering gradually in 2009. The global economy might thus stay weak for longer than anticipated. Economic growth in the United States, the United Kingdom and the Euro area is projected to slow down in coming quarters. Consumer and investment spending – the main drivers of growth in the developed world – are set to grow at a lower pace amid tighter credit conditions.

The MPC reviewed the domestic macroeconomic situation in the light of recent developments. Consumption spending is likely to recover in 2008 on account of the fiscal stimulus stemming from the 2008-09 Budget and higher earnings in the public sector. Claims for higher remuneration in the private sector could also complement consumption growth. In the view of a majority of MPC members, however, downside risks to growth have gathered momentum over the last month. Downside risks to growth emanating from the export-oriented sectors persist amid heightened uncertainties and faltering consumer spending in Mauritius' main export markets. The view was also expressed that, although the forecast of economic growth for 2008 has been revised downward, growth was still above trend and was likely to stay robust.

Recent trends in money supply and private sector credit have consistently brought out the underlying strength in monetary and credit aggregates relative to nominal output growth. On current expansion rates, monetary and credit conditions are accommodative to higher inflation in the medium-term.

Headline inflation in Mauritius stood at 8.8 per cent in June 2008 and continues to be driven by externally-generated pressures resulting from high oil and commodity prices. The Governor drew the attention of members to the fact that the year-on-year inflation, a measure widely used by central banks around the world, stood at 9.7 per cent in June 2008.[1] At this juncture, such pressures if left unchecked are likely to seep through the broader economy and affect the whole internal price structure. The domestic inflation outlook has worsened in the aftermath of the recent decision to hike fuel prices. Moreover, the potential for a wage-price spiral to set in following the recent salary increase in the public sector accompanied by demands for higher wages in the private sector could add to prevailing inflationary pressures.

The MPC concluded in its overall assessment of the growth and inflation outlook that the downside risks to economic growth and the upside risks to inflation were both serious with, however, higher risks to inflation. The MPC considered it

[1] The year-on-year inflation for June 2008 is measured as the percentage change in the Consumer Price Index (CPI) compared with the same month of the preceding year.

judicious to review the monetary policy stance to avoid the domestic economy falling into an inflation spiral.

The MPC was of the view that an increase in the policy interest rate signals its concern about the inflation outlook and its commitment to take appropriate measures to fight inflation. Some members were of the view that a steep rise in the key Repo Rate was required to contain inflationary expectations and normalise monetary policy with a view to moving real short-term interest rates into positive territory. While the exchange rate has been characterised by relative stability in the recent past, concern was expressed on the exchange rate implication of a substantial increase in interest rate.

The MPC will continue to monitor domestic and international economic developments and remains committed to price stability and to promote orderly and balanced economic development.

Voting Pattern

The MPC voted unanimously to increase the key Repo Rate, with a majority of 4 to 3 to increase the key Repo Rate by 25 basis points to 8.25 per cent per annum. Of the other three members, two voted for a 100 basis points and one for a 50 basis points increase.

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21 July 2008