BANK OF MAURITIUS

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MONETARY POLICY STATEMENT

The Monetary Policy Committee (MPC) of the Bank of Mauritius met on 26 March 2009 and decided to reduce the key Repo Rate by 100 basis points to 5.75 per cent per annum. The interest rate chargeable on the Special Deposits Facility, set at 100 basis points below the key Repo Rate, drops to 4.75 per cent per annum while that on the Overnight Facility, set at 150 basis points above the key Repo Rate, falls to 7.25 per cent per annum. The interest rate payable on the Standing Facility, set at 400 basis points above the key Repo Rate, declines to 9.75 per cent per annum.

The MPC reviewed international and domestic economic as well as financial developments and benefited extensively from the views and insights of Dr M. Blejer, Honorary Adviser to the MPC, on the global situation and outlook.

International developments and outlook

Global economic conditions have worsened further since the MPC last met in December 2008. Deterioration in the health of financial institutions and contraction of economic activity are the main causes of rising unemployment and severe strains on consumers as well as on the business sector in major economies. Concurrently, emerging and developing economies are being adversely affected. Despite significant monetary easing by central banks and the implementation of fiscal stimulus by governments, the global economic and financial woes are still persisting. The International Monetary Fund (IMF) has further downgraded its growth projections according to the latest data released on 19 March 2009. The IMF now projects a contraction in global economic activity by 0.5 to 1.0 per cent in 2009. Nonetheless, uncertainty still persists as to the depth and duration of the global economic meltdown, the more so as the IMF anticipates receding prospects for a global economic recovery before mid-2010.

There is growing consensus that the current economic recession has not yet bottomed out. The turnaround in global growth would depend critically on more concerted policy actions to stabilise financial market conditions as well as sustained strong policy support to bolster demand. Global trade volume has collapsed and the spectre of trade protectionism is becoming a growing concern.

The economic recession in major advanced economies could deepen further over the next few quarters. The IMF has projected growth in advanced economies to contract by 3.0 to 3.5 per cent in 2009. A marginal recovery in economic activity ranging from zero to 0.5 per cent is estimated for 2010. In the United States and the euro area, the contraction in activity is forecast at 2.6 per cent and 3.2 per cent, respectively. Growth in emerging and developing economies is expected to slow sharply to a range of 1.5 to 2.5 per cent under the drag of falling export demand, lower commodity prices and much tighter external financing conditions.

Central banks worldwide have continued to ease monetary policy. Several major central banks, after having cut their key interest rates to near-zero levels, have switched to quantitative easing to minimise deflation risks. A number of major central banks – including the US Federal Reserve, the Bank of England and the Swiss National Bank – have embarked on non-conventional measures, such as asset purchase, to keep credit flowing to consumers and the business sector as their policy interest rates are already at the lowest levels. In emerging economies, central banks have maintained their easing monetary policy stance to shore up their economies.

Globally, inflation has been falling steeply from high levels reached in the second half of 2008, mainly on account of the rapid drop in commodity prices, especially crude oil, and increasing economic slack. Crude oil prices have come down further in February 2009 to US$39, from US$42 in December 2008, before going up to US$48 a barrel in March 2009. The Food and Agricultural Organisation Food Price Index has been declining steadily since July 2008, reaching 143 in December 2008 and dropping further to 140 in February 2009.

Consumer spending in our main markets for tourism and textile continued to be undermined by poor growth prospects and rising unemployment. Retail sales in the main markets of the euro area remain depressed, backed by renewed weakening of consumer confidence. In the United Kingdom, the largest export market for Mauritius, retail sales have been falling sharply. Consumer spending is expected to be vulnerable in the United States with the economic contraction projected for 2009. In South Africa retail sales remain weak as well. Consumers are also choosing to travel less and air passenger traffic declined further in March 2009.

Domestic developments and outlook

The global economic slowdown and falling demand in our main export markets are already affecting the Mauritian economy – in particular, the export-oriented sectors with spill-over effects to other sectors. The Central Statistics Office (CSO) has revised downward the 2008 growth rate to 5.3 per cent, from an earlier estimate of 5.6 per cent, after the economy witnessed fairly broad-based weakness in the second half of 2008.

The textile sector is technically in recession after real output contracted for two successive quarters.[1]

The CSO had projected, in December 2008, that the Mauritian economy would grow by 4.0 per cent in 2009, based on the assumptions that both tourist arrivals and textile output would stagnate at 2008 levels while almost all the other sectors would record slower but positive growth rates largely on account of the *Additional Stimulus Package* announced by the government in the same month. However, since then, downside risks to domestic growth have substantially intensified as conditions further worsened in major export markets. The growth outlook for 2009 has deteriorated from an estimated 4.0 per cent to a range of 2.0 to 2.8 per cent.[2] The IMF, citing much weaker external demand for textiles and tourism, expects growth to decelerate to 2 per cent in 2009. Nevertheless, the weakness of external demand is expected to be compensated to some extent by consumption and investment spending during 2009.

The economic outlook for 2009 critically depends on how the tourism and textile sectors would perform, as these two sectors have important linkages with the rest of the economy. The textile and tourism sectors are already being adversely affected by the global economic downturn and they are expected to contract in 2009. Our main markets for textile have already moved into recession and are expected to contract further in 2009. The tourism sector is going through a difficult phase with reduced room reservations and lower tourist arrivals from our main markets. Overall, visibility in the export-oriented sectors for the months ahead remains poor. The second-round effects of the weak performance of export-oriented sectors would also spread to other sectors having strong linkages with the former, such as air transportation, construction, real estate and financial intermediation.

The unemployment rate fell to 7.2 per cent in 2008, from 8.5 per cent a year earlier. However, the expected weak performance of the export-oriented sectors, coupled with the spill-over effects to other sectors of the economy, have undermined the outlook for employment.

Recent monetary developments, characterised by moderate growth rates in both money supply and credit, potentially support the attainment of lower inflation over the medium-term. The pace of expansion of money supply moderated in the year to January 2009 to 14.3 per cent, from 14.7 per cent in the year to December 2008. The growth rate of claims on the private sector, which peaked at an all–time high of 28.5

[1] *The textile sector further contracted in the last quarter of 2008 according to data released by the CSO on 31 March 2009, resulting in three quarters of contraction for the sector.*

[2] *On 31 March 2009, the CSO published its revised growth forecast of 2.5 per cent for 2009.*

per cent in the year to October 2008, slowed down to 25.8 per cent in the year to December 2008 and further to 21.3 per cent in the year to January 2009.

Inflationary pressures have receded significantly since the last MPC meeting. Inflation for the twelve-month period ended February 2009 fell to 8.8 per cent, from 9.7 per cent for the twelve-month period ended December 2008. However, on a year-on-year basis, a methodology commonly used by central banks and also advocated for Mauritius by the IMF Staff Mission which visited the country in February 2009, inflation has declined more markedly to 4.6 per cent in February 2009, from 6.7 per cent in December 2008. Much of the decline in inflation relates to the transmission of favourable commodity price developments on international markets into domestic prices. The MPC expects inflation, measured by both the average and the year-on-year methods, to converge to around 4 per cent during 2009.

The MPC, while assessing the risks to inflation and deciding on monetary policy, also considers movements in year-on-year inflation. It acknowledges that this methodology captures the dynamics of inflation movements and is a more appropriate measure for assessing inflationary pressures and for guiding monetary policy decisions than the backward-looking average.[3] Henceforth, the Bank of Mauritius will publish the year-on-year inflation rate on its website and in its publications.

The MPC judged that the inflation outlook during 2009 could continue to improve. Looking further ahead, however, the inflation outlook is clouded by uncertainties regarding the future direction of commodity prices, particularly oil, on international markets and exchange rate movements.

The MPC expressed concern over the widening current account deficit of the balance of payments and the slowdown in private capital flows while considering the scope for further easing of monetary policy. Balance of payments developments in the last quarter of 2008 were characterised by a further deepening of the current account deficit to Rs6.9 billion. Overall, the current account deficit, as a proportion of Gross Domestic Product (GDP), went up from 5.7 per cent in 2007 to 10.5 per cent in 2008 and is projected to widen further to 11.3 per cent in 2009.

In absolute terms, the current account deficit rose from Rs13.4 billion in 2007 to Rs27.7 billion in 2008. The deterioration in the current account resulted from a higher deficit of Rs56.5 billion on the merchandise account together with lower surpluses on

[3] *Year-on-year inflation is computed as the change in the Consumer Price Index (CPI) for a given month compared with the same month of the preceding year in percentage terms. The Central Statistics Office computes the inflation rate by comparing the average level of prices, as measured by the CPI, during a twelve-month period with the average level during the corresponding previous twelve-month period.*

both the services and income accounts. The deficit on the merchandise account of the balance of payments went up by 28.6 per cent in 2008 after registering an increase of 27.2 per cent in 2007. The widening merchandise account deficit reflected an acceleration in the growth of imports (f.o.b.) from 4.7 per cent in 2007 to 9.9 per cent in 2008, while exports contracted by 5.8 per cent and 1.9 per cent in 2007 and 2008, respectively. As a percentage of GDP, the deficit on the merchandise account is estimated at 21.4 per cent in 2008, up from 18.7 per cent in 2007. The current account deficit has been mostly financed by sustained net Foreign Direct Investment (FDI) inflows of Rs9.4 billion and net other investment inflows of Rs21.0 billion. The latter mainly reflects a drawdown in banks' foreign assets and an increase in short-term liabilities. The magnitude and pace at which the current account deficit is fast deteriorating indicate a serious imbalance between gross national saving and investment in the economy, which needs to be addressed.

The Saving Rate, which stood at 21.2 per cent in 2007, has collapsed by 4.5 percentage points to 16.7 per cent in 2008. The estimate for 2009 suggests a further decline to 14.7 per cent.

After registering surpluses in 2007 and 2008, the overall balance of payments is expected to post a deficit in 2009. The data for the last quarter of 2008 already indicate that the overall balance of payments recorded a deficit of Rs2.4 billion. In the current environment characterised by weak business sentiment, some of the contemplated FDI projects might be deferred. The projected slowdown of FDI inflows and the reversal of portfolio inflows would have implications for the financing of the overall balance of payments. In the context of a sharply deteriorating external environment, there is need for continued vigilance in preventing excessive exchange rate movements, containing emerging balance of payments pressures and maintaining a prudent level of foreign exchange reserves.

In the light of its assessment, the MPC determined that, on account of the ongoing uncertainty, the protracted economic downturn in our main export markets and the projected decline in the domestic inflation rate, monetary policy could be eased further. This monetary easing will further support the government's policy to stimulate the domestic economy in the face of the global economic downturn.

The MPC will continue to monitor economic and financial developments and remains committed, as per its mandate, to formulate and determine monetary policy, taking into account the orderly and balanced economic development of Mauritius. The MPC stands ready to meet outside its regular quarterly meetings as and when required to assess the evolution of the economic situation and, if needed, take appropriate policy measures.

Voting Pattern

The MPC voted unanimously to reduce the key Repo Rate, with a majority of 5 to 2 to cut the key Repo Rate by 100 basis points to 5.75 per cent per annum. Of the other two members, one voted for a 75 basis points and the other for a 50 basis points reduction.

Since the setting up of the MPC in April 2007, the key Repo Rate has been reduced on six occasions, kept unchanged on four occasions and increased on two occasions. Since October 2008, the key Repo Rate has been reduced by a cumulative 250 basis points.

Bank of Mauritius
26 March 2009