BANK OF MAURITIUS

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MONETARY POLICY STATEMENT

The Monetary Policy Committee (MPC) of the Bank of Mauritius decided to maintain the key Repo Rate at 5.75 per cent per annum at its regular meeting held on 23 March 2010. The interest rate chargeable on the Special Deposits Facility, set at 100 basis points below the key Repo Rate, remains at 4.75 per cent per annum while that on the Overnight Facility, set at 150 basis points above the key Repo Rate, is held at 7.25 per cent per annum. The interest rate payable on the Standing Facility, set at 400 basis points above the key Repo Rate, is 9.75 per cent per annum.

The MPC reviewed current international and domestic economic as well as financial developments and assessed the outlook for the global and domestic economy before reaching its decision.

International developments and outlook

Recent data and economic reports from international agencies confirm that the global economy is picking up, although the pace of expansion varies across countries and regions. Recovery still relies, albeit to different degrees, on the massive monetary and fiscal stimulus. Major advanced economies registered positive growth rates in the last two quarters of 2009 with the United Kingdom coming out of recession in the fourth quarter. The United States is growing faster while Europe is seeing a more moderate and uneven recovery. Emerging economies are experiencing a solid and dynamic growth. Industrial production continues to improve around the world with emerging Asia leading the way. World trade has continued to rebound reflecting improved global demand and an easing of trade finance constraints.

The MPC noted that the International Monetary Fund (IMF), in its January 2010 World Economic Outlook Update, significantly upgraded its 2010 growth forecasts for both advanced and emerging and developing countries. It projected world output to grow by 3.9 per cent. Advanced economies were forecast to grow at 2.1 per cent. Real output in emerging and developing economies was expected to be more vigorous, growing by 6.0 per cent, largely driven by buoyant internal demand. The IMF has projected the volume of world trade to grow by 5.8 per cent this year.

The MPC observed that financial market conditions worldwide had been improving generally despite jitters caused by debt problems in some countries. It considered that the degree of uncertainty and vulnerability surrounding the recovery process had continued to diminish. Nonetheless, it is viewed that high unemployment rate could adversely affect household spending in most advanced economies. On balance, global growth prospects are still brighter.

The MPC noted that the accommodative monetary policy stance adopted by many countries was being maintained to support the pick-up in economic activity. Interest rates were generally expected to stay low for some more time. However, central banks in Australia, China, Norway and India had already started removing monetary stimulus in order to anchor inflation expectations and preserve price stability as domestic economic conditions strengthened. Members took note of the greater attention being focused on the cautious unwinding of economic stimulus measures as growth becomes self-sustaining and expectations of a tightening of monetary policy towards the second half of 2010 in a number of economies.

The MPC considered the turnaround in inflation in most countries around November 2009 due to rising food and oil prices. Globally, inflation was still low and no major upward pressure from international commodity prices was foreseen in the short term given low levels of capacity utilisation and the output gap. International commodity prices were likely to stabilise around current levels according to forecasts of international organisations. Looking further ahead, however, the inflation outlook could worsen as global economic activity gathers momentum and the extent of economic slack shrinks.

Domestic developments and outlook

The MPC assessed the most recent domestic indicators. There were indications of a continuous improvement in economic activity as from the second quarter of 2009, supported by the expansionary economic policies pursued by the Government and the Bank of Mauritius. The constraint exerted by soft external demand – with the euro zone, the United Kingdom and the United States representing major export markets for Mauritius – has been partly offset by buoyant domestic demand conditions. The initial forecast of real economic growth of 2.8 per cent for 2009 is likely to be revised upward on account of the better performance of certain sectors in the last quarter of 2009.

The economy grew by 3.8 per cent in the third quarter, up from 2.3 per cent in the second quarter, and is projected to have recorded even higher growth in the fourth quarter. The seasonally-adjusted quarter-on-quarter real growth rate showed that the pace of economic expansion quickened in the third quarter. The higher growth rate was mainly due to the recovery of the manufacturing, distributive trade, and construction sectors. Real output in the textile and the hotels and restaurants sectors, which are heavily dependent on external demand, contracted further in the third quarter of 2009.

Available information suggests soft external demand conditions to continue prevailing in Mauritius' main export markets and real economic activity is forecast to stay below potential owing to still subdued performance anticipated for the export sector over the next few quarters. Downside risks to growth appear relatively limited. On present indications, the economic growth forecast for 2010 is likely to be revised upward to 4.5 per cent from 4.3 per cent. Should the external environment improve further, growth prospects would be enhanced.

Better economic performance in the second half of 2009 bolstered a rise in employment leading to a decline in the unemployment rate.[1] The expected revival of economic activity closer to potential during 2010 might lead to further positive effects on the labour market.

Money growth has moderated further, pursuing the downward trend that began in May 2009 and reflecting the low level of economic activity. Money supply grew by 7.0 per cent in the year to January 2010. However, there was a pick up in the growth rate of credit to the private sector to 2.9 per cent in January 2010. The extension of additional credit was channelled solely to the household sector while credit to the corporate sector contracted. Notwithstanding the increase, the demand for credit has remained sluggish during the past few months. Overall, monetary developments are consistent with the maintenance of low and stable inflation over the short to medium term.

The deficit on the current account of the balance of payments is estimated to have narrowed to Rs5,632 million in the fourth quarter of 2009, from Rs5,927 million in the third quarter representing, as a percentage of GDP, a drop from 8.6 per cent to 7.4 per cent. Larger surpluses on the services account, driven mostly by higher tourism receipts, and in net current transfers, partly offset by the substantial increase in the merchandise trade deficit resulting from nominal imports rising much faster than nominal exports, contributed to lower the current account deficit. The surplus on the financial account fell to Rs1,006 million compared to Rs2,751 million in the third quarter, largely on account of a drop in other investment flows. Foreign direct investment remained buoyant in the current context, rising from Rs1,419 million to Rs1,529 million. The overall balance of payments, measured as the change in reserve

[1] *Data released by the Central Statistics Office on 26 March 2010 show a drop in the seasonally-adjusted rate of unemployment to 7.2 per cent in the last quarter of 2009 from 7.7 per cent in the third quarter.*

assets excluding valuation changes, for the fourth quarter of 2009 registered a higher surplus of Rs4,130 million compared to Rs3,875 million the preceding quarter. Based on current trends, the current account deficit, as a percentage of GDP, is expected to widen to 7.9 per cent in 2010 from 7.7 per cent in 2009.

Members examined recent exchange rate developments and noted that the implementation of swap operations by the Bank of Mauritius in December 2009 had a positive effect on the functioning of the domestic foreign exchange market with daily turnover almost doubling. Overall, the rupee continues to reflect movements of major currencies on international markets as well as local market conditions. The MPC took note of the high and comfortable level of foreign exchange reserves. Expected positive development on the overall balance of payments should consolidate the foreign exchange reserves position. Exchange rate developments will continue to be monitored. Continued vigilance in preventing excessive exchange rate movements is warranted.

Inflation remains low by historical standard. The twelve-month average inflation rate was 2.1 per cent in February 2010, having fallen continuously since late 2008. On a year-on-year basis, inflation was 2.4 per cent in February 2010, after reaching a trough of 0.1 per cent in October 2009.[2] The pass-through of higher food and energy prices on international markets into domestic prices has contributed to exert some upward pressure on inflation.

The MPC assessed that, on balance, the inflation outlook was broadly unchanged since December 2009. Subdued domestic demand conditions and relatively stable international commodity prices are expected to mitigate significant upward pressures on inflation in the short term, suggesting that inflation could remain below past trends at around 4 per cent over the next few quarters. Further ahead over the policy-relevant horizon, however, potential risks to the inflation outlook may stem mostly from external sources, in particular from higher upward pressure in international food and energy prices. Inflation risks emanating from exchange rate developments remain fairly low at this juncture.

Members took note of the positive comments made in the Staff Report of the 2009 IMF's Article IV Consultation following its assessment of the economic situation of Mauritius and concurred with the view that it was an appropriate time to anchor low inflationary expectations.

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[2] *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.*

As customary, the MPC weighed the risks to the growth and inflation outlook over the policy-relevant horizon and discussed alternative interest rate scenarios. It judged that, on balance, inflation would remain benign in the short term with, however, potential upside risks over the medium to long term. With soft external demand and in the current low inflation environment, the MPC agreed that the support to the economy should be maintained for some more time until growth becomes self-sustaining. The MPC felt that the current stance of monetary policy was appropriate.

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.

Voting Pattern

The MPC voted unanimously to maintain the key Repo Rate at 5.75 per cent per annum.

Date for Regular Meeting

The MPC will convene its next quarterly meeting on 22 June 2010. It stands ready to meet outside regular meetings as and when required to assess the evolution of the economic situation and, if needed, take appropriate policy measures.

Bank of Mauritius
30 March 2010