BANK OF MAURITIUS

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MONETARY POLICY STATEMENT

The Monetary Policy Committee (MPC) of the Bank of Mauritius unanimously decided to maintain the Key Repo Rate at 4.75 per cent per annum at its regular meeting held on 6 December 2010. The interest rate chargeable on the Special Deposits Facility, set at 100 basis points below the Key Repo Rate, remains 3.75 per cent per annum while the interest rate on the Overnight Facility, set at 150 basis points above the Key Repo Rate, remains 6.25 per cent per annum. The interest rate payable on the Standing Facility, set at 400 basis points above the Key Repo Rate, remains 8.75 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

The global economy had evolved as anticipated at the MPC meeting in September 2010. While the underlying economic recovery was still progressing, although unevenly across regions, the growth momentum had clearly dampened in the United States, Japan, and several European economies mainly due to sustained weakness in autonomous private demand. The pace of economic expansion was also expected to moderate in the fast-growing emerging economies as national authorities tightened policy to slow demand and withdraw monetary stimulus in the face of mounting capital inflows, rising consumer and asset prices.

In its October 2010 World Economic Outlook, the International Monetary Fund (IMF) had marginally upgraded the global growth prospects for 2010 but downgraded the outlook for 2011 after having kept it on hold at 4.3 per cent in its three previous assessments during the year. While the IMF had revised the growth forecasts for 2010 for several major advanced and emerging economies substantially up, it had significantly lowered growth projections for the United States by 0.7 percentage point. For 2011, except for a few economies, the growth outlook had either remained unchanged or been downgraded - the growth forecast for the United States had been lowered by 0.6 percentage point. Weak household consumption spending, high unemployment and sizeable fiscal deficits and public debt were seen as major factors dragging economic growth down in most advanced economies dependent on domestic demand. For other advanced economies with a strong export sector and relatively weak currencies, however, the outlook had improved. Largely reflecting the tepid recovery, world trade activity had slowed in the third quarter after having risen rapidly in the first two quarters of 2010.

The most recent economic data had, however, been mixed. While third quarter 2010 national accounts data in the United States, euro area, and Britain pointed to a slowdown, purchasing managers indices and confidence indicators suggested that economic conditions in these countries were not as weak as anticipated earlier.

In the US, real GDP grew by a seasonally adjusted quarter-on-quarter rate of 0.6 per cent in the third quarter of 2010 compared to 0.4 per cent in the preceding quarter. Higher output was driven by higher levels of productivity as job growth continued to be subdued and the unemployment rate remained at an elevated level of 9.8 per cent in November.

Eurostat's flash estimates for third quarter 2010 GDP showed that real output growth in the euro area decelerated to 0.4 per cent from 1.0 per cent in the second quarter. Individual country data seemed to point to a broad-based slowdown as seasonally adjusted quarter-on-quarter real output growth rate in the four largest economies namely, Germany, France, Spain and Italy declined from 2.3 per cent, 0.7 per cent, 0.3 per cent and 0.5 per cent in the previous quarter to 0.7 per cent, 0.4 per cent, 0.0 per cent and 0.2 per cent, respectively, in the third quarter. The German economy, which had grown strongly on increasing exports to Eastern Europe and Asia, slowed as exports eased but the outlook stayed upbeat on robust domestic demand. French real output increased by 0.4 per cent quarter-on-quarter during the third quarter of 2010 partly supported by higher growth rate in private final consumption expenditure in the third quarter relative to the second quarter.

In the United Kingdom, real output grew by 0.8 per cent in the third quarter of 2010, down from a nine-year high of 1.2 per cent in the second quarter. Household expenditure rose by 0.3 per cent following an increase of 0.7 per cent in the second quarter of 2010 while gross fixed capital formation was higher by 0.6 per cent on the quarter. Consumer confidence had improved in October 2010 while retail industry surveys showed that the economy was not slowing as rapidly in the second half of the year as was initially feared.

Purchasing Managers' Indices (PMI) for the US services and manufacturing sectors grew more quickly than expected in October, its tenth straight month of expansion. Euro zone's flash estimates of the composite manufacturing and services PMI for November 2010 surprised markets, which had expected a further fall from October's eight-month low of 53.8 with a leap to 55.4. Strong private sector growth in Germany and France largely offset the stagnation in other core and periphery member economies. Britain's services sector PMI unexpectedly rose to 53.2 in October from 52.8 in September.

Looking ahead, downside risks would keep economic activity in main trading partners subdued for a while. With little policy coordination at the global level, the rebalancing of advanced economies away from domestic demand would take much longer and with fiscal tightening looming ahead, most economies would struggle in 2011. Increasingly, financial markets had been characterised by wild gyrations and heightened risk aversion. Currencies had been particularly volatile. Government bond yields in the peripheral euro area economies as well as the cost of insurance against default had shot up as investors demand a higher risk premium over German bonds. Contagion risks across deficit countries and into corporate bonds cannot be overlooked: if this was to materialise, long term interest rates would flare up, complicating efforts to stimulate the economy further.

The MPC noted that while inflation had remained benign in most advanced economies, it had surprised on the upside in several emerging economies on account of rapid growth, higher wages, rising food and energy prices, and higher industrial input prices. Stronger currencies due largely to substantial capital inflows had, however, helped contain inflationary pressures in these emerging economies. Against this backdrop, central banks in several emerging economies had responded by tightening monetary policy.

The short to medium term outlook for food prices in particular appeared bleak as highlighted by the Food and Agriculture Organisation (FAO) in its November 2010 Food Outlook. Higher world prices of most agricultural commodities were expected mainly due to unforeseen supply disruptions. Since June 2010, the FAO Food Price Index (FFPI) has steadily increased month-on-month to average 197 points in October, the highest level in 27 months. Separately, crude futures had on average risen since the last MPC meeting, recording a settlement price of US$91.42 for ICE Brent and US$89.19 for NYMEX on 3 December.

Domestic developments and outlook

In Mauritius, the latest available data supported the view that the economy was gradually recovering and real activity was likely to expand at a pace below trend average for a prolonged period. Growth was expected to be around 4.2 per cent in 2010. Reflecting sub-par economic performance, the unemployment rate had remained above 7.0 per cent.

The 2010 national accounts data for the second quarter released by the CSO on 30 September showed that the seasonally adjusted real growth rate had rebounded to 0.3 per cent quarter-on-quarter following a contraction by a revised 3.7 per cent in the first quarter of 2010. Seasonally adjusted production data pointed to persistent weakness in manufacturing and transport, storage and communications as real activity in both sectors shrank further in the second quarter. Within the manufacturing sector, food excluding sugar contracted for the second consecutive quarter, while real output in the textile sector after a quarter-on-quarter contraction in the first quarter remained virtually flat in the second quarter. Other manufacturing posted a negative real growth rate of 6.8 per cent following a strong growth of 6.2 per cent in the first quarter. In almost all other sectors that had also contracted in the first quarter (agriculture, hunting, forestry and fishing, construction, distributive trade, hotels and restaurants, financial intermediation, and real estate, renting and business), real output growth had recovered and turned positive in the second quarter, while utilities posted a flat growth rate.

Overall for the year ended second quarter 2010, real output grew at a lower rate of 3.8 per cent from 4.2 per cent in the first quarter of 2010 with all key sectors of the economy recording positive growth rates.

By main expenditure categories, household real consumption expenditure slowed from 2.3 per cent in the preceding quarter to a year-on-year rate of 2.0 per cent in the second quarter - its third straight quarter of decline. Gross domestic fixed capital formation recovered in the second quarter of 2010, posting a year-on-year growth rate of 4.7 per cent compared with a decline of 2.5 per cent in the preceding quarter. By type of capital goods, the recovery was more pronounced in building and construction work and less in machinery and equipment. For 2010, private sector investment was expected to decline by 1.2 per cent after a contraction of 2.0 per cent in 2009 while public sector real investment spending, excluding aircraft and marine vessels, would expand by 13.3 per cent following a positive growth rate of 33.2 per cent in the preceding year.

The most recent data available up to October 2010 had surprised on the upside and indicated that the domestic economy was holding up fairly well despite difficult international trading conditions. Adjusted for exchange rate effects computed from the change in the nominal effective exchange rate over the corresponding period, the increase in exports was more pronounced. Separately, market intelligence pointed to fairly bullish forecasts as higher wages, higher consumer inflation and currency appreciation in competitor countries contributed to shift some of the business to Mauritius. With regard to the tourism industry, the latest reports pointed to a global recovery in international arrivals although earnings would continue to lag behind arrival figures due to heavy discounting by hotels. Domestic data on both arrivals and earnings up to October 2010 broadly supported this view. Adjusted for exchange rate effects, gross tourism earnings in the nine months to September 2010 had exceeded earnings in the corresponding period of 2009 and come close to the level of 2008.

The sovereign debt crisis remains a major source of uncertainty for growth in the euro area, a major export market for Mauritius.

The MPC reviewed the sizeable current account deficit forecast at 9.3 per cent of GDP in 2010, which did not appear to be abating despite currently weak economic conditions. The MPC considered the slow pace of expansion of domestic credit to the productive sectors, in particular, the export manufacturing sector. Several MPC members observed that the current bank liquidity overhang needed to be channelled in a way conducive to boosting economic activity.

The MPC took note of the latest price developments and discussed the inflation outlook. Headline inflation, measured by the change in the average level of prices over twelve months, rose from 2.0 per cent in September 2010 to 2.3 per cent and 2.5 per cent in October 2010 and November 2010 respectively. The MPC's preferred year-on-year measure of CPI inflation increased for the second month in a row, climbing from 2.5 per cent in September 2010 to 3.2 per cent in October 2010 and further to 3.9 per cent in November 2010. Despite higher prices on average between September and November 2010, CORE2, which strips the CPI basket of food, beverages, tobacco, mortgage interest, energy prices as well as administered prices, continued to remain tame indicating that first round price increases had yet to feed into the entire price structure.

The MPC took note of the latest wage developments and also assessed the impact of recent budgetary measures as well as rising food and energy prices on the price level and economic growth. The Bank forecast that the year-on-year CPI inflation would reach 5.7 per cent by December 2010 and would exceed 7.0 per cent by June 2011.

The MPC weighed the risks to the growth and inflation outlook over the policy-relevant horizon and discussed alternative interest rate scenarios. Several members of the MPC observed that inflation might rise faster than anticipated at the September 2010 meeting but, in view of the uncertainty about the global economic prospects and the potential downside risks to the Mauritian economy, MPC members felt that the balance of risks did not warrant a change in the Key Repo Rate at that meeting.

The MPC will continue to monitor economic and financial developments and remains committed, as per its mandate, to formulate and determine monetary policy with a view to maintaining price stability and promoting the orderly and balanced economic development of Mauritius.

Voting Pattern

The MPC voted unanimously to maintain the Key Repo Rate at 4.75 per cent per annum.

Date for Regular Meeting

The MPC will convene its next quarterly meeting on 28 March 2011. 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
13 December 2010