**BANK OF MAURITIUS**

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# Minutes of the 27th Monetary Policy Committee Meeting 24 September 2012

The 27th meeting of the Monetary Policy Committee was held on 24 September 2012 at 10.00 hours at the Bank of Mauritius, with Mr Rundheersing Bheenick, Governor, in the chair.

Members present: Mr Yandraduth Googoolye, First Deputy Governor; Mr Mohammed Iqbal Belath, Second Deputy Governor; Mr Jitendra Nathsingh Bissessur, Head-Financial Markets Analysis Division, Bank of Mauritius; Mr Nishan Degnarain, Mr Pierre Dinan, Mr Alain Madelin, Mr Rajkamal Taposeea and Ms Silvana Tenreyro, External Members.

Observers: Dr Streevarsen Narrainen, Senior Economic Adviser, Ministry of Finance and Economic Development, and Mr Neetyanand Kowlessur, Chief-Governor's Office, Bank of Mauritius.

## Summary of Staff Reports on Economic and Financial Developments

The Staff reported on economic and financial developments since the 26th MPC meeting held on 11 June 2012.

### *The International Economic Environment*

1. Information received since the June 2012 MPC meeting had confirmed the global economic slowdown, amid lingering euro area debt crisis and long-lasting debt issues in major advanced economies. Despite new policy measures announced by the European Central Bank (ECB) and the US Federal Reserve, considerable uncertainty with regard to the global growth outlook continued to prevail.

2. Leading economic indicators had substantiated the sluggish pace of global economic activity, suggesting that world growth would fall short of its long-term trend rate in 2012. Recent institutional forecasts had downgraded the projected growth rate of some major advanced and emerging economies in 2012 and 2013.

3. In the United States, the economy had grown at a moderate annual pace of 1.7 per cent in 2012Q2 compared to 2.0 per cent in 2012Q1. Labour market conditions had stayed lacklustre, with the unemployment rate estimated at 8.1 per cent in August 2012. Leading activity

indicators had pointed to protracted slow growth in the US economy, reflecting fragile consumer and business confidence as well as the uncertainty generated by the end of the tax-relief measures by end-2012. The US Federal Reserve had engaged in a third round of quantitative easing in an effort to stimulate economic growth and improve the labour market.

4. The economic situation in the Eurozone had continued to deteriorate. Real GDP had declined by 0.2 per cent in 2012Q2 compared to zero growth in 2012Q1 while the unemployment rate had reached a record high of 11.3 per cent in July. Notwithstanding the plan for Outright Monetary Transactions by the ECB to address the severe distortions in distressed Eurozone sovereign bond markets, recent economic indicators suggested that the economy was on course to contract in 2012.

5. The British economy had registered its third consecutive quarter of decline in 2012Q2, with real output shrinking by 0.5 per cent on poor performance of the production and services sectors. While the economy was expected to rebound in 2012Q3, growth would not compensate for the contraction experienced in 2012H1.

6. Growth had continued to moderate in major emerging economies as external demand conditions weakened. Leading economic indicators showed that economic activity was likely to stay muted given the headwinds affecting main export markets.

7. Global commodity prices had increased since the June 2012 MPC meeting. After three consecutive months of decline, the FAO Food Price Index had surged in July on supply concerns and had remained at an elevated level thereafter. Crude oil futures markets had also rebounded following the re-emergence of geopolitical tensions in the Middle East.

8. Global inflation had been mild in a number of advanced and emerging economies, with demand pressures contained by the soft economic environment. However, upside risks to the global inflation outlook had resurfaced recently in the wake of increases in food and energy prices.

9. The policy actions of the ECB had contributed to improve financial conditions in the Eurozone. Major financial markets had perked up, amid falling market volatility and increased confidence. As market risk aversion faded, the euro reversed its downward trend, global equity markets rallied and troubled Eurozone sovereign bond yields declined.

***Domestic Economic Developments***

10. National accounts data released by Statistics Mauritius in June 2012 showed that the domestic growth momentum had remained subdued. Seasonally-adjusted q-o-q growth had ticked down slightly to 0.2 per cent in 2012Q1, from 0.3 per cent in 2011Q4. Except for **'manufacturing'** and **'transport, storage and communications',** which recorded growth in 2012Q1, declines had been broad-based across sectors.

11. Annual output growth had picked up to 2.8 per cent in 2012Q1, from 1.9 per cent in 2011Q4. While **'transport, storage and communications'**, and **'construction'** had recorded higher growth rates**, 'wholesale and retail trade'**, **'financial intermediation'** and **'real estate, renting and business activities'** had slowed and **'hotels and restaurants'** had stagnated. Following a steep contraction of 6.0 per cent in 2011Q4, **'Manufacturing'** had contracted further by 0.4 per cent in 2012Q1 as growth of 8.5 per cent in *'food'* was offset by declines in *'other manufacturing'* and *'textile'*. In June 2012, Statistics Mauritius projected the domestic economy to grow at 3.5 per cent in 2012.

12. **'Final consumption expenditure'** growth had recovered to 2.8 per cent in 2012Q1, from 2.1 per cent in 2011Q4, mainly reflecting a rebound in *'general government consumption expenditure'* growth to 2.7 per cent while *'household consumption expenditure'* growth had increased marginally to 2.8 per cent. **'Gross domestic fixed capital formation'** had progressed by 10.4 per cent in 2012Q1, largely on account of growth of 26.5 per cent registered in *'machinery and equipment'* following the acquisition of a power generating plant. Excluding *'aircraft and marine vessel'*, **'gross domestic fixed capital formation'** was projected to contract by 0.7 per cent in 2012.

13. Total exports *f.o.b.* had increased by 6.2 per cent y-o-y in 2012H1, with a rise of 13.9 per cent in *'food and live animals'* exports partly offset by a fall of 3.5 per cent in *'miscellaneous manufactured goods'* exports. Total imports *c.i.f.* had climbed by 11.8 per cent y-o-y, led by increases in the imports of *'machinery and transport equipment'*, *'food and live animals'* and *'mineral fuels, lubricants and related products'*, which outweighed the fall in the imports of *'manufactured goods'*.

14. Weak demand in main export markets had continued to impact on the textile and tourism sectors. While the textile sector was supported to some extent by regional market diversification and the renewal of the Third Country Fabric derogation under AGOA, total tourist arrivals over the period January to August 2012 had remained almost unchanged compared to the preceding year. A drop in arrivals from several key European markets had been noted. Tourist earnings had increased by 9.4 per cent y-o-y over the period January to July 2012 to reach Rs26,618 million.

15. In line with its earlier decision to have recourse to external consultants on real sector issues, the MPC benefited from a presentation by Mr Bhavik Desai of Axys Stockbroking Ltd., a local brokerage firm, on the Mauritian tourism industry. Members took note of the challenging conditions faced by the hotel industry where diversification into new, emerging source markets had not been enough to compensate for the retreat of tourist arrivals from main European markets. In addition to the risks posed by the recession in the Eurozone, the sector was confronted with increased regional competition and high indebtedness. The study confirmed that the Bank was proactive in offering a debt-refinancing scheme to the hotel sector and that

there was an urgent need to review the strategies that had been adopted so far in efforts to boost the tourism sector.

16. Provisional estimates of the balance of payments, including cross-border transactions of GBC1s, had indicated a lower current account deficit of Rs8.8 billion in 2012Q2 compared to Rs9.7 billion registered in 2011Q2. Significant gains recorded in the '*services'* and *'income'* accounts had more than offset the worsening merchandise trade deficit and the lower surplus on the *'current transfers'* account.

17. Inclusive of GBC1s financial flows, the capital and financial account had recorded higher net inflows of Rs10.1 billion in 2012Q2 relative to 2011Q2. Net inflows on foreign direct investment and *'other investment'* had amounted to Rs71.9 billion and Rs37.3 billion, respectively, in 2012Q2 while *'portfolio investment'* had registered net outflows of Rs96 billion. The overall balance of payments posted a surplus of Rs3.0 billion in 2012Q2.

18. The unemployment rate had risen slightly to 7.6 per cent in 2012Q1, from 7.5 per cent in 2011Q4. On a seasonally-adjusted basis, however, the unemployment rate had decreased to 7.0 per cent, from 8.4 per cent.

19. The growth of monetary aggregates had picked up some momentum since the June 2012 MPC meeting. The annual growth rate of broad money liabilities had increased to 7.5 per cent in July 2012, from 6.1 per cent in April 2012, while the annual growth rate of credit to the private sector had accelerated to reach 15.7 per cent in July 2012.

20. Since May 2012, the CPI had progressed slightly by 0.7 point to 133.2 in August 2012. Headline inflation had steadily declined from 5.3 per cent in May 2012 to 4.6 per cent in August 2012 while y-o-y inflation had remained modest at 3.7 per cent in August 2012. **'Alcoholic beverages and tobacco'** had contributed 1.5 percentage points to the y-o-y inflation outcome, followed by **'food and non-alcoholic beverages'** (0.7 percentage point) and **'housing, water, electricity, gas and other fuels'** (0.6 percentage point).

21. Underlying core measures of inflation had continued to indicate moderate inflationary pressures. Both y-o-y CORE1 and CORE2 inflation had edged down by 0.1 percentage point between May and August 2012 to 3.0 per cent and 2.7 per cent, respectively. On a 12-month average period, CORE1 and CORE2 inflation had consistently trended downwards to 3.9 per cent and 3.2 per cent, respectively, in August 2012.

22. The Bank's *Inflation Expectations Survey* of August 2012 had indicated that around 75 per cent of respondents expected prices to go up over the next 12 months while some 15 per cent believed prices would remain unchanged and 10 per cent thought they would go down. Most respondents anticipated inflation to be within a range of 4.5-6.5 per cent over the next 12 months, with the mean inflation rate down to 5.8 per cent one year ahead.

### *Domestic Financial Markets Developments*

23. Overall excess liquidity in the domestic money market had increased to an average of Rs3.3 billion since the June 2012 MPC meeting. Except for one bank resorting to the overnight facility, the Bank had not intervened on the domestic money market.

24. At the primary auctions of Treasury Bills, the weighted average yields on 91-day, 182-day and 273-day Treasury Bills had declined to 3.16 per cent, 3.38 per cent and 3.46 per cent respectively. The weighted average yield on the 364-day Treasury Bills had, however, risen to 3.91 per cent.

25. The weighted average interest rate on rupee deposits and rupee advances had decreased between May and July 2012. The real interest rate on savings deposits, using the y-o-y or headline inflation rate, had remained in negative territory since around the beginning of 2011.

26. Reflecting international currency market conditions and the implementation of Operation Reserves Reconstitution (ORR) by the Bank, the dealt rupee exchange rate had depreciated against the US dollar, euro and Pound sterling. In nominal effective terms, MERI1 and MERI2 had depreciated by 2.44 per cent and 2.53 per cent, respectively, since the Bank started the ORR.

### *Staff Economic Outlook*

27. Staff estimated that the output gap had stayed negative in 2012Q2, with the economy operating below trend. The precarious global economic backdrop was impacting negatively on domestic economic activity though growth was expected remain positive. Given that the downside risks identified at the June 2012 MPC meeting had largely materialised, the domestic growth forecast for 2012 had been revised downwards to 3.3 per cent, from an earlier estimate of 3.8 per cent. Risks emanating from the Eurozone sovereign debt crisis were estimated to have lessened in the wake of measures taken by the ECB, but they remained significant.

28. Staff assessed that upside risks to the domestic inflation outlook had increased. The main factors that were likely to affect the inflation path in the coming quarters were external supply shocks to world food and energy prices and, on the domestic front, the recent rupee depreciation, the forthcoming Pay Research Bureau (PRB) salary review and the expected upward revision to retail petroleum prices. On current trends, y-o-y inflation could stay at high levels.

## The Monetary Policy Decision

29. The MPC considered that there were sustained risks for prolonged sub-par growth in main export markets despite recent actions by the ECB and US Federal Reserve, which had provided clear signals of their commitment to support growth in their respective economies. Growth prospects had remained moderate in the US but had deteriorated further in the euro area, UK

and emerging economies. Besides downside risks from the Eurozone sovereign debt crisis, fiscal austerity measures in major advanced economies and fiscal uncertainty in the US were also likely to weigh on the global growth outlook. Meanwhile, global inflationary pressures had re-emerged as supply concerns and geopolitical factors pushed up world food and energy prices. Members viewed that quantitative easing by major foreign central banks could exert further upward pressures on commodity prices.

30. The Committee assessed that the domestic economy had continued to hold up well to the prolonged crisis although the pace of economic activity, especially in the export-led sectors, had been affected by the escalating global headwinds. Fragile business confidence was expected to dent private investment growth while public investment growth could be constrained by implementation capacity. Considerable uncertainty remained with regard to the domestic economic outlook and members took the view that downside risks would persist as long as the problems in the Eurozone were not solved.

31. Members examined developments in the domestic foreign exchange market since the implementation of the ORR. The Bank's greater intervention to purchase foreign exchange from the domestic market had led gross official international reserves to increase to about 5 months of import cover since June 2012. The intervention had contributed to stem the appreciating trend of the rupee. However, members noted that long-term competitiveness issues could not be resolved through short-term palliatives, such as exchange rate depreciation. Most considered that it was important for the central bank to retain the focus on its mandate of price stability.

32. The MPC discussed the growing indebtedness of some major sectors in the economy and noted that non-performing loans had increased in the manufacturing, tourism and construction sectors over 2012Q2. Some members took the view that this situation might have partly resulted from the accommodative monetary policy stance. They urged greater use of the Special Foreign Currency Line of Credit to minimise exporters' exchange rate risks and uphold banking sector stability.

33. The MPC remained concerned about conditions in the labour market where across-the-board wage compensation and salary increases might not match productivity increases and the profitability of enterprises. The need for labour market reforms was highlighted to tackle the structural skills mismatch in the economy and improve the wage-setting process.

34. While inflation had been relatively benign since the June 2012 MPC meeting, the MPC was of the view that inflationary pressures had shifted to the upside given the recent increases in global food and energy prices. Domestically, the depreciation of the rupee – and its potential pass-through to prices in the economy – as well as the projected adjustment to retail petroleum prices posed additional upside risks to the inflation outlook. Although subdued economic conditions and the negative output gap had contributed to constrain demand pressures so far,

the forthcoming public sector salary review and the possible upward pull that it could exert on private sector wages could amplify those risks.

35. The Committee weighed the risks to the growth and inflation outlook over the policy-relevant horizon and discussed alternative interest rate scenarios. Opinion was divided on the monetary policy stance to be adopted. Some on the Committee were of the view that the weak global economic outlook and the threats posed to domestic growth prospects significantly outweighed upside risks to inflation, and therefore called for more monetary policy accommodation. While acknowledging the muted domestic growth outlook, a majority of members nonetheless judged that the monetary policy stance was broadly appropriate. The upside risks to inflation coupled with the uncertainty surrounding the future evolution of the Eurozone crisis and the fiscal stance of the forthcoming Budget warranted caution on the monetary policy front. Some members further expressed concerns about the persistent negative real interest rate in the economy and its potential impact on savings deposits, asset prices and corporate indebtedness.

***Voting Pattern***

36. At the conclusion of the discussion, the Committee voted with a majority of 6-3 to keep the Key Repo Rate unchanged at 4.90 per cent per annum. The three dissenting members voted to cut the Key Repo Rate by 40, 50 and 60 basis points, respectively.

37. The MPC will maintain strong vigilance in monitoring economic and financial developments and stands ready to meet in between its regular meetings if the need arises.

38. The meeting adjourned at 17.20 hours. The next MPC meeting is scheduled on Monday 26 November 2012.

39. **Voting for the MPC action:** Mr Rundheersing Bheenick, Mr Yandraduth Googoolye, Mr Mohammed Iqbal Belath, Mr Jitendra Nathsingh Bissessur, Mr Pierre Dinan and Mr Alain Madelin.

40. **Voting against the MPC action:** Ms Silvana Tenreyro who voted for a 40 basis point rate cut, Mr Nishan Degnarain who voted for a 50 basis point rate cut and Mr Rajkamal Taposeea who voted for a 60 basis point rate cut.

*Bank of Mauritius*
*08 October 2012*

## Editor's Note

According to the Bank of Mauritius Act 2004, the primary object of the Bank shall be to maintain price stability and to promote orderly and balanced economic development. The Act gives the Monetary Policy Committee (MPC) responsibility to formulate and determine the monetary policy to be conducted by the Bank. The MPC meets on a regular quarterly basis.

In line with amendments brought to the Bank of Mauritius Act 2004 in December 2011, the composition of the MPC was revised in March 2012. Members of the MPC now comprise the Governor (Chairperson), three Senior Officers of the Bank appointed by the Governor, and 5 other persons (external members) appointed by the Minister of Finance and Economic Development after consultation with the Governor.

When the MPC met on 24 September 2012, the last available data on national accounts and employment were for 2012Q1 while the last data on external trade and the balance of payments were for 2012Q2. Monetary data on hand was for July 2012 and the last data available on CPI and inflation were for August 2012.

### *Abbreviations and Definitions*

**Headline inflation** is measured by the change in the average Consumer Price Index (CPI) over a twelve-month period compared with the corresponding previous twelve-month period.

**Y-o-y inflation** is measured by the change in the CPI for a given month compared with the corresponding month of the preceding year.

**CORE1 inflation** excludes food, beverages and tobacco and mortgage interest on housing loan from the CPI basket. Both headline and y-o-y CORE1 inflation measures are available.

**CORE2 inflation** excludes food, beverages and tobacco, mortgage interest, energy prices and administered prices from the CPI basket. Both headline and y-o-y CORE2 inflation measures are available.

**Dealt exchange rate** is the weighted average rupee selling rate derived from transactions of US$30,000, and above, or equivalent.

**MERI 1** is the Mauritius Exchange Rate Index, a nominal effective exchange rate introduced in July 2008, based on the currency distribution of merchandise trade.

**MERI 2** is the Mauritius Exchange Rate Index, a nominal effective exchange rate introduced in July 2008, based on the currency distribution of merchandise trade and tourist earnings.

**GBC1s** are resident corporations which conduct business outside Mauritius. The law has recently been amended to allow them to transact with residents provided that their activities in Mauritius are ancillary to their core business with non-residents.

**Other investment** includes all debt liabilities between unaffiliated non-residents and residents, which are not securitised. It can be classified by institutional sector: general government, monetary authorities, banks, and other sector, and sub-classified between short-term and long-term.

**Y-o-y** refers to year-on-year changes.

**Q-o-q** refers to quarter-on-quarter changes.