BANK OF MAURITIUS

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Minutes of the 30th Monetary Policy Committee Meeting held on 17 June 2013

The 30th meeting of the Monetary Policy Committee was held on 17 June 2013 at 9.30 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 Nishan Degnarain, Mr Pierre Dinan and Mr Hemraz Oopuddhye Jankee, External Members.

Professor Jeffrey Frankel and Professor Silvana Tenreyro, External Members, attended the meeting via video-conference.

Observer: Dr Streevarsen Narrainen, Senior Economic Adviser, Ministry of Finance and Economic Development.

Summary of Staff Reports on Economic and Financial Developments

The Staff reported on economic and financial developments since the 29th MPC meeting held on 11 March 2013.

The International Economic Environment

1. Fears about the fragile state of the global economy had been confirmed since the March 2013 MPC meeting. Latest data available and leading economic indicators pointed to a modest pace of growth in global output for 2013 and beginning of 2014, with increasing divergences between countries and regions. Substantial downside risks to the global growth outlook, partly emanating from restrictive fiscal policy in advanced economies, persisted.

2. The US economy continued to recover slowly, with GDP growth of 2.4 per cent q-o-q in 2013Q1. While the unemployment rate had remained relatively high at 7.6 per cent in May 2013, consumer confidence had improved. Activity was expected to expand gradually in 2013H2 but there were lingering fears that the cutbacks in federal spending might prove a drag on the economy.

3. The Eurozone had remained mired in recession in 2013Q1 as the economy contracted for the sixth consecutive quarter, at a rate of 0.2 per cent q-o-q. Output had fallen in most core economies, including France, which was back in recession. A record-high unemployment rate of 12.2 per cent in April 2013 amid low consumer and business confidence as well as lacklustre leading indicators highlighted the risk for a prolonged recession in the area and prompted the ECB to ease monetary policy.

4. The UK avoided a triple-dip recession, with growth picking up to 0.3 per cent q-o-q in 2013Q1. However, the labour market had shown some signs of slowing down. Despite indications of an improvement in the manufacturing sector, the economy still appeared far from a sustainable recovery.

5. Output growth in a number of emerging and developing economies had decelerated in 2013Q1 mainly due to deteriorating domestic demand conditions and persistent external headwinds. Leading indicators suggested that these factors would continue to impact on economic activity in the near term.

6. The global inflation outlook had stayed benign given significant economic slack and slower growth in commodity prices. Global consumer price inflation had decelerated since the March 2013 MPC meeting and inflation risks as well as inflation expectations had receded. While the FAO Food Price Index had mostly stabilised at elevated levels, a fairly significant retreat was noted in global oil prices.

7. Global financial sentiment had been buoyant though recent speculation around an early end to quantitative easing in the US had increased market volatility and triggered a broad correction across world bond and equity markets while the US dollar had gained ground.

Domestic Economic Developments

8. The most recent national accounts data released in March 2013 highlighted a loss of momentum in 2012Q4 as seasonally-adjusted q-o-q growth had slowed to 0.2 per cent, from 1.2 per cent in 2012Q3, partly as a result of a contraction in **'manufacturing'**.

9. Over the year to 2012Q4, the domestic economy had expanded by 3.2 per cent compared to 2.2 per cent in 2011Q4. Growth had rebounded to 2.8 per cent in **'manufacturing'**, led by positive growth of 4.7 per cent and 7.4 per cent in *'food'* and *'textile'*, respectively, whereas *'sugar'* and *'other manufacturing'* had contracted. **'Wholesale and retail trade'**, **'information and communication'** and **'real estate activities'** had also registered higher growth rates than a year earlier. By contrast, real output had decelerated in **'transportation and storage'** and '**financial and insurance activities**'. **'Accommodation and food service activities'** had stagnated in 2012Q4 while construction activity had regressed by 9.4 per cent.

Growth of 3.8 per cent was recorded in **'export-oriented enterprises'** following contraction of 7.9 per cent a year earlier.

10. In March 2013, Statistics Mauritius had confirmed a fairly broad-based GDP expansion of 3.3 per cent in 2012. Growth for 2013 was revised downwards to 3.5 per cent, from the initial forecast of 3.7 per cent made in December 2012.

11. **'Final consumption expenditure'** had risen by 3.3 per cent in 2012Q4, compared to 2.7 per cent in 2012Q3, boosted by increases in both household and government consumption. By contrast, **'gross domestic fixed capital formation'** (GDFCF) had sharply contracted by 14.3 per cent over the same period, following negative growth of 3.4 per cent in 2012Q3, as a result of significant declines of 27.5 per cent and 8.3 per cent in *'machinery & equipment'* and *'building & construction work'*, respectively. For 2013, **'final consumption expenditure'** was projected to expand by 3.0 per cent while, excluding *'aircraft and marine vessel'*, GDFCF was forecast to contract further by 2.6 per cent in 2013.

12. Despite challenges from the grim economic conditions in main trading-partner countries, total exports, excluding *'ship's stores and bunkers'*, had increased by 5.1 per cent y-o-y in 2013Q1, pushed up by the exports of *'food and live animals'*, which offset the fall in *'miscellaneous manufactured goods'* exports. Imports *c.i.f.* had grown slightly by 0.9 per cent as imports of *'food and live animals'* and *'mineral fuels, lubricants and related materials'* were offset by a steep 30.3 per cent decline in *'machinery and transport equipment'*.

13. Latest data showed an increase of 1.0 per cent y-o-y in tourist arrivals over the period January to May 2013. Tourist earnings had contracted by 9.0 per cent y-o-y over the period January to April 2013. Statistics Mauritius had marginally reviewed downward tourist arrivals in 2013 to 990,000, from the initial forecast of 1 million, while gross tourist earnings were estimated at around Rs46.1 billion, compared to Rs47 billion forecast previously.

14. Preliminary estimates for 2013Q1 pointed to a current account deficit to GDP ratio of 8.3 per cent, higher than the ratio of 5.4 per cent recorded a year ago. Although the merchandise account had registered a lower deficit, it was not enough to bring about an improvement in the current account performance as the surplus on the services account had registered a sharper fall. However, the overall balance of payments recorded a surplus due to strong capital inflows.

15. The unemployment rate had fallen to 7.8 per cent in 2012Q4, from 7.9 per cent in 2012Q3. On a seasonally-adjusted basis, however, the unemployment rate had increased by 0.5 percentage point to 8.6 per cent in 2012Q4.

16. Monetary and credit developments had remained subdued since the last MPC meeting. The annual growth rate of Broad Money Liabilities had gone up slightly to 7.9 per cent in April

2013 compared with 7.2 per cent in January 2013 while the annual growth rate of claims on other sectors held by other depository corporations had declined to 15.9 per cent in April 2013.

17. As from April 2013, the weights used in the calculation of the CPI had been revised in line with the findings of the 2012 Household Budget Survey. The new CPI series showed that headline inflation had remained unchanged for the fourth straight month at 3.6 per cent in May 2013 while y-o-y inflation had edged up from 3.6 per cent in February 2013 to 3.7 per cent in May 2013. *'Alcoholic beverages and tobacco'* (+1.1 percentage point) and *'food and non-alcoholic beverages'* (+1.0 percentage point) had been the largest contributors to y-o-y inflation in May 2013.

18. Underlying inflationary pressures had remained moderate. Y-o-y CORE1 inflation had risen from 2.2 per cent in February 2013 to 2.6 per cent in May 2013 while CORE2 inflation had edged down to 2.5 per cent in May 2013, from 2.6 per cent in February 2013.

19. The Bank's 19th *Inflation Expectations Survey* carried out in May 2013 had shown that 61.2 per cent of respondents expected headline inflation to be less than 4.5 per cent in December 2013 while 36.7 per cent of respondents expected inflation to be within a range of 4.5 to 6.5 per cent. By June 2014, however, the majority of respondents expected inflation in the range of 4.5 to 6.5 per cent. None of the respondents anticipated headline inflation above 6.5 per cent.

Domestic Financial Markets Developments

20. Staff reported that the overall excess liquidity in the banking system had averaged Rs3.8 billion since the March 2013 MPC meeting, partly as a result of intervention on the domestic foreign exchange market and the placement of funds with banks by the National Resilience Fund. Concurrently, the Bank had issued Bank of Mauritius securities for a total amount of Rs7.2 billion to mop up excess liquidity.

21. At the primary auctions for Treasury Bills, weighted yields on the 182-Day and 364-Day Treasury Bills had increased to 2.65 per cent and 2.91 per cent, respectively, while the weighted yields on the 91-Day and 273-Day Treasury Bills stood at 2.26 per cent and 2.41 per cent, respectively.

22. The weighted average interest rates on rupee deposits and advances stood at 3.45 per cent and 8.33 per cent, respectively, as at end-April 2013. The real modal savings deposits rate, using the y-o-y inflation rate, moved from 0.1 per cent in February 2013 to negative 0.2 per cent in April 2013.

23. Under the Special Line of Credit in Foreign Currency of €600 million made available to operators in the export sector, the Bank had disbursed funds totalling €38.6 million as at mid-June 2013, mainly to operators in the tourism sector.

24. Movements in the rupee exchange rate continued to be affected by international currency fluctuations as well as domestic demand and supply conditions. Since March 2013, the dealt rupee exchange rate had slightly appreciated against the US dollar but had depreciated against the euro and Pound sterling. In nominal effective terms, the rupee had depreciated by around 0.3 per cent.

Staff Economic Outlook

25. Data available at the time of the meeting suggested that the output gap had remained negative in 2013Q1 although diversification efforts in the textile and tourism sectors as well as the strong performance of the seafood and ICT sectors had helped the economy to maintain a positive growth momentum. External demand conditions were assessed to have slightly deteriorated since the March 2013 MPC meeting and were expected to remain unfavourable for domestic export-oriented enterprises given the prolonged recession in the Eurozone and volatile growth recorded elsewhere. Staff revised the growth forecast for 2013 downward to a range of 3.2 to 3.7 per cent, as against a range of 3.4 to 3.9 per cent projected at the previous MPC meeting to reflect the slightly worsening global growth outlook. Downside risks to domestic growth outlook remained and are reflected in the revised range of the growth forecast.

26. Staff estimated that the public sector wage award and its possible spill-overs across the economy continued to pose significant upside risks to the inflation outlook. In the medium term, it was expected that these upside risks could more than offset the downward price pressures emanating from the negative output gap and the new 2012 consumer basket with updated weights that might have introduced a downward bias arising from consumer substitution for lower-priced products. On a no-policy change basis, the Bank's staff forecast y-o-y inflation within a range of 5.3 to 5.8 per cent by December 2013, equivalent to a headline inflation forecast of 4.1 to 4.3 per cent.

Representations to the MPC

27. In line with the amendments brought to the Bank of Mauritius Act 2004 in December 2012, the MPC is required to "*take into account the views of the Bank, the Ministry* [Ministry of Finance and Economic Development] *and such other institution or organization as it considers appropriate*" in the discharge of its functions. In this meeting, the MPC benefited from presentations by the Financial Secretary, Mr Ali Mansoor, on behalf of the Ministry and by the *Association des Consommateurs de l'Ile Maurice* (ACIM), represented by Mr Jayen Chellum, General Secretary, and Dr Edwin Grégoire, Executive Committee member. The Finance Ministry argued for a rate cut of 50 basis points while stating that a smaller decrease of 25 basis points would also serve the purpose. ACIM, on its part, made a case for a rate increase in the range 15 to 25 basis points. Their views are summarised in Annex 1.

The Monetary Policy Decision

28. The MPC noted that global economic conditions had remained weak and uneven since the March 2013 meeting and major institutional forecasters had downgraded the global growth outlook. While members saw growth in the US evolving broadly according to expectations, strong concerns were raised about the further deterioration of output in the euro area and in France, a major trading-partner country. The slowdown in some of the largest emerging market economies also raised some worries. There was uncertainty about the prospects for a sustained recovery in the world economy, with important downside risks seen in the medium term. Concurrently, the global inflation outlook was subdued as demand pressures and commodity prices remained under control.

29. The Committee took note of the downward revisions to the domestic growth projections for 2013 and viewed that real activity in the domestic economy was likely to stay vulnerable to the subdued external backdrop. While diversification away from traditional markets into emerging markets with better growth prospects was expected to keep the growth momentum positive, it was judged insufficient to shift the economy back towards a trend pace of growth in the medium term. Trade performance was expected to remain lacklustre at the current juncture. Given the downside risks to the domestic growth outlook, it was anticipated that firms would remain cautious about committing to large capacity expansions and that the potential for private investment growth would remain dim.

30. The situation in the labour market where the last available data had revealed a sharp increase in the unemployment rate in 2012Q4 appeared as a serious concern to some Committee members. Other members, however, underlined the fact that (i) the fourth quarter unemployment figures have been rising over the last 5 years and the increase in 2012Q4 was slightly above trend and not as alarming, when viewed from this perspective, and (ii) there had been net job creation of 9,100 in the country during 2012, including an additional 1,000 foreign workers. Numerous job vacancies were still being advertised. The slight worsening of the unemployment rate to 8.3 per cent for 2013, well below the high of 9.6 per cent recorded in 2005, i.e. before the current global economic and financial crisis, was consistent with the muted domestic growth outlook, itself due to depressed global economic conditions affecting major partner countries.

31. Members observed that headline, y-o-y and core inflation measures had remained broadly unchanged since the March 2013 MPC meeting. On the downside, the degree of slack in the economy and the decline in global energy prices were viewed as containing domestic inflation pressures while the updated weights in the new consumer basket might have introduced a downward substitution bias in the CPI. However, significant upside risks to the inflation outlook lingered from possible adverse spill-overs of the public sector wage award to the private sector, especially in a context of relatively lower productivity growth. Global food

prices were an additional cause of concern as they were still at elevated levels, just below the highs recorded in 2011 and roughly at the same level as 2008.

32. The Committee weighed the risks to the growth and inflation outlook over the policy-relevant horizon and discussed alternative interest rate scenarios. It noted that in the current global economic environment, monetary policy in a number of advanced and emerging market countries had remained accommodative. For some members, the set of data since the last MPC meeting had highlighted slowing growth prospects in the domestic economy along with a decline in the fundamental drivers of inflation and inflation expectations. In their view, new data were seen to lend support to a further easing of the monetary policy stance. In the very short run, this would alleviate the debt-service burden of highly leveraged economic operators. They took the view that while fiscal policy was constrained by the need to meet statutory debt targets, there was still plenty of room to adjust monetary policy to send the right signal to the market about the softer economic conditions and promote balanced and orderly economic development.

33. Other members considered that the upside risks to the inflation outlook still outweighed the downside risks to the growth outlook. An independent survey of analysts showed that a majority (70 per cent) expected headline inflation of up to, and above, 4.5 per cent by December 2013. Except for the construction sector, activity in major sectors was assessed to be fairly resilient to the depressed global economic background while job creation was still proceeding. Although the growth forecast had been revised downwards, it still showed that the economy could expand at a higher rate than in 2012 under a best-case scenario. Moreover, with monetary conditions already accommodative, any further easing of monetary policy was expected to have little impact on the pace of domestic growth or on domestic investment.

34. Inflation remained a key threat in the economy, with y-o-y inflation expected to be in the range of 5.3 to 5.8 per cent by December 2013. After a gradual pick-up in the short-term, inflation is expected to gain momentum towards year-end and spill over in the first half of 2014 as the dynamics start to change to reflect the effects of higher wages and possible adjustments in administered prices. These members were of the view that the MPC’s mandate of price stability dictated proactive action to tackle inflation in the medium-term. This would concurrently help to tighten credit standards in certain sectors that were over-leveraged while addressing concerns that the real rate of return on savings continued to be in negative territory.

Voting Pattern

35. After discussion, a preliminary consultation on voting intentions resulted in Mr Nishan Degnarain, Professor Jeffrey Frankel and Professor Silvana Tenreyro opting to **cut** the Key Repo Rate while Mr Rundheersing Bheenick and Mr Mohammed Iqbal Belath were inclined to **increase** the Key Repo Rate by 10 to 15 basis points and Mr Yandraduth Googoolye opted to **increase** by 10 basis points. The remaining two members, Mr Hemraz Oopuddhye Jankee and

Mr Pierre Dinan, were inclined to keep the Key Repo Rate unchanged, with Mr Dinan also indicating support for a small cut.

36. The first round of voting led to the following outcome:

Voting for an increase of the KRR by 10 basis points:
Mr Rundheersing Bheenick, Mr Mohammed Iqbal Belath and Mr Yandraduth Googoolye

Voting to keep the KRR on hold:
Mr Hemraz Oopuddhye Jankee

Voting for a decrease of the KRR by 25 basis points:
Mr Nishan Degnarain, Mr Pierre Dinan, Professor Jeffrey Frankel and Professor Silvana Tenreyro

37. After further discussion leading to a second round of voting, the Committee voted with a majority of 5 to 3 to **cut** the Key Repo Rate by 25 basis points to 4.65 per cent per annum. The three dissenting members voted to **increase** the Key Repo Rate by 10 basis points.

38. 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.

39. The meeting adjourned at 17.55 hours. The next MPC meeting is scheduled on Monday 30 September 2013.

40. **Voting for the MPC action:** Mr Nishan Degnarain, Mr Pierre Dinan, Professor Jeffrey Frankel, Mr Hemraz Oopuddhye Jankee and Professor Silvana Tenreyro.

41. **Voting against the MPC action:** Mr Rundheersing Bheenick, Mr Mohammed Iqbal Belath and Mr Yandraduth Googoolye.

Bank of Mauritius
01 July 2013

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 2012, the MPC was reconstituted in March 2013. Members of the MPC now comprise the Governor (Chairperson), the 2 Deputy Governors, 2 other persons appointed by the Prime Minister and 3 other persons, not being Directors or employees of the Bank, appointed by the Finance Minister.

When the MPC met on 17 June, the last available data on national accounts and employment were for 2012Q4 while the last data on external trade and the balance of payments were for 2013Q1. The last monetary data available was for April 2013 while the last data available on CPI and inflation were for May 2013.

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.

KRR is the Key Repo Rate.

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.