ASSOCIATION FOR THE PROTECTION OF THE ENVIRONMENT & CONSUMERS

Memorandum

To

Monetary Policy Committee

2 Mgr, Gonin Street
Port Louis
14th July 2014

A strong case for raising the Key Repo rate: the WHYs?

The declining rate of savings in Mauritius is a bad forerunner to our economy. In the absence of any measure to stimulate it, the country runs the risk of falling in the trap of excessive spending while imported inflation will hit severely our competitiveness. This situation demands a profound reflexion on the need to raise the repo rate from its present level while at the same time striking the right balance between savings and investment.

The Monetary Policy Committee, following the resignation of the Minister of Finance, should be in a better position to demonstrate its real independence and take the appropriate measures that will benefit the country at large and not just a handful of businessmen, who use credits at a very cheap rate to invest elsewhere than in Mauritius.

Now that the Prime Minister has taken the responsibility of the Finance Ministry, it is expected that the MPC will take on board our representations outlined underneath before taking a decision in the national interest.

The following are our arguments for a rise in the repo rate:

1. The twelve-month average (**headline**) inflation rate has remained quite high at 4.0 per cent over the past months. In contrast, inflation rate in the Euro zone, one of our main trading partners, is near zero per cent. We need to reduce this large inflation rate differential so as to be competitive on the international market.

2. True, the **year-on-year CPI inflation** has receded to 3.4 per cent in May 2014. However, it is likely to rise again in the coming months as the prices of petroleum products and of basic commodities are expected to go up. It is worth noting that the **year-on-year CORE2 inflation rate**, which excludes food, beverages, tobacco, mortgage interest, energy prices and administered prices from the CPI basket, has trended upwards to 3.4 per cent in May 2014.

(per cent)

Year 2014	Headline inflation	Year-on-Year CPI inflation
January	3.7	5.1
February	3.9	5.6
March	4.0	4.5
April	4.0	4.2
May	4.0	3.4

(per cent)

Year 2014	Headline CORE1	Headline CORE2	Year-on-Year CORE1	Year-on-Year CORE2
January	2.8	2.6	3.6	3.4
February	2.9	2.7	3.5	3.2
March	2.9	2.7	2.7	3.1
April	2.9	2.8	2.8	3.3
May	2.9	2.9	2.9	3.4

3. The fact remains that **real interest rate** is still deep into negative territory. Many banks are offering interest rates on saving of less than the current maximum rate of 3.40 per cent. The minimum rate presently proposed on savings account is 2.40 per cent, which is 160 basis points lower than the headline inflation rate of 4.0 per cent.

4. Investors are demanding higher return on **long-term sovereign bonds**. At the auction of 6.95 per cent 15-year Bank of Mauritius bonds held on 5 March 2014, yields on bids accepted were higher at 7.60 per cent per annum.

5. The **saving-to-GDP ratio** remains stubbornly low. According to Statistics Mauritius, gross domestic saving would represent 12.0 per cent of GDP in 2014. This can be explained by the fall in both corporate and household savings.

6. **Domestic credit** is still growing faster than the real production. Statistics Mauritius has forecasted that the gross domestic product (GDP) would register a nominal increase of 6.5 per cent this year. Tellingly, the annual rate of growth of domestic claims stood at 9.7 per cent at the end of May 2014.

7. The banking system is still awash with **excess money.** Although the Bank of Mauritius has recently raised the fortnightly average Cash Reserve Ratio on rupee deposits from 8.0 to 9.0 per cent, excess cash holdings amount to more than Rs 1.1 billion. For the maintenance period ended 29 May 2014, the average cash ratio stood at a high of 12.03 per cent.

8. The **unemployment** situation is still manageable. Statistics Mauritius has forecasted that the unemployment rate in 2014 would remain the same as in 2012 and in 2013, i.e. at 8.0 per cent.

9. In view of the British economy's rapid rebound and surging confidence levels, the governor of the **Bank of England**, Mark Carney, has swung from being dovish to hawkish. In a speech on 12 June 2014, he hinted that the Bank might increase its key policy rate sooner than markets have been expecting, which would imply an increase in the policy rate late this year.

10. There are some concerns about the **real independence** of our MPC. It seems that the external members of MPC were influenced by the stance of the former Finance Minister on interest rate. When Pravind Jugnauth held this post, he was perceived to have a very constructive relationship with the Governor of the Bank of Mauritius. Incidentally, the MPC raised the Key Repo Rate (KRR) twice, by 50 basis points on 28 March 2011 and by 25 basis points on 13 June 2011. Afterwards, since Xavier-Luc Duval as Finance Minister had been calling for a reduction in interest rate, the MPC brought down the KRR on three occasions, which has said above, in favour to a handful of businessmen but at the expense of the national interest and the population.

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14 July 2014