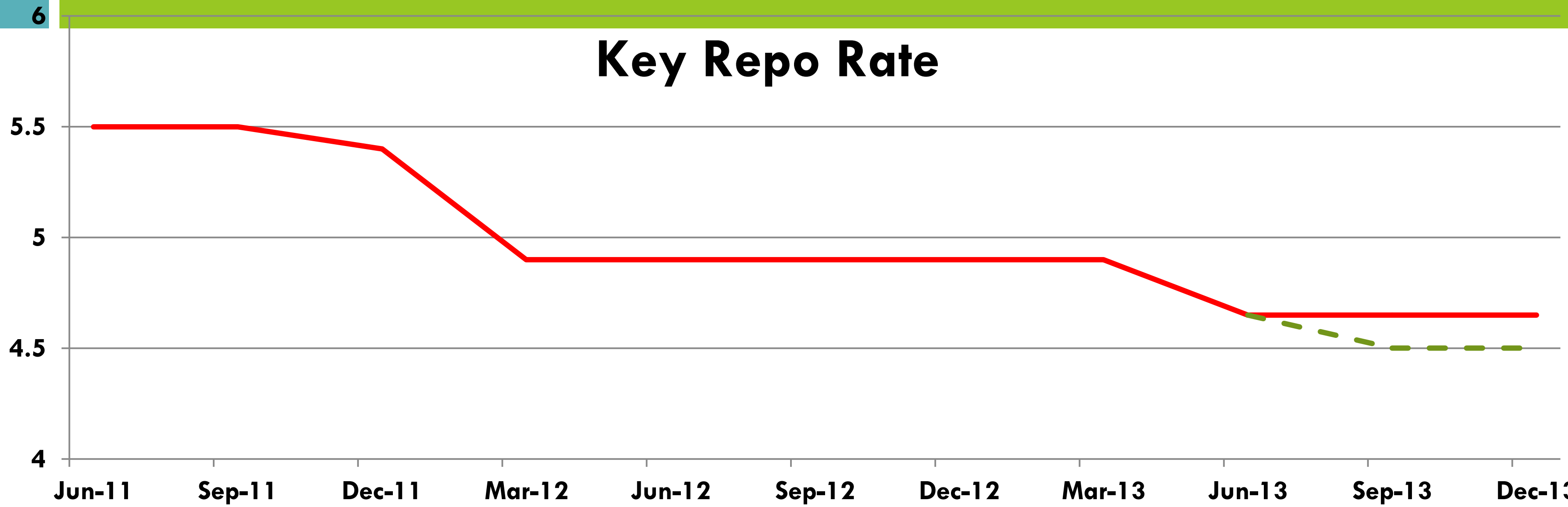
PRESENTATION FOR THE MONETARY POLICY COMMITTEE (MEETING OF 30 SEPTEMBER 2013)

Ministry of Finance and Economic Development

Recommendation: Keep rate steady

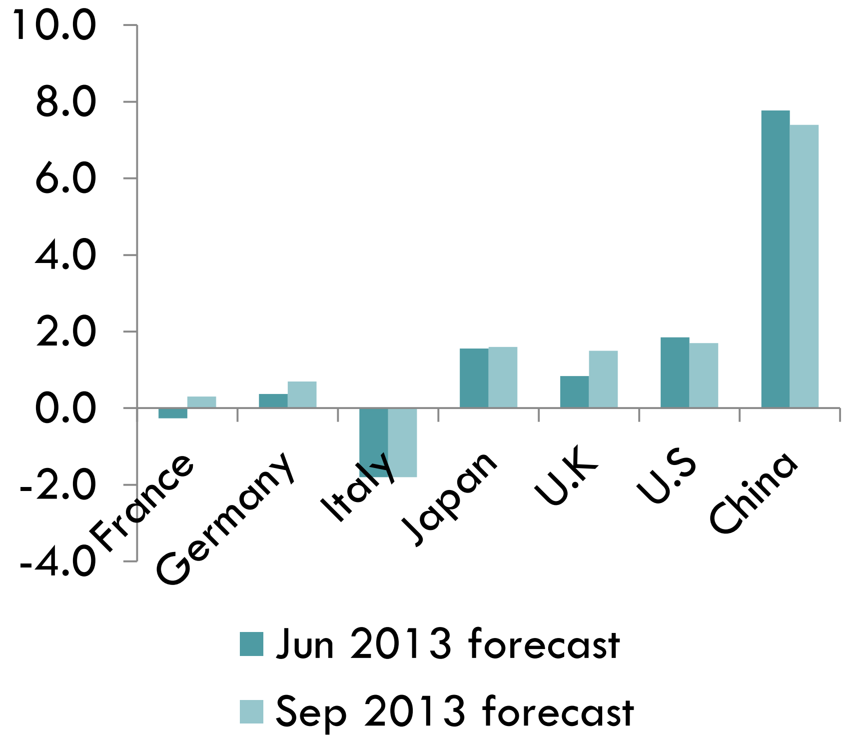


- Taking developments since the last MPC into account, the Committee may wish to **keep the interest rate steady.**
- However, inflation is quiescent and the economy remains fragile. This offers the MPC the opportunity to have a rate that is aligned to the normal quarter point scale rather than the odd 0.15%. As such an interest rate of 4.5% would make more sense than the current 4.65%.

Global economic context: recovery is gathering pace in the advanced economies but risks remain

- Growth in major advanced economies, including US, has been stronger than initial forecasts in the second quarter.
- **Eurozone is now out of recession with a growth rate of 0.3% for the second quarter.** For the year as a whole,
  - France is expected to register a positive growth of 0.3% in 2013 compared to a contraction of 0.3% projected in June
  - The growth rate in UK is projected at around 1.5% - almost double the 0.8% growth initially expected in June
  - Germany is expected to perform better with a growth rate of 0.7% in 2013 compared to June forecast of 0.4%

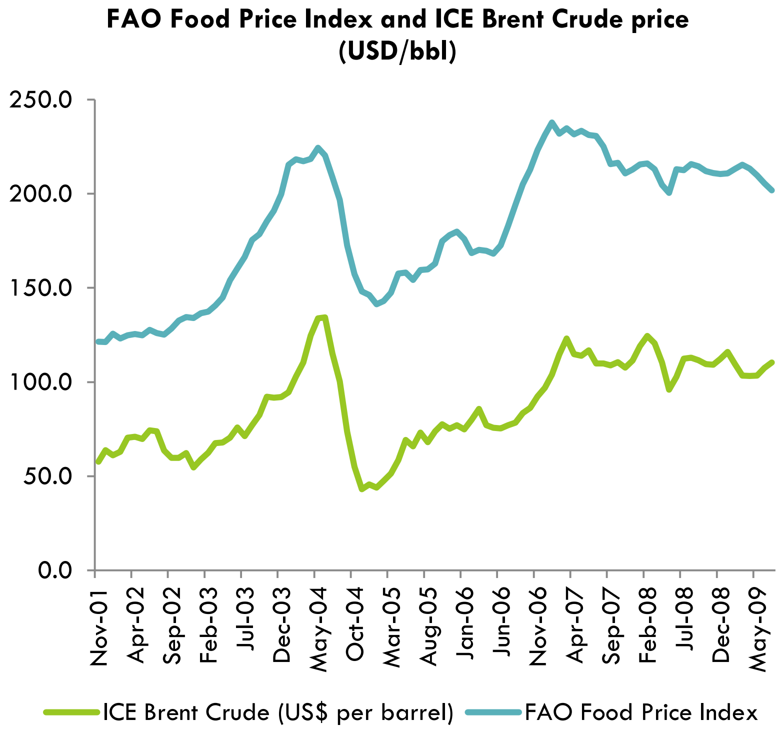
GDP Growth in the major economies (%)



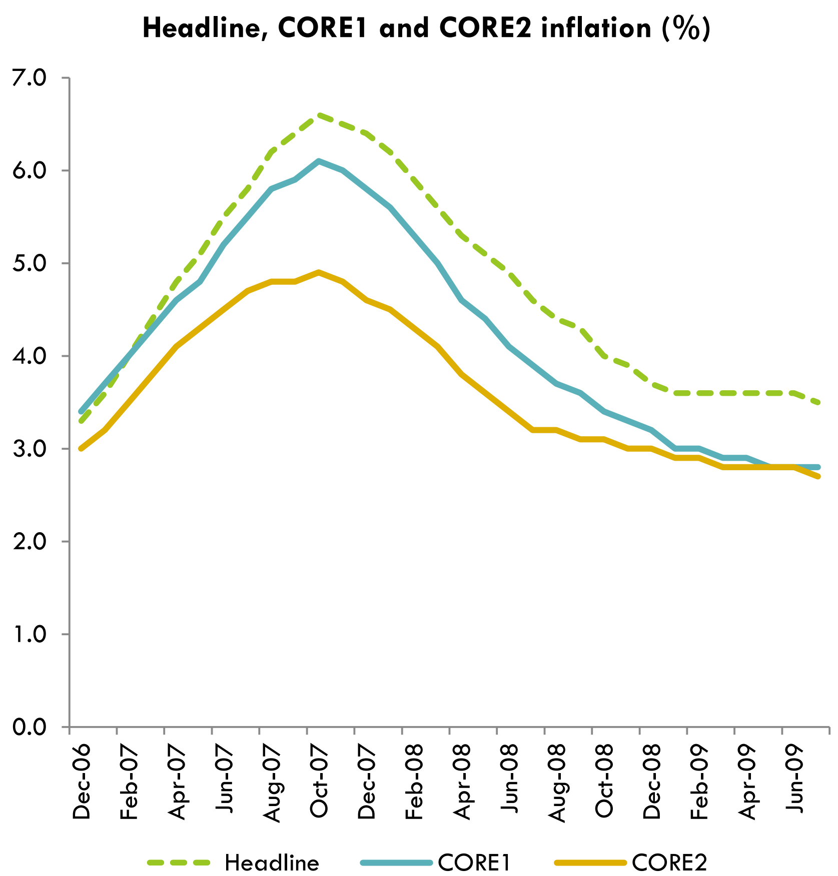
(Source: OECD Sep 2013 Interim Economic Assessment)

Inflation even less of a threat than in June

- Global inflation projections for 2013 and 2014 are even lower than stated during the last MPC.
- Inflation continues on a downward path compared with 2012 and is projected to be 3.8% in 2013 and 2014, helped by stabilizing commodity prices.



Domestic inflation is stabilising at near historical lows…

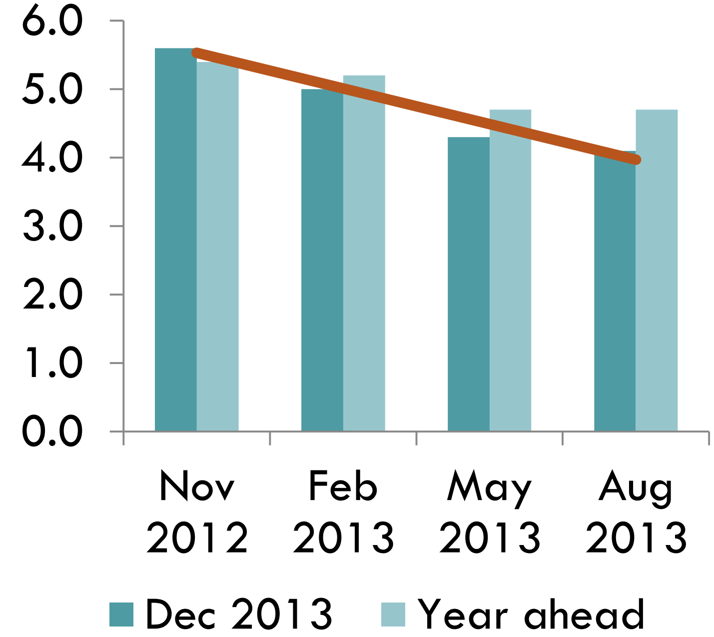


- Headline inflation for the year ending August 2013 stood at 3.5%
- Over the same period, CORE1 and CORE2 inflation continued on a downward trend at 2.7% and 2.8% respectively
- Inflation projections are now **3.5-3.7%** for the year and similar for next year compared with June projections of **4.1%** for 2013 and about **4.0%** for 2014.

Inflation expectations remain well-anchored

- 4.1% in August 2013 Inflation Expectations Survey instead of 4.3% in May 2013.
- **This reinforces the argument of MOFED that the implementation of the PRB and Errors Omissions and Anomalies Commission (EOAC) report would not affect inflation** as it has had a limited impact on permanent income expectations.

Inflation expectations for December 2013 and a year ahead



Growth prospects: Positive but Fragile and below par

- The growth outlook for Mauritius remains broadly positive, with GDP growth expected to be close to 3.2% this year.
- **However, output remains below trend and the economy remains fragile**
- Assuming the recovery in our traditional markets gathers pace, we are confident that Mauritius can achieve 3.5-4% growth in 2014, and close to 5% by 2016.
- **However, monetary and exchange rate policy must be aligned with fiscal policy and supportive of growth and recovery.**

Sectoral outlook: Construction, Tourism & commerce under threat. New sectors, financial services & manufacturing drive resilience

In 2013 growth will be driven by both traditional sectors like manufacturing, financial services as well as emerging sectors such as ICT and Seafood.

Construction

- The construction sector continues to struggle and is expected to contract in 2013, with the completion of major projects such as the airport extension as well as the major shopping malls.

Commerce (wholesale & retail trade)

- This sector is suffering from weaknesses in tourism and the dominance of the precautionary demand for money. Consequently, for the first time since 2009 the sector will fail to grow faster than overall GDP. This sector would benefit from improved confidence. Inter alia, this could come from the MPC better aligning monetary policy to fiscal policy.

Sectoral outlook (Contd)

Tourism

- For the first semester of 2013, tourism earnings declined by 6.5% compared to the corresponding period in 2012.
- Government action, particularly subsidising direct flights to China and more marketing, has begun reversing trends. Over the period January to August 2013, tourist arrivals increased by 2.2% to 622,492. The 2.9% contraction in arrivals from Europe has been offset by strong growth in new markets such as China (+93.9%) and the UAE (+66.5%).
- Overall, for 2013 growth of 2.5% is expected compared with no growth in 2012.
- Tourist arrivals will be around 990,000, compared to around 965,400 registered in 2012, while tourism earnings are expected to increase only marginally to around Rs 45 billion this year compared to Rs 44.4 billion last year.

Sectoral outlook (Contd)

Seafood

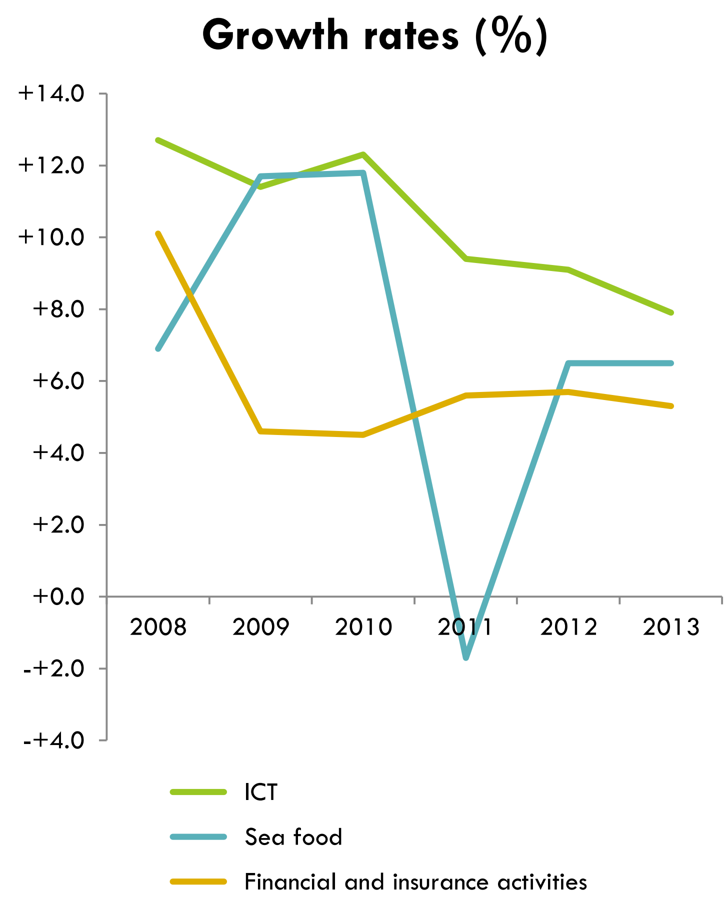
- The seafood sector is expected to grow by 6.5% in 2013 – same as in 2012.
- Exports of seafood products increased by 13.6% during the first semester 2013 to Rs 7.1 billion. (mainly due to price increases)

Information & Communication Technology

- To grow by around 7.9% in 2013 compared to an average annual growth of 10.3% over the past three years.

Financial Services

- The financial services sector will grow by a slightly lower rate of 5.3% in 2013 – but same as the average growth recorded over the past three years.



Fiscal sector

- **For 2013, the budget deficit will be around 3% of GDP, higher than the 2.2% estimates.** This is mainly the result of lower revenue while savings in some items of spending will be absorbed by unforeseen expenditures arising mainly from the implementation of the Errors, Omissions and Anomalies Committee Report, increased spending on land drainage and road decongestion.
- **The Discounted Public Sector Debt as a share of GDP is thus likely to increase this year. This would be a reversal in the declining trend registered over the years.**
- However, Government remains committed to bringing public debt down to 50 per cent of GDP by 2018. Government will be taking measures towards this end in the forthcoming budget.

Conclusion and recommendations

- It appears that the global economy is entering a new phase, characterised by mild recovery in the advanced economies and a pickup in the emerging economies without resurgence of inflation.
- At the domestic level, we are witnessing the emergence of a two speed economy, with traditional sectors (such as construction, textiles and tourism) displaying low growth and “new” sectors (Seafood, ICT/BPO and to a certain extent financial services) growing in excess of 5% annually.
- Fiscal policy is constrained, and with public debt likely to increase this year, the ability of the public sector to boost growth through investment will be limited.
- Despite the fiscal constraints, Government has contributed to keep enterprises globally competitive through a multitude of programmes financed by the NRF.
- Unless the MPC believes the fiscal stance is wrong, it needs to contribute to restoring confidence by aligning monetary policy to fiscal policy.

Conclusion and recommendations (Contd)

- However, the context remains difficult for the business sector. Our key sectors are heavily indebted, and this is impairing their capacity to grow, invest in machinery and equipment, and generate employment, as they struggle to deal with a crisis in demand in their main export markets.

- Inflationary pressures will remain subdued both locally and internationally. This gives the MPC the room to support the competitiveness of our enterprises by operating low interest rates in support of the NRF interventions and in coordination with the fiscal policy.

Conclusion and recommendations (Contd)

- Non-performing loans of banks have increased over time to reach 5.2% of total private sector credit in March 2013. Major sectors being affected are construction and the export-oriented enterprises sector.
- The financial crisis has never been attributed to interest rates that are too low but to poor regulation. In order to address the issue of risky lending by banks, there is need for Central Bank regulation rather than using interest rate policy that would be ineffective.
- Whilst it is true that conditions are improving on the external front, our local enterprises will not be able to benefit from this recovery unless monetary policy remains supportive.

Conclusion and recommendations (Contd)

- Taking these developments into account, the MPC may wish to further cut the policy rate. It may make sense to have a rate that is aligned to the normal quarter point scale rather than the odd 0.15%. As such an interest rate of 4.5% would make more sense than the current 4.65%. However, the MPC has done enough at its last meeting so that the Ministry of Finance could see staying put as a reasonable option under the current circumstances.
- **For the above reasons, our recommendation to the MPC is to keep the interest rate steady.**