Annex 1

Summary of the presentation by the Ministry of Finance and Economic Development including responses to questions from MPC members

The Ministry was represented by Mr Ali M. Mansoor, Financial Secretary. The main thrust of his submission was as follows:

1. All economic indicators pointed towards a lowering of the KRR. The recovery in the world economy was slower than expected, with the recession worsening in the Eurozone. There was no single major economy which was performing better.

2. The Monetary Policy Committee did not have credibility in the market as it had consistently set interest rates which the market was not following. With regard to liquidity conditions, one solution was to spend a lot of funds and deteriorate the balance sheet of the central bank or the other was to get taxpayers to bear the burden because an interest rate was set which was inconsistent with market conditions. The policy rate was considered not effective as it had been set too high against the market.

3. The Bank of Mauritius had consistently been over worried about inflation and part of the problem lied in blindly following models. In a period of turmoil, the use of models might not be adequate because of structural breaks.

4. Growth was going to be much lower than what was thought a few months ago and some of the downside risks assessed in the previous MPC submission had materialized. It was expected that the Road Decongestion Programme would have increased growth rate by 1 percentage point but it encountered significant delays, resulting in growth going down in the range of 0.5 to 1 per cent.

5. Given that the economy was performing worse than expected and inflation as well as inflation expectations were coming down, the decision of the MPC about the interest rate policy was essential. Though there were no grounds that growth would be below 3 per cent as some observers had seemed to believe, downside risks to the Mauritian economy remained.

6. The room for fiscal manoeuvre was much more limited if debt targets were to be met. Monetary policy ought to be a little looser than it would otherwise have been given the fiscal policy constraint. Monetary policy had much more room to support fiscal policy given that inflation expectations were well anchored. The trade-offs between debt reduction and tight monetary policy would probably go in favour of debt reduction, particularly when there were no inflation threats on the horizon.

7. Both major public investment and private sector projects had come to an end. Government programmes, which were supposed to boost investment, were slow in taking off. The financial services sector was performing relatively well but was not sufficient to offset negative performance elsewhere in the economy.

8. The spectre of unemployment was worrisome and the MPC should think very carefully about its responsibility, not only to history but also right now. Risks need to be balanced amid uncertainty. A lot of firms were on the verge of closing down and that was more visible in the tourism sector. Textiles had been less shy about coming to the National Resilience Fund for restructuring. The tourism sector was over indebted and needed to be restructured.

9. While a cut in the KRR would not have large macro effects, and certainly not in the short run, it might have large micro effects. The Rupee exchange rate remained over-valued. Firms were squeezed on the cost side by the decisions of Government on wages, over which they had no control.

10. An appeal was made to MPC members who shared the view that an increase in the KRR at this point would be suicidal. Members should either collectively adopt a voting system that would allow a sensible decision-making or else accept the second best option to co-share the risk on unemployment by at least keeping the KRR unchanged.

11. Taking into consideration liquidity conditions, inflation expectations and the risk to unemployment, the Financial Secretary viewed that a 50 basis points drop in the Key Repo Rate would give a strong signal to the market that monetary and fiscal policy are now well coordinated and that Government is determined to do everything it can to fight unemployment.

Summary of the presentation by ACIM Representatives

12. In its presentation to the MPC members, ACIM had three objectives. First, it wanted to press for an interest rate increase in the range of 15 to 25 basis points. It noted that the current low level of interest rates did not encourage savings, which were on a downtrend in Mauritius. Low interest rates were also seen to bring about rupee depreciation and thus increase the risk of imported inflation as higher import prices are passed on to consumers. There were risks that inflation might go up in coming months as private sector trade unions make demands for adjustments in their remuneration orders following the Pay Research Bureau wage award to the public sector. Second-round effects from the recent increase in fuel prices as well as high vegetable prices might also push up inflation.

13. Secondly, ACIM questioned the weight of inflation in the MPC decision. The Household Budget Survey of 2012 had shown a widening of the gap between the rich and the poor while a 2006 survey by Statistics Mauritius had revealed that the inflation rate faced by the lower income groups was higher than that faced by the upper income groups. The decline in the purchasing power of the lower income groups should be given greater attention in reaching the interest rate decision.

14. Lastly, ACIM pointed out that economic growth had not been inclusive. Government investment in infrastructural projects for development purposes had limited impact on the poorer section of the population. ACIM noted that there had been no job losses in the textile and tourism sectors. It was therefore possible to consider implementing pro-poor policies, including an interest rate increase.