BANK OF MAURITIUS

Inflation Report

April 2010 | Issue No. 4

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INFLATION REPORT

April 2010

The Inflation Report is published twice a year by the Bank of Mauritius in accordance with section 33(2)(b) of the Bank of Mauritius Act 2004. The Inflation Report is released to the public in April and October. It provides an analysis of inflation developments as well as the assessment underpinning monetary policy, and concludes with the outlook for inflation. This issue of the Inflation Report refers to information for the semester ended 31 December 2009, unless otherwise stated.

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List of Acronyms

APM	Automatic Pricing Mechanism
BDI	Baltic Dry Index
BML	Broad Money Liabilities
CIF	Cost, Insurance, Freight
CPI	Consumer Price Index
CSO	Central Statistics Office
ECB	European Central Bank
EU	European Union
FAO	Food and Agriculture Organisation
FDI	Foreign Direct Investment
FOB	Free on Board
FPI	Food Price Index
GDFCF	Gross Domestic Fixed Capital Formation
GDP	Gross Domestic Product
IMF	International Monetary Fund
IPE	International Petroleum Exchange
IPI	Import Price Index
MERI	Mauritius Exchange Rate Index
MPC	Monetary Policy Committee
NYMEX WTI	New York Mercantile Exchange West Texas Intermediate
ODC	Other Depository Corporations
OECD	Organisation for Economic Co-operation and Development
PCE	Personal Consumption Expenditure
PMI	Purchasing Managers' Index
PPI-A	Producer Price Index-Agriculture
PPI-M	Producer Price Index-Manufacturing
REER	Real Effective Exchange Rate
SDR	Special Drawing Rights
WRI	Wage Rate Index

1. Overview

Economic growth resumed in all major advanced economies in the second half of 2009 following several quarters of contraction while real activity in key emerging economies expanded at a faster pace. The growth revival relied heavily on the massive expansionary fiscal and monetary policies and policy support to financial systems. There were few indications in advanced economies that autonomous private demand was taking hold. Nevertheless, the recovery of global economic activity led to increasing business and consumer confidence. Equity markets gained further ground after reaching a trough in March 2009 amid a return of risk appetite of investors. World trade, which picked up timidly in the second quarter of 2009, expanded at a more vigorous pace as from the third quarter. However, labour market conditions continued to remain weak and unemployment further rose in the main advanced economies. Although large segments of the global financial markets continued to stabilise translating into a significant rise in corporate lending and bond issuance, smaller-firm lending and consumer credit were still far from pre-crisis levels.

Reflecting the increasing pace of economic activity, inflation moved into positive territory in the United States and the euro area in the final quarter of 2009 after both had experienced deflation in the third quarter. Japan was, however, still mired in deflation by the final quarter of 2009. Overall, global inflation remained subdued in the second semester of 2009 amid low level of capacity utilisation and benign inflation expectations despite the recovery of commodity prices in the second semester of 2009.

Domestic economic activity improved significantly in the second half of 2009 after reaching a trough in the first quarter of the year. The expansionary monetary and fiscal stimulus measures as well as the front-loading of major infrastructural work have helped the economy to bounce back in the second semester of 2009. Better-than-expected export sector performance, namely textiles and tourism, in the final quarter of 2009 despite still soft external demand coupled with stronger domestic demand buoyed by higher public capital spending explained most of the rebound. Household consumption, representing around 75 per cent of total aggregate expenditure, grew at a faster pace than in the first semester of 2009, reflecting robust consumer confidence. On the production front, sectors, other than textiles and tourism, posted solid growth in the second semester. Reflecting these developments, the economy was estimated to have grown by 3.1 per cent in 2009, higher than a previous forecast of 2.8 per cent. With the banking sector largely unscathed from the global financial crisis, bank credit remained well-supplied but a major deceleration in demand for bank credit was noted. Moreover, the unemployment rate eased as job creation outpaced job losses.

Against this backdrop and little evidence of price pressures, headline inflation rate continued to decline during the second semester of 2009 to close the year at 2.5 per cent. Year-on-year measure of inflation indicated a rebound from a record low of 0.1 per cent in October 2009 to 1.5 per cent in December 2009. Underlying core inflation measures also indicated restraint in price-setting.

Government has indicated that the fiscal stimulus package would be pursued up to December 2010. At the September 2009, December 2009 and March 2010 meetings, the Monetary Policy Committee (MPC) of the Bank of Mauritius left the key Repo Rate unchanged at 5.75 per cent arguing for monetary stimulus to stay supportive of the domestic economy for some more time until growth became self-sustaining amid soft external demand and the currently low inflation environment.

1.1 THE EXTERNAL ENVIRONMENT

The revival of growth

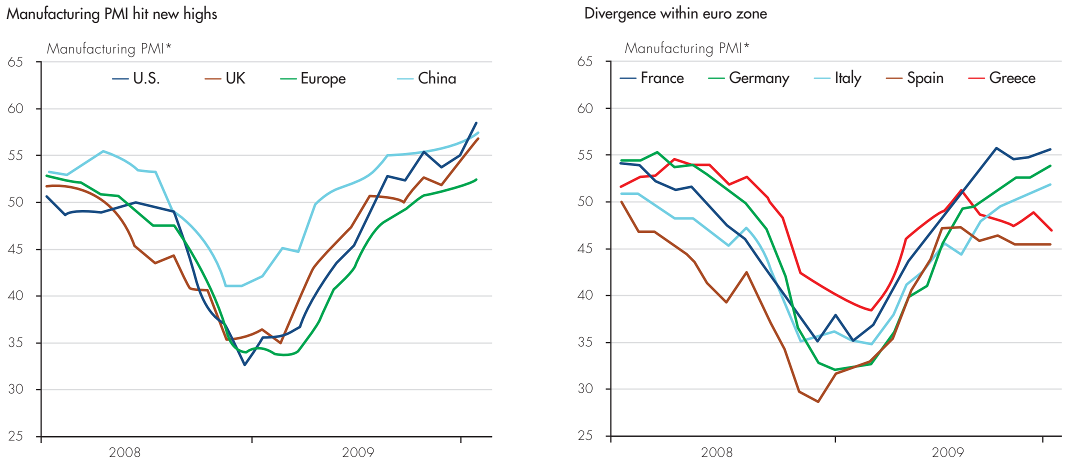
The global economy began to recover in the second half of 2009 with most advanced economies posting positive growth and emerging economies leading the recovery. Industrial production as well as retail sales revived and world merchandise exports started picking up. Conditions in the international financial markets continued to stabilise but smaller-firm lending and consumer credit were still far from pre-crisis levels. The global recovery was still heavily reliant on the massive fiscal and monetary stimulus provided by governments and central banks around the world and there was little indication in advanced economies that autonomous private demand was taking hold. Unemployment remained high while improvement in labour markets was anticipated to lag economic recovery. Although the recovery was fragile, commodity prices, particularly oil and metals, staged noticeable rebounds towards the end of 2009. The International Monetary Fund (IMF) estimated world output to have contracted by 0.6 per cent in 2009, with real activity in advanced economies estimated to have contracted by 3.2 per cent.[1]

Emerging economies grew faster than advanced economies in the second half of 2009. Activity in these economies was boosted by strong final domestic demand and the gradual normalisation of global trade. Net private capital flows to emerging market economies were sustained in 2009, even rising for fast-growing Asian and Latin American economies. The IMF estimated growth in emerging and developing economies at 2.4 per cent in 2009.

The revival of manufacturing activity was a catalyst for economic recovery as underscored by the JPMorgan Global Manufacturing Purchasing Managers' Index (PMI) depicted in Chart 1.1. The JPMorgan Global Manufacturing PMI has been posting a reading of above 50 since August 2009, recording its highest reading of 55.0 in December 2009 in over 44 months. The PMI also revealed that production growth in the euro area lagged the global trend, despite hitting a 27-month high in December 2009. While there were manifest disparities within the euro zone, the recovery was well under way in Germany, France and Italy.

Economic growth in the United States resumed in the third quarter of 2009, after four consecutive quarters of contraction. Real output expanded at a seasonally-adjusted quarter-on-quarter rate of 0.6 per cent in the third quarter and at a higher rate of 1.4 per cent in the fourth quarter. The increase in real Gross Domestic Product (GDP) in the second semester of 2009 was led by sustained positive contributions from personal consumption expenditures (PCE), exports, and private inventory investment. Non-residential fixed investment, after having negatively contributed to GDP in the third quarter of 2009, made a positive contribution in the fourth quarter. Reflecting growing optimism about a US economic recovery, real exports and imports of goods and services increased in both quarters in contrast to decreases in the previous two quarters. The high growth rate in the fourth quarter relative to the third quarter was largely explained by the acceleration in the growth rate of exports and private inventory investment, and a resurgence of non-residential fixed investment as well as a deceleration in imports. Real PCE and residential fixed investment decelerated in the fourth quarter while federal spending remained flat. While

Chart 1.1: Global Manufacturing Purchasing Managers' Index



**A reading over 50 indicates expansion of activity in the manufacturing sector.*
Sources: Thomson Reuters, Markit, Institute for Supply Management, CLSA.
Courtesy of Thomson Reuters.

[1]*IMF's World Economic Outlook, April 2010.*

industrial production sustained the broad-based expansion that began in the third quarter, capacity utilisation remained low. However, surveys of purchasing managers and indicators of business and consumer confidence showed significant and sustained improvement. Job losses slowed noticeably in December 2009 although the unemployment rate remained elevated at 9.7 per cent. In 2009, the US economy was estimated to have contracted by 2.4 per cent but is forecast to grow by 3.1 per cent and 2.6 per cent in 2010 and 2011, respectively according to the IMF's April 2010 World Economic Outlook update.

The euro zone economy also came out of recession in the third quarter of 2009 posting a real growth rate of 0.4 per cent following five consecutive quarters of contraction. In the fourth quarter, economic activity remained flat. Household final consumption expenditure was stable after a contraction of 0.1 per cent in the previous quarter. Investment fell by 1.3 per cent in the fourth quarter after a 0.9 per cent contraction in the third quarter while the growth in exports slowed down to 1.9 per cent, from 2.9 per cent in the previous quarter. Imports growth, however, decelerated to 1.3 per cent from 2.9 per cent in the third quarter. Over the whole of 2009, real output in the euro area contracted by 4.1 per cent while a year ago the euro zone economy had expanded by 0.6 per cent. The two single largest economies – namely, France and Germany – recorded growth rates of 0.2 per cent and 0.7 per cent, respectively, in the third quarter and 0.6 per cent and zero per cent in the final quarter. Nonetheless, business confidence still showed a steady improvement from March 2009 and industrial orders trended upward. Labour market conditions continued to be weak, with the unemployment rate rising to 9.9 per cent in December 2009. The IMF estimates the euro zone economy to have contracted by 4.1 per cent in 2009 but to grow by 1.0 per cent in 2010 and by 1.5 per cent in 2011.

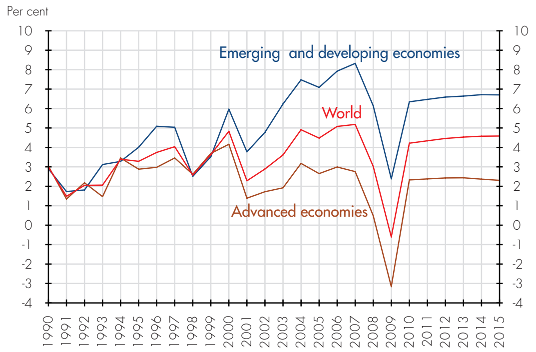
In the United Kingdom, quarter-on-quarter growth data showed that real GDP contracted by 0.3 per cent in the third quarter of 2009 – the sixth consecutive quarter of decline – but expanded by 0.4 per cent in the fourth quarter. While the services sector had recovered in the second quarter of 2009,manufacturing output did so in the second half of 2009. The economic recovery in the fourth quarter was mainly explained by positive contributions from household and government final consumption expenditure. Gross fixed capital formation fell by 2.7 per cent in the last quarter of 2009 compared with a rise of 2.8 per cent in the previous quarter, driven by a drop of 4.3 per cent in business investment. The labour market remained weak with the unemployment rate reaching 7.8 per cent for the three months to December 2009. Overall, real output contracted by 4.9 per cent in 2009. The IMF estimates the UK economy to expand by 1.3 per cent in 2010 and by 2.5 per cent in 2011.

After four consecutive quarters of contraction, Japan's economy posted positive growth rate in the second quarter of 2009. It, however, contracted marginally by 0.1 per cent in the third quarter before growing by 0.9 per cent in the fourth quarter. In addition to the significant positive contributions of expansionary fiscal policies, growth in Japan was also supported by improvements in private consumption, capital spending in the non-residential sector and net exports. The unemployment rate dropped to 5.1 per cent in December 2009, leaving it 0.6 percentage point below its July 2009 peak. However, deflation remained the main problem of Japan's economy with the seasonally-adjusted Consumer Price Index (CPI) falling by 0.1 per cent in December 2009. According to the IMF, Japan's economy is expected to grow by 1.9 per cent and 2.0 per cent in 2010 and 2011 compared to a contraction of 5.2 per cent in 2009.

The two major emerging economies in Asia, namely China and India, recovered strongly in the second half of 2009. Largely on account of the authorities' aggressive expansionary monetary and fiscal policies, China's economy expanded vigorously at a year-on-year growth of 10.7 per cent in the fourth quarter of 2009, compared to 9.1 per cent in the previous quarter. Growth of industrial production steadily accelerated during the second half of 2009, spurred by the demand for infrastructure and other construction projects. Although growing slightly slower than manufacturing activity, the services sector was nevertheless robust. Job creation remained solid in both sectors. India's pace of economic activity also witnessed a robust turnaround in the third quarter of 2009. Output rose, in real terms, by 7.9 per cent in the third quarter and by 6.1 per cent in the final quarter. The rebound was steered by industrial and services sector growth. The IMF growth forecasts for both China and India for 2010 are 10.0 per cent and 8.8 per cent, respectively.

Growth prospects for 2010 were brighter with world output forecast by the IMF to expand by 4.2 per cent in 2010, driven mainly by emerging and developing economies with a growth of 6.3 per cent compared to 2.3 per cent for advanced economies. Chart 1.2 and Table 1.1 show real growth rates, actual and projected.

Chart 1.2: Quarterly Global Growth*



*quarter-over-quarter, annualised.
Source: IMF's World Economic Outlook, April 2010.

Inflation

Inflation remained subdued in the second half of 2009 worldwide mainly on account of significant economic slack. Nonetheless, global inflation picked up towards the end of 2009 but remained at historical lows. The picture across economies was, however, mixed. Within the selected sample of countries in Table 1.2, most economies, with the exception of Indonesia and South Africa, had seen a rise in their inflation rates by December 2009. Increases in international commodity prices and base effects given the massive slump in prices in the second half of 2008 contributed most to the rise in inflation rates. The inflation rates of selected economies are shown in Table 1.2.

International stock markets

Growing optimism about global economic prospects propelled equity prices higher during the second semester of 2009. The near-zero interest rate monetary policy stance in most advanced economies and better-than-expected corporate earnings announcements in the third quarter of 2009 boosted activity on major stock markets. Except for the SSEC, which declined significantly in August 2009 after investors reassessed share valuation, which had got ahead of earnings improvements, other stock markets' indices continued to strengthen.

Table 1.1: Real GDP Growth Rates in Selected Economies

Per cent

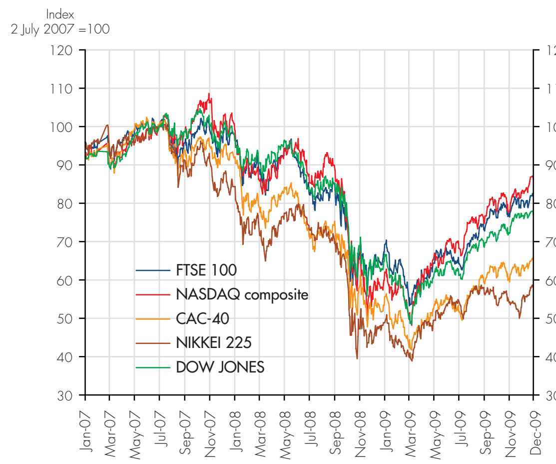
	Q1-2009	Q2-2009	Q3-2009	Q4-2009	2008	2009	2010	2011
	Quarter-on-quarter Growth Rates						*Projections*	
World output					**3.0**	**-0.6**	**4.2**	**4.3**
Advanced economies					**0.5**	**-3.2**	**2.3**	**2.4**
of which								
United States	-1.6	-0.2	0.6	1.4	0.4	-2.4	3.1	2.6
Euro Area	-2.5	-0.1	0.4	0.0	0.6	-4.1	1.0	1.5
Japan	-3.6	1.5	-0.1	0.9	-1.2	-5.2	1.9	2.0
United Kingdom	-2.6	-0.7	-0.3	0.4	0.5	-4.9	1.3	2.5
	Q1-2009	**Q2-2009**	**Q3-2009**	**Q4-2009**				
	Year-on-year Growth Rates							
Emerging market and developing economies					**6.1**	**2.4**	**6.3**	**6.5**
Sub Saharan Africa					5.5	2.1	4.7	5.9
Developing Asia					7.9	6.6	8.7	8.7
of which								
China	6.2	7.9	9.1	10.7	9.6	8.7	10.0	9.9
India	5.8	6.1	7.9	6.0	7.3	5.7	8.8	8.4

Sources: IMF's World Economic Outlook, April 2010; offices of national statistics' websites, central banks' websites and OECD website.

The FTSE, Nasdaq and Dow Jones Industrial Average touched fresh highs by November 2009 mostly due to the combined effects of the broad weakness in the US dollar, positive comments from US Federal Reserve Chairman and data pointing to stabilisation in the US labour and housing markets. But, early December, most international stock markets were temporarily dragged down as risk aversion returned over concerns about debt-related problems.

For the period July to December 2009, the FTSE, Nasdaq and CAC-40 rose by 24.7 per cent, 22.9 per cent and 22.4 per cent, respectively, while NIKKEI posted a lower performance of 6.1 per cent due to a stronger yen. Chart 1.3 shows movements in major international stock market indices.

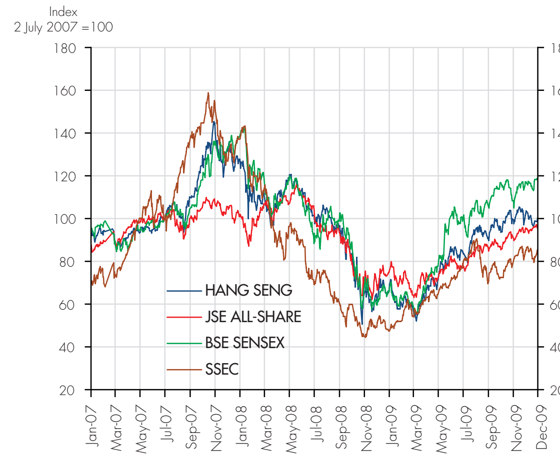
Chart 1.3: Equity Indices of Selected Major International Stock Markets



Source: Thomson Reuters.

Among the major emerging stock markets, as depicted in Chart 1.4, the Bombay Stock Exchange posted the best performance on the back of massive capital inflows, positive effects of the fiscal stimulus packages and a strong information technology sector. For the six months ended 31 December 2009, Hang Seng, JSE and BSE increased by 19.0 per cent, 21.8 per cent and 19.2 per cent, respectively.

Chart 1.4: Equity Indices of Selected Emerging Stock Markets



Source: Thomson Reuters.

Monetary policy in selected economies

Central banks, with a few exceptions, pursued their accommodative monetary policy stance in the second half of 2009. Policy interest rates were further reduced in Hungary, Czech Republic and South Africa. A few central banks continued with

Table 1.2: Consumer Prices

Annual percentage change

	2005	2006	2007	2008	January 2009	June 2009	December 2009
China	1.8	1.5	4.8	5.9	1.0	-1.7	1.9
Euro Area	2.2	2.2	2.1	3.3	1.1	-0.1	0.9
Hong Kong	0.9	2.0	2.0	4.3	3.1	-0.9	1.3
Hungary	3.6	3.9	7.9	6.1	3.1	3.7	5.6
India	4.2	6.2	6.4	8.3	10.4	9.3	15.1
Indonesia	10.5	13.1	6.0	9.8	9.2	3.7	2.8
Philippines	7.6	6.2	2.8	9.3	7.1	1.5	4.4
Singapore	0.5	1.0	2.1	6.5	2.9	-0.5	nil
South Africa	3.4	4.7	7.1	11.5	8.1	6.9	6.3
South Korea	2.8	2.2	2.5	4.7	3.7	2.0	2.8
Thailand	4.5	4.6	2.2	5.5	-0.4	-4.0	3.5
Turkey	8.2	9.6	8.8	10.4	9.5	5.7	6.5
United Kingdom	2.0	2.3	2.3	3.6	3.0	1.8	2.9
United States	3.4	3.2	2.9	3.8	0.0	-1.4	2.7

Sources: IMF's World Economic Outlook, April 2010, The Economist and central banks' websites.

their quantitative easing policies to ease credit extension. However, many segments of the credit market in advanced economies were still supply-constrained. Several central banks, namely US Federal Reserve, Bank of Canada, Bank of Japan and the Reserve Bank of New Zealand remained committed to low interest rates for an extended period subject to inflationary pressures remaining at bay.

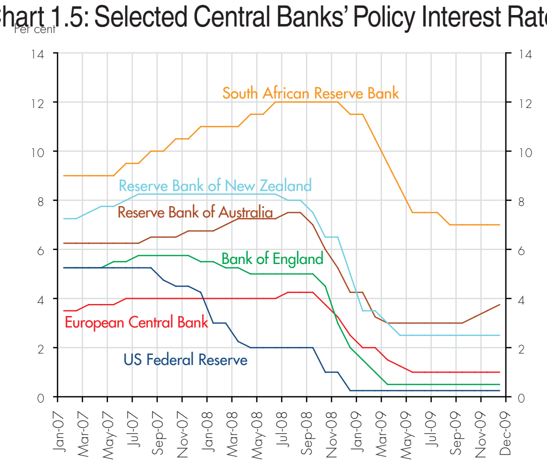
Among the few central banks which began removing the monetary stimulus by hiking their policy interest rates were the Reserve Bank of Australia, Bank of Israel and Norges Bank. Firmer economic conditions in these countries warranted central bank action to address the threat of rising inflation unanchoring inflation expectations.

The US Federal Reserve kept its federal funds rate in the target range of zero to 0.25 per cent but slowed the pace of its quantitative easing measures with a view to promoting a smooth transition to financial markets operations. With inflation expectations at modest levels, the accommodative stance of monetary policy would continue to support recovery.

The European Central Bank (ECB) and the Bank of England maintained their policy interest rates at 1.0 per cent and 0.5 per cent, respectively. They pursued quantitative easing policies buying bonds and securities to support bank lending. The ECB continued to lend money to banks while the Bank of England increased its asset purchase programme from £125 billion to £175 billion in August 2009 and further to £200 billion in November to support its struggling economy. Corporate credit remained hard to access in the United Kingdom but credit conditions eased towards the last quarter of 2009. Chart 1.5 shows end-of-month policy interest rates of selected central banks.

For the first semester of 2010, the majority of central banks are expected to maintain the highly accommodative monetary policy stance but changing yield curves in several countries suggested that market expectations of rising interest rates in the latter half of the year have firmed in recent weeks. Quantitative easing measures are anticipated to be scaled back as financial markets conditions normalise. Already, the demand in major advanced economies for short-term liquidity-providing programmes dwindled towards the end of 2009. The challenge for central banks of an early exit that could jeopardise growth, however, still remains. Governments would also have to unwind their fiscal stimulus and restore fiscal balances to sustainable levels.

Chart 1.5: Selected Central Banks' Policy Interest Rates



Sources: Thomson Reuters and central banks' websites.

1.2 THE DOMESTIC ENVIRONMENT

In the second semester of 2009, persistently weak external demand was more than offset by robust domestic demand, which benefited mainly from strong public spending in infrastructure work and fairly resilient household consumption expenditure. Credit to households sustained a growth path comparable with pre-crisis trend, while growth of credit to businesses plummeted. Following the strong rebound in the second half, the Mauritian economy grew by 3.1 per cent in 2009, higher than the previous forecast of 2.8 per cent.

Despite soft external demand, real activity in export sectors, which had been contracting for several quarters, posted positive year-on-year growth rates in the final quarter of 2009. The textiles and hotels and restaurants sectors posted seasonally-adjusted quarter-on-quarter growth rates of 4.3 per cent and 11.6 per cent, respectively. Except for the sugar industry and other manufacturing, all sectors posted positive quarter-on-quarter growth rates in the fourth quarter of 2009. Along with hotels and restaurants, the construction sector was the only other sector which recorded double-digit quarter-on-quarter growth rates. The distributive sector and to a lesser extent transport, storage and communications failed to sustain the growth momentum of the third quarter of 2009. The other key drivers of the economy namely financial intermediation and real estate, renting and dwelling activities indicated greater resilience by growing faster than the previous quarter.

Overall, growth dynamics indicated that economic conditions have improved significantly in the second semester relative to the first semester of 2009. Seasonally-adjusted quarter-on-quarter data showed that the domestic economy was gradually recovering as it grew by 0.6 per cent, 3.4 per cent and 3.3 per cent in the second, third and fourth quarters, respectively, after having contracted by 0.8 per cent in the first quarter of 2009. The Central Statistics Office (CSO) has forecast a growth of 4.6 per cent for the current year. A slow recovery in main export markets is expected. The growth impetus will come from the front-loading of massive infrastructural projects and continued Government support for the private sector, which is earmarked to be terminated by end-December 2010.

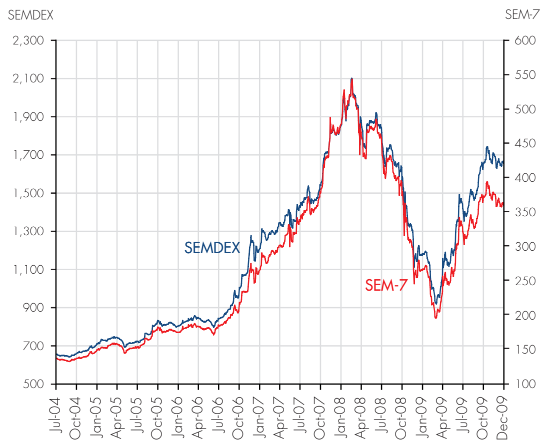
Stock market

Reflecting international stock market movements and improving domestic business conditions, the Mauritian stock market rallied in the second half of 2009. Share prices got a boost from the resumption of growth in key export markets, positive financial results from listed banks showing comfortable profit levels, and increasing interest from foreign investors in banks' and hotels' shares mainly.

Non-residents' net investments on the stock market, which had been consistently negative since October 2008, turned positive in the months of August, September, November and December 2009. Overall, for the period July to December 2009, non-residents' net inward investments amounted to Rs131.7 million compared to net disinvestments of Rs1,219 million for the period January to June 2009.

Both SEMDEX and the SEM-7 peaked at 1,743.30 and 394.06 on 19 October 2009, but slipped thereafter to reach 1,660.87 and 360.75 on 31 December, respectively. The drop in the stock market indices was induced to some extent by profit-taking as well as dips in the share prices of blue-chips caused by the somewhat less rosy corporate announcements for the third quarter of 2009 and a few hotels reporting poor visibility ahead. For the six months ended 31 December 2009, SEMDEX and the SEM-7 gained 17 per cent and 12 per cent, respectively, after both indices had climbed by around 20 per cent in the first half of 2009. Chart 1.6 depicts the evolution of the local stock market indices.

Chart 1.6: SEMDEX and SEM-7



Source: Stock Exchange of Mauritius Ltd.

Balance of payments and foreign exchange reserves

The current account of the balance of payments, inclusive of the purchase of an aircraft, posted a deficit of Rs11.6 billion in the second half of 2009, almost 23 per cent lower than a year ago but higher by nearly 17.0 per cent relative to the first semester of 2009. Exclusive of aircraft, however, the current account deficit in the second semester of 2009 declined by 12.0 per cent from the deficit level reached in the preceding semester. Slightly higher surpluses on the services and income accounts combined with an increase of Rs3.5 billion in current transfers helped to partly offset the increase of Rs6.7 billion in the merchandise account deficit.

The capital and financial account of the balance of payments recorded lower net inflows of Rs3.8 billion in the second semester of 2009 compared with Rs7.3 billion in the first semester. Foreign direct investment and portfolio investment registered combined net inflows of Rs2.4 billion in the second semester, up from Rs1.8 billion in the first semester. Net other investments recorded an increase in liabilities of Rs9.4 billion in the second semester compared with a reduction in assets of Rs9.5 billion in the six month period to June 2009. Reserve assets, excluding valuation change, rose by Rs8.0 billion inclusive of Special Drawing Rights (SDR) allocations of Rs4.0 billion in the second half 2009.

Exchange rate

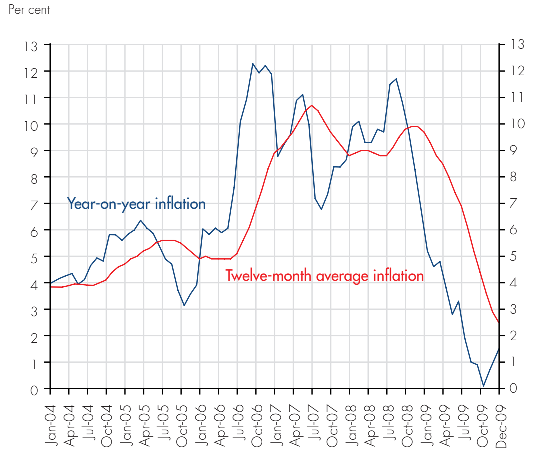
Lower demand pressures coupled with ample foreign exchange liquidity meant that the rupee exchange rate was driven mostly by international currency movements. During the period July to November 2009, the Mauritian rupee appreciated against the US dollar as the latter was dumped for riskier equity assets and higher yielding currencies. The rupee pared some gains in December as the US currency strengthened on international markets on investors' increased risk aversion. Against the euro, the rupee fluctuated within a relatively tight range between July and November 2009 after which, it started gaining strongly as sovereign debt concerns in the euro zone and contagion effects weighed on the single currency. Overall for the six months to December 2009, the rupee appreciated vis-à-vis the US dollar, the euro and the Pound sterling on a consolidated point-to-point basis.

On the domestic foreign exchange market, the Bank did not intervene but introduced foreign currency swaps to provide additional liquidity to the market effective 22 December 2009 as the domestic foreign exchange spot market was experiencing undue volatility as a result of reduced volume of transactions.

Inflation

Inflation was lower in the second semester of 2009 compared to the first semester, as shown in Chart 1.7, in line with the central bank's projection. Having reached a historical low of 0.1 per cent in October 2009, inflation picked up in November to close the year at 1.5 per cent. The Consumer Price Index (CPI) stayed more or less flat in the final quarter of 2009 and the rise in inflation primarily reflected base effects, given the significant drop in the CPI towards the end of 2008. The twelve-month average inflation dropped steadily from 6.9 per cent in June 2009 to 2.5 per cent in December 2009, reinforcing the trend observed since late 2008.

Chart 1.7: Inflation Rate



Sources: CSO, Government of Mauritius, and Bank calculations.

1.3 MONETARY POLICY

The MPC of the Bank of Mauritius convened two regular meetings during the second semester of 2009, notably on 22 September and 10 December. The key Repo Rate was maintained on hold at 5.75 per cent by the MPC.

The amendment brought to the Bank of Mauritius Act 2004 in July 2009, increasing the number of external members on the MPC from three to four, was given effect with the appointment of the ninth member of the MPC in August 2009. As per section 54 of the Act, the membership of the MPC comprises the Governor as chairperson, two Deputy Governors, two Board Directors and four external members. Two observers, one from the Treasury and one from the Bank, were appointed to sit on the MPC. Another noteworthy development was the enhancement of transparency on MPC-related administrative matters. In addition to dates of meetings and decisions of the MPC, details on attendance and costs were published in the Annual Report of the Bank for the year ended 30 June 2009.

Monetary policy decisions

Clear signs of global economic recovery had emerged when the MPC met on 22 September

2009. Economic as well as financial markets conditions had improved, largely facilitated by supportive policies. Most major advanced economies were moving out of recession and growth prospects had brightened amid low inflation and uncertainty about the pace and extent of the economic recovery.

Domestic economic activity was still constrained by weak external demand. Key export sectors contracted while other economic sectors had slowed down significantly in the first semester of 2009. There were indications that the worst was behind and a better economic performance was anticipated in the second half of 2009 on the back of improved prospects in main export markets, stimulative economic policy measures and increasing confidence about the business outlook. Inflation had continued to fall against a backdrop of receding short-term inflationary pressures on account of the domestic economic slack and low price pressures from external sources. Much uncertainty remained about the medium-term inflation outlook as a result of the potential upside risks from the future course of oil and food prices on international markets. As a measure of consolidating the economic gains, the MPC unanimously decided to maintain the key Repo Rate at 5.75 per cent per annum.

By the time the MPC met on 10 December 2009, global economic activity and financial markets conditions had strengthened further. Nearly all major advanced economies were out of recession and many large emerging economies were already rebounding at a fast pace. Inflation was anticipated to remain low worldwide in the short term but the outlook was expected to worsen as the pick-up in global economic activity would lead to higher international commodity prices.

The MPC noted that the domestic economic activity had been gathering pace in the second half of 2009 and the medium-term economic prospects had improved. Several underlying factors were likely to stimulate overall economic activity during coming quarters. The MPC maintained its previous assessment of inflation staying significantly below trend in the short term but with potential upside risks in the medium term arising from the future course of international commodity prices. The MPC left the key Repo Rate unchanged at 5.75 per cent.

The decisions on the key Repo Rate are summarised in Table 1.3.

Table 1.3: Decisions of the MPC on the Key Repo Rate

Date of MPC meeting and effective date of decision	Decision on the key Repo Rate	Key Repo Rate *(post-decision level, per cent per annum)*	Voting pattern	Details on voting pattern
22 September 2009	Unchanged	5.75	Unanimous	-
10 December 2009	Unchanged	5.75	Unanimous	-

2. Recent Developments in Inflation

Consumer price inflation fell to low levels by historical standards in the second semester of 2009. While the twelve-month average inflation declined steadily, there was marginal pick-up in the year-on-year measure as from November 2009 coinciding with the turnaround in inflation observed in many other countries.

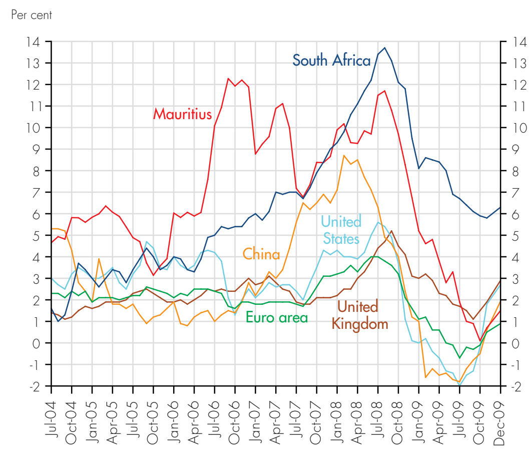
The CPI barely went up, recording a marginal increase of 0.1 index point. The pass-through of the strengthening of the rupee exchange rate, low demand-side pressures and base effects arising from past price levels were among the major factors affecting the CPI. Prices of administered items, in particular motor gasoline and diesel oil, declined on average under the Automatic Pricing Mechanism (APM) monthly review.

2.1 GLOBAL INFLATION AND COSTS

Global inflation remained subdued in the second half of 2009, suppressed by significant economic slack.[2] The decline in inflation, which began from the final quarter of 2008, continued in the third quarter of 2009 but there was a reversal in the last quarter. Rising international commodity prices, brighter prospects for global economic recovery and base effects given the massive slump in prices in the second half of 2008 accounted for the rise in inflation.

Amongst Mauritius' major trading partner countries, consumer price inflation in the United States dropped to -2.1 per cent in July 2009 but subsequently rose to 2.7 per cent in December. In the euro area, inflation picked up from -0.7 per cent in July 2009 to -0.3 per cent in September but became positive at 0.9 per cent in December. Inflation in the United Kingdom remained positive throughout, falling from 1.8 per cent in July 2009 to 1.1 per cent in September before reversing trend to close December at 2.9 per cent. In South Africa, the rate of inflation declined from 6.7 per cent in July 2009 to 5.8 per cent in November but increased to 6.3 per cent in December. In China, inflation moved up from -1.8 per cent in July 2009 to 1.9 per cent in December. Chart 2.1 shows year-on-year inflation for selected economies, including Mauritius.

Chart 2.1: Inflation in Selected Countries



Sources: CSO, Government of Mauritius, and Bank calculations, central banks' and offices of national statistics' websites.

Looking ahead, the IMF forecasts that headline inflation in advanced economies would pick up from zero per cent in 2009 to 1.25 per cent in 2010 as low levels of capacity utilisation and well-anchored inflation expectations are expected to contain inflation pressures. Inflation in emerging and developing economies is also expected to remain subdued but the vigorous pace of growth recovery in some of these economies may give rise to upward inflationary pressures.

Commodity prices

Oil prices

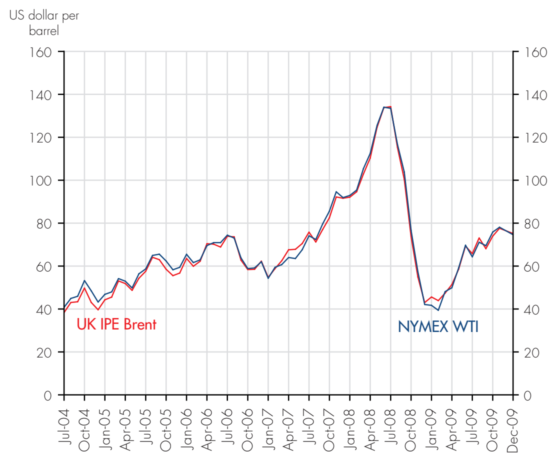
International oil prices firmed up in the last half of 2009. Monthly average oil prices for both NYMEX WTI and IPE Brent declined momentarily in July 2009 from June's levels before picking up again. Except for September 2009 when monthly average oil prices fell to US$69.5 for NYMEX WTI and US$68.1 for IPE Brent, oil prices remained above the US$70 level for the rest of the year.

[2] *In this section, official inflation figures cited represent year-on-year inflation.*

On a daily settlement basis, NYMEX WTI crossed the US$80 mark on a few occasions late in October and early November 2009 as data supported the view that the pace of global economic recovery could quicken earlier than expected. Subsequent data led to a return to cautious optimism as expectations of economic recovery and higher future oil consumption were weighed against weak current demand and high inventories. Oil prices pulled back in the first two weeks of December 2009 to an intra-month low settlement price of US$69.51 on 14 December for NYMEX WTI and US$71.86 on 10 December for IPE Brent on renewed concerns about the US economy, a stronger US dollar and healthy US oil inventories. However, oil prices were quick to rebound on falling crude stocks, exceptionally cold weather, and regained optimism about global economic recovery.

Overall for the six months to December 2009, oil prices were firmer relative to the first semester of 2009 with daily settlement prices of NYMEX WTI and IPE Brent fluctuating within a range of US$59.5 and US$81.3 per barrel compared to a range of US$34.0 and US$72.7 per barrel in the first half of 2009. Chart 2.2 shows movements in monthly average oil prices.

Chart 2.2: Movements in Monthly Average NYMEX WTI and IPE Brent



Source: Thomson Reuters.

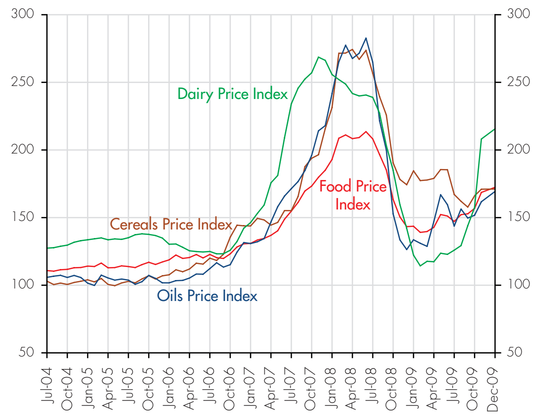
Food prices

Global food prices were on the rise again in the second half of 2009 and broadly higher on average relative to the first semester with the exception of cereals. Ample crop supplies had depressed cereals prices in the second semester of 2009 relative to the first but October 2009 onwards, the cereals price index had resumed its upward movement.

The Food and Agriculture Organisation (FAO) Food Price Index (FPI) rose steadily from August 2009 onwards - a trend reflected in nearly all of its components, as shown in Chart 2.3.[3] The FPI gained ground on continuing robust recovery in international prices of dairy products, oils and fats, and in the final quarter of 2009 for cereals, averaging 172 points in December 2009, up by 13.8 per cent from June 2009. At this level, the FPI was at its highest level since September 2008.

Though the global food economy seemed less vulnerable to external developments than was the case in 2008, factors such as government export restrictions and volatile oil prices could help push food prices higher.

Chart 2.3: FAO Food Price Index and Sub-Indices



Source: FAO website.

Other commodity prices

Most of the non-energy and non-food commodities had relatively firmed up in the second half of 2009, reflecting the improved economic prospects for the world economy. Table 2.1 shows the quarterly averages of selected non-energy commodities for the year 2009.

[3] The FAO FPI consists of the average of six commodity group price indices, namely, meat, dairy, cereals, oil and fats, and sugar, weighted with the average export shares of each of the groups for 2002-2004.

Table 2.1: Non-energy Commodities

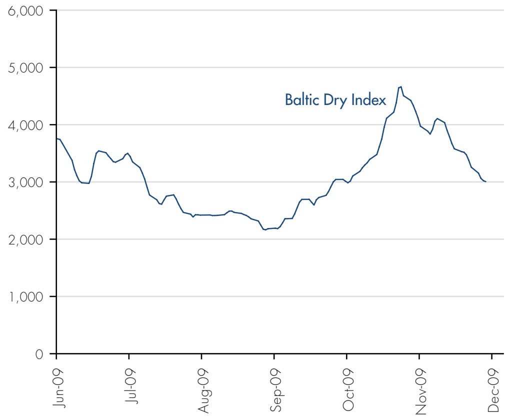
Commodity	Unit	Quarterly Averages Jan-Mar 2009	Apr-Jun 2009	Jul-Sep 2009	Oct-Dec 2009
Cotton A Index	c/kg	121	132	142	158
Aluminum	$/mt	1,360	1,485	1,812	2,003
Copper	$/mt	3,428	4,663	5,859	6,648
Gold	$/toz	909	922	960	1,102
Iron ore	c/dmtu	101	101	101	101
Lead	c/kg	116	150	193	229
Nickel	$/mt	10,471	12,920	17,700	17,528
Silver	c/toz	1,265	1,376	1,477	1,760
Steel (cold rolled) coilsheet	$/mt	1,033	700	700	700
Steel (hot rolled) coilsheet	$/mt	933	600	600	600
Tin	c/kg	1,103	1,351	1,459	1,517
Zinc	c/kg	117	147	176	221
Cocoa	c/kg	259	258	296	342
Plywood	c/sheets	573	566	562	558
Tea, auctions (3) average	c/kg	218	266	304	302

$ = US dollar c = US cent mt = metric ton
kg = kilogram dmtu = dry metric ton unit toz = troy oz
Source: World Bank's Commodity Price Data.

Freight costs

The Baltic Dry Index (BDI), the benchmark for tracking commodity shipping costs, fluctuated widely during the second half of 2009, as depicted in Chart 2.4. The BDI, which averaged 3,355 points in July 2009 dropped to 2,685 points in August and further to 2,351 points in September as demand from China slowed. The BDI bounced back in October, recording its year-high on 19 November 2009 at 4,661 points before receding to 3,005 points on 24 December.

Chart 2.4: Daily Baltic Dry Index: 30 June – 24 December 2009



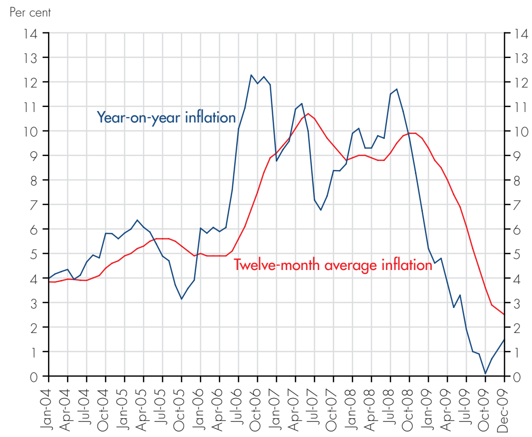
Source: Dowjonesclose website.

2.2 INFLATION: HEADLINE AND CORE

Consumer price inflation, as measured by both twelve-month moving average and year-on-year methodologies, remained at historically low levels in the second half of 2009, as illustrated in Charts 2.5, 2.6 and 2.7. However, after maintaining a downtrend and reaching 0.1 per cent in October, year-on-year inflation, defined as the percentage change in the CPI of a given month compared to the same month of the preceding year, subsequently rose to 0.7 per cent in November and further to 1.5 per cent in December. With the CPI barely moving in the three months to December 2009, the rise in inflation mostly reflected base effects given the large drop in the CPI towards the end of 2008.

Inflation, measured by the percentage change between the average CPI during a twelve-month period and the average CPI during the corresponding previous twelve-month period, continued to decline in the second semester of 2009. Inflation fell to 6.1 per cent in July 2009, to 4.4 per cent in September and further to 2.5 per cent in December.

Chart 2.5: Inflation – twelve-month average and year-on-year



Sources: CSO, Government of Mauritius, and Bank calculations.

Core inflation

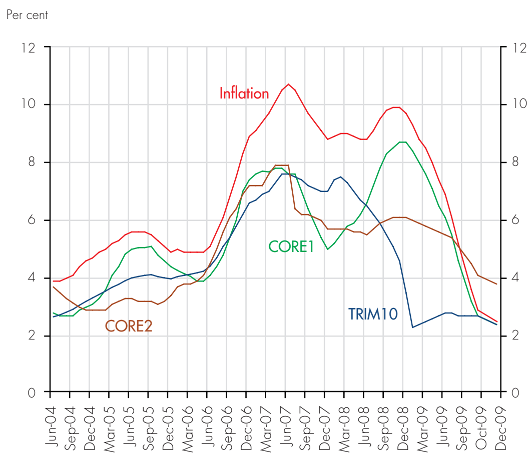
There was no marked divergence between the Bank's three measures of underlying inflation and headline inflation.[4] There was no hard evidence either from the evolution of year-on-year CORE1 and CORE2 inflation that monthly APM changes in domestic fuel prices were having second round effects on inflation.

[4] *Core inflation measures the change in average consumer prices after excluding from the CPI certain items with volatile price movements and using statistical approaches. CORE1 is obtained using the exclusion-based approach and strips "Food, Beverages and Tobacco" components and mortgage interest on housing loan from headline inflation. CORE2 also an exclusion-based approach further excludes energy prices and administered prices from the overall CPI. TRIM10 truncates 5 per cent of each tail of the distribution of price changes.*

Based on the twelve-month average methodology, CORE1 inflation dropped from 6.1 per cent in June 2009 to 2.4 per cent in December, while CORE2 fell from 5.5 per cent to 3.8 per cent over the same period. TRIM10 inflation remained flat at 2.8 per cent in June and July 2009 before edging down to 2.7 per cent in the following four months to finally close December at 2.4 per cent.

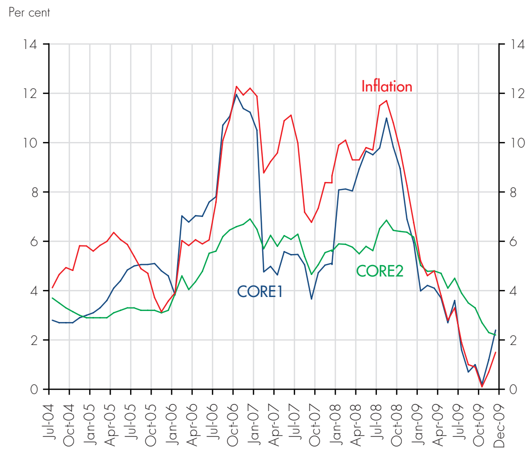
On a year-on-year basis, except for the month of September 2009 when it briefly ticked up to 1.0 per cent, CORE1 steadily fell between June and October 2009, from 3.6 per cent to an intra-year low of 0.2 per cent. CORE1 inflation thereafter picked up to 1.2 per cent in November 2009 and to double that in December. In contrast, CORE2 inflation declined throughout the period June to December 2009 from 4.5 per cent to 2.2 per cent.

Chart 2.6: Inflation and Core Inflation - twelve-month average



Sources: CSO, Government of Mauritius, and Bank calculations.

Chart 2.7: Inflation and Core Inflation - year-on-year



Sources: CSO, Government of Mauritius, and Bank calculations.

2.3 EVOLUTION OF MAJOR COMMODITY GROUP INDICES

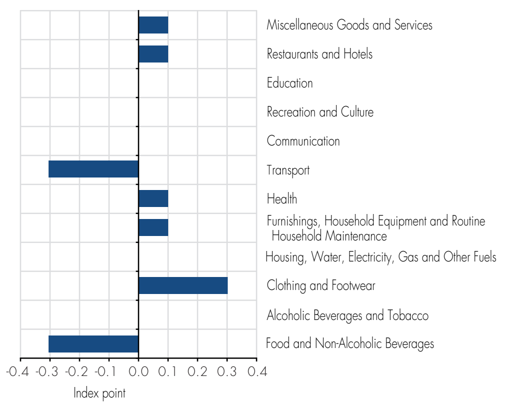
Upward price pressures were almost absent in the six months to December 2009, as demonstrated by movements in the CPI. The CPI hardly went up, rising from 117.1 in June 2009 to 117.2 in December although in between it went up to 117.8 in July and September.

Clothing and footwear, which rose by 4.5 per cent between June and December 2009, was the single largest contributor with 0.3 index point to the rise in the CPI. Four divisions, namely *Furnishings, household equipment and routine household maintenance, Health, Restaurants and hotels, and Miscellaneous goods and services* recorded contributions of 0.1 index point each. These increases were partially offset by a weighted decline of 0.3 index point both in the *Food and non-alcoholic beverages and Transport divisions.*

Chart 2.8 illustrates the weighted contribution of the main divisions of the CPI basket to the change in the CPI between June 2009 and December 2009.

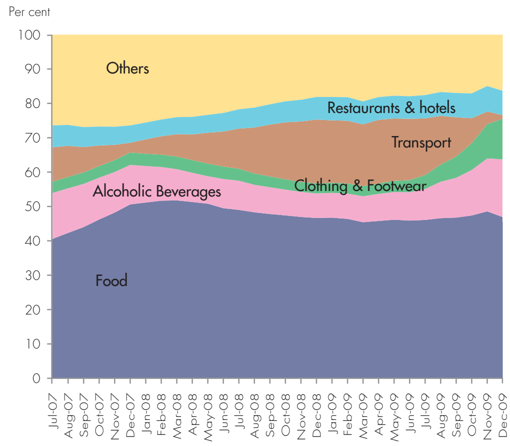
Chart 2.9 depicts the monthly weighted contribution of the main components of the CPI basket to twelve-month average inflation.

Chart 2.8: Weighted Contribution of Main Divisions to the Change in the CPI: June – December 2009



Sources: CSO, Government of Mauritius, and Bank calculations.

Chart 2.9: Weighted Contribution of Main Divisions of the CPI Basket to Inflation

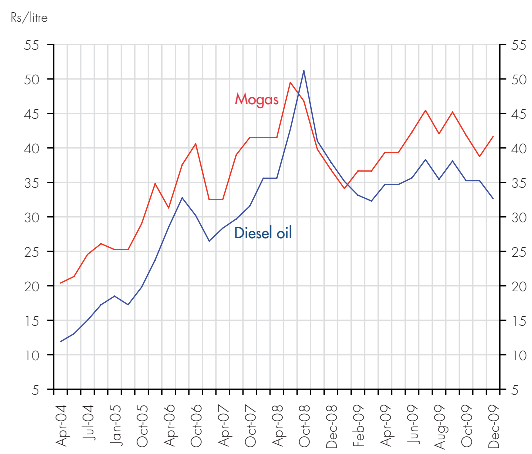


Sources: CSO, Government of Mauritius, and Bank calculations.

Domestic prices of mogas and diesel oil

The domestic prices of motor gasoline oil (mogas) and diesel oil as determined by the APM Review Committee in the first week of the month remained contained in the second half of 2009, as shown in Chart 2.10.[5] The retail price of mogas was adjusted upward at three APM committee meetings and downward at the other three meetings. The retail price of diesel oil was cut on three occasions, raised on two others and kept unchanged on one occasion. Overall, between July and December 2009, the net contribution of adjustments in mogas and diesel oil prices stood at -0.1 index point in the CPI, thus pulling the CPI downward.

Chart 2.10: Domestic Prices of Mogas and Diesel Oil



Source: State Trading Corporation.

[5]*Refer to Box 1 in the November 2009 issue of the Inflation Report for a review of the APM for fuel prices.*

Food and non-food inflation

There was a steady decline in food inflation - with food carrying a weight of 26.5 per cent in CPI basket - from 11.5 per cent in June 2009 to 7.4 per cent in September and further to 4.1 per cent in December. Non-food inflation also declined from 5.0 per cent in June 2009 to 3.2 per cent in September and further to 1.9 per cent in December. Table 2.2 and Charts 2.11 and 2.12 illustrate movements in food and non-food inflation.

Based on the year-on-year methodology, food inflation fell from 4.7 per cent in June 2009 to 0.6 per cent in October, before edging up to 1.0 per cent and 1.1 per cent in November and December, respectively. Non-food inflation came to -0.2 per cent in October 2009 before turning around to 0.5 per cent in November and further 1.6 per cent in December.

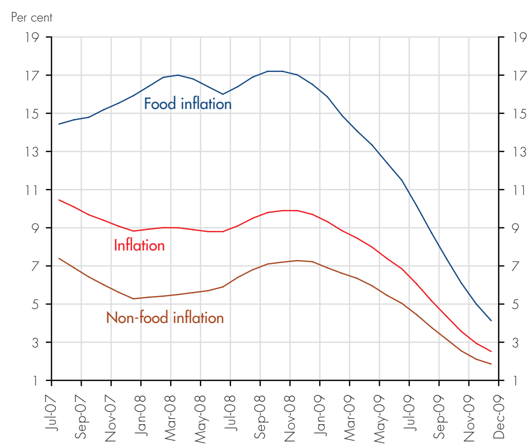
Table 2.2: Food and Non-food Inflation

Per cent

	Food	Non-Food	Food	Non-Food
	12-month average		Year-on-year	
Jun-09	11.5	5.0	4.7	2.7
Jul-09	10.1	4.4	3.0	1.5
Aug-09	8.7	3.8	2.1	0.6
Sep-09	7.4	3.2	1.7	0.6
Oct-09	6.1	2.5	0.6	-0.2
Nov-09	5.0	2.1	1.0	0.5
Dec-09	4.1	1.9	1.1	1.6

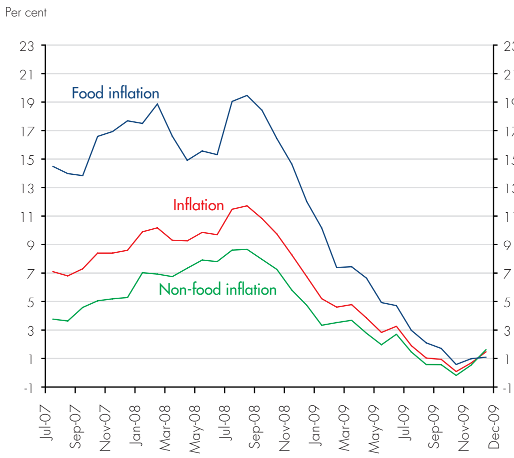
Sources: CSO, Government of Mauritius, and Bank calculations.

Chart 2.11: Headline, Food and Non-food Inflation – twelve-month average



Sources: CSO, Government of Mauritius, and Bank calculations.

Chart 2.12: Headline, Food and Non-food Inflation – year-on-year



Sources: CSO, Government of Mauritius, and Bank calculations.

Goods and services inflation

Goods inflation continued its decline in the second half of 2009 to reach 2.8 per cent in December 2009 from 7.0 per cent in June 2009, reflecting to a great extent the moderation of goods prices since mid-2008.

Services inflation also significantly slowed down partly as a result of the deceleration in the pace of economic activity. In December 2009, services inflation stood at 1.8 per cent, down from 6.5 per cent in June 2009.

Based on the year-on-year methodology, goods inflation remained on the low side despite signs of a pick-up in the last two months of 2009. Goods inflation declined from 4.1 per cent in June 2009 to 0.4 per cent in October and thereafter rose steadily in November and December. Services inflation eased from 1.6 per cent in June 2009 to 0.6 per cent in July and moved in negative territory subsequently for four months running. Table 2.3 and Charts 2.13 and 2.14 show movements in food and non-food inflation.

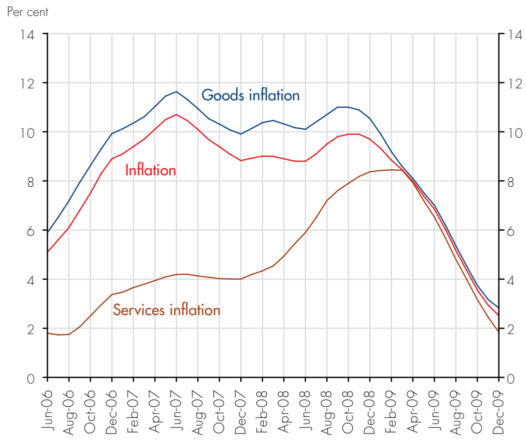
Table 2.3: Goods and Services Inflation

Per cent

	Goods	Services	Goods	Services
	12-month average		Year-on-year	
Jun-09	7.0	6.5	4.1	1.6
Jul-09	6.2	5.7	2.5	0.6
Aug-09	5.4	4.8	1.6	-0.1
Sep-09	4.5	4.0	1.6	-0.6
Oct-09	3.7	3.2	0.4	-0.7
Nov-09	3.2	2.5	1.2	-0.4
Dec-09	2.8	1.8	2.2	0.0

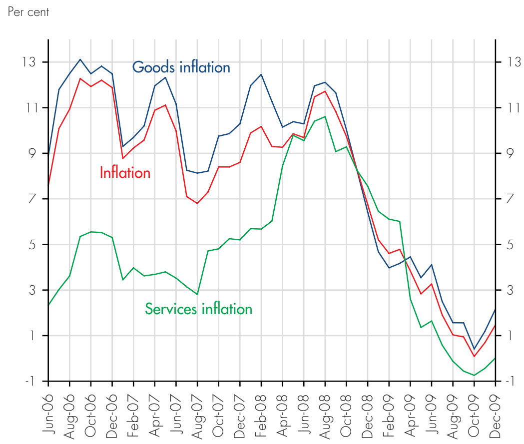
Sources: CSO, Government of Mauritius, and Bank calculations.

Chart 2.13: Goods and Services Inflation - twelve-month average



Sources: CSO, Government of Mauritius, and Bank calculations.

Chart 2.14: Goods and Services Inflation - year-on-year



Sources: CSO, Government of Mauritius, and Bank calculations.

2.4 EVOLUTION OF OTHER PRICE/COST INDICES

Import Price Index

The Import Price Index (IPI), which measures prices of goods imported in Mauritius inclusive of exchange rate movements, rose by 1.8 per cent between the third and fourth quarters of 2009 in part reflecting the increase in international oil prices, the depreciation of the rupee and the rise in freight rates. Between the second and third quarters of 2009, the IPI dropped marginally by 0.4 per cent.

The IPI fell from 110.9 in the fourth quarter of 2008 to 105.8 in the fourth quarter of 2009, as shown in Table 2.4, representing a drop of 4.6 per cent. Between the fourth quarters of 2008 and 2009, sub-indices of the IPI namely for animal and vegetable oils, food and live animals, manufactured products, crude materials, chemical materials and related products, and machinery and transport equipment had declined significantly.

Producer Price Index

Price pressures at producers' level, both for agricultural and manufactured products, showed signs of further moderation in the second half of 2009. The Producer Price Index-Agriculture (PPI-A) inflation dropped steadily from 3.8 per cent in June 2009 to -2.4 per cent in December 2009. The Producer Price Index-Manufacturing (PPI-M) inflation in December stood at -0.7 per cent, down from 9.2 per cent in June 2009.

Producer prices for agricultural as well as manufactured products fell compared to a year earlier. On a year-on-year basis, PPI-M inflation eased markedly from zero per cent in June 2009 to -4.2 per cent in December. The drop in the index of the sub-component Manufacture of food products, beverages and tobacco contributed to the PPI-M deflation. PPI-A inflation remained in negative territory, standing at -7.0 per cent in December 2009 compared to -1.5 per cent in June 2009, denoting lower prices obtained by agricultural producers for their products relative to a year ago.

The producer price inflation for manufacturing and agricultural products based on twelve-month average and year-on-year methodologies are depicted in Table 2.5 and Charts 2.15 and 2.16.

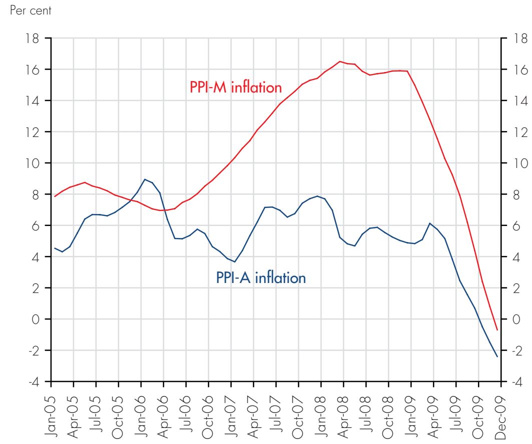
Table 2.5: Producer Price Inflation

Per cent

	PPI-A	PPI-M	PPI-A	PPI-M
	12-month average		Year-on-year	
Jun-09	3.8	9.2	-1.5	0.0
Jul-09	2.5	7.9	-7.4	-1.4
Aug-09	1.6	6.2	-5.9	-3.6
Sep-09	0.7	4.4	-6.9	-5.0
Oct-09	-0.5	2.4	-9.2	-6.0
Nov-09	-1.5	0.8	-7.3	-4.8
Dec-09	-2.4	-0.7	-7.0	-4.2

Sources: CSO, Government of Mauritius, and Bank calculations.

Chart 2.15: Producer Price Inflation for Manufacturing and Agriculture - twelve-month average



Sources: CSO, Government of Mauritius, and Bank calculations.

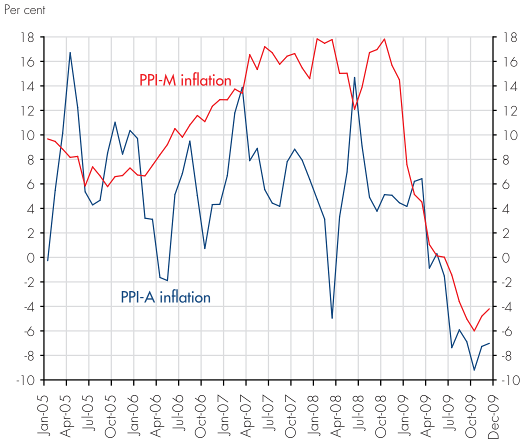
Table 2.4: Import Price Index

Description	2008 Quarter 3	2008 Quarter 4	2009 Quarter 1	2009 Quarter 2	2009 Quarter 3[1]	2009 Quarter 4[2]	Percentage change: Between 4th Quarter 2009 and 3rd Quarter 2009	Percentage change: Between 4th Quarter 2009 and 4th Quarter 2008
Food and live animals	121.8	129.9	110.0	109.4	111.5	108.9	-2.3	-16.1
Beverages and tobacco	112.3	110.9	116.4	137.9	140.5	144.2	2.6	30.1
Crude materials, inedible, except fuels	132.5	147.4	153.6	135.6	138.4	135.5	-2.1	-8.1
Mineral fuels, lubricants and related materials	166.8	100.4	78.5	82.1	97.3	112.7	15.8	12.2
Animal and vegetable oils, fats and waxes	150.8	144.9	109.7	96.4	101.7	99.8	-1.9	-31.1
Chemical materials and related products, n.e.s	103.6	110.9	112.5	113.7	108.6	102.6	-5.5	-7.5
Manufactured goods classified chiefly by material	105.4	108.8	102.7	106.0	94.8	96.3	1.6	-11.5
Machinery and transport equipment	93.5	102.0	105.4	104.3	103.3	100.6	-2.7	-1.4
Miscellaneous manufactured articles	94.1	102.5	107.0	107.9	106.1	105.3	-0.8	2.7
Overall Index	**118.7**	**110.9**	**102.6**	**103.5**	**103.9**	**105.8**	**1.8**	**-4.6**

[1] *Revised.* [2] *Provisional.* *n.e.s: not elsewhere specified.*

Sources: CSO, Government of Mauritius, and Bank calculations.

Chart 2.16: Producer Price Inflation for Manufacturing and Agriculture - year-on-year



Sources: CSO, Government of Mauritius, and Bank calculations.

Wage Rate Index

The Wage Rate Index (WRI), a measure of the cost of labour, increased by 4.8 per cent and 0.7 per cent in the third and fourth quarters of 2009 relative to the preceding quarters. The increase in the WRI in the third quarter was mainly due to seasonally higher wage rates paid during the sugar-cane harvest period. In the fourth quarter of 2009, the largest rise of 3.4 per cent was recorded in Hotels and restaurants, followed by 3.2 per cent in Real estate, renting and business activities while Financial intermediation, Construction and Transport, storage and communications registered increases of 2.7 per cent, 2.3 per cent and 2.0 per cent, respectively. Industrial groups which had witnessed wage rate decreases over the same period were Agriculture, hunting, forestry and fishing with a 5.3 per cent fall followed by 2.1 per cent decline in Electricity and water. Table 2.6 shows the quarterly change in the WRI by industry group.

Table 2.6: Changes in the Wage Rate Index by Industry Group

		2009				Weighted contribution between (index points)		Percentage change between	
	INDUSTRY GROUPS	Quarter 1	Quarter 2	Quarter 3	Quarter 4	Quarter 2 and Quarter 3	Quarter 3 and Quarter 4	Quarter 2 and Quarter 3	Quarter 3 and Quarter 4
1	Agriculture, hunting, forestry and fishing	115.5	119.3	153.8	145.7	2.1	-0.5	28.9	-5.3
2	Manufacturing, mining and quarrying	121.5	122.5	126.1	125.7	0.6	-0.1	2.9	-0.3
3	Electricity and water	119.9	119.7	138.2	135.3	0.4	-0.1	15.5	-2.1
4	Construction	117.6	122.2	128.1	131.0	0.2	0.1	4.8	2.3
5	Wholesale and retail trade; repair of motor vehicles, motorcycles, personal and household goods	128.5	134.7	130.6	132.1	-0.3	0.1	-3.0	1.1
6	Hotels and restaurants	123.3	127.1	134.8	139.4	0.5	0.3	6.1	3.4
7	Transport, storage and communications	125.9	126.4	132.4	135.0	0.5	0.2	4.7	2.0
8	Financial intermediation	117.7	117.2	120.4	123.7	0.2	0.2	2.7	2.7
9	Real estate, renting and business activities	130.9	132.3	143.2	147.8	0.6	0.2	8.2	3.2
10	Public administration and defence; compulsory social security	137.2	136.9	140.5	140.8	0.6	0.1	2.6	0.2
11	Education	138.1	137.7	140.4	142.3	0.3	0.2	2.0	1.4
12	Health and social work	136.6	128.8	136.8	136.2	0.5	0.0	6.2	-0.4
13	Other community, social and personal services	128.2	131.8	130.7	133.1	0.0	0.0	-0.8	1.8
ALL GROUPS		**128.0**	**128.8**	**135.0**	**136.0**	**6.2**	**1.0**	**4.8**	**0.7**

Sources: CSO, Government of Mauritius, and Bank calculations.

3. Demand and Output

Rebound in economic activity

As widely expected, the domestic economy rebounded in the second half of 2009. Output of the major economic sectors regained thrust, although key export-oriented industries came out of recession in the last quarter. Year-on-year, the economy grew by 3.5 per cent and further by 6.4 per cent in the third and fourth quarters, respectively. Short-term dynamics reflected in seasonally-adjusted quarter-on-quarter growth rates showed that the economy sustained its momentum in the third and fourth quarters of 2009 with growth rates of 3.4 per cent and 3.3 per cent, respectively - such magnitude was last seen in the third quarter of 2007. Labour market conditions also improved during this period.

Seasonally-adjusted data indicated that the economy had slumped in the first half of 2009 following a contraction of 0.8 per cent in the first quarter and a positive growth rate of 0.6 per cent in the second quarter. Negative growth rates in the first quarter for 7 out of 14 economic sectors followed by contraction in 4 sectors in the second quarter largely explained the poor economic performance in the first semester. The situation improved drastically in the second semester after most of the sectors, including export-oriented ones, recorded stronger positive growth rates especially in the final quarter of 2009.

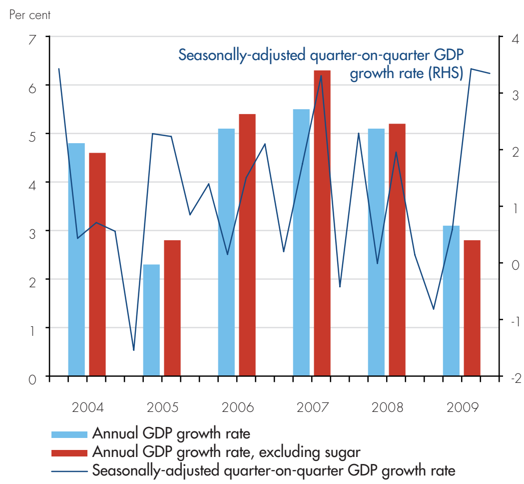
Weak external demand continued to adversely affect the export sectors. The economy of the United Kingdom, which is the largest buyer of textiles and seafood exports from Mauritius, was still in bad shape. But exporting firms' structural adjustments to cope with the crisis conditions helped them to remain price competitive and retain their market shares in the United Kingdom. Tourist arrivals from the United Kingdom declined in the second semester of 2009 from a year ago but the French market was unexpectedly resilient as inbound tourism from that country continued to record positive growth rates.

The rest of the economy fared better than the export sectors on the back of still robust domestic demand and little exposure to crisis-hit economies. Construction and the distributive trade were among the key sectors seen driving the economy in the second semester of 2009. Seasonally-adjusted data showed that the construction sector recovered strongly to grow by 9.7 per cent and 17.0 per cent in the third and fourth quarters of 2009. The distributive trade sector expanded by 7.3 per cent and 2.7 per cent in the third and fourth quarters compared with a contraction of 8.2 per cent and a positive growth rate of 4.4 per cent in the first two quarters of 2009. Financial intermediation, real estate, renting and business activities, and transport, storage, and communications posted higher growth rates in the second semester of 2009 relative to the first.

Chart 3.1 depicts annual and seasonally-adjusted quarterly GDP growth rates and Chart 3.2 shows the contribution of selected aggregate demand components to growth of GDP at market prices.

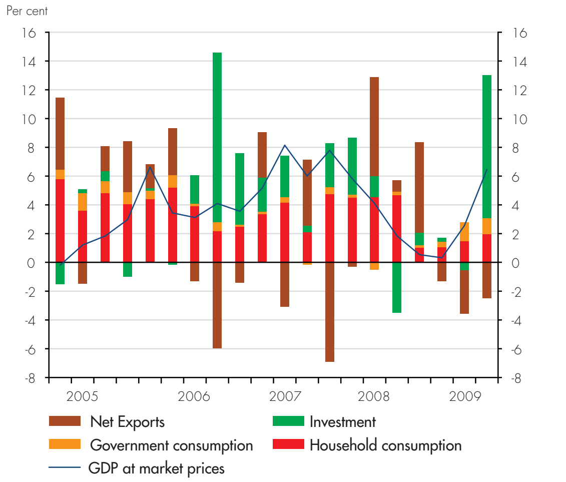
The below-trend growth rate gave rise to a substantial negative output gap – measured as the difference between actual and potential output – which contributed to keep inflationary pressures emanating from the supply side in check.

Chart 3.1: Real GDP Growth Rate



Source: CSO, Government of Mauritius.

Chart 3.2: Contribution of Selected Aggregate Demand Components to Growth of GDP at market prices



Sources: CSO, Government of Mauritius, and Bank calculations.

Risks to growth prospects

The global economy is forecast to pick up momentum in the coming year and projections put out by the IMF in successive World Economic Outlook reviews have consistently showed improvements. For 2010, the world economy is expected to grow by a higher rate of 4.2 per cent from an initial forecast of 3.1 per cent.

At this juncture, global growth forecasts remain well below pre-crisis levels due mainly to the fragile recovery in most advanced economies, specifically in Mauritius' main trading partners. A substantial and persisting drag in these economies is the high rate of unemployment and still weak consumer spending. Sovereign debt-related problems, which had been contained until now, could also emerge as another major drag given the size of public debt in economies having implemented massive fiscal stimulus packages.

According to the CSO, the domestic economy is forecast to recover and grow by 4.6 per cent in 2010 - a view shared by the IMF in its last Article IV Mission Report, which put the economic growth for 2010 at 4.1 per cent. The growth impetus would come from the construction sector in the light of Government massive planned infrastructure projects and private sector investment. A recovery of the export-oriented sectors is also expected as economic conditions in main trading partner countries get better.

Although domestic economic prospects have largely improved, there are still risks going forward namely, the potential for external demand conditions emanating from trading partners to remain weak for longer than expected. The recovery of international commodity prices on growing demand in China and India could also pose a substantial downside risk in the medium term.

Fiscal and monetary stimulus

The coordination of expansionary fiscal and monetary policies, which started in October 2008, continued in the period under review. Fiscal authorities are committed to maintaining the fiscal stimulus package until December 2010 while the MPC kept the policy rate unchanged at 5.75 per cent. The front-loading of public infrastructure investment, which is part of the fiscal policy package, was initiated towards the end of the third quarter of 2009 while Government financial support and guarantees increased under the Mechanism for Transitional Support to the Private Sector.

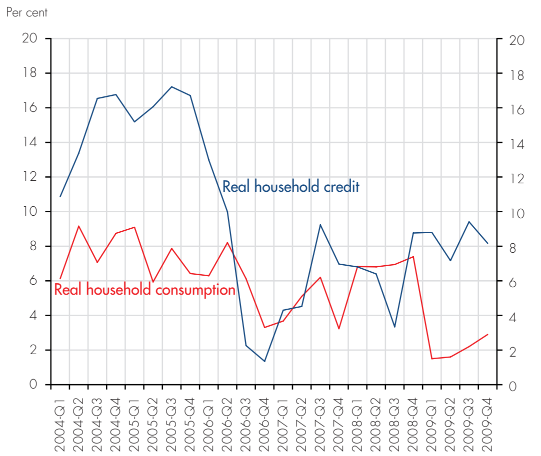
3.1 CONSUMPTION

The pace of final consumption expenditure growth quickened to year-on-year rates of 3.5 per cent and 3.9 per cent in the third and fourth quarters of 2009, respectively compared to 1.4 per cent and 1.8 per cent in the first and second quarters of the same year, respectively. Higher final consumption expenditure was driven by significant General Government spending in the second half of 2009. Household consumption expenditure, which accounts for around 75 per cent of total aggregate spending, gathered momentum over the period compared with the first semester of 2009.

Real bank credit to households, which rose in the second quarter of 2009 before easing in the third quarter, remained well supported throughout the second semester of 2009, as depicted in Chart 3.3.

The combination of brighter economic prospects and inflation staying subdued in 2010 should bolster consumer confidence further. The CSO forecasts final consumption expenditure to remain flat at 2.6 per cent in 2010 but household consumption is expected to grow by 2.5 per cent, higher than the 2.1 per cent growth in 2009. Government consumption expenditure is projected to decelerate to 3.0 per cent, as the focus shifts to public investment spending. Chart 3.4 illustrates the evolution of GDP growth rate and the growth rates of final consumption and its components.

Chart 3.3: Real Household Consumption Growth and Real Growth in Credit to Households



Note: The CPI has been used to deflate nominal credit.

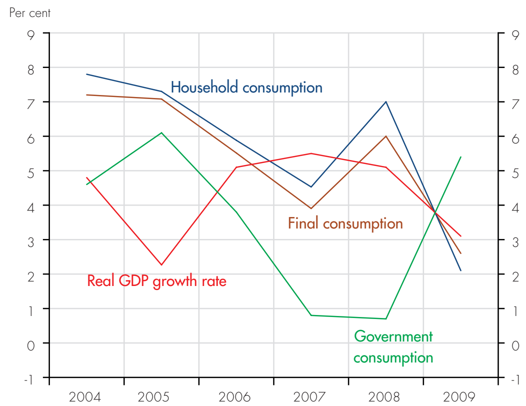
Sources: CSO, Government of Mauritius, and Bank of Mauritius.

3.2 INVESTMENT

Investment spending grew at a higher rate of 39.4 per cent in the fourth quarter of 2009 over the corresponding quarter of 2008. Excluding investment in aircraft and marine vessels, the growth rate was lower at 8.6 per cent, which is the highest year-on-year growth rate since the second quarter of 2008. In the third quarter of 2009, excluding the purchase of a marine vessel a year ago, real investment spending had expanded by 3.5 per cent. The contributions of *Building and construction work*, which accounts for around two-third of investment expenditure, to the real growth rate of Gross Domestic Fixed Capital Formation (GDFCF) in the third and fourth quarters of 2009 were 5.0 and 15.7 percentage points, excluding spending on aircrafts and marine vessels, respectively while real spending on *Machinery and equipment* subtracted 1.4 and 7.1 percentage points to the percentage increase in GDFCF. All three components of *Building and construction work* namely, residential and non-residential building as well as other infrastructure work made significant additions to the expansion of GDFCF. The highest percentage contribution came from major public sector spending on infrastructure followed by private spending on residential and commercial real estate.

Investment is forecast to contract by 1.6 per cent in 2010 as a result of a 3.7 per cent cut in private sector real investment spending partly offset by a moderate growth of 4.5 per cent in public sector real investment expenditure.

Chart 3.4: Real GDP and Consumption Growth Rates



Source: CSO, Government of Mauritius.

Table 3.1: Components of Aggregate Demand - Real Growth Rate

(percentage change over previous year for annual data and over corresponding quarter of previous year for quarterly data)

	2005	2006	2007	2008[1]	2009[1]	2008[1]				2009			
						Quarter 1	Quarter 2	Quarter 3	Quarter 4	Quarter 1[1]	Quarter 2[1]	Quarter 3[1]	Quarter 4[2]
Final consumption expenditure	7.1	5.5	3.9	6.0	2.6	6.2	5.8	5.1	6.5	1.4	1.8	3.5	3.9
of which:													
Household consumption	7.3	5.9	4.5	7.0	2.1	6.8	6.8	6.9	7.4	1.5	1.6	2.2	2.9
Government consumption	6.1	3.8	0.8	0.7	5.4	3.3	1.3	-3.8	2.0	0.8	2.4	10.2	8.5
Investment	-1.9	19.0	8.6	3.6	9.1	12.5	15.2	5.5	-12.0	3.5	0.9	-2.0	39.4
Investment *(exclusive of the acquisition of aircraft and marine vessel)*	-1.6	5.5	17.0	7.2	5.0	n.a.	n.a	n.a	n.a	n.a	n.a	n.a	n.a
Exports of goods and services	10.6	7.7	3.4	2.3	-4.8	4.6	6.8	6.7	-6.7	-4.7	-10.7	-6.1	1.0
Imports of goods and services	6.4	9.3	2.0	1.8	-4.6	18.3	7.4	-5.8	-8.4	-15.5	-8.3	-0.7	5.8

[1] : Revised estimates. [2] : First estimates. *n.a.: not available.*

Source: CSO, Government of Mauritius.

3.3 FOREIGN TRADE AND EXTERNAL DEMAND

The current account deficit, as a percentage of GDP at market prices, dropped in the second half of 2009 to 8.0 per cent from 10.7 per cent in the corresponding period of 2008. The decline was more cyclical than structural as it reflected to a large extent lower import prices compared with a year ago. Looking ahead, the expansion of the domestic economy was likely to be accompanied by a deterioration in the merchandise account deficit as demand for imports picked up at a faster pace than the rise in exports, which significantly depends on the economic recovery in the United Kingdom and the euro zone. Inward capital flows are expected to be sustainable and continue to finance the shortfall on the current account.

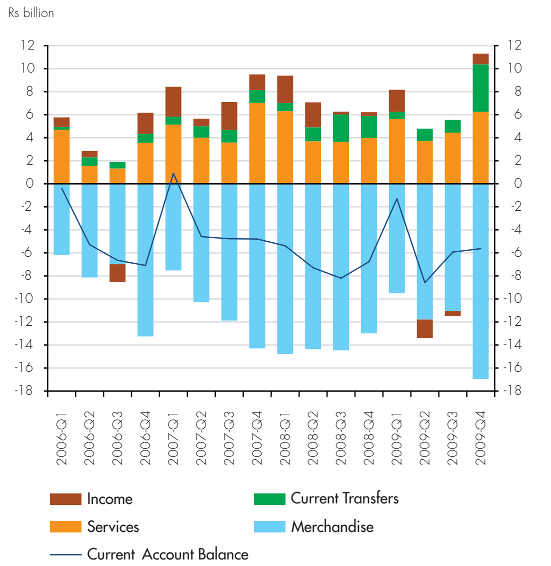
Current account balance

The current account, inclusive of the purchase of an aircraft, ended in a deficit of Rs11.6 billion in the second half of 2009. Compared to the corresponding period of 2008, the deficit declined by almost 23 per cent, largely attributable to a higher surplus recorded on the services account. However, the deficit was higher relative to the first semester of 2009, due to the jump in the merchandise trade deficit to nearly Rs28.0 billion as the rise in imports outpaced exports. The merchandise trade balance recorded a marginally higher shortfall relative to the second semester of 2008.

The surplus on the services account was larger at Rs10.7 billion in the second semester of 2009, representing an increase of 39.8 per cent over the corresponding period of 2008. The improvement came mostly from favourable developments in Other services account, largely driven by a significant expansion in merchanting exports and trade-related services. The rate of decline in the surplus recorded on the Travel account significantly eased in the second semester of 2009 as inbound tourism grew higher than initially anticipated, in the fourth quarter of 2009 in particular.

The surplus on the income account improved partly due to higher net income earned by banks. The surplus on the current transfers account was higher on account of European Union (EU) grants channelled to the Government in the fourth quarter of 2009. The components of the current account are shown in Chart 3.5.

Chart 3.5: Components of the Current Account



Capital and financial account

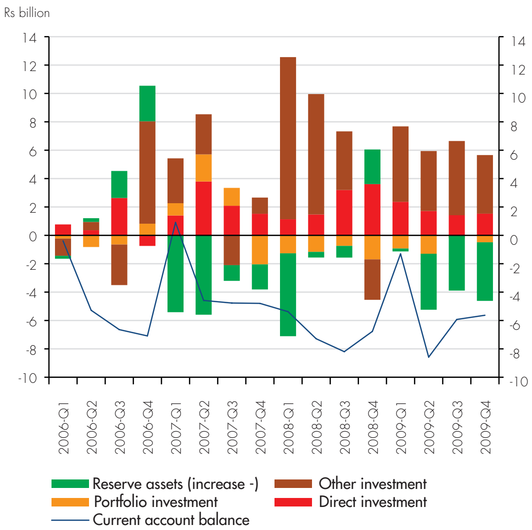
External financing of the current account deficit during the second half of 2009 fell significantly to Rs3.8 billion, a considerable decrease from the net surplus of Rs7.3 billion recorded during the corresponding period in 2008 and Rs7.3 billion in the first semester of 2009. The financing of the balance of payments witnessed a major change with the reduction in Foreign Direct Investment (FDI) net inflows by 56.7 per cent to Rs2.9 billion relative to the second semester of 2008.

Debt-creating liabilities reflected in Other investment posted net inflows of Rs9.4 billion, a seven-fold increase compared to the second half of 2008, in the form of long-term external borrowings mainly. Disbursements on account of non-financial government guaranteed loans, private sector borrowing and the SDR allocations made by the IMF to the country amounted to more than Rs8.0 billion.

During the second semester of 2009, portfolio investment recorded lower net outflows of Rs0.5 billion compared to Rs2.4 billion a year earlier, reflecting lower non-resident disinvestments in the equity market as well as a return of foreign investors on the debt market. Portfolio investment liabilities posted a net inflow of Rs0.3 billion, a shift from a shortfall of Rs1.2 billion during the second half of 2008. Non-residents' demand for domestic money market instruments was positive at Rs0.2 billion. Total purchases by non-residents on the stock market amounted to Rs0.1 billion as against net sales of Rs0.3 billion for the six-month period ended December 2008.

The country's overall balance of payments, as measured by the change in reserve assets excluding valuation change, reverted to a surplus of Rs8.0 billion in the second half 2009, compared to a deficit in the corresponding period of 2008. The increase was also driven by the SDR allocations made by the IMF in August and September 2009. Details on the balance of payments summary are provided in Table 3.2. The financing of the current account deficit is depicted in Chart 3.6.

Chart 3.6: Financing of the Current Account



Net external demand

The value of foreign trade in the second half of 2009 suggested a moderation of the adverse effects of the global economic downturn. The decline in both exports and imports of goods and services slowed. As shown in Chart 3.7, however, the decline in exports growth was slightly more pronounced than imports growth.

Imports declined by 4.7 per cent in the second half of 2009 compared to a drop of 5.6 per cent in the first half of 2009 – that is, nearly 1 percentage point. Concurrently, the annual rate of decline of exports halved compared to the first semester of 2009 – that is, from -12.8 per cent to -6.4 per cent in the second half of 2009.

Chart 3.7: External Trade Turnover

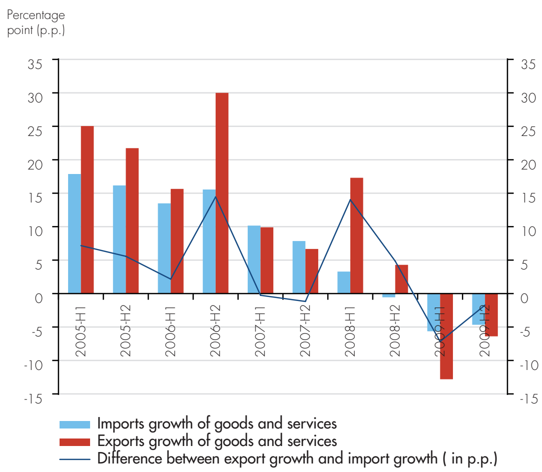


Table 3.2: Balance of Payments Summary

Rs million

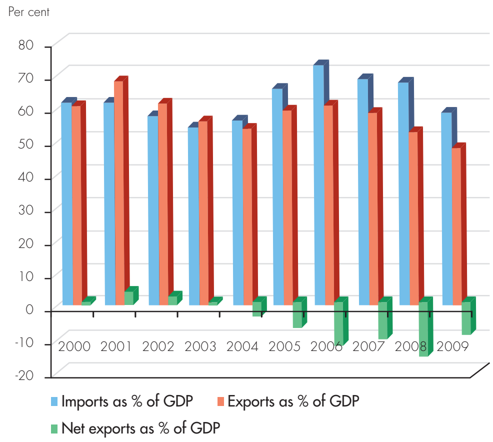
	2008		2009[1]	
	Semester 1	Semester 2	Semester 1[2]	Semester 2[1]
Current Account	**-12,667**	**-14,966**	**-9,883**	**-11,559**
Exports (f.o.b)	30,057	37,913	28,976	32,808
Imports (f.o.b)	-59,198	-65,369	-50,233	-60,774
of which: aircrafts/marine vessels	-	*583*	-	*2,862*
Trade balance	-29,141	-27,456	-21,257	-27,966
Services, net	10,002	7,653	9,349	10,698
of which:travel, net	*16,052*	*12,322*	*12,564*	*11,822*
Income, net	4,555	345	344	481
Current transfers, net	1,917	4,492	1,681	5,228
Capital and Financial Account	**13,816**	**7,257**	**7,292**	**3,757**
Capital account, net	-29	-11	-5	-38
Direct investment, net	2,605	6,806	4,076	2,948
Portfolio investment, net	-2,431	-2,437	-2,225	-507
Other investment, net	19,910	1,284	9,545	9,358
Balance of Payments Surplus (-)/ Deficit (+)	-6,239	1,615	-4,099	-8,004
Net Errors and Omissions	**-1,149**	**7,709**	**2,591**	**7,802**

[1] Provisional estimates. [2] Revised estimates.

Figures may not add up to totals due to rounding.

Overall, the contribution of net exports of goods and services to GDP continued to be negative in 2009, as depicted in Chart 3.8. This situation is not anticipated to be alleviated in 2010.

Chart 3.8: Imports, Exports and Net Exports of Goods and Services as a Percentage of GDP at Market Prices



Exports

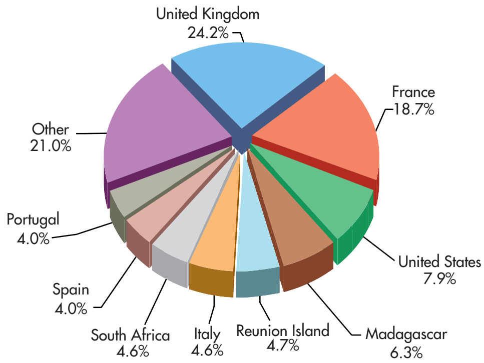
Total nominal exports of goods contracted by 13.5 per cent to Rs32.8 billion in the second semester of 2009 as compared to the corresponding period of the previous year. However, excluding ships' stores and bunkers, exports fell at a slower pace of 9.6 per cent.

In terms of commodity structure, the significant fall in domestic exports – that is, total exports of goods adjusted for re-exports (freeport exports) – was largely driven by a 64 per cent decline in exports of Machinery and transport equipment due to a slump in re-exports of cellular phones and a 12.3 per cent decrease in Foods and live animals on account of falling sugar exports proceeds, prompted by the 22.8 per cent reduction in the EU reference prices that were effective from 1 October 2009. The depreciation of the rupee vis-à-vis the euro and US dollar on a year-on-year basis alleviated the fall in export proceeds to some extent.

Europe remained the major export market for Mauritius in the second half of 2009 accounting for 65.7 per cent of total exports of goods, although its share fell from 67.4 per cent in the second half of 2008. Demand from the United Kingdom fell sharply, but was still the most important market with a share of 24.2 per cent, a significant drop from 36.6 per cent in the second semester of 2008. The other main destinations for exports were France, United States, Madagascar, Reunion Island, Italy and South Africa, as shown in Chart 3.9.

Compared to the second semester of 2008, total nominal exports to France, United States and Madagascar increased by 49.4 per cent, 13.7 per cent and 9.8 per cent, respectively. In contrast, exports to United Kingdom declined significantly by 40.1 per cent. Exports to our regional markets were also on the rise, namely, Seychelles and Reunion Island by 15.4 per cent and 8.7 per cent, respectively, while exports to South Africa fell marginally by 0.2 per cent.

Chart 3.9: Main Export Destinations in the Second Semester of 2009



Source: CSO, Government of Mauritius.

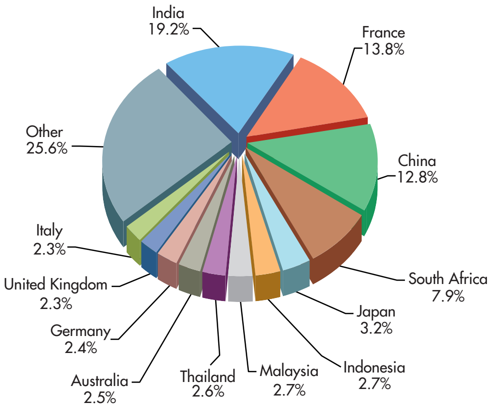
Imports

Total nominal imports (c.i.f) declined by 7.3 per cent in the second semester of 2009 compared to the same period in 2008, with imports valued at Rs64.4 billion. After excluding the purchase of aircraft, the fall in nominal imports was higher at 10.6 per cent.

The contraction in imports, due to the decline in both volume and prices, was primarily due to lower import value for three main commodity groups, namely, Mineral fuels, lubricants and related materials by 25.1 per cent, Manufactured goods classified chiefly by material by 17.0 per cent, and Food and live animals by 5.9 per cent. The contraction in the import bill for Mineral fuels, lubricants and related products reflected in part lower prices as crude oil prices on the world market had declined, on average, in between. NYMEX WTI price of crude oil averaged US$72.2 per barrel in the second semester of 2009, 18.3 per cent lower than the average of US$88.4 in the corresponding period of 2008.

The Asian continent accounted for 50.7 per cent of total imports in the second semester of 2009, down from 53.6 per cent in the corresponding semester of 2008. Imports originated mostly from India, France, China, South Africa and Japan, as depicted in Chart 3.10. The relatively high share of India in our import bill is attributable to the fact that India is Mauritius' main supplier of petroleum products.

Chart 3.10: Main Sources of Imports in the Second Semester of 2009



Source: CSO, Government of Mauritius.

3.4 LABOUR MARKET

Expectations of a deterioration in the labour market with massive job losses quickly dissipated as it turned out that the private sector had shed fewer jobs than initially anticipated. Labour market conditions even improved in the second half of 2009. The unemployment rate declined to 6.3 per cent in the fourth quarter of 2009, after increasing sharply from 6.2 per cent in the fourth quarter of 2008 to 8.3 per cent in the second quarter of 2009.

The seasonally-adjusted unemployment rate stabilised in the third quarter before declining to 7.2 per cent in the fourth quarter. The unemployment rate for the year 2009 is estimated at 7.3 per cent, slightly up from 7.2 per cent in 2008. Table 3.3 shows the movements in the unemployment rate.

Employment in the export-oriented sector declined by 3,710 in the year to December 2009, mainly as a result of a fall in employment by 2,778 in the Wearing Apparel industry.

Labour market outlook

The resilience of the domestic economy against the fallout of the global economic downturn, prompted by policy responses of the fiscal and monetary authorities to shore up and restore confidence in the economy, as well as better global economic conditions supported employment in the second semester of 2009.

With the global economic recovery expected to firm in 2010 and domestic economic growth to rise to 4.6 per cent, unemployment is anticipated to ease further. Although job losses may persist for a while in the textile sector, job creation in other key sectors and in the emerging Information and Communication Technology sector should continue to strengthen.

Table 3.3: Unemployment Rate

Per cent

	2006	2007	2008	2009	2008				2009			
					Quarter 1	Quarter 2	Quarter 3	Quarter 4	Quarter 1	Quarter 2	Quarter 3	Quarter 4
Actual	9.1	8.5	7.2	7.3	8.2	7.4	7.2	6.2	8.0	8.3	7.4	6.3
Seasonally-adjusted	9.1	8.5	7.2	7.3	7.6	6.8	7.5	7.1	7.4	7.7	7.7	7.2

Source: CSO, Government of Mauritius.

Box 1: External Indicators

In 2009, external debt indicators were higher reflecting the external loan disbursements and SDR allocations.

Overall, gross external debt as at end-December 2009 increased by Rs12.3 billion on account of Rs4.3 billion disbursed to government, Rs3.1 billion to public corporations, Rs4.0 billion to monetary authorities and Rs0.8 billion to the private sector. The ratio of gross external debt to GDP at market prices rose to 12.7 per cent in 2009, from 8.6 per cent a year ago. The ratio of gross external debt to exports increased significantly to 56.6 per cent in the year 2009 as compared to 33.4 per cent a year earlier.

The ratio of gross official international reserves to gross external debt decreased from 249.6 per cent in 2008 to 199.5 per cent in 2009 due to higher increase in gross external debt.

The external debt service as measured by the sum of capital repayments, interest payments and other charges registered a decline of Rs3.0 billion in 2009 compared to 2008. The higher level of external debt service in 2008 was, in fact, mostly attributable to maturing non-residents' holdings of Treasury Bills totalling Rs2.8 billion. The participation of debt service in exports consequently dropped from 11.7 per cent in 2008 to 8.0 per cent in 2009.

	2008	**2009**
	Rs million	
Exports of goods	67,970	61,784
Exports of goods and services	140,166	132,980
Imports of goods and services	179,108	162,156
External debt service	7,984	4,945
Gross external debt [1]	22,719	34,972
Gross Official International Reserves [2]	56,703	69,761
GDP at market prices	264,886	274,819
Indicators	*Per cent*	
Gross external debt to GDP	8.6	12.6
Gross external debt to exports of goods	33.4	56.6
Gross external debt to exports of goods and services	16.2	26.3
External debt service to exports	11.7	8.0
External debt service to exports of goods and services	5.7	3.7
Reserves to gross external debt	249.6	199.5
Reserves to GDP	21.4	25.4
Reserves to imports of goods and services	31.7	43.0

[1] *Gross External debt outstanding as at end of period comprises central government, public corporations, monetary authorities and private sector.*
[2] *Gross Official International Reserves as at end of period comprise gross foreign assets of the Bank of Mauritius, reserve position in the IMF and the foreign assets of Government.*

4. Monetary and Financial Developments

4.1 MONETARY AND CREDIT DEVELOPMENTS

Money and credit growth moderated further in the second half of 2009, reflecting lower real economic activity. A sector-wise breakdown of credit reveals that credit to households sustained a growth path comparable with pre-crisis trend, while growth of credit to businesses plummeted.

Monetary base

The monetary base grew at a higher rate of 20.3 per cent between end-June 2009 and end-December 2009 compared to a rise of 12.3 per cent in the corresponding period of 2008.[6] Seasonal year-end demand for currency led to an increase in currency in circulation of around Rs4.1 billion while liabilities to other depository corporations (ODCs) rose by nearly Rs2.0 billion.

On the sources side, the rise in the monetary base was driven by the growth of net foreign assets of the Bank of 2.8 per cent in the second semester of 2009, contrasting with the decline of 1.8 per cent registered in the second semester of 2008. Domestic claims by the Bank, representing claims on central government predominantly, continued to contract but at a slower pace than in the corresponding period in 2008.

Broad Money Liabilities

The deceleration in Broad Money Liabilities (BML) that began in the second half of 2008 persisted till the end of 2009 partly reflecting the sharp slowdown in growth of credit to the private sector.[7] BML growth fell to 4.5 per cent in the second semester of 2009, from 8.9 per cent in the second semester of 2008. Chart 4.1 illustrates movements in the monetary base and BML. The evolution of BML and credit to the private sector and the inflation rate is shown in Chart 4.2.

[6]*The monetary base, also termed high-powered money or reserve money, comprises central bank liabilities that support the expansion of broad money and, thus, cedit. Changes in the monetary base usually lead to increases in money and credit that are larger than the changes in the monetary base, due to what is termed the money multiplier effect. The final impact of a change in monetary base on money supply also depends on the size and stability of the money multiplier.*

[7]*Broad Money Liabilities include deposits of banks and non-bank deposit-taking institutions.*

Chart 4.1: Growth Rate of Monetary Base and Broad Money Liabilities

Percentage change over corresponding month of previous year

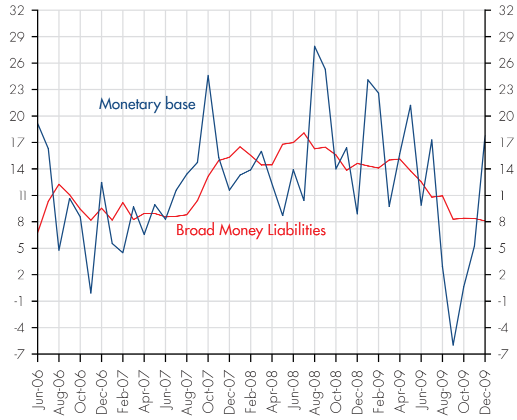
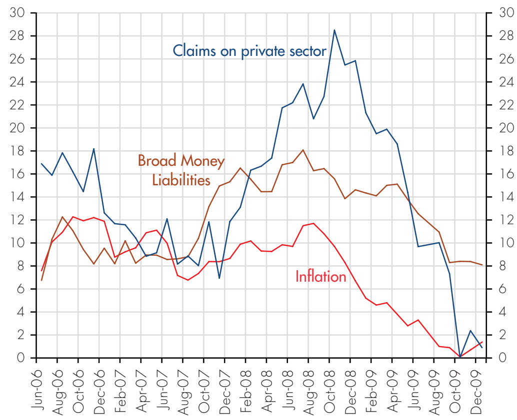


Chart 4.2: Growth Rate of Broad Money Liabilities and Credit to Private Sector and Inflation

Percentage change over corresponding month of previous year



Components of Broad Money Liabilities

The slowdown of BML growth over the six months to December 2009 reflected slow growth in the components making up quasi-money liabilities, in particular foreign currency and rupee time deposits. Quasi-money liabilities grew by 2.9 per cent in the second semester of 2009, lower than the 7.4 per cent recorded in the second semester of 2008. Narrow Money Liabilities rose by 13.0 per cent between end-June 2009 and end-December 2009, compared to a rise of 15.7 per cent in the corresponding period of the preceding year. The third component of BML, Securities other than Shares, decreased by 50.4 per cent in the second half of 2009 as compared to a fall of 0.3 per cent in the second semester of 2008.[8] Table 4.1 provides details on the components of BML and credit.

Sources of Broad Money Liabilities

Net foreign assets

The net foreign assets of depository corporations increased by 8.2 per cent in the second semester of 2009 compared to a rise of 7.0 per cent in the second half of 2008, mainly as a result of an expansion in both net foreign assets held by the ODCs and the Bank. The net foreign assets of the Bank rose by 2.8 per cent in the second semester of 2009 as compared to a decline of 1.8 per cent over the same period in 2008. The appreciation of foreign exchange reserves and a grant of EUR53.5 million in November 2009 by the EU to the government were among the factors contributing to the rise. On 7 August 2009, the IMF Board of Governors approved an allocation of SDR to member countries. Accordingly, a total amount of SDR8,161,549 was allocated to Mauritius. However, the additional SDR allocations did not increase the net foreign assets of the Bank since both foreign liabilities and assets increased simultaneously by the same amount.

The composition of the portfolio of external assets of the Bank also witnessed some diversification in the second half of 2009. As part of its foreign exchange reserves management operations, the Bank of Mauritius purchased 2 metric tons of gold from the IMF under the Fund's Limited Gold Sales Programme on 13 November 2009.

Net foreign assets held by ODCs went up by 18.3 per cent in the second semester of 2009 compared to a rise of 25.9 per cent in the second semester of 2008.

Domestic credit

Growth in domestic credit by depository corporations fell from 5.3 per cent in the second semester of 2008 to 0.8 per cent in the second semester of 2009 due essentially to a deceleration in credit to the private sector.

Net credit to budgetary central government rose marginally by 0.1 per cent in the second half of 2009 as compared to a drop of 11.7 per cent in the corresponding period of 2008. Credit to the private sector by ODCs edged up by 0.9 per cent compared to a rise of 9.7 per cent recorded in the second semester of 2008. Demand for loans remained sluggish rather than the banks' reluctance to lend. However, several factors are expected to stimulate overall economic activity during coming quarters which could bolster credit growth.

Overall, the contributors to the 4.5 per cent increase in BML in the second semester of 2009 were net foreign assets with 2.8 percentage points and domestic credit with 0.8 percentage point – of

Table 4.1: Broad Money Liabilities, Domestic Credit and Net Foreign Assets

Rs million

	Dec-07	Mar-08	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09
Broad Money Liabilities	**239,318**	**241,748**	**252,007**	**259,834**	**274,314**	**278,029**	**283,613**	**281,387**	**296,480**
Narrow Money Liabilities	47,219	44,128	45,981	48,344	53,186	50,788	53,920	54,760	60,904
Currency with public	*14,260*	*12,735*	*12,746*	*13,451*	*16,156*	*14,800*	*14,683*	*15,013*	*17,153*
Transferable deposits	*32,959*	*31,393*	*33,234*	*34,893*	*37,030*	*35,987*	*39,237*	*39,747*	*43,751*
Quasi-Money Liabilities	190,753	196,128	204,487	210,000	219,592	225,802	228,137	225,884	234,805
Savings deposits	*65,461*	*69,218*	*73,444*	*73,615*	*75,850*	*79,777*	*79,604*	*81,072*	*84,477*
Time deposits	*79,346*	*83,124*	*83,164*	*87,685*	*89,409*	*90,139*	*92,051*	*92,697*	*94,251*
Foreign currency deposits	*45,945*	*43,786*	*47,878*	*48,700*	*54,334*	*55,886*	*56,482*	*52,115*	*56,077*
Securities other than shares	1,346	1,491	1,540	1,490	1,535	1,439	1,556	742	772
Domestic Credit	**224,683**	**236,527**	**258,704**	**258,438**	**272,426**	**274,420**	**275,223**	**273,468**	**277,412**
Credit to private sector	179,167	187,623	205,533	208,166	225,468	224,939	225,439	223,411	227,569
Net Foreign Assets	**85,520**	**81,479**	**83,628**	**80,050**	**89,520**	**88,509**	**97,146**	**93,271**	**105,124**

[8] *The component Securities other than Shares comprises essentially certificates of deposits.*

which credit to other sectors contributed a positive 0.8 percentage point and net claims on central government a positive 0.02 percentage point.

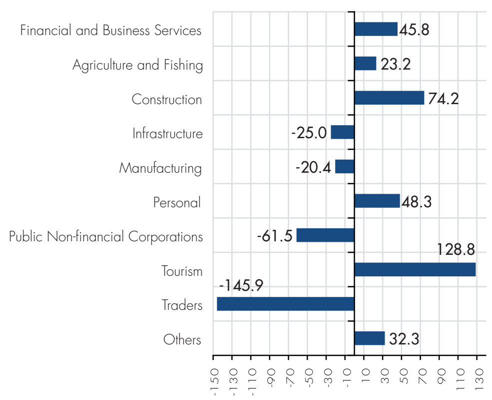
Sector-wise distribution of credit by banks

Total credit to private sector by banks expanded by 1.1 per cent between end-June and end-December 2009, significantly lower than the rise of 14.8 per cent in the corresponding period of 2008. Additional credit of Rs2.5 billion was channelled to Tourism and Rs1.5 billion to Construction. The extension of credit to the Personal sector rose by nearly Rs1.0 billion, to Financial and Business by Rs0.9 billion and to Agriculture and Fishing by Rs0.5 billion. In contrast, outstanding credit to Traders fell by Rs2.9 billion, to Public non-financial corporations by Rs1.2 billion, to Infrastructure by Rs0.5 billion and to Manufacturing by Rs0.4 billion.

Credit to the household sector expanded by 6.4 per cent in the second half of 2009 compared to 8.1 per cent recorded in the corresponding period of the previous year. The growth rate of credit to the business sector, excluding public corporations, collapsed to 0.5 per cent in the second half of 2009 compared to 16.9 per cent in the corresponding period of 2008.

The distribution of the change in bank credit to the private sector over the period June 2009 to December 2009 is shown in Chart 4.3.

Chart 4.3: Distribution of the Change in Bank Credit to the Private Sector – end-June to end-December 2009



In terms of currency composition of credit, between end-June 2009 and end-December 2009, rupee loans and overdrafts expanded by 4.6 per cent while foreign currency loans fell substantially by 15.9 per cent as compared to growth rates of 14.1 per cent and 18.6 per cent, respectively, in the corresponding period of 2008.

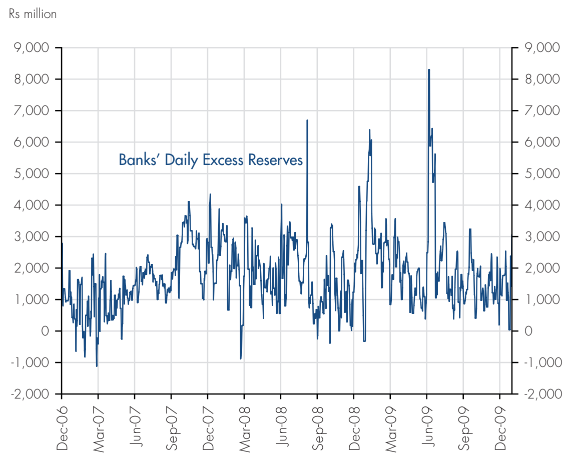
4.2 MONEY MARKET

Liquidity management

There was no major liquidity pressure on the money market during the six months to December 2009. Banks' daily average excess reserves declined to an average of Rs1.6 billion from an average of Rs2.5 billion in the preceding six months. The fall in the daily average excess reserves was mainly attributed to the cumulative effects of net issue of government securities and tax receipts accruing to Government.

The Bank's monetary policy operations were scant given normal conditions on the money market. Operations consisted of one Special Deposits Facility in September 2009 and a Repo transaction for a 14-day period in December 2009, each for an amount of Rs1.2 billion to alleviate liquidity conditions. The evolution of banks' daily excess reserves is shown in Chart 4.4.

Chart 4.4: Banks' Daily Excess Reserves

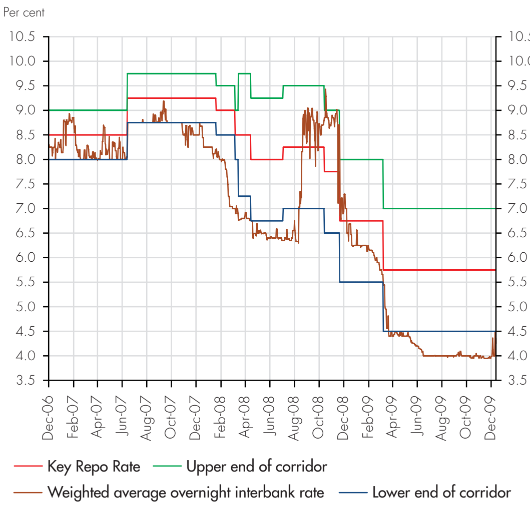


Interbank interest rates

With the key Repo Rate kept unchanged in the second half of 2009, interest rates on the interbank money market were predominantly influenced by the level of liquidity in the banking system. The weighted average interbank interest rate remained almost flat at around 4 per cent during most of the period from July to December. However, following large corporate tax payments in December 2009, the weighted average interbank interest rate rose by some 50 basis points to 4.50 per cent.

Thus, overnight interbank interest rates rose from a range of 3.90-4.25 per cent in the period July to November 2009 to 3.95-4.50 per cent in December. The weighted average interbank interest rate stayed far below the lower bound of the corridor for most of the second half of 2009 except in December 2009 when it rose to briefly touch the lower bound of the corridor. The evolution of the overnight weighted average interbank interest rate is depicted in Chart 4.5.

Chart 4.5: Overnight Weighted Average Interbank Interest Rate



Yields on Government debt instruments

In general, as shown in Chart 4.6, yields on short-term Treasury Bills declined gradually in the second half of 2009 as market participants aggressively bid for risk-free Government paper in a context of broadly slowing bank credit expansion. Primary auctions of Treasury Bills remained oversubscribed with an average bid-cover ratio of 1.9.[9]

Yields on the 91-day Bills, 182-day Bills and 364-day Bills declined from 4.65 per cent, 4.69 per cent and 5.14 per cent as at the end of June 2009 to 4.31 per cent, 4.38 per cent and 4.59 per cent as at the end of December 2009, respectively. Market bidding preference was skewed towards the 91-day maturity showing investors' desire for shorter term instruments in an environment where expectations of future higher yields prevailed.

Auctions for the other government instruments, namely Treasury Notes, Five-Year Government of Mauritius Bonds and Long Term Government of Mauritius Bonds were, on average, oversubscribed. The weighted average yields of these instruments also declined. Chart 4.7 illustrates movements in yields on Treasury Notes.

Chart 4.6: Yields on Treasury/Bank of Mauritius Bills

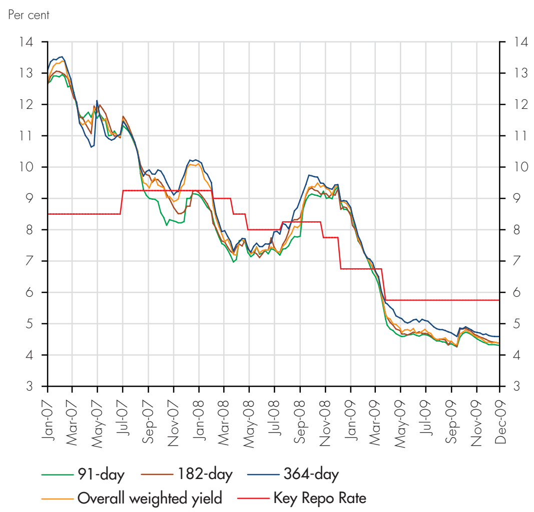
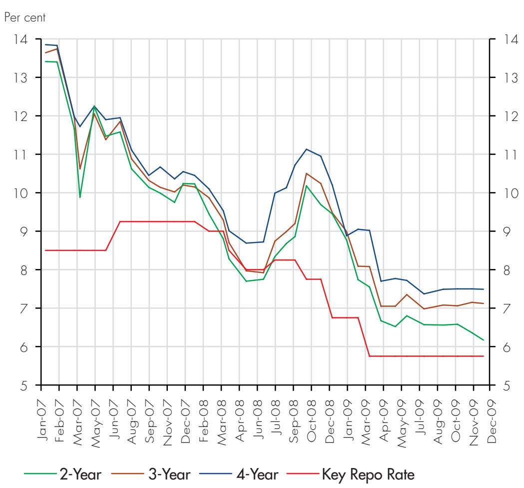


Chart 4.7: Yields on Treasury Notes



[9]*Bid-cover ratio is the ratio of the value of bids received to the tendered amount.*

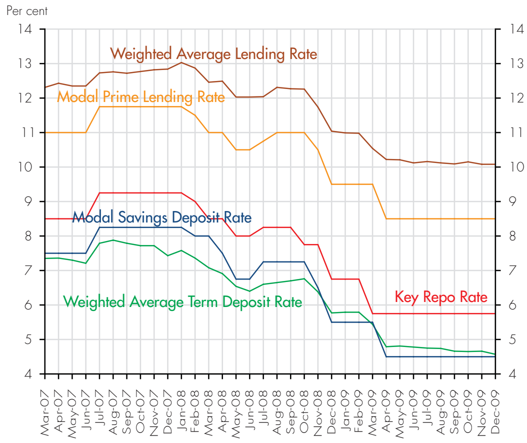
Non-residents' holdings of government and central bank securities went up from Rs59 million at the end of June 2009 to Rs267 million at the end of December 2009. Resident holders of government and central bank securities comprised principally banks and pension funds.

4.3 INTEREST RATES

During second semester of 2009, interest rates on savings deposits and the prime lending rates remained unchanged in the range of 4.00-4.75 per cent and 8.05-9.00 per cent, respectively, as shown in Chart 4.8. The modal savings deposits and the prime lending rates were also steady at 4.50 per cent and 8.50 per cent, respectively.

In June 2009, the real interest rate on savings deposits was -2.2 per cent but it gradually increased to 0.1 per cent in September 2009 and further to 2.0 per cent in December 2009, reflecting the decline in the rate of inflation and with nominal interest rates remaining flat.

Chart 4.8: Key Repo Rate and Deposit and Lending Rates



4.4 FOREIGN EXCHANGE MARKET AND EXCHANGE RATES

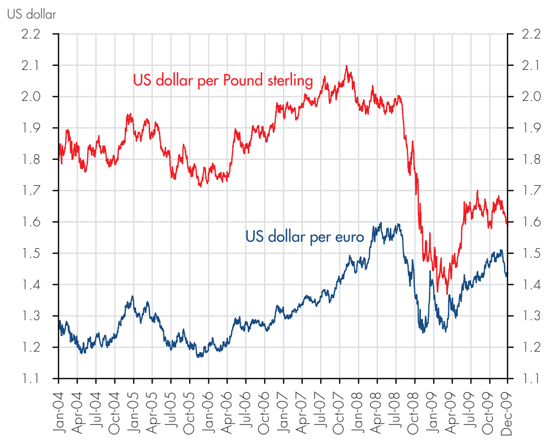
Major international currencies

The US dollar continued to weaken against the euro in the second half of 2009 on increasing signs of global economic recovery. The US dollar lost ground as the US economy contracted by less than expected in the second quarter of 2009 and global stock markets turned bullish with economic data from around the world lifting investors' risk appetite thereby denting the greenback's safe haven appeal. The US dollar touched a low of 1.5109 against the euro on 26 November 2009 before recouping quickly on safe haven flows following sovereign debt-related problems.

The weakening trend of the US currency was reversed in December 2009. The US dollar maintained its upward momentum throughout December 2009 as it benefitted from a host of upbeat US data on jobs, retail sales, and consumer sentiment bolstering hopes that the US economy was on a stable path to recovery. The US dollar also benefitted from investors' unwinding positions in riskier assets ahead of the year-end, prompted in part by sovereign debt concerns. Overall for the six months to December 2009, the US currency depreciated against the euro and the Japanese Yen but appreciated vis-à-vis the Pound sterling.

The Pound was volatile against the US dollar in the period under review. It rallied to reach a high of US$1.6990 against the US dollar on 6 August 2009 following better-than-expected data in the major economies boosting equity markets. Subsequently, the Pound faded on account of the Bank of England's further quantitative easing, deteriorating public finances in the United Kingdom, disappointing economic figures and low interest rate outlook. After regaining some ground in October and November, the Pound was undermined again in December on concerns about British banks' potential exposure to sovereign debt problems and the delayed growth prospects of the UK economy. Chart 4.9 shows the evolution of the US dollar against the euro and the Pound sterling.

Chart 4.9: Evolution of the US dollar against the Pound Sterling and the Euro



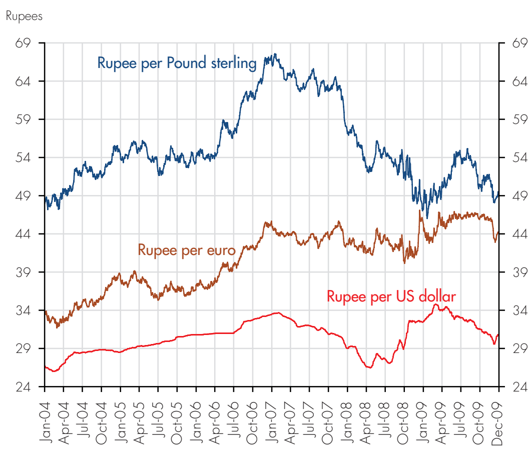
Domestic currency

The rupee exchange rate reflected mostly international currency trends, but excess supply pressures gradually started to build up on account of reduced demand for foreign currencies from importers resulting from subdued economic activity and low oil prices. The combination of excess supply and movements of major currencies on international markets reinforced the appreciation of the exchange rate of the rupee. Thereafter the imbalance on the foreign exchange market narrowed down to some extent after exporters gradually withdrew from the market, preferring to hold the foreign exchange proceeds rather than exchanging them for lower rupee proceeds.

The rupee appreciated vis-à-vis the US dollar from July to November 2009, accelerating in early December to reach a high of Rs29.58 against the US currency. Against the Pound sterling, the rupee kept appreciating and touched a high of Rs48.09 in December as worries about the UK's economic recovery and deteriorating finances weighed on its currency. The rupee vis-à-vis the euro hovered in the range of Rs45.50-46.85 up till November but appreciated strongly in early December as a result of domestic supply pressures. The rupee appreciated, on a point-to-point basis between 1 July and 31 December 2009, against the US dollar, the Pound sterling and the euro by 7.2 per cent, 5.2 per cent and 10.9 per cent, respectively, in the second half of 2009.

The evolution of the rupee exchange rate against the US dollar, the Pound sterling and the euro is shown in chart 4.10

Chart 4.10: Exchange Rate Movements



In a bid to boost liquidity in the domestic foreign exchange market, the Bank, on 22 December 2009, offered a spot-to-three month forward swap transactions in US dollar, euro and Pound sterling in the domestic foreign exchange market for a target amount not exceeding US$100 million or its equivalent. The rupee pared some gains following the introduction of the short-term foreign currency swaps to inject liquidity in the market.

Activity on the domestic foreign exchange market

Since November 2008, the Bank had not intervened in the domestic foreign exchange market. Reflecting this de facto state, the IMF, had, as part of its annual review exercise, re-classified the exchange arrangement of Mauritius from managed float to free floating.

Banks maintained an overbought foreign exchange position of US$69 million during the period July to December 2009, lower compared to US$77.9 million in the period January to June 2009. Activity on the interbank foreign exchange market increased to a monthly average of US$31.5 million in the period July to December 2009 compared to a monthly average of US$11.4 million in the period January to June 2009.

Transactions remained buoyant on the domestic foreign exchange market. Total turnover of spot and forward transactions amounted to US$3,305 million, representing a daily average of US$25.8 million during the period July to December 2009 compared to a daily average of US$25.9 million during the period January to June 2009.

Movements in MERIs and REER

The nominal effective exchange rates of the rupee, measured by MERI1 and MERI2, appreciated in the six months to December 2009. MERI1, which uses the currency distribution of trade as weights, appreciated by 7.5 per cent while MERI2, which includes currency distribution of trade combined with that of tourism receipts as weights, strengthened by 7.4 per cent. Chart 4.11 depicts the evolution of MERI1 and MERI2.

The Real Effective Exchange Rate (REER), with weights based on trade distribution with countries that make up at least 80 per cent of total trade and adjusted for price differentials between the domestic economy and its trading partners, showed an appreciation of 4.1 per cent. Chart 4.12 illustrates the evolution of the REER.

Chart 4.11: MERI1 and MERI2

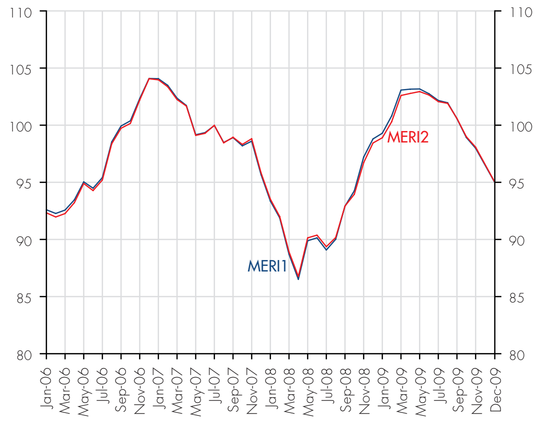
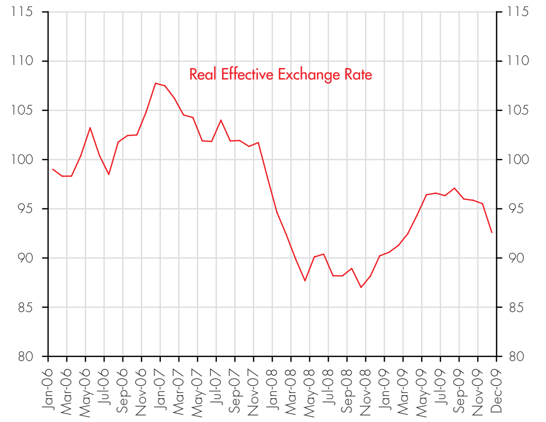


Chart 4.12: Real Effective Exchange Rate



5. The Outlook for Inflation

Notwithstanding the likely implications of the massive emergency stimulus policies on inflation if not withdrawn on time, the gradual waning of the slackness in capacity utilisation is likely to exert upward pressure on inflation globally. The expected rise in world demand over the medium term suggests the return of commodity market bottlenecks and renewed surge in commodity prices at some point.

A turnaround in inflation has already taken place late in 2009 on account of rising commodity prices. However, the current strength of the economic recovery worldwide and still low levels of capacity utilisation suggest that demand pressures on inflation could be rather limited in the short term.

International organisations forecast that international commodity prices are likely to stabilise around current levels over the short term. Nonetheless, the future path of commodity prices remains rather uncertain as, among other factors, it would be influenced significantly by the pace of the global economic recovery. According to the US Energy Information Administration Short Term Energy Outlook released on 10 March 2010, the price of WTI crude oil is expected to average around US$80 and US$84 per barrel in 2010 and 2011, respectively, after averaging $62 per barrel in 2009. The world oil market is expected to gradually tighten in 2010 and 2011. According to the FAO, food supplies are anticipated to be adequate to respond to rising demand over the foreseeable future than was the case during the price surge period but the demand for biofuels could put additional pressure on prices.

The IMF forecasts inflation to pick up from 0.1 per cent in 2009 to 1.5 per cent in 2010 in advanced economies. In emerging and developing economies, inflation is expected to go up from 5.2 per cent in 2009 to 6.2 per cent in 2010 as some of these economies may face growing upward pressures due to more limited economic slack, especially in emerging Asia.

5.1 Risks to the Inflation Outlook

Inflation in the Mauritian economy has hovered around low levels in the recent past by historical standards. This tendency is expected to continue prevailing over the short term, with risks broadly balanced around the inflation forecast.

The uncertainties around the forecast of inflation are contingent on both external as well as domestic factors. On the external front, no major rise in energy and food prices is expected over the short term. The expected moderate economic recovery this year should also minimise demand-driven price pressures.

Real output is anticipated to expand at a gradual pace but below potential in 2010 at 4.6 per cent with consumption slowing down to 2.6 per cent, slightly above 2009 but well below pre-crisis levels. Investment would contract at the rate of 1.6 per cent. The output gap is estimated to stay in negative territory during 2010. Money and credit growth rates remain moderate and are in line with the attainment of low inflation over the short to medium term. Domestic costs pressures appear broadly contained. Overall, domestic pressures on inflation seem to be well contained in the short term.

However, there may be upside risks to the short-term inflation outlook emanating from the supply side. If global recovery turns out to be stronger than expected in 2010 – especially if driven by emerging economies – international commodity prices could overrun short-term expectations. As a major net importer of commodities, any rapid increase of international commodity prices could bring about imported inflationary pressures. This scenario as of now is less likely to hold in the short term and is more likely to happen over the medium term as global economic conditions normalise.

The behaviour of the exchange rate of the rupee and its pass-through into prices of consumer goods is a critical factor in shaping up the inflation path. The rupee has appreciated in effective terms in the second half of 2009, which provided some buffer to increases in global commodity prices. Exchange rate depreciation could fuel higher producer price inflation and eventually consumer price inflation. Overall, inflation risks emanating from exchange rate developments remain fairly low in the short term.

Inflation fan chart

The inflation fan chart, as shown in Chart 5.1, illustrates the uncertainty surrounding the central projection of twelve-month average inflation up till December 2011. The central forecast is denoted by the darkest band in the chart and the risks surrounding it are represented by lighter bands. The central projection covers 10 per cent of the forecast and each successive pair of bands are drawn to cover a further 10 per cent probability until 90 per cent of the probability distribution is covered. The bands widen as the time frame is extended, indicating increasing uncertainty around the forecast.

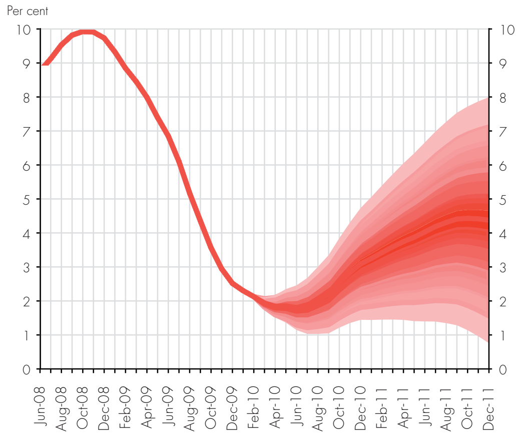
The inflation fan chart suggests a still benign inflation environment up to around late 2010. The central projection signals further decline in the twelve-month average inflation till June 2010 before picking up till September 2011, stabilising somewhat thereafter.

Beyond 2010, potential risks to the inflation outlook stem mostly from external sources – in particular, higher international food and energy prices as the global economy consolidates further. The widening of the bands around the central projection as from early 2011 shows the substantial uncertainties clouding the inflation forecasts. The path of inflation is influenced by expected strengthening of domestic demand conditions as external demand picks up, although the fading effects of the fiscal stimulus measures may be an offsetting factor to a certain extent over the policy relevant horizon.

Overall, with risks around the central forecast fairly well balanced, inflation could settle around 4 per cent over the next few quarters – that is, well below past trends.

The outlook has remained broadly unchanged in comparison to the previous forecast published in the Inflation Report of November 2009. A positive feature is the slight narrowing of the fan chart towards December 2010, pointing to lower uncertainty around the inflation forecasts due mainly to more visibility on domestic demand conditions, costs pressures and international commodity prices.

Chart 5.1: Inflation Fan Chart



Inflation expectations

The fifth Inflation Expectations Survey, which the Bank carried out in December 2009, revealed that 76.1 per cent of respondents expected prices to go up, while 10.9 per cent of respondents anticipated a decrease in prices and the remaining 13.0 per cent of respondents expecting prices to remain unchanged over the next twelve months. The mean inflation rate expected by the respondents was 3.8 per cent for June 2010, 4.5 per cent for December 2010 and 5.3 per cent for June 2011. External factors were viewed by 67.4 per cent of respondents as the primary source of inflation in Mauritius. There is some broad convergence between inflation expectations of stakeholders and the Bank’s projections.

Box 2: Inflation Expectations

The fifth Inflation Expectations Survey was carried out in December 2009. Out of the 50 stakeholders chosen from the financial and real sectors of the economy, 46 responded to the survey. The survey findings are thus based on these 46 responses.

Findings of the Inflation Expectations Survey

1. With respect to how respondents perceived the 2.9 per cent inflation rate for the twelve months ended November 2009, 67.4 per cent of respondents considered this rate as being appropriate while 21.7 per cent judged it to be low. 10.9 per cent of respondents viewed this rate as being high.

2. With regard to their best description of the movement of prices over the preceding twelve months, 39.1 per cent of respondents indicated that prices of goods and services had gone down while 37.0 per cent were of the opinion that prices had gone up. 23.9 per cent of respondents viewed that prices were unchanged.

3. Concerning the three main factors that accounted for the prevailing inflation pattern, external factors were viewed by 67.4 per cent of respondents as the primary source of inflation in Mauritius. Wage policy was regarded by 30.4 per cent of respondents as the second most important factor while 37.0 per cent of respondents viewed monetary policy as the third most important factor.

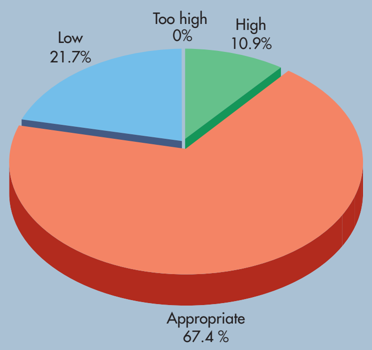
4. In relation to movement of prices over the following twelve months, 76.1 per cent of respondents expected prices to go up, while 13.0 per cent of respondents expected that prices would remain unchanged. 10.9 per cent of respondents anticipated a decrease in prices.

5. Finally, respondents were requested to provide their expectations of the rate of inflation for the twelve months ending June 2010, December 2010 and June 2011. June 2010: 50.0 per cent of respondents expect inflation to be 3.5 per cent or less while 45.7 per cent expect inflation to be between 3.6 per cent and 5 per cent. 4.3 per cent of respondents anticipate inflation to be higher than 5 per cent. December 2010: 30.4 per cent of respondents expect inflation to be 3.5 per cent or below while 47.8 per cent expect inflation to range between 3.6 per cent and 5 per cent. 21.8 per cent of respondents anticipate inflation to be above 5 per cent. June 2011: 8.7 per cent of respondents expect inflation to be 3.5 per cent or less while 34.8 per cent expect inflation to be within 3.6 per cent and 5 per cent. 56.5 per cent of respondents anticipate inflation to be higher than 5 per cent.

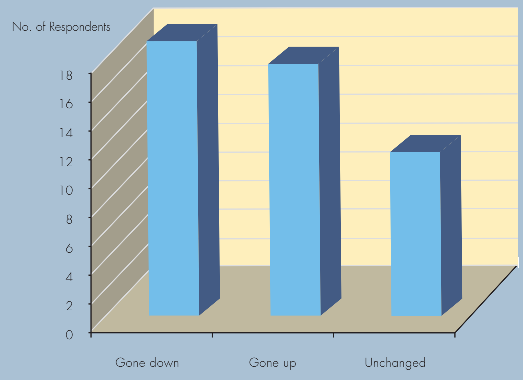
6. The mean inflation rates expected by respondents were 3.8 per cent, 4.5 per cent and 5.3 per cent, respectively for the twelve months ending June 2010, December 2010 and June 2011.

Graphical Representation of Responses

QI.1. Inflation for the twelve-month period ended November 2009 was 2.9 per cent. Do you perceive this rate to be ...



QI.2. Which of the following best describes the movement of prices over the past 12 months?

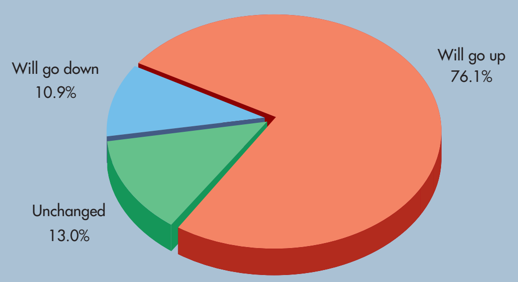


QI.3. Which of the following factors account for the current inflation pattern? (Ranking in order of importance starting with 1 for most important)

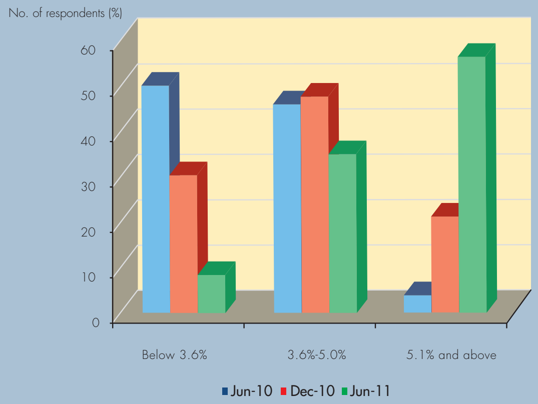
(Ranking in order of importance starting with 1 for most important.)

Factors	**1**	**2**	**3**
Fiscal policy	6	2	6
Monetary policy	3	12	17
External factors	31	8	2
Wage policy	0	14	13
Fall in aggregate demand	6	9	7
Other	0	1	1

QI.4. Which of the following would best describe the movement of prices over the next 12 months?



QI.5. What is your expectation of inflation in (a) June 2010; (b) December 2010; and (c) June 2011?



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