BANK OF MAURITIUS

Inflation Report

APRIL 2015

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INFLATION REPORT

April 2015

The Bank of Mauritius publishes the Inflation Report twice a year as required by Section 33(2) of the Bank of Mauritius Act 2004. The Bank releases the Report in April and October. The Report provides an assessment of factors underpinning monetary policy decisions as well as the risk factors that could make these projections deviate from the baseline macroeconomic scenario. This issue of the Inflation Report refers to information since the last Inflation Report in October 2014 to end of March 2015 unless otherwise stated.

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Inflation Report April 2015

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1. SUMMARY

Monetary Policy

At the last Monetary Policy Committee (MPC) meeting held on 06 April 2015, the Key Repo Rate (KRR) has been left unchanged at 4.65 per cent on the basis of the balance of external and internal risks affecting growth and inflation outlook of the economy. The MPC took note that the domestic economic activity was projected to strengthen in 2015. Measures announced in Budget 2015/16 are predicated to have a positive impact on investment and business confidence. The main downside risk to the domestic economic growth outlook remains the lingering economic uncertainty prevailing in our main export markets.

The high level of excess liquidity in the banking system remained a persistent issue, despite coordinated efforts made by the Bank and the Ministry of Finance and Economic Development (MOFED). The Budget 2014 target of a ratio of 60 per cent of foreign financing against 40 per cent of domestic financing was reversed with the latter accounting for about 68 per cent. Recourse to deficit financing was skewed towards domestic sources; including an amount of Rs4.0 billion of Treasury Bills issued specifically for liquidity management purposes. The disconnect between short-term interest rates and the KRR perpetuated. For the year 2015/16, net borrowing requirements of Government are projected to be financed primarily by domestic sources.

International Economy

During the second half of 2014, global economic growth has continued to face difficulty in gaining strong momentum. While activity in the US and the UK has remained buoyant, recovery is still sputtering in the Eurozone and Japan. Concurrently, economic and financial weaknesses continued to weigh on the performance of some large emerging economies. In its April 2015 World Economic Outlook, the IMF has noted that potential output growth in advanced economies is likely to increase slightly from current rates, as a result of the gradual increase in capital growth. In contrast, potential output growth is expected to decline in emerging market economies on the back of ageing population, weak investment and lower total factor productivity growth. Notwithstanding the asymmetric effect of the fall in oil and commodity prices as against diverging monetary policy across economies, global growth is forecast to rise moderately to 3.5 per cent in 2015, and will average 3.7 per cent in 2016 amid significant divergences between regions.

A new milestone will be set for global monetary policy as some advanced economies will attempt to break their synchronized quantitative easing cycle. While the ECB and BoJ continue with their asset purchase programmes, the US Fed will gradually move towards normalising the stance of monetary policy, with interest rate expected to increase during 2015. Monetary policy in developing and emerging market economies will remain divergent, with a few of the largest emerging markets facing concerns over country-specific structural and cyclical weaknesses. While it is assumed that global markets have factored in policy normalisation in the US, emerging markets will remain highly sensitive to changes in the pattern of global capital flows and to financial market volatility in 2015.

Against the lack of momentum in global economic recovery, inflation has remained subdued in many parts of the world mainly in the wake of negative output gaps and declining commodity prices. During 2014, the main factor that brought about downward pressures on inflation was the significant decline in oil and other commodity prices. The BRICS presented a mixed picture, with CPI inflation rising in Brazil but stabilising in China and India. According to IMF's April 2015 WEO, consumer price inflation is projected to drop further from 1.4 per cent in 2014 to 0.4 per cent in 2015 in advanced economies, but is estimated to increase from 5.1 per cent in 2014 to 5.4 per cent in emerging market and developing economies.

Domestic Economy

Growth performance of the domestic economy improved marginally over the four quarters of 2014. Real GDP growth rate stood at 3.5 per cent in 2014, up from 3.3 per cent in 2013. Final consumption expenditure and net external demand made a positive contribution to GDP growth while

Gross Domestic Fixed Capital Formation (GDFCF) registered a larger contraction than in the previous year. Statistics Mauritius has estimated an annual GDP growth of about 4.1 per cent for 2015. Faster growth in 2015 is forecast to result from improved performance in leading economic sectors, including a rebound in the construction sector and further growth in 'accommodation and food service activities' sector due to an increase in tourist arrivals.

Notwithstanding a drop in unemployment rate from 8.0 per cent in 2014Q1 to 7.5 per cent in 2014Q4, the labour market continued to be characterised by a large number of jobseekers mainly among the youth and female workforce. The main constraints in job prospects among the young population remained qualification mismatch with industry demand, and lack of employability skills. Sustained productivity gains are viewed as a key ingredient in Mauritius graduating to a high-income economy.

Fiscal Policy

During the second half of 2014, fiscal consolidation and prudent macroeconomic management was on-going, causing further decline in the overall fiscal deficit as a share of GDP. Current expenditure dropped from 21.8 per cent in 2013 to 21.4 per cent in 2014. The decline was driven by compensation of employees, debt servicing, and grants and subsidies. Likewise, revenue performance was subdued amid a slowdown in growth of tax revenue and contraction in other revenue sources. Nonetheless, total government expenditure is estimated to be lower than the Budget 2014 commitments, implying a declining overall fiscal deficit estimated at 3.2 per cent as a share of GDP. For the year 2015/16, the budget deficit is estimated to increase to 3.5 per cent of GDP. While fiscal consolidation is viewed positively, the projected fall in capital expenditure from 3.0 per cent in 2013 to 2.5 per cent in 2014 may seem to fall short with the goal of sustained economic growth.

Monetary and Financial Developments

Since the October 2014 Inflation Report, monetary aggregates grew at a strong pace while credit growth remained moderate. Broad money accelerated to 9.6 per cent in February 2015, from 8.3 per cent in September 2014. The velocity of circulation of broad money remained more or less stable at around one. With a nominal GDP growth rate of 5.7 per cent in 2014 and inflation rate of 2.5 per cent in February 2015, the pace of monetary expansion might suggest a potential build-up of inflationary pressures in the foreseeable future. Meanwhile, bank credit to the private sector - excluding GBCs - has shown signs of recovery, improving to 1.2 per cent in February 2015 from a contraction of 0.6 per cent in September 2014 and driven by credit to the household sector, as well as corporate credit extended to the construction and traders sectors.

The SEMDEX retreated in the fourth quarter of 2014, with declines mainly borne by hotel stocks, and banking and insurance sector. Recent trends indicate that local investors are generally supporting domestic stocks, while net outflows have been recorded for foreign investors.

The Savings-Investment Balance

Reflecting the persistent current account deficit estimated at 10.3 per cent of GDP, the savings-investment gap is assessed to have widened in 2014. With further declines in both public and private sector savings, the contribution of external savings is expected to be higher than in previous projections. Latest data released by Statistics Mauritius indicate that the level of domestic investment has been revised downward in 2014 to 21.0 per cent, from 22.3 per cent of GDP. The decline in overall domestic investment in 2014 points to a contraction of 8.4 per cent in private investment that was marginally offset by an increase of 1.8 per cent in public investment.

Inflation

Based on the Bank's short-term forecasting model, and under the baseline scenario, CPI inflation will be moderate during 2015. The current slack in the domestic economy and subdued energy and food prices are likely to prevent any substantial pick-up in inflation in the short term. Accordingly, headline inflation is projected to remain subdued in the near term, stabilising at about 3.0 per cent in 2015. It is expected that the depreciation of the rupee would not have a notable impact on inflation given the current international economic environment.

The Balance of Risks

The Bank's staff assessment for the year 2015, based on alternative assumptions, shows that the balance of risks to the inflation outlook appears slightly tilted on the upside. In this context, the baseline scenario depicting a higher negative output gap in the Eurozone and weaker private investment would deliver a lower inflation rate for 2015. However, there is greater probability for inflation to be higher than in the baseline scenario on assumptions of higher-than-expected unit labour costs and further depreciation of the currency. The balance of risks across various scenarios indicates that on an overall basis, the impact of the risk factors would result in a slight deviation of the inflation projection from the baseline scenario.

Table 1.1: Mauritius: Selected Economic Indicators, 2012-2014	2012	2013	2014
Nominal GDP (Rs billion)	343.8	366.2	386.3
Real GDP growth (basic prices; growth rate in per cent)	3.4	3.2	3.5
Inflation rate (y-o-y end period; growth rate in per cent)	3.2	4.0	0.2
CORE1 (y-o-y end period; growth rate in per cent)	3.2	3.3	0.8
CORE2 (y-o-y end period; growth rate in per cent)	3.0	3.2	2.1
Key Repo Rate (end December)	4.90	4.65	4.65
Unemployment rate (in per cent)	8.0	8.0	7.8
Nominal exchange rate (Rs/US$)	31.0	30.6	32.1
Nominal Effective Exchange Rate (Indices) [1]			
MERI1 (currrency weighted)	93.3	94.7	94.4
MERI2 (currrency weighted)	93.0	94.4	94.1
NEER (trade weighted)	99.2	98.1	96.0
Real Effective Exchange Rate [1]	87.3	86.7	84.2
Saving-Investment Balance (in per cent GDP)			
Investment	24.8	24.0	22.5
Private [2]	19.2	19.0	17.1
Public	5.5	5.0	5.4
Savings	24.8	24.0	22.5
External	7.3	9.9	8.4
Domestic	17.5	14.1	14.1
Private	17.1	15.0	14.7
Public [3]	0.3	-0.8	-0.6
Public Finance (in per cent GDP)			
Revenue	21.5	21.4	20.6
Expenditure	23.2	24.9	23.9
Current	20.4	21.8	21.4
Capital	2.8	3.0	2.5
Overall Balance	-1.8	-3.5	-3.2
Primary Balance	1.2	-0.9	-0.6
Public Debt	57.9	60.1	61.5
Domestic	44.2	44.2	45.3
External	13.7	15.8	16.3
Monetary			
Broad Money Liabilities (growth rate in per cent)	8.2	5.8	8.7
Private sector bank credit (growth rate in per cent)	12.8	5.9	1.3
Velocity of circulation	1.03	1.03	1.03
Balance of Payments			
Current account balance (in per cent GDP)	-7.3	-9.9	-10.3
Trade balance (in per cent GDP)	-21.5	-19.0	-17.9
Gross official reserves (Rs million)	92,988	105,009	124,344
Gross official reserves (US$ million)	3,046	3,491	3,919
Reserve import coverage [4]	4.9	5.2	6.2

[1] *An increase in the index indicates depreciation of the index.*
[2] *Includes changes in inventories.*
[3] *Defined as the difference between government's total revenue and current expenditure.*
[4] *In months of imports of goods and services.*

Sources: Statistics Mauritius, Ministry of Finance and Economic Development and Bank of Mauritius.

2. INTERNATIONAL ECONOMY

2.1 Global Economic Activity

Notwithstanding the positive effects of lower crude oil prices, the global economy continues to face difficulty in gaining strong momentum. Activity in the US and the UK remains more buoyant with improving labour market conditions. Realised savings from lower gasoline prices seem to have bolstered consumer confidence and boosted consumer spending. Monetary policy, which was largely accommodative, is likely to enter a new regime of flexibility implying forward guidance may be over. The recovery is still weak in the Eurozone and Japan, although there are signs the latter may be emerging from recession with a growth forecast of 1.0 per cent for 2015. China, meanwhile, is undergoing a carefully managed slowdown while India is emerging as the fastest-growing member of the BRICS.

The improvement in world growth is expected to continue in 2015 and 2016. However, significant differentiation between regions would prevail, given the asymmetric effects of the fall in commodity prices and the divergence of monetary policies across economies. Overall, global growth is expected to rise moderately to 3.5 per cent in 2015, and 3.8 per cent in 2016[1]. Advanced economies are likely to see growth of 2.4 per cent in 2015 and 2016, up from 1.8 per cent in 2014, on the back of gradually improving labour markets, reduced fiscal consolidation and still low financing costs. Economic growth in the US is expected to become self-sustaining mainly due to the decline in oil prices, despite the drag from an appreciation of the US dollar. Nonetheless, in the Eurozone and Japan, growth is expected to remain weak despite additional policy stimulus, as the hurdles from deleveraging and uncertainty dissipate gradually. While the recovery in high-income countries slowly strengthens, growth in emerging market and developing economies is expected to accelerate gradually, averaging 4.3 per cent and 4.7 per cent in 2015 and 2016, respectively. Lower oil prices will contribute to diverging prospects for oil-exporting and -importing countries, particularly in 2015.

Discussions on global outlook are likely to focus on financial conditions, given that event risks may dominate, if not, outweigh broad trends. Two such events of interest that may affect global growth are:

i. the highly possible US Federal Reserve interest rate hike; and
ii. geopolitical tensions (such as recent developments in Greece, Russia and Ukraine)

Advanced Economies

Growth in the US economy is poised to pick up in the coming quarters, although unfavourable weather conditions in February and reductions in oil and gas drilling could limit the pace of expansion. The US economy grew by 2.2 per cent in the fourth quarter of 2014, after a 5.0 per cent rise in the previous quarter[2] – the strongest expansion in 11 years. The marked slowdown came on the back of weaker business stockpiling and a larger trade deficit. However, recent indicators show that the US economy is expanding at a solid pace, supported by positive trends in the labour market, rising house and equity prices and higher consumption due to lower oil prices. The latest Purchasing Managers Indices (PMIs) for manufacturing and services suggest that both sectors are on course to make a robust contribution to the economy[3]. Overall, growth is projected to stay above post-crisis trend well into 2015 and 2016. While the recent dollar appreciation is projected to reduce net exports, the outlook remains positive mainly on account of better employment and investment prospects. Until now, inflation has been stable although signs of broad-based wage pressures are building up due to higher youth employment and the recent trend in wage growth.

The Eurozone ended the year 2014 better than expected and its economic recovery is likely to gather pace over the medium-term following the European Central Bank's (ECB's) extensive quantitative easing programme. Available data confirm that lower oil prices and a weak euro are supporting economic activity. The latest Eurozone composite PMI from Markit shows that the economy gathered momentum in January 2015. Retail sales and consumer sentiment are also improving. Looking ahead, the adoption of quantitative easing by the ECB should help drive even stronger growth in coming months. A competitive exchange rate, the absence of

[1] *IMF's World Economic Outlook, April 2015.*
[2] *US Bureau of Economic Analysis.*
[3] *US Institute of Supply Management.*

significant fiscal restraint and an improving external environment, including a persistently lower oil price, should also help to strengthen and broaden the recovery this year and next. Nevertheless, downside risks still prevail and could change the outlook for the Eurozone significantly.

The UK experienced a good economic performance during 2014 but the economy is now giving way to a slowdown. Although the UK is still likely to grow faster than most other parts of the world this year, the weak recovery of the Eurozone and many emerging markets may constrain expansion of its economy. With a general election in May 2015 and huge uncertainty about the outcome, companies are likely to move cautiously on new investments. Leading indicators already point to a slowing down in economic activity. While the PMI for both manufacturing and services remained at a high level in March[4], the housing market is cooling again.

Emerging Markets (BRICS)

Among the BRICS, economic growth remains relatively healthy in China and India, while Russia and Brazil are experiencing severe problems. South Africa continues to struggle with power supply constraints, leading to subdued growth in 2015.

- **China's** economic growth fell to 7.0 per cent in 2015Q1[5] as a consequence of the diminished housing-related activity and credit, and government efforts to reduce excessive reliance on publicly-funded investments. The PMI for Chinese manufacturing remains weak, although a slight improvement was noted in February. As the authorities have balanced the competing goals of reducing vulnerabilities with supporting growth, the medium-term growth outlook has been revised downwards. For 2015, soft oil prices are expected to boost activity and reduce the need for additional policy stimulus.

- **India's** economic growth picked up in 2014, accelerating to above 5.0 per cent. This has been driven by strong fundamentals, notably high savings and investment rates. Recent data show that growth has continued to pick up, rising to 7.5 per cent year-on-year in 2014Q4[6]. In the short-term, lower oil prices are likely to increase GDP growth, ease the pressures on India's high current account deficit and help bring down inflation. Recent forecasts by the IMF and the World Bank show that India's economy will grow faster than that of China within a year or two.

- **South Africa's** economy grew by 1.3 per cent in 2014Q4, down from 1.6 per cent in the previous quarter[7]. The weak growth and investment trends are reflected in the slow rate of formal sector employment creation. The growth outlook remains subdued as electricity supply disruptions more than offset the positive growth impact of lower oil prices.

- Growth in **Brazil** contracted by 0.2 per cent y-o-y in 2014Q4[8], due to weak consumer spending and a fall in exports. Households have been under pressure, facing high debt, rising interest rates, and weak economic prospects. Forecasts of a rapid rebound in Brazil are constrained by an unfinished economic reform agenda and weak business confidence.

- **Russia** has been severely affected by the sharp fall in oil prices and by sanctions for its role in the Ukraine crisis, leaving the country to face its first year of recession since 2009 in the wake of the global financial crisis. The government forecasts the economy to contract by 4-5 per cent in 2015.

Commodity-producing Countries

Commodity-producing countries such as Canada, Australia, and Chile are being negatively impacted by falling commodity prices. Deteriorating profitability and cash flows are already triggering a sizeable retrenchment in capital spending in the oil and iron ore sectors that have been severely impacted by increasing supply overhangs. Production will be more adversely affected if the demand-supply imbalance does not change. Government revenues are being negatively affected by the decline in nominal income associated with the increasing weakness in demand and prices of commodities.

[4] *Markit Economics.*
[5] *China National Bureau of Statistics.*
[6,7,8] *Trading Economics.*

2.2 Global Inflation Developments

Inflation remains low in many parts of the world, driven by a combination of slow growth, negative output gaps and declining commodity prices. The April 2015 WEO projected consumer price inflation in the advanced economies to fall from 1.4 per cent in 2014 to 0.4 per cent in 2015. In emerging market and developing economies, it is projected to increase from 5.1 per cent in 2014 to 5.4 per cent in 2015 (Table 2.2).

Advanced Economies

The large decline in oil prices has been the main reason for the drop in inflation across major advanced countries. US inflation is currently at 0.2 per cent, while in the UK, annual CPI inflation remains below the Bank of England's (BoE's) target. Deflationary conditions are still a threat in the Eurozone and Japan.

Emerging Markets

Inflation developments in emerging market economies remain mixed. CPI inflation continues to rise in Brazil, but is stabilising in China and India.

Table 2.1: Real Growth Rates in Selected Economies

Per cent

			January 2015 WEO Update Projections		April 2015 WEO Projections		Difference from January 2015 WEO Update projections	
	2013	2014	2015	2016	2015	2016	2015	2016
World Output	**3.4**	**3.4**	**3.5**	**3.7**	**3.5**	**3.8**	**0.0**	**0.1**
Advanced Economies	**1.4**	**1.8**	**2.4**	**2.4**	**2.4**	**2.4**	**0.0**	**0.0**
of which								
United States	2.2	2.4	3.6	3.3	3.1	3.1	-0.5	-0.2
Euro Area	-0.5	0.9	1.2	1.4	1.5	1.6	0.3	0.2
Germany	*0.2*	*1.6*	*1.3*	*1.5*	*1.6*	*1.7*	*0.3*	*0.2*
France	*0.3*	*0.4*	*0.9*	*1.3*	*1.2*	*1.5*	*0.3*	*0.2*
Italy	*-1.7*	*-0.4*	*0.4*	*0.8*	*0.5*	*1.1*	*0.1*	*0.3*
Spain	*-1.2*	*1.4*	*2.0*	*1.8*	*2.5*	*2.0*	*0.5*	*0.2*
United Kingdom	1.7	2.6	2.7	2.4	2.7	2.3	0.0	-0.1
Japan	1.6	-0.1	0.6	0.8	1.0	1.2	0.4	0.4
Emerging Market and Developing Economies	**5.0**	**4.6**	**4.3**	**4.7**	**4.3**	**4.7**	**0.0**	**0.0**
Sub Saharan Africa	5.2	5.0	4.9	5.2	4.5	5.1	-0.4	-0.1
South Africa	*2.2*	*1.5*	*2.1*	*2.5*	*2.0*	*2.1*	*-0.1*	*-0.4*
Emerging and Developing Asia	7.0	6.8	6.4	6.2	6.6	6.4	0.2	0.2
of which								
China	7.8	7.4	6.8	6.3	6.8	6.3	0.0	0.0
India	6.9	7.2	6.3	6.5	7.5	7.5	1.2	1.0

Source: IMF.

2.3 Monetary Policy Stances

Global monetary policies are coming to a new milestone. The Federal Reserve (Fed) is expected to start increasing interest rate during 2015, while the Eurozone and Japan will most probably adopt more easing policies. Among emerging and developing economies, monetary policies will continue to diverge, reflecting different stages of recovery.

Advanced Economies

Advanced economies have broken their synchronized easing policies. In the US, the Fed ended the asset purchase programme at the October 2014 Federal Open Market Committee (FOMC) meeting amid lower labour market utilisation. Owing to the fall in oil prices, the Fed lowered its median inflation forecast for 2015 to 1.1-1.2 per cent in December 2014 compared to its September 2014 forecast of 1.7-1.8 per cent. Strengthening US growth, supported by declining unemployment, is now providing the Fed with the opportunity to gradually firm policy and normalise low borrowing costs. A majority of FOMC members now expect the Fed to raise rates in 2015. Table 2.3 summarises the monetary policy stance of selected economies.

In the UK, a rise in interest rates in 2015 is looking less likely after a sharp decline in the rate of inflation at the end of 2014 and given that the recovery has proved less robust than anticipated.

In contrast, the ECB introduced new purchase programmes for asset-backed securities and covered bonds in October 2014, to support economic growth and reduce the risk of deflation in the Eurozone. In January 2015, the asset-purchase programme was expanded to EUR60 per month between March 2015 until at least September 2016, to include the purchase of bonds issued by euro area central governments, agencies and European institutions. The ECB may continue bond purchases until there are clear signs of 'a sustained adjustment in the path of inflation'.

The Bank of Japan (BoJ) increased its annual asset purchases to JPY80 trillion compared to a previous target range of JPY60-70 trillion, amid continued concerns on disinflation. The BOJ is expected to come up with further stimulus measures during the year.

Table 2.2: Consumer Price Inflation in Selected Economies

Per cent

			October 2014 WEO Projections	April 2015 WEO Projections		Difference from October 2014 WEO projections
	2013	**2014**	2015	2015	2016	2015
Advanced Economies	**1.4**	**1.4**	**1.8**	**0.4**	**1.4**	**-1.4**
of which						
United States	1.5	1.6	2.1	0.1	1.5	-2.0
Euro Area	1.3	0.4	0.9	0.1	1.0	-0.8
Germany	*1.6*	*0.8*	*1.2*	*0.2*	*1.3*	*-1.0*
France	*1.0*	*0.6*	*0.9*	*0.1*	*0.8*	*-0.8*
Italy	*1.3*	*0.2*	*0.5*	*0.0*	*0.8*	*-0.5*
Spain	*1.5*	*-0.2*	*0.6*	*-0.7*	*0.7*	*-1.3*
United Kingdom	2.6	1.5	1.8	0.1	1.7	-1.7
Japan	0.4	2.7	2.0	1.0	0.9	-1.0
Emerging Market and Developing Economies	**5.9**	**5.1**	**5.6**	**5.4**	**4.8**	**-0.2**
Sub Saharan Africa	6.5	6.3	7.0	6.6	7.0	-0.4
South Africa	*5.8*	*6.1*	*5.8*	*4.5*	*5.6*	*-1.3*
Emerging and Developing Asia	4.8	3.5	4.2	3.0	3.1	-1.2
of which						
China	2.6	2.0	2.5	1.2	1.5	-1.3
India	10.0	6.0	7.5	6.1	5.7	-1.4

Source: IMF.

Emerging Economies (BRICS)

In emerging and developing economies, monetary policies remained mixed. The People's Bank of China (PBoC) has cut benchmark interest rates twice since November 2014. However, those moves are mainly aimed at preventing a rise in real interest rates amid weak inflation. Lending figures indicate that authorities have not aggressively loosened liquidity.

The Reserve Bank of India (RBI) lowered interest rate twice in the first quarter of 2015. After cutting the policy rate by 25 basis points to 8.0 per cent in January 2015, the central bank reduced rates again in March 2015 to 7.50 per cent. India's central bank and the finance ministry have also agreed to introduce inflation targets to counter a long history of volatile prices. Both the Ministry and the RBI have set a consumer inflation target of 4.0 per cent, with a band of plus or minus 2 percentage points, by March 2017.

The Brazilian central bank raised interest rates to a six-year high on 04 March 2015. The central bank's monetary policy committee raised the benchmark Selic rate by 50 basis points to 12.75 per cent as the authorities seek to contain inflation that recorded its highest monthly increase in 12 years in January 2015. The central bank is expected to continue tightening monetary policy in the coming months, as price pressures remain elevated and the Bank looks to anchor inflation expectations.

Russia's central bank lowered its key interest rate in March 2015. The one-week auction rate was cut by one percentage point to 14 per cent after a 2 percentage-point cut at its previous meeting in January 2015. Even with price growth more than fourfold its mid-term target, the central bank stands ready to unwind December's emergency increase to 17 per cent to buoy an economy entering its first recession in six years.

After increasing its policy rate in July 2014 to stem rising inflationary pressures, the South African Reserve Bank (SARB) subsequently left interest rate unchanged. At its meeting in January 2015, the SARB lowered both growth and inflation forecasts for 2015 and 2016, citing balanced risks to the inflation outlook, but continued downside risks to the domestic growth trajectory.

2.4 Global Equity Markets

Global stock markets managed to keep their upward march as the US economic recovery gained traction coupled with the accommodative policy and low interest environment in major economies (Chart 2.1). The S&P 500 reached a new all-time high in March 2015 as the US economic growth remained robust and cheap energy relieved the cost burden for many companies. The US dollar

Table 2.3: Monetary Policy Stance

		Change since (bp*)		Forecast (Per cent)
	Current rate (Per cent p.a)	2005-07 avg	July 2011	June 2015
Developed economies	**0.24**	**-325**	**-61**	**0.38**
of which				
United States	0.125	-438	0.0	0.50
Euro Area	0.05	-293	-145	0.05
United Kingdom	0.50	-444	0.0	0.50
Japan	0.05	-17	0.0	0.05
Emerging Economies	**6.27**	**-7.3**	**2.0**	**6.12**
South Africa	5.75	-254	25	5.75
Emerging and Developing Asia				
of which				
China	5.35	-79	-121	5.10
India	7.50	63	-50.0	7.50

**Basis points.*

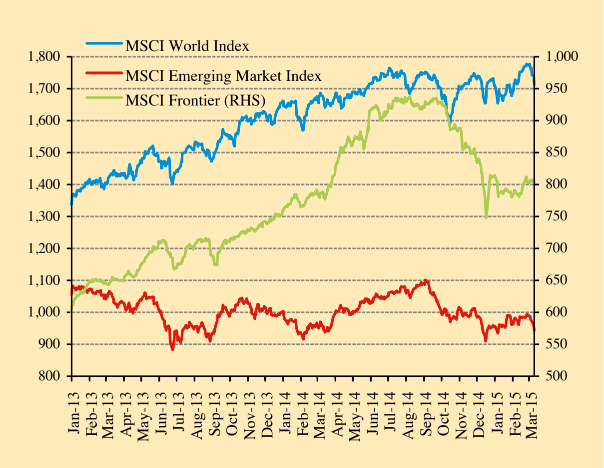
Source: JPMorgan.

appreciation may, however, prove a drawback to companies' earnings. The major equity markets in Europe were underpinned by the bigger than expected quantitative easing program of the ECB and the substantial depreciation of the euro but the political and financial future of Greece remains a major risk factor for financial markets. Share prices in the Asian markets like, China, Hong Kong and Japan, have all risen with a combination of a more than accommodative central bank, a weak currency and lower energy prices. However, some emerging markets suffered losses as Chinese growth moderated and on fears that the Fed moves closer to hike interest rate.

2.5 Exchange Rates

Currency markets were mainly influenced by the contrast between the major central banks' policy stance. The US is looking forward to hike interest rate later in the year while policy is expected to remain ultra-loose in Europe and Japan to stimulate the sluggish growth. The US dollar rallied over the period on upbeat economic data supporting that the economy is steadily recovering. Heightened expectations are that the Fed is on track to eventually hike interest rates after the halt of its bond-buying programme in October 2014. Rising US Treasury yields and widening interest rate differentials attracted more capital inflows. In addition, risk aversion from the rout in oil prices and global slowdown added support to the safe haven appeal of the US currency. The Japanese yen weakened as the BoJ added further monetary stimulus with a view to countering deflation and to stimulating growth.

Chart 2.1: Stock Market Indices



Source: Reuters.

The euro tumbled against other major currencies on the back of weak economic growth, negative inflation and the dovish stance of the ECB. Having slashed its policy rates to near zero, and taken banks' deposits rate into negative territory, the ECB finally plunged into a full scale quantitative easing. The political and financial situation in Greece and concerns over the health of the European banking sector also pressured the single currency. The Swiss National Bank stunned markets by suddenly abandoning its long-held pledge to cap the franc at 1.20 per euro. The euro fell to a low of USD1.04 in March 2015 as the ECB fired up its bond-purchase program. Bond yields reached record lows across many euro zone countries.

Poor data releases, uncertainty about the outcome of election and dimming expectations of an interest rate increase kept the Pound sterling on the back foot. UK economic data releases was not encouraging and the minutes of BoE's Monetary Policy Committee led investors to push back expectations for an interest rate hike well into 2016. In February 2015, the British currency gained briefly as investors' confidence rose in light of UK's robust growth outlook. However, the Pound sterling fell below US$1.47 in March 2015 following the weakness in the euro and the upcoming tight national election.

Emerging market currencies tumbled as the Fed looks forward to raising interest rates in 2015 against a backdrop in the reversal of capital inflows. These economies struggled with falling commodity prices, declining inflation and softening growth expectations. Many of these countries have cut interest rates or taken other measures with a view to stimulate growth.

3. DOMESTIC ECONOMIC ACTIVITY AND DEMAND

3.1 GDP by Sector

In its March 2015 national accounts, Statistics Mauritius estimated an annual GDP growth (at basic prices) of around 4.1 per cent for 2015, higher than 3.5 per cent for 2014. Faster growth in 2015 is expected to result mainly from a rebound in 'construction', better performance in 'accommodation and food service activities', 'manufacturing', 'transportation and storage' and 'information and communication'. The 'construction' sector is projected to expand by 3.3 per cent in 2015, after four consecutive years of decline. The higher growth in the 'accommodation and food service activities' sector is based on a forecast of around 1,100,000 tourist arrivals in 2015 compared to 1,038,968 in 2014. Tourist earnings are estimated at Rs48.5 billion in 2015 compared to Rs44.3 billion in 2014. However, growth in 'wholesale and retail trade', 'public administration and defence' and 'real estate activities' is expected to be lower than in 2014 (Table 3.1).

The domestic economy grew at a higher rate of 3.7 per cent in the fourth quarter of 2014 compared to 2.7 per cent in the corresponding quarter of the previous year (Table 3.2). This reflected higher growth in the 'public administration and defence', 'accommodation and food service activities', 'wholesale and retail trade', 'information and communication', and 'financial and insurance activities' sectors. Moreover, the 'construction' sector recorded a lower decline of 9.0 per cent compared to a negative growth of 19.1 per cent in the fourth quarter of 2013. The 'manufacturing' sector grew by a slightly lower rate of 3.7 per cent in the last quarter of 2014 compared to 3.8 per cent in the corresponding

Table 3.1: Sectoral Real Growth Rates (per cent over previous year)

	2014 (1)	2015 (2)	Changes (2) - (1)
Primary Sector			
Agriculture, forestry & fishing	3.9	6.1	2.2
Mining & quarrying	-5.0	2.0	7.0
Secondary Sector			
Manufacturing	2.2	2.5	0.3
Electricity, gas, steam & air conditioning supply	4.0	4.6	0.6
Water supply	3.0	3.0	0.0
Construction	-8.5	3.3	11.8
Tertiary Sector			
Wholesale & retail trade	3.2	3.0	-0.2
Transportation & storage	2.5	3.0	0.5
Accommodation & food service activities	4.1	5.4	1.3
Information and communication	6.4	7.0	0.6
Financial & insurance activities	5.4	5.4	0.0
Real estate activities	2.7	2.2	-0.5
Professional, scientific & technical activities	7.0	6.0	-1.0
Administrative & support service activities	7.4	6.0	-1.4
Public administration	5.6	4.5	-1.1
Education	2.9	3.0	0.1
Health	6.3	4.8	-1.5
Art, entertainment & recreation	6.7	5.0	-1.7
Other service activities	5.2	4.2	-1.0
GDP at basic prices	**3.5**	**4.1**	**0.6**
Taxes on products (net of subsidies)	4.7	2.3	-2.4
GDP at market prices	**3.6**	**3.9**	**0.3**

Source: Statistics Mauritius.

quarter of 2013 on account of lower expansion in the textile and other manufacturing sub-sectors. The 'transportation and storage' sector also decelerated compared to the last quarter of 2013.

A look at disaggregated leading economic indicators gives a mixed picture of economic activity throughout the last two quarters of 2014 and during the first few months of 2015 (Chart 3.1). The following indicators have been used:

- building permits
- job vacancies
- electricity production
- tourist arrivals
- industrial production index
- money supply M1

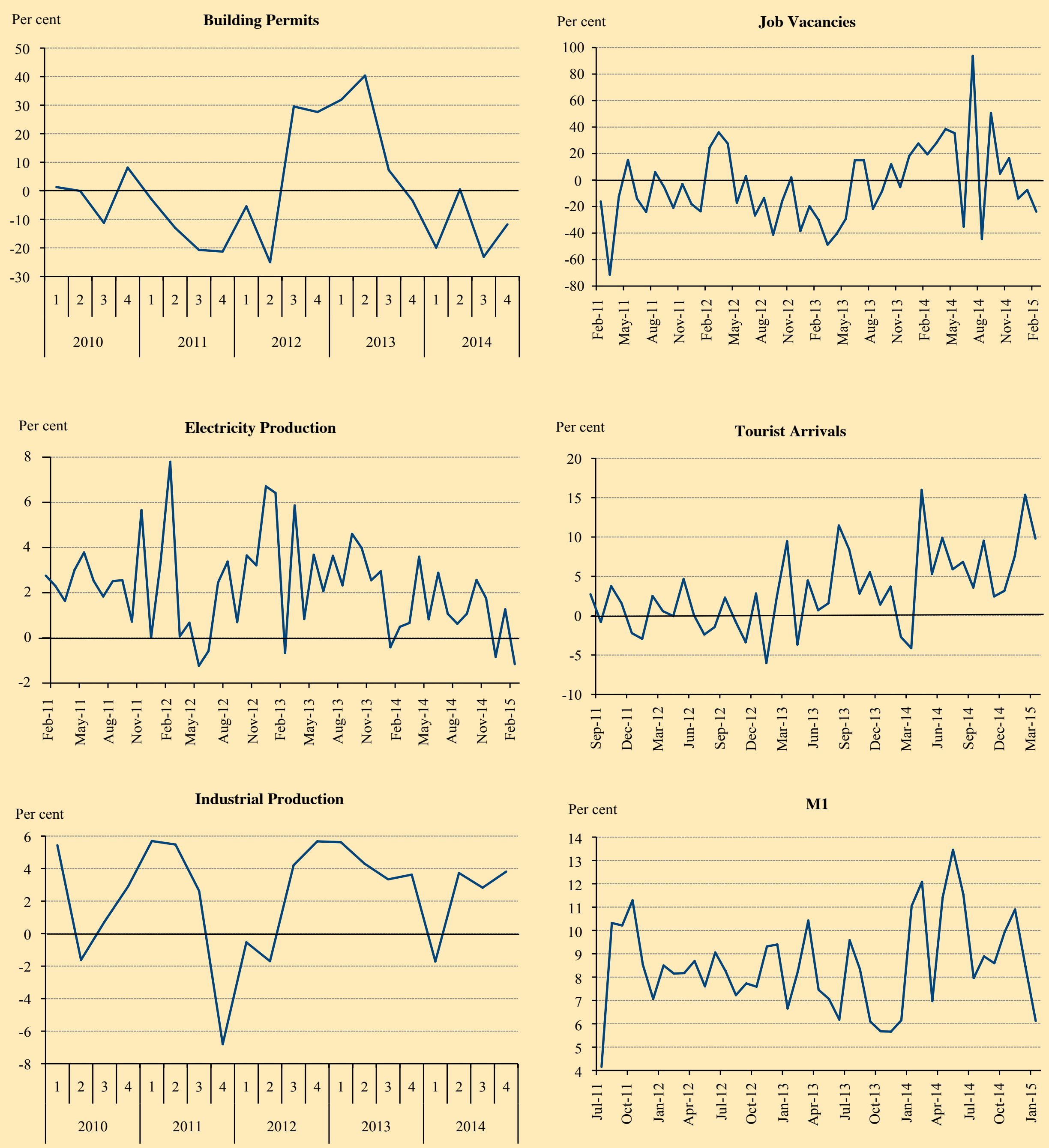
While some of these leading indicators have followed a downward trend lately, especially regarding the contraction in electricity production, tourist arrivals, job vacancies and money supply, the other leading indicators depict a positive outlook. The number of building permits is rising and the industrial production index is increasing. More importantly, an analysis of these highly volatile data over a longer period of time projects a somewhat better picture in economic activity.

Table 3.2: GDP - Sectoral Growth Rates, Volume Terms (Annual growth rates, in per cent)

	2013				2014			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Primary Sector								
Agriculture forestry & fishing	-4.6	-0.1	4.5	0.2	5.4	4.8	3.7	2.8
Mining & quarrying	-2.4	-6.6	-0.7	-8.0	-15.0	-4.8	-5.0	2.7
Secondary Sector								
Manufacturing	6.0	4.8	3.4	3.8	-2.5	3.4	2.7	3.7
Electricity, gas, steam & air conditioning supply	6.5	2.5	3.7	4.5	3.6	6.5	2.3	3.4
Water supply	2.9	1.1	1.9	3.9	4.7	1.9	3.6	2.1
Construction	-2.0	3.1	-11.4	-19.1	-5.9	-9.6	-9.2	-9.0
Tertiary Sector								
Wholesale & retail trade	3.7	3.1	2.6	2.8	3.0	3.1	3.2	3.5
Transportation & storage	2.6	-1.0	1.6	4.4	2.6	3.4	2.2	1.8
Accommodation & food service activities	1.4	0.3	6.8	1.6	-1.2	8.8	5.1	5.2
Information and communication	7.2	8.0	7.2	5.5	6.8	6.0	6.5	6.4
Financial & insurance activities	5.1	5.3	5.7	5.2	6.1	5.7	4.8	5.4
Real estate activities	2.9	3.0	2.9	2.8	2.6	2.8	2.9	2.8
Professional, scientific & technical activities	7.4	7.2	7.2	6.9	6.9	7.0	7.1	7.0
Administrative & support service activities	7.2	7.1	7.2	8.0	7.2	7.5	7.5	7.4
Public administration	1.2	1.8	2.5	3.1	2.6	6.6	6.3	6.6
Education	2.7	2.7	2.6	3.0	2.9	3.0	3.0	2.8
Health	6.3	5.9	6.4	6.8	6.4	6.2	6.2	6.6
Art, entertainment & recreation	8.0	8.1	8.1	8.4	6.9	6.7	6.7	6.7
Other service activities	5.1	5.9	6.5	7.4	5.1	5.1	5.1	5.3
GDP at basic prices	**3.8**	**3.4**	**3.4**	**2.7**	**2.5**	**4.0**	**3.6**	**3.7**
Taxes on products (net of subsidies)	-0.4	4.1	3.0	4.1	3.5	6.0	4.2	5.0
GDP at market prices	**3.3**	**3.5**	**3.4**	**2.8**	**2.6**	**4.3**	**3.6**	**3.9**

Source: Statistics Mauritius.

Chart 3.1: Y-o-y Growth Rates of Leading Indicators of Economic Activity



Sources: Statistics Mauritius; Ministry of Labour, Industrial Relations, Employment & Training; and Bank of Mauritius.

3.2 GDP by Expenditure

Both final consumption expenditure and external demand made positive contributions to GDP growth over the four quarters of 2014, while Gross Domestic Fixed Capital Formation (GDFCF) registered a larger contraction than in 2013 (Table 3.3). On average, net external demand recorded a positive growth over the four quarters of 2014 in contrast to a decline in the corresponding quarters of the previous year, mainly as a result of a larger expansion in exports of goods. In addition, imports of goods and services, on average, registered a lower increase in 2014 compared to 2013. Final consumption expenditure went up by a higher average rate of 2.9 per cent in 2014 compared to 2.3 per cent in the previous year owing to higher growth in general government consumption expenditure, while household consumption expenditure maintained the same average rate of expansion. GDFCF registered a higher drop than in the corresponding four quarters of 2013 on account of a contraction in investment in machinery and equipment.

On an annual basis, final consumption expenditure is projected to grow by 3.2 per cent in 2015 compared to 2.9 per cent in 2014, driven by both higher household and government consumption expenditure. GDFCF is expected to record a positive growth of 6.7 per cent in 2015, following three consecutive years of decline, as a result of major public and private investment projects that are due to be implemented, as announced in the 2015/16 Budget.

Per cent

Table 3.3: Domestic and External Demand

	2012					2013					2014				
	Q1	Q2	Q3	Q4	Avg.	Q1	Q2	Q3	Q4	Avg.	Q1	Q2	Q3	Q4	Avg.
I. Domestic Demand															
Final consumption	2.9	2.4	2.2	3.5	2.8	2.8	2.1	2.6	1.8	2.3	1.6	3.4	3.2	3.4	2.9
Households	2.9	2.7	2.1	3.3	2.8	2.7	2.6	3.0	2.1	2.6	1.6	2.9	3.1	2.9	2.6
General Government	3.1	1.0	2.9	4.6	2.9	2.9	-0.5	0.5	-0.1	0.7	1.4	6.2	3.5	5.9	4.3
GDFCF	14.4	5.6	-4.1	-13.8	0.5	-10.7	-4.3	-0.6	1.9	-3.4	-3.3	-4.5	-11.4	-4.2	-5.9
Building & construction work	7.2	4.0	-3.9	-8.3	-0.3	-4.1	-4.1	-11.4	-19.1	-9.7	-5.1	-8.9	-8.4	-7.1	-7.4
Machinery & equipment	29.4	9.1	-4.8	-26.1	1.9	-21.6	-4.4	25.8	59.7	14.9	0.1	4.6	-16.5	0.3	-2.9
II. Net External Demand															
Exports of Goods & Services	2.7	13.8	-4.0	1.7	3.6	-0.9	4.5	5.1	8.7	4.4	-4.5	3.1	14	1.6	3.6
Exports (goods)	-2.0	5.5	-2.2	2.3	0.9	4.5	0.2	6.0	7.5	4.6	4.7	17.3	17	6.2	11.3
Export (services)	6.1	21.2	-5.4	1.2	5.8	-4.5	7.9	4.2	9.6	4.3	-11.2	-7.1	11.3	-2.0	-2.3
Imports of Goods & Services	4.8	11.2	-8.2	-1.0	1.7	0.2	0.3	11.4	12.0	6.0	-4.1	1.1	7.2	2.8	1.8
Imports (goods)	3.1	10.4	-2.1	-0.8	2.7	-1.5	-3.0	10.8	12.4	4.7	-1.7	11.6	12	6.7	7.2
Imports (services)	8.0	13.0	-18.8	-1.5	0.2	3.4	7.0	12.6	11.1	8.5	-8.4	-17.8	-2.9	-6.0	-8.8
III. GDP at market prices	**2.9**	**3.0**	**3.6**	**3.5**	**3.3**	**3.3**	**3.5**	**3.4**	**2.8**	**3.3**	**2.6**	**4.3**	**3.6**	**3.9**	**3.6**

Source: Statistics Mauritius.

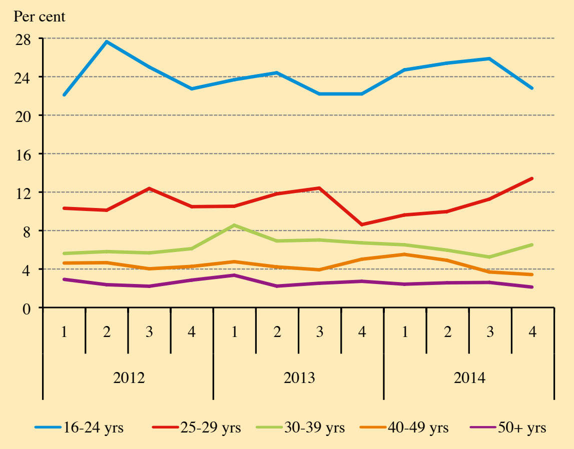
3.3 Labour Market and Unit Labour Costs

Notwithstanding slightly improved labour market conditions, human resources continue to remain involuntarily idle. The labour market continued to operate below capacity with a preponderant high unemployment rate among the youth and female workforce. The qualification mismatch with industry demand and lack of employability skills adversely impacted job prospects among the young population (Chart 3.2). An analysis of the nature of unemployment shows that the majority of those without a rewarding job have the following characteristics: (i) they are young, often less than 30 years of age; (ii) many have never held a first job; (iii) most of them have failed primary or secondary education; (iv) they did not have vocational or technical training; and (v) they are single and family supported. The need for appropriate policy measures on the basis of these factors is becoming increasingly pronounced.

Overall, the unemployment rate dropped from 8.0 per cent in 2014Q1 to 7.5 per cent in 2014Q4. However, on a seasonally-adjusted basis, the picture is contrasting altogether, with the unemployment rate increasing from 7.4 per cent in 2014Q1 to 8.3 per cent in 2014Q4.

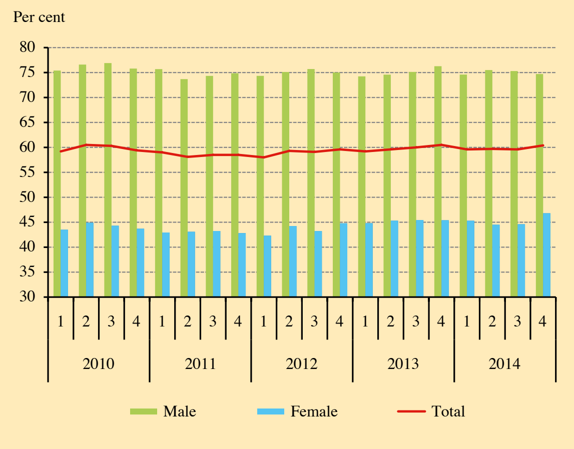
Over the year to 2014Q4, gains in employment (3,600) were principally recorded in the 'manufacturing', 'accommodation and food service activities', 'agriculture, forestry and fishing', and 'financial and insurance activities' sectors, which more than offset declining employment in the 'construction' sector and 'wholesale and retail trade' (Chart 3.4). In fact, over the years 2011-14, the construction sector has registered negative growth rates throughout.

Chart 3.2 Unemployment by Age



Source: Statistics Mauritius.

Chart 3.3 Participation Rate

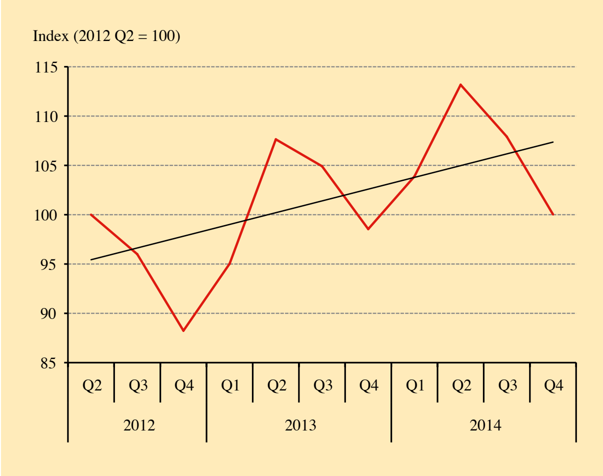


Source: Statistics Mauritius.

Since 2011, the unemployment rate has been rather stable, hovering around 8 per cent. Statistics Mauritius estimates the unemployment rate at around 7.8 per cent for 2014, down from 8.0 per cent the previous year. The labour market outlook in the short to medium-term would depend on the performance of the economy and its ability to fuel job creation through key employment generating sectors. The need to address the structural skills mismatch has become increasingly urgent in that it affects mainly women and the youth, including a large number of unemployed graduates. This skills gap is partly responsible for the slower pace of improvement in the labour market.

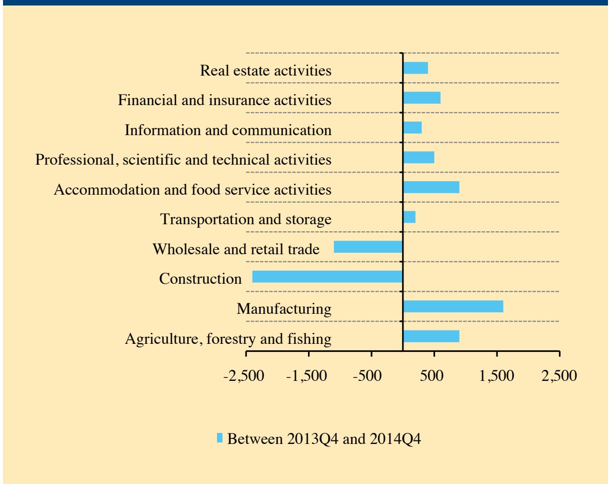
After increasing markedly in the first semester of 2014, unit labour costs for the total economy declined in the second half of 2014 as a result of the pick-up in productivity outpacing the wage increase (Charts 3.5 and 3.6). In US dollar terms, over the same period, unit labour cost fell as a result of a depreciation of the Mauritian rupee, which implies that Mauritian labour has become more competitive vis-à-vis its competitor countries. Improvement in international competitiveness strongly rests with quality standards, technological advances and innovation, high skills through enhanced education and appropriate skills training and delivery services. For an open market economy, shifting focus on factors with long-lasting impact is more likely to attain the goals set such as productive employment, sustained high growth and high-income status.

Chart 3.5: Unit Labour Costs for the Total Economy



Source: Bank of Mauritius calculations.

Chart 3.4: Employment Change by Main Sectors



Source: Statistics Mauritius.

Chart 3.6: Productivity and Wage Indices

Source: Bank of Mauritius calculations.

4. PUBLIC FINANCE

4.1 Developments and Outlook

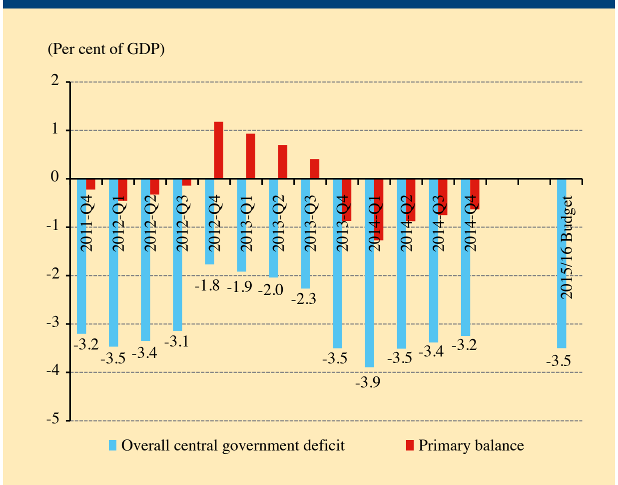
Fiscal consolidation and prudent macroeconomic management were on-going during the second half of 2014, with continued declines in the overall fiscal deficit (as a share of GDP) in the third and fourth quarters. Nonetheless, the overall fiscal deficit is estimated to be in line with the 2014 Budget target (Chart 4.1). Since the release of the October 2014 Inflation Report, the overall central government deficit, as a share of GDP, has declined to an estimated 3.4 per cent in 2014Q3 and to 3.2 per cent for the year 2014. This trend was mirrored in the primary balance[9] with lower ratios during the period under review (-0.6 per cent in 2014). While the overall fiscal deficit reached the target of 3.2 per cent, the primary balance was estimated to be higher than the target 0.4 per cent of GDP. For the year 2015/16, the budget deficit is estimated at 3.5 per cent of GDP.

Revenue performance was rather subdued during the second half of 2014 with a slowdown in growth of tax revenue while other revenue contracted (Chart 4.2). Total revenue as a share of GDP dropped to 21.1 per cent and 20.6 per cent in 2014Q3 and 2014Q4, respectively. Y-o-y growth of tax revenue fell to 6.2 per cent and 5.5 per cent in 2014Q3 and 2014Q4, respectively. Both direct and indirect taxes declined. The lower tax revenue collection in the third quarter of the year was due to seasonal factors, the main reason being most companies have December accounting year end but submit their tax returns and pay corporate tax on 30 June. Other revenue, which accounted for around 10 per cent of total revenue, contracted by 23.1 per cent and 22.3 per cent in 2014Q3 and 2014Q4. Central government revenue is estimated at 20.6 per cent of GDP for the fiscal year 2015/16, with tax collections at 17.7 per cent and other revenue at 2.9 per cent.

Total government expenditure for 2014, as a share of GDP, is estimated to be lower than the Budget 2014 commitments (Chart 4.3). During the third and fourth quarters of 2014, total government expenditure, as a share of GDP, amounted to 24.4 per cent and 23.9 per cent, respectively, triggered by both current and capital expenditures.

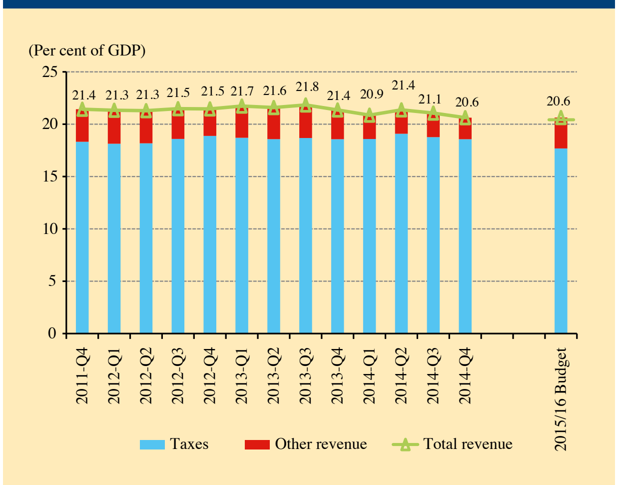
Current expenditure, as a share of GDP, stood at 21.4 per cent in 2014 compared to 21.8 per cent in 2013. On the other hand, capital expenditure is estimated to have fallen to 2.5 per cent in 2014, from 3.0 per cent in 2013. For the year 2015/16, total expenditure is estimated at 24.1 per cent with current expenditure at 21.3 per cent of GDP while capital expenditure is expected at 2.9 per cent of GDP. Such low capital expenditure, unless compensated by private sector, would be inconsistent with the goals of sustained economic growth of around 5.0 per cent.

Chart 4.1: Overall Central Government Deficit and Primary Balance



Source: Ministry of Finance and Economic Development.

Chart 4.2: Central Government Revenue



Source: Ministry of Finance and Economic Development.

[9] *The primary balance is the overall fiscal deficit less interest payments on national debt.*

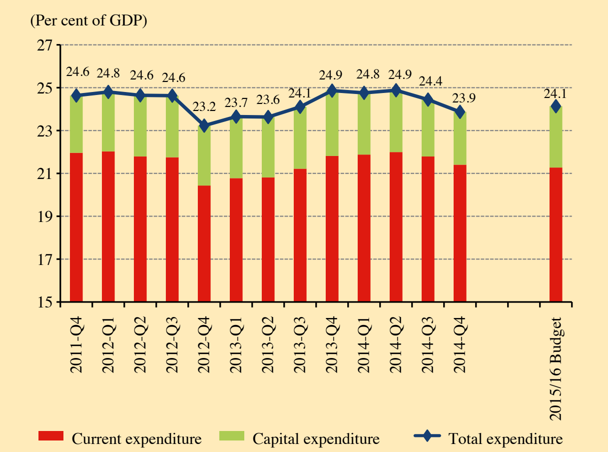
During the year 2014, government's recourse to deficit financing was skewed towards domestic sources amid excess liquidity in the banking system (Table 4.1). Thus, the Budget 2014 target of a ratio of 60/40 of foreign to domestic financing was somewhat reversed with the latter estimated at around 68 per cent. For the year 2015/16, the net borrowing requirement is expected to be financed principally from domestic sources. A shift of this nature is a positive sign in diminishing the tension from excess liquidity. The liquidity situation improved in the latter part of 2014 but excess liquidity remained high. In the absence of further frontloading since the issue of the last Inflation Report, efforts to mop up the excess liquidity have continued. Higher amounts were accepted at auctions of government securities than those put on tender. Concurrently, a total amount of Rs4.0 billion of Treasury Bills was issued for liquidity management purposes. Government's accumulation of deposits with the central bank fell to about Rs25 billion by end-December 2014 (Chart 4.4).

4.2 Public Sector Debt

Public sector debt increased by 8.1 per cent, from Rs219.9 billion as at end-December 2013 to Rs237.8 billion as at end-December 2014 (Table 4.2, and Chart 4.5). As a percentage of GDP, total public sector debt as per international definition increased by 1.4 percentage points to 61.5 per cent as at end-December 2014. The increase has been driven by both external and domestic debt, with the latter showing a lengthening of its maturity profile. Excluding government securities issued for mopping up excess liquidity amounting to Rs5.4 million, total public sector debt stood at 60 per cent of GDP at more or less the same level as in 2013.

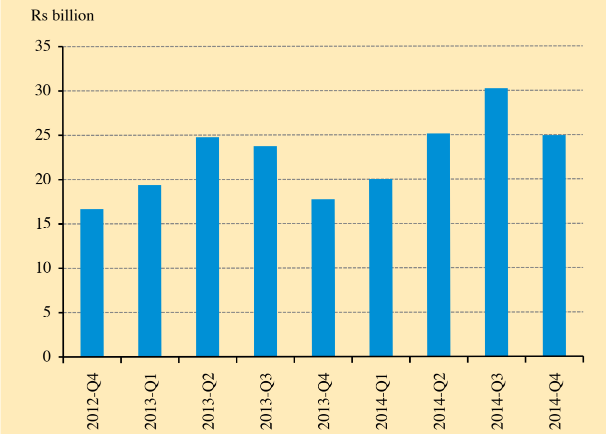
According to the Budget 2015/16, the discounted public sector debt shall remain at around 54.2 per cent of GDP in 2015/16[10]. A reduction to around 50 per cent of GDP is targeted by 2018.

Chart 4.3: Central Government Expenditure



Source: Ministry of Finance and Economic Development.

Chart 4.4: BoM Net Claims on Central Government



Source: Ministry of Finance and Economic Development.

10 *Discounted public sector debt evaluates/adjusts total public sector debt for the fiscal risks associated with debt of parastatals and state-owned enterprises. Accordingly, this debt is discounted whenever the fiscal risk is small. For operational purposes of adherence to the provisions of the PDMA 2008, it is the discounted public sector debt that is relevant.*

Table 4.1: Statement of Budgetary Central Government Operations						
	2012	2013	2014	2015/16	Jan -Jun 2014	Jan - Jun 2015
	(Actual)	(Actual)	(Prov.)	Estimates	(Prov.)	Estimates
	(Rs million)					
1. Revenue	**73,794**	**78,224**	**79,674**	**90,800**	**37,750**	**39,113**
Taxes on income, profits, and capital gains	14,634	15,920	17,089	19,520	8,280	-
Taxes on goods & services	43,008	44,964	46,236	49,645	22,269	-
2. Expense	**79,871**	**91,048**	**90,254**	**106,200**	**41,773**	**47,099**
Current	70,255	79,886	80,726	93,600	38,177	43,229
of which Interest	10,129	9,629	10,118	-	5,045	4,945
Capital[1]	9,616	11,161	9,528	12,600	3,596	3,870
3. Gross Operating Balance/Overall Balance (1-2)	**-6,078**	**-12,823**	**-10,580**	**-15,400**	**-4,023**	**-7,986**
Primary Balance	**4,052**	**-3,194**	**-462**	**-**	**1,022**	**-3,041**
Net Lending	**1,032**	**4,967**	**851**	**-**	**-164.8**	**564**
Overall borrowing requirement	**-7,110**	**-17,791**	**-11,431**	**-**	**-3,858**	**-8,550**
Financing	**7,110**	**17,791**	**11,431**	**-**	**3,858**	**8,550**
Domestic	4,493	7,283	9,314	-	-336	-
Monetary Authority[2]	-5,946	-657	-2,582	-	-577	-
Banks	5,384	2,836	15,248	-	9,226	-
Non-Banks	5,056	5,104	4,451	-	-647	-
Foreign	2,981	10,805	4,233	-	-8,339	-
Other	-365	-297	-2,116	-	4,223	-
	(In per cent of GDP)					
1. Revenue	**21.5**	**21.3**	**20.6**	**20.6**		
Taxes on income, profits, and capital gains	4.3	4.3	4.4	4.4		
Taxes on goods & services	12.5	12.3	11.9	11.3		
2. Expense	**23.2**	**24.8**	**23.3**	**24.1**		
Current	20.4	21.8	20.8	21.3		
of which Interest	2.9	2.6	2.6	-		
Capital	2.8	3.0	2.5	2.9		
3. Gross Operating Balance/Overall Balance	**-1.8**	**-3.5**	**-2.7**	**-3.5**		
Primary Balance	**1.2**	**-0.9**	**-0.1**	**-**		
Net Lending	**0.3**	**1.4**	**0.2**	**-**		
Overall borrowing requirement	**-2.1**	**-4.9**	**-3.0**	**-**		
Financing	**2.1**	**4.9**	**3.0**	**-**		
Domestic	1.3	2.0	2.4	-		
Monetary Authority[2]	-1.7	-0.2	-0.7	-		
Banks	1.6	0.8	3.9	-		
Non-Banks	1.5	1.4	1.1	-		
Foreign	0.9	2.9	1.1	-		
Other	-0.1	-0.1	-0.5	-		

[1] Does not include transfer to special funds, grants, other transfers and contingencies, except for 2015/16.
[2] Includes Government deposits with the Bank of Mauritius.

Source: Ministry of Finance and Economic Development and BoM staff calculations.

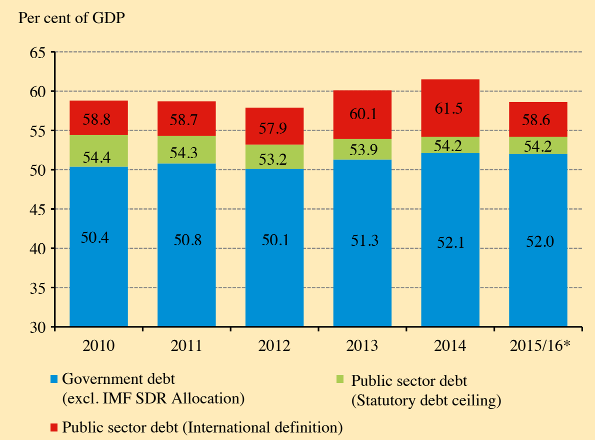
Table 4.2: Public Sector Debt

Rs million

	Dec-12	Jun-13	Dec-13	Jun-14	Dec-14 *Provisional*
1. Short-term Domestic Obligations[1]	**31,093**	**29,880**	**27,497**	**22,984**	**22,647**
o/w: Treasury Bills	29,486	29,861	27,497	22,984	22,647
2. Medium-term Domestic Obligations[1]	**40,174**	**40,697**	**43,251**	**50,692**	**47,911**
o/w: Treasury Notes	40,157	40,680	43,251	**50,692**	47,911
3. Long-term Domestic Obligations[1]	**69,539**	**73,309**	**79,212**	**83,301**	**89,305**
o/w: MDLS/Government of Mauritius Bonds	39,892	42,287	46,062	40,079	53,307
Five-Year Government of Mauritius Bonds	29,647	31,022	33,150	34,222	35,998
4. Domestic Central Government Debt (1+2+3)	**140,806**	**143,886**	**149,960**	**156,977**	**159,863**
	(41.0)	(40.6)	(40.9)	(41.6)	(41.3)
5. External Government Debt	**35,947**	**42,530**	**47,162**	**51,456**	**51,466**
	(10.5)	(12.0)	(12.9)	(13.6)	(13.3)
(a) Foreign Loans	31,188	37,883	42,269	46,539	46,810
(b) Foreign Investment in Government Securities	216	132	400	392	207
(c) IMF SDR Allocations	4,543	4,515	4,493	4,525	4,449
6. Extra Budgetary Unit Domestic Debt	**105**	**105**	**24**	**24**	**24**
7. Extra Budgetary Unit External Debt	**180**	**171**	**160**	**149**	**137**
8. Local Government Domestic Debt	**2**	**1**	**0**	**0**	**0**
9. Public Enterprise Domestic Debt	**11,130**	**10,175**	**12,062**	**9,437**	**9,552**
10. Public Enterprise External Debt	**10,888**	**10,994**	**10,569**	**10,838**	**11,301**
11. Domestic Public Sector Debt	**152,043**	**154,167**	**162,046**	**166,438**	**174,861**
	(44.2)	(43.5)	(44.2)	(44.1)	(45.2)
12. External Public Sector Debt	**47,015**	**53,695**	**57,891**	**62,443**	**62,904**
	(13.7)	(15.1)	(15.8)	(16.6)	(16.2)
13. Total Public Sector Debt (11+12)	**199,058**	**207,862**	**219,937**	**228,881**	**237,765**
	(57.9)	(58.6)	(60.1)	(60.7)	(61.4)

[1] By original maturity
Notes: (i) Short-term: Up to 12 months; Medium-term: Over 1 year but less than 5 years; Long-term: 5 years and above;
(ii) Figures in brackets are percentages to GDP; (iii) Figures may not add up to totals due to rounding.
Source: Ministry of Finance and Economic Development.

Chart 4.5: Government Debt and Public Sector Debt



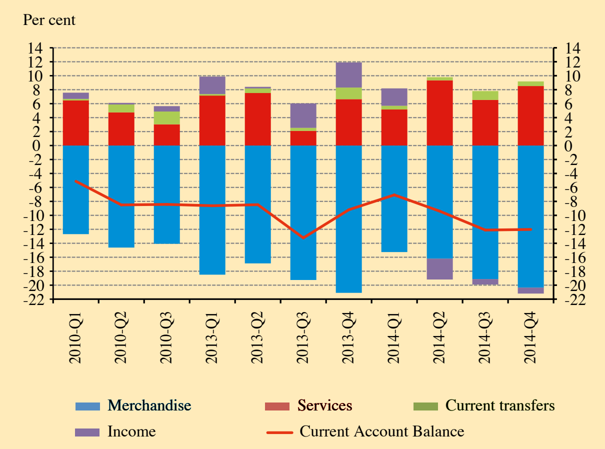
Source: Ministry of Finance and Economic Development.

5. BALANCE OF PAYMENTS

5.1 Overall Trends and Outlook

Preliminary estimates for 2014H2 indicated that the current account registered a higher deficit of Rs24.4 billion compared with Rs21.4 billion in 2013H2. The merchandise trade balance, the largest component of the current account, increased marginally to Rs40 billion in 2014H2, from Rs39 billion in 2013H2. Total exports went up by Rs4.1 billion (+8.9 per cent), driven by an increase of Rs5.8 billion in re-exports that was partly offset by a decline of Rs1.3 billion in 'ship's stores and bunkers'. Imports of goods meant for re-exports – chiefly 'Telecommunications equipment' – led the expansion of total imports (f.o.b.) that went up by Rs5.1 billion. The widening of the surplus on the services account (+Rs6.7 billion) was completely offset by the deterioration of the income account (-Rs8.5 billion) as shown in Table 5.1.

Chart 5.1: Components of the Current Account



Source: Statistics Division, Bank of Mauritius.

Table 5.1: Balance of Payments Summary, 2012-2014

Rs million

	2012 [1]		2013 [1]		2014 [2]	
	H1	H2	H1	H2	H1	H2
Current Account	**-8,435**	**-16,624**	**-14,828**	**-21,406**	**-15,266**	**-24,359**
Exports (f.o.b.)	38,274	41,384	41,975	46,073	45,019	50,172
Imports (f.o.b.)	-74,161	-79,310	-72,634	-85,039	-74,048	-90,108
of which: aircrafts/marine vessels	-	-	-	-1,732	-	-
Trade balance	-35,887	-37,926	-30,659	-38,966	-29,029	**-39,936**
Services, net	17,083	11,753	12,834	8,647	13,505	15,315
of which: travel, net	18,341	15,041	15,762	11,407	15,684	13,843
Income, net	8,244	7,415	2,297	6,837	-635	-1,649
Current transfers, net	2,125	2,135	700	2,076	893	1,911
Capital and Financial Account	**32,553**	**2,911**	**14,347**	**18,826**	**12,480**	**22,348**
Capital account, net	-113	-128	-55	-68	-43	-103
Direct investment, net	82,134	88,069	30,641	36,572	40,586	105,598
Portfolio investment, net	24,415	17,643	40,576	19,184	20,933	14,142
Other investment, net	-72,528	-97,988	-41,165	-35,932	-33,987	-89,279
BOP Surplus (-)/ Deficit (+)	-1,356	-4,685	-15,650	-930	-15,009	-8,010
Net Errors and Omissions	**-24,118**	**13,713**	**481**	**2,580**	**2,786**	**2,011**

[1] *Revised.* [2] *Provisional.*

Figures may not add up to totals due to rounding.

Source: Statistics Division, Bank of Mauritius.

For the year 2014 as a whole, the current account deficit was revised upward to Rs39.6 billion, from the last projection of Rs32.3 billion made in October 2014 (Table 5.3). This resulted mainly from deterioration in the income account, which tipped into a deficit of Rs2.3 billion compared with the previous estimate of a surplus of Rs4.4 billion. In addition, the trade balance deteriorated to Rs69.0 billion compared with the initial estimate of Rs66.5 billion. However, the surplus on the services account improved from Rs26.9 billion to Rs28.8 billion. The current account deficit as a percentage of GDP increased from 9.9 per cent in 2013 to 10.3 per cent in 2014.

The current account deficit in 2014 was essentially financed by direct investment with net inflows of around Rs146 billion and, to a lesser extent, from portfolio investment, with net inflows to the tune of Rs35 billion. The estimated net outflows on the 'Other investment' account were quite substantial at around Rs123 billion. The reserve assets (excluding valuation changes), which expanded by Rs23 billion, contributed to the gross official international reserves increasing from Rs105.0 billion as at end-2013 to Rs124.3 billion as at end-2014.

Table 5.2: Exports and Imports by SITC

	2013			2014			Growth rate (Y-o-y)		
	Q3	Q4	H2	Q3	Q4	H2	Q3	Q4	H2
	(Rs million)						*(Per cent)*		
Total Exports (f.o.b.)	**22,408**	**23,665**	**46,073**	**25,422**	**24,750**	**50,172**	13.5	4.6	**8.9**
Domestic exports	14,739	14,681	29,420	14,966	14,091	29,057	1.5	- 4.0	- 1.2
Re-exports	3,710	4,825	8,535	7,126	7,164	14,290	92.1	48.5	67.4
Ship's Stores and Bunkers	3,959	4,159	8,118	3,330	3,495	6,825	- 15.9	- 16.0	- 15.9
Exports by section									
Food and live animals	6,894	6,934	13,828	6,730	5,614	12,344	- 2.4	- 19.0	- 10.7
Machinery and transport equipment	928	1,618	2,546	4,046	3,861	7,907	336.0	138.6	210.6
Miscellaneous manufactured goods	7,508	7,736	15,244	7,779	7,991	15,770	3.6	3.3	3.5
of which: Articles of apparel & clothing accessories	6,047	6,090	12,137	6,262	6,454	12,716	3.6	6.0	4.8
Manufactured goods classified chiefly by material	2,014	1,970	3,984	2,088	2,270	4,358	3.7	**15.2**	**9.4**
Total Imports (c.i.f.)	**42,056**	**47,203**	**89,259**	**45,598**	**48,893**	**94,491**	8.4	3.6	**5.9**
Domestic Imports	38,346	42,378	80,724	38,472	41,729	80,201	0.3	- 1.5	- 0.6
Imports for re-exports*	3,710	4,825	8,535	7,126	7,164	14,290	92.1	48.5	67.4
Imports by section									
Food and live animals	9,031	8,070	17,101	8,571	8,779	17,350	- 5.1	8.8	1.5
Mineral fuels, lubricants, & related products	7,873	9,469	17,342	8,719	7,618	16,337	10.7	- 19.5	- 5.8
Machinery & transport equipment	8,567	10,817	19,384	11,647	13,580	25,227	36.0	25.5	30.1
Miscellaneous manufactured articles	3,583	4,682	8,265	3,521	4,867	8,388	- 1.7	4.0	1.5
Manufactured goods classified chiefly	7,246	7,985	15,231	7,240	7,527	14,767	- 0.1	- 5.7	- 3.0

** Assumed to be the same as re-exports.*

Source: Statistics Mauritius.

Table 5.3: Balance of Payments, 2010 – 2014

	2010	2011	2012	2013[1]	2014 Oct-2014 Estimate	2014 Mar-2015 Provisional
			(Rs million)			
Current Account	**-30,985**	**-44,630**	**-25,059**	**-36,234**	**-32,261**	**-39,625**
Trade balance	-58,289	-67,585	-73,813	-69,625	-66,526	-68,965
Service balance	21,949	22,869	28,838	21,481	26,912	28,820
Income balance	-274	-3,389	15,659	9,134	4,406	-2,284
o/w GBC1 flows	-6,478	-7,179	11,273	5,282	2,924	155
Current transfers	5,629	3,475	4,260	2,776	2,947	2,804
Capital and Financial Account	**26,138**	**39,188**	**35,463**	**33,173**	**29,202**	**34,828**
Capital account	-148	-53	-241	-123	-150	-146
Financial account	26,286	39,241	35,704	33,296	29,352	34,974
Direct investment	423,658	-29,009	170,204	67,213	75,911	146,184
Portfolio investment	-300,682	256,972	42,059	59,760	43,405	35,075
Other investment	-90,512	-183,475	-170,518	-77,097	-68,273	-123,266
o/w Banks (net)	-56,096	-7,911	-24,971	46,892	41,408	-34,880
Reserve assets	-6,177	-5,247	-6,041	-16,580	-21,691	-23,019
Net Errors and Omissions	**4,847**	**5,442**	**-10,404**	**3,061**	**3,058**	**4,797**
			(In per cent of GDP)			
Current account	**-10.4**	**-13.8**	**-7.3**	**-9.9**	**-8.3**	**-10.3**
Trade balance	-19.5	-20.9	-21.5	-19.0	-17.1	-17.9
Service balance	7.3	7.1	8.4	5.9	6.9	7.5
Income balance	-0.1	-1.0	4.6	2.5	1.1	-0.6
o/w GBC1 net inflows	*-2.2*	*-2.2*	*3.3*	*1.4*	*0.7*	*0.04*
Current transfers	1.9	1.1	1.2	0.8	0.8	0.7
Capital and Financial account	**8.7**	**12.1**	**10.3**	**9.1**	**7.5**	**9.0**
Capital account	0.0	0.0	-0.1	0.0	0.0	-0.04
Financial account	8.8	12.1	10.4	9.1	7.5	9.1
Direct Investment	141.6	-9.0	49.5	18.4	19.5	37.8
Portfolio investment	-100.5	79.6	12.2	16.3	11.1	9.1
Other investment	-30.3	-56.8	-49.6	-21.1	-17.5	-31.9
o/w Banks (net)	-18.8	-2.4	-7.3	12.8	10.6	-9.0
Reserve assets	-2.1	-1.6	-1.8	-4.5	-5.6	-6.0
Net Errors and Omissions	**1.6**	**1.7**	**-3.0**	**0.8**	**0.8**	**1.2**
Memo items:						
Nominal GDP (Rs million)	299,173	323,011	343,835	366,208	389,999	386,336
					Oct-14	**Dec-14**
Gross official international reserves (Rs million)	79,044	81,474	92,988	105,009	122,504	124,344
Import cover (in months, of Goods & Services)	5.0	4.6	4.9	5.2	6.1	6.2

[1] *Revised.*

Source: Statistics Division, Bank of Mauritius.

5.2 Gross Official International Reserves

The import cover stood at 7.0 months at the end of March 2015, up from 6.1 months in September 2014 (Chart 5.3). It reflected the sustained build-up in foreign exchange reserves that took place largely on account of net capital inflows in the domestic economy.

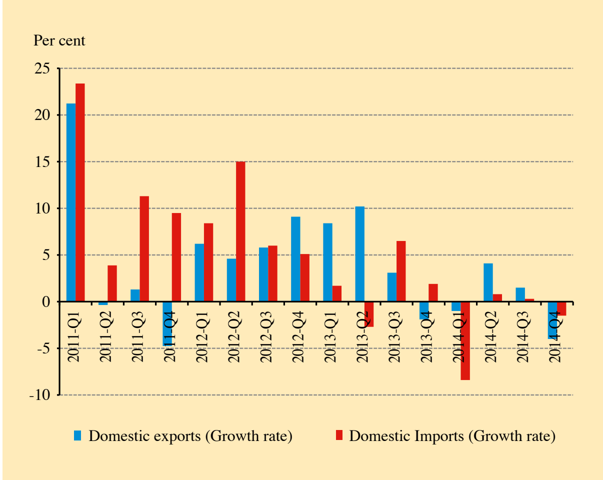
5.3 International Terms of Trade

On an average basis, the terms of trade improved to 89.0 in 2014, from 88.5 in 2013. The export price index deteriorated by 2.5 per cent in 2014 compared to 2013 as a result of lower sugar and fish prices offsetting gains in prices of apparel and clothing and other exports. The import price index declined by 3.0 per cent in 2014, mainly on account of easing food, petroleum and other import prices. For 2015, the terms of trade is expected to improve slightly with mixed export prices while import prices are expected to stabilise at lower levels than in 2014.

Food Prices

International food prices have continued to fall since April 2014, with various food commodity prices touching their lows in March 2015. The Food and Agriculture Organisation's (FAO) food price index declined to 173.8 points in March 2015, down by 40.0 points from a year ago (Chart 5.4). Except for meat prices, the prices of all other food products in the FAO index declined significantly: dairy, cereals, oils and sugar sub-indices registered falls of 83.6, 39.1, 53.1 and 66.1 points, respectively. Ample supplies, low inflation, mild demand as well as the appreciation of the US dollar have been the main drivers of these declines. It is foreseen that food prices would be contained as these factors are expected to persist in 2015.

Chart 5.2: Domestic Exports and Imports (Annual growth rates)



Source: Statistics Division, Bank of Mauritius.

Chart 5.3: Gross Official International Reserves and Import Cover

Source: Statistics Division, Bank of Mauritius.

Table 5.4: International Terms of Trade (Index: 2007 = 100)

	Weights	2009	2010	2011	2012	2013	2014Q1	2014Q2	2014Q3	2014Q4	2014
Export price index	**1.0000**	**96.7**	**93.7**	**97.2**	**103.9**	**108.6**	**107.3**	**105.2**	**105.9**	**105.2**	**105.9**
Apparel & clothing	0.5389	94.5	90.8	91.9	93.5	96.0	101.1	101.6	102.8	103.1	102.1
Sugar	0.1904	87.3	84.6	94.6	109.9	108.0	94.5	91.4	89.2	83.7	89.7
Fish	0.1262	93.1	92.7	96.0	115.7	127.1	114.5	100.0	104.5	107.1	106.5
Other exports	0.1445	120.5	117.0	121.8	124.7	139.9	140.8	141.3	141.0	139.9	140.8
Import price index	**1.0000**	**103.2**	**110.6**	**117.6**	**124.6**	**122.7**	**118.9**	**119.4**	**121.4**	**116.4**	**119.0**
Food	0.1808	109.9	115.5	122.8	131.5	138.2	122.5	128.7	132.4	129.4	128.3
Petroleum	0.1725	86.1	110.0	135.0	148.5	146.6	142.6	141.1	141.0	118.6	135.8
Manufacturing	0.2141	99.9	105.2	109.4	115.1	112.4	113.7	112.3	117.6	115.2	114.7
Other	0.4326	108.8	111.4	112.5	116.9	111.8	110.5	110.3	110.8	110.6	110.5
Terms of trade		93.7	84.7	82.7	83.4	88.5	90.3	88.1	87.3	90.4	89.0

Source: Statistics Mauritius.

Muted global demand and increased supply are expected to dampen sugar prices further. Looking ahead, sugar prices are expected to continue to fall on improved crop prospects in Brazil, the world's largest producer and exporter of sugar, and weakening of the Brazilian Real against the US dollar. In addition, the announcement by India to grant subsidies to sugar exports has put downward pressure on prices.

Following substantial fall in dairy prices up till January 2015, a turnaround was registered in February 2015 with the FAO dairy price index up by 8 points month-on-month. The reversal in prices is the consequence of drought-induced fall in milk output in New Zealand combined with limited exports from Australia. These factors are expected to persist in 2015 and keep dairy prices well-supported. On a different note, a rise in the US dollar and muted demand globally could project a mixed picture regarding dairy prices. Wheat prices declined on growing inventories as a result of increasing supply and contained demand. The January 2015 World Bank Commodity Markets Outlook projects wheat prices to decline by 2 per cent in 2015.

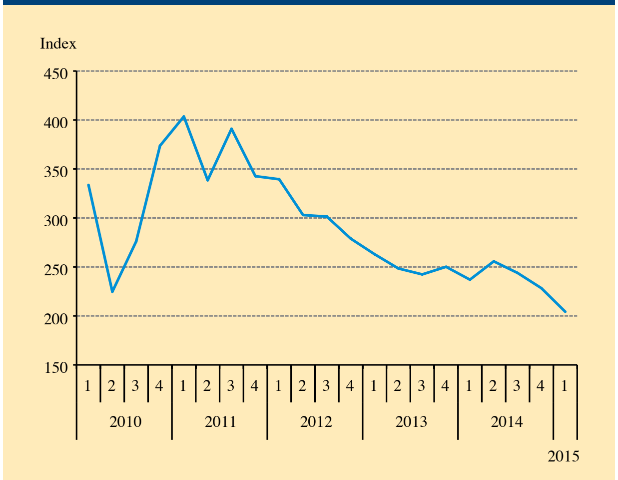
Crude oil prices

In the last quarter of 2014, crude oil prices dropped significantly and continuously, bringing an end to a four-year stable period of high prices (Chart 5.6). Supply from non-conventional sources like shale oil production in the US as well as new supply sources, disappointing global growth and an appreciating US dollar weighed heavily on world market prices. The drop in prices was more pronounced following a series of price discounts by the major oil exporter, Saudi Arabia. These price declines were further precipitated by OPEC's decision in November 2014 to leave the market to determine price rather than engaging in supply management, as has been the practice in the past. The January 2015 World Bank Commodity Markets Outlook projects average crude oil prices at US$53 a barrel in 2015, 45 per cent lower than the average for 2014.

5.4 Savings-Investment Gap

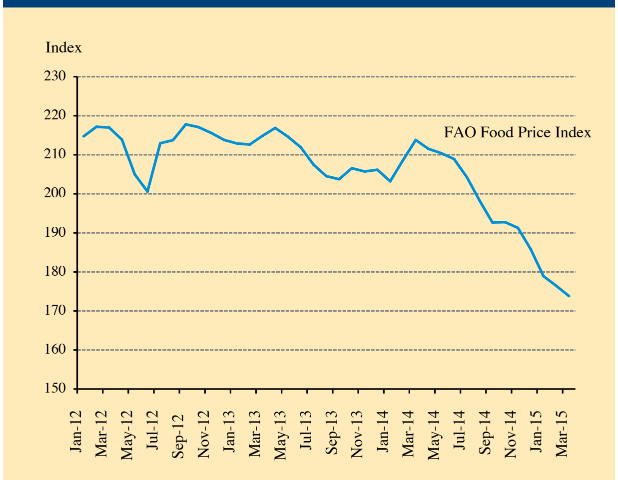
Reflecting the persistent current account deficit, the savings-investment gap is estimated to have continued in 2014. Compared to the Bank's October 2014 estimate, the contribution of external savings is now assessed to be higher (Table 5.5). The external current account deficit in 2014 is estimated at 10.3 per cent of GDP, due to higher trade deficit. Public

Chart 5.5 Sugar Prices



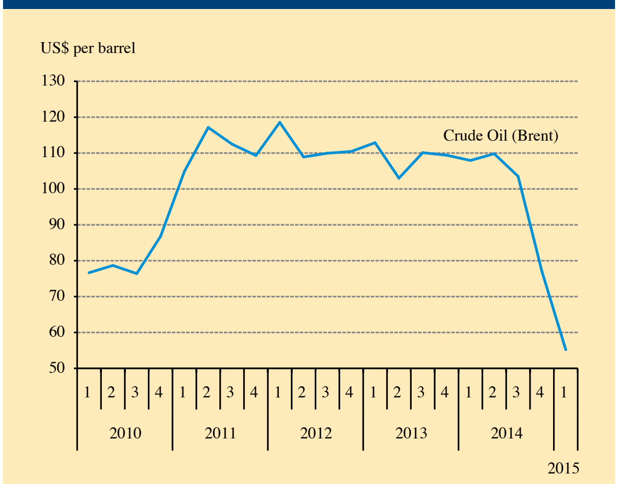
Source: FAO.

Chart 5.4: FAO Food Prices



Source: FAO.

Chart 5.6: Crude Oil Prices



Source: Thomson Reuters.

sector savings remained negative while domestic private savings fell further to Rs42.9 billion in 2014. Since the last Inflation Report, the level of domestic investment has been revised further down to 21.0 per cent of GDP, from the previous estimate of 22.3 per cent. The drop in overall domestic investment is explained by the decline in both private and public investment, and lower inventories accumulation.

Table 5.5: Saving-Investment Balance[1]

	2011	2012	2013	2014	
				Oct-2014 Estimate	Mar-2015 Provisional
(Rs million)					
Investment	**83,905**	**85,162**	**87,919**	**86,784**	**81,033**
Private (GDFCF)	59,667	60,175	59,266	58,413	55,048
Public	17,898	19,010	18,352	20,702	18,942
Change in inventories	6,340	5,977	10,301	7,669	7,043
Savings	**83,905**	**85,162**	**87,919**	**86,784**	**81,033**
External	44,630	25,059	36,234	32,261	39,625
Domestic	39,275	60,103	51,685	54,523	41,408
Private	43,334	58,962	54,750	56,963	42,866
Public	-4,059	1,141	-3,065	-2,440	-1,458
(In per cent of GDP)					
Investment	**26.0**	**24.8**	**24.0**	**22.3**	**21.0**
Private (GDFCF)	18.5	17.5	16.2	15.0	14.2
Public	5.5	5.5	5.0	5.3	4.9
Change in inventories	2.0	1.7	2.8	2.0	1.8
Savings	**26.0**	**24.8**	**24.0**	**22.3**	**21.0**
External (with global business)	13.8	7.3	9.9	8.3	10.3
Domestic	12.2	17.5	14.1	14.0	10.7
Private	13.4	17.1	15.0	14.7	11.1
Public	-1.3	0.3	-0.8	-0.6	-0.4
(In per cent of GNDI)					
Savings	**26.2**	**23.6**	**23.5**	**22.0**	**21.1**
External (with global business)	13.9	7.0	9.7	8.2	10.3
Domestic	12.3	16.7	13.8	13.8	10.8
Private	13.5	16.4	14.6	14.4	11.2
Public	-1.3	0.3	-0.8	-0.6	-0.4
Memo item:					
CY GDP (Rs million)	323,011	343,835	366,208	388,297	386,336
CY GNDI	320,145	360,490	374,695	394,430	383,240

Sources: Statistics Mauritius and Bank of Mauritius calculations.

[1] *Savings is estimated reflecting accounting identity: Investment equal Savings (External plus Domestic).*

6. Monetary Policy

6.1 Overview

The first Monetary Policy Committee (MPC) meeting for this year was held on 06 April 2015 during which members unanimously decided to keep the Key Repo Rate unchanged at 4.65 per cent per annum (Chart 6.1). The MPC noted that the global economy continues to grow at a moderate pace. While economic recovery has strengthened in the US, the prospects for growth in some developed economies – particularly the Eurozone and Japan – and in several emerging economies remain fragile.

Members took note of a broad-based appreciation of the US dollar on international foreign exchange markets due to, amongst others, expectations of a rise in the US Federal Funds rate later in 2015 and further monetary stimulus in other economies, namely the Eurozone and Japan. Global inflation remained low and several economies are even confronted with deflationary pressures.

The domestic economy grew by 3.7 per cent in 2014Q4 and all major sectors of the economy, except the construction sector, recorded positive growth rates. Looking ahead, domestic economic activity is projected to strengthen further, supported by recent budgetary measures and their positive impact on investment and business confidence. Bank staff projected real GDP growth for 2015 at 4.3 per cent. The main downside risk to the growth outlook would be the uncertain economic environment in our main export markets.

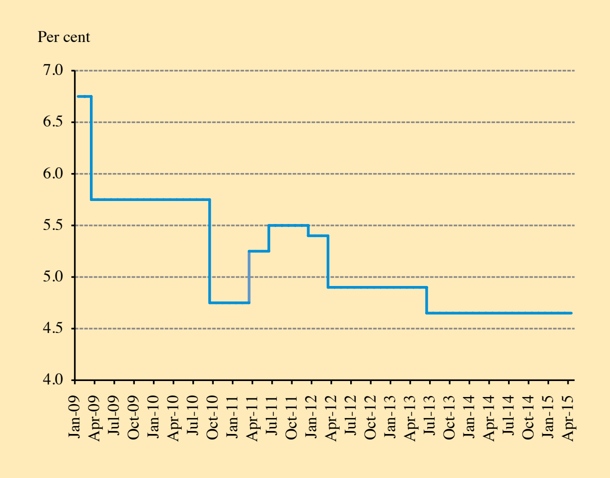
Headline inflation maintained its downtrend amidst subsiding food and energy inflation while y-o-y inflation, after falling to a low of 0.2 per cent in December 2014, increased to 2.0 per cent in February 2015 on account of higher prices of fresh vegetables following adverse climatic conditions in the first two months of 2015. Barring any exceptional developments, headline inflation is forecast at about 3.0 per cent for 2015.

The MPC weighed the risks to growth and inflation outlook over the relevant policy horizon and considers the Key Repo Rate to be appropriate at the current juncture. The MPC took note of the market adjustment of the rupee following the significant strengthening of the US dollar recently. It also took cognizance of the recent budgetary measures which are expected to give a fillip to economic growth.

6.2 Short-term Interest Rates and Monetary Operations

Since the October 2014 Inflation Report, short-term interest rates in general picked up moderately, however, in December 2014 and January 2015, the increase was more significant reflecting a reduction in the level of excess liquidity in the banking sector. Notwithstanding the sizeable issue of government papers, the gap between the Key Repo Rate and short-term interest rates (i.e., the yields on Treasury Bills and the interbank rate) narrowed since December 2014 (Chart 6.2).

Chart 6.1: Key Repo Rate (In per cent)



Source: Bank of Mauritius.

During 2014, the trade-weighted nominal exchange rate for the Mauritian Rupee (NEER) increased largely due to the depreciation of the euro against the Mauritian Rupee (Chart 6.3). In 2015Q1, the Mauritian Rupee has depreciated in effective terms (as measured by the NEER and REER) along the broad based strength of the US dollar. During this period, the Bank effected a net purchase of USD 83.6 million on the FOREX interbank market (Chart 6.4). The currency-weighted nominal exchange rate (MERI1 or MERI2) has also depreciated significantly in recent months (Chart 6.5).

Banks' lending rates have been on a declining trend since September 2014, in spite of the rise of interest rates in the interbank money market and Treasury Bills yields towards late 2014 (Chart 6.6). Lending rates for key sectors in the economy ranged between 7.20 per cent and 9.99 per cent over the period September 2014 to February 2015.

Weighted average rupee deposit rate has been higher than the y-o-y inflation rate since September 2014. In February 2015, however, the weighted average rupee deposit rate was higher than both inflation indicators (Chart 6.7).

The Bank has employed an array of instruments in the money market with a view to mopping up excess liquidity in the banking system (Table 6.1). Since September 2014, the central bank has intervened using instruments with maturities ranging from 91-day maturity to 3-year maturity. The issuance of BoM securities has been concentrated in the 364-day and 3-year maturities and by end-March 2015, a total amount of Rs19.1 billion of BoM securities was outstanding (Chart 6.8). In order not to exacerbate the excess liquidity conditions in the system, the Bank has been conducting sterilised intervention in the domestic Foreign Exchange market as from January 2015 through the placement of rupee deposits by banks with the Bank of Mauritius for a period of one year. On average, domestic banks held the largest proportion of BoM securities, although social security funds also hold a significant amount of these instruments (Table 6.2). The issue of BoM instruments has exerted a dampening effect on the growth of monetary base.

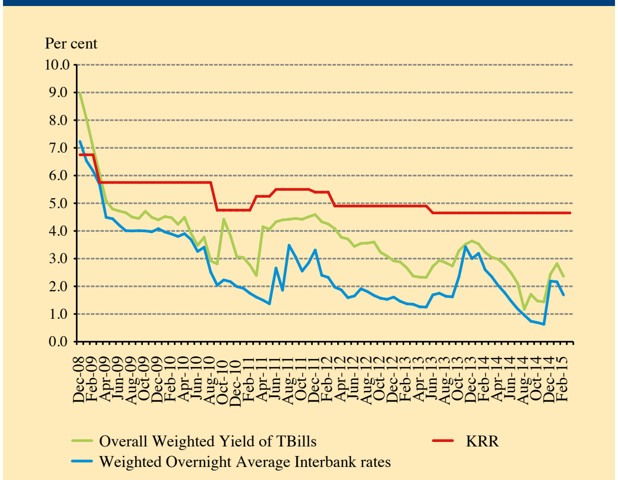
Despite coordinated efforts of the BoM and MOFED, excess liquidity in the banking system, as measured by the difference between cash reserve requirements held at the central bank and actual bank reserves, remained high in 2014 (Chart 6.9). Since the last Inflation Report, the daily average rupee excess reserves stood at around Rs8 billion. The stock of excess reserves declined briefly following issuances of Government of Mauritius Savings Instruments for retail investors in a bid to contain excess liquidity. Also, the fall in the level of excess reserves in December 2014 was mainly due to the rise in currency in circulation.

6.3 Monetary and Credit Developments

Since the October 2014 Inflation Report, monetary aggregates grew at a strong pace while credit growth remained moderate. Broad money accelerated to 9.6 per cent in February 2015, from 8.3 per cent in September 2014 (Chart 6.10). Velocity of circulation of broad money remained more or less stable at about 1.0 in February 2015. Relative to a nominal growth rate of 5.7 per cent in 2014 and an inflation rate of 2.5 per cent in February 2015, the pace of monetary expansion of 9.6 per cent could potentially induce a build-up of inflationary pressures in the economy.

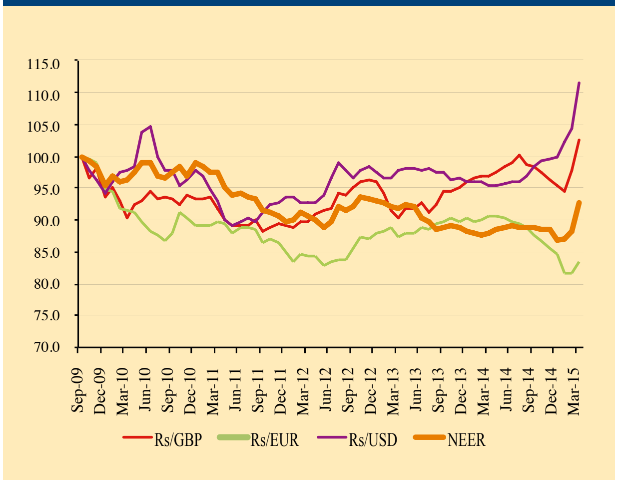
During the period under review, y-o-y growth in net foreign assets of depository corporations accelerated. The net foreign asset position of Other Depository Corporations (ODCs) and those of the

Chart 6.2: KRR, Money Market and Interbank Interest Rates



Source: Bank of Mauritius.

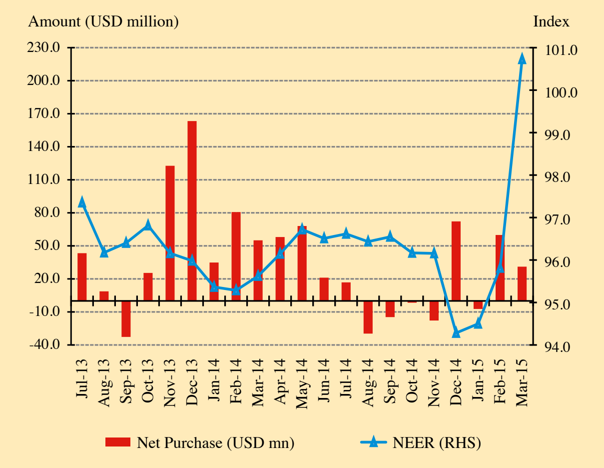
Chart 6.3: Indicative Selling Rates for the Rupee and NEER Index (August 2009=100)



An increase in the NEER index indicates a depreciation of the NEER which is a trade weighted index.

Source: Bank of Mauritius.

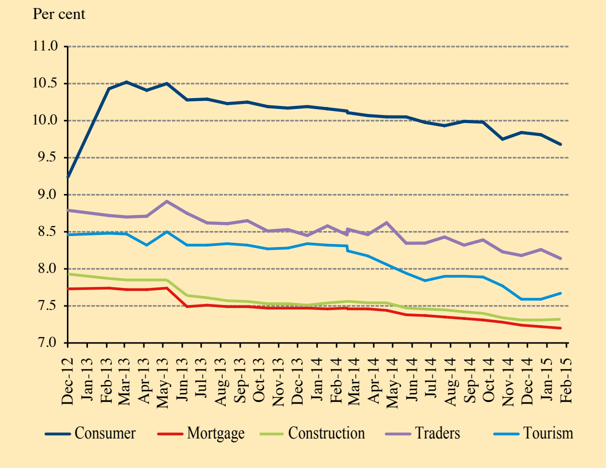
Chart 6.4 BoM Forex Intervention and NEER



An increase in the NEER index indicates a depreciation of the NEER which is a trade weighted index.

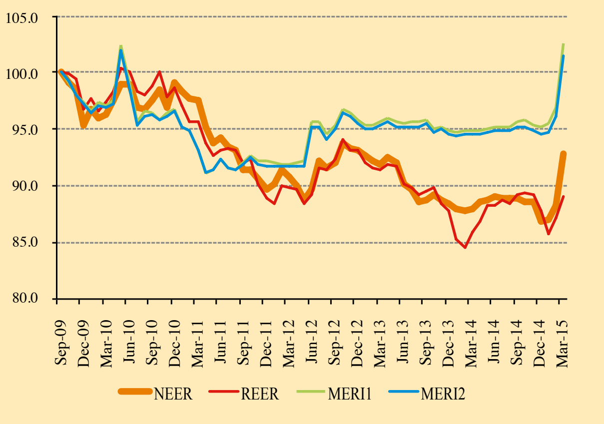
Source: Bank of Mauritius.

Chart 6.6: Lending Rates by Sector



Source: Bank of Mauritius.

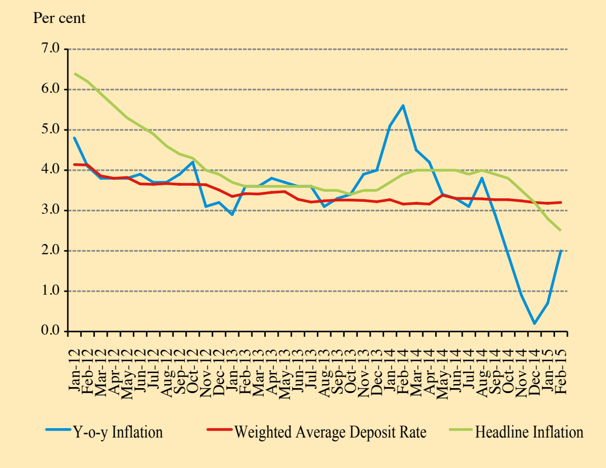
Chart 6.5: NEER, MERI1, MERI2 and REER Indices (August 2009 = 100)



Note: 1 An increase in the NEER index indicates a depreciation of the NEER which is a trade weighted index.
2 The MERI1 and MERI2 are based on the currency distribution of merchandise trade and services, excluding transactions in Rupees.

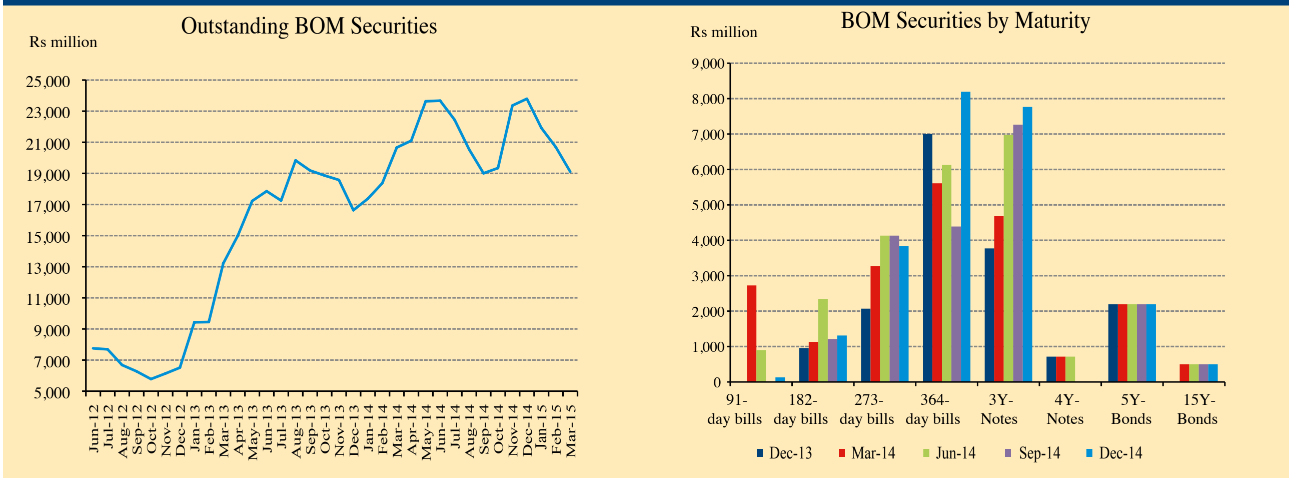
Source: Bank of Mauritius.

Chart 6.7 Inflation and Weighted Average Rupee Deposit Rate



Source: Bank of Mauritius.

Chart 6.8: BOM Securities



Source: Bank of Mauritius.

Table 6.1 : Yield on BoM Securities

Per cent

	Key Repo Rate	91-day	182-day	273-day	364-day	3-year	5-year	15-year
2012M1	5.40			4.30				
2012M3	4.90				4.37			
2012M9	4.90					4.73		
2012M11	4.90		2.96		3.22			
2012M12	4.90		2.80					
2013M1	4.90		2.72	2.88	2.87			
2013M2	4.90		2.62	2.74				
2013M3	4.90		2.34	2.35	2.47			
2013M4	4.90			2.34	2.38	3.65		
2013M5	4.90			2.28	2.30	3.62		
2013M6	4.65			2.81	2.91		4.29	
2013M7	4.65			2.88	2.96			
2013M8	4.65		2.62		3.08	3.88	4.28	
2013M9	4.65	2.51		2.77	3.04			
2014M1	4.65		3.42	3.44	3.70	4.54		
2014M2	4.65	3.04			3.46	4.33		
2014M3	4.65	2.78	3.07	3.05	3.30			7.60
2014M4	4.65			2.93	3.00			
2014M5	4.65		2.79	2.79	2.90	4.12		
2014M6	4.65	2.43	2.32	2.56				
2014M8	4.65						4.28	
2014M9	4.65							
2014M10	4.65				1.62			
2014M11	4.65		1.33	1.21	1.61	2.74		
2014M12	4.65	2.21	2.88	2.60	3.15	3.11		
2015M1	4.65							
2015M2	4.65							

Source: Bank of Mauritius.

Bank of Mauritius registered y-o-y growths of 35.0 per cent and 16.1 per cent, respectively, as at end-February 2015 compared to 13.8 per cent and 19.6 per cent, respectively, as at end-September 2014 (Table 6.3). Since September 2014, the y-o-y increase in ODCs' net foreign assets positions broadly reflected the growth in GBC deposits held with domestic banks, with banks' gross foreign assets showing considerable progression through February 2015.

Concurrently, the annual growth rates of credit to the private sector by banks continued to remain moderate, albeit a slight recovery in January and February 2015. Banking sector net claims on the Central Government increased on a y-o-y basis, reaching Rs46 billion by end-February 2015 compared to Rs34.1 billion by end-September 2014.

The annual growth rate of the monetary base increased by 9.9 per cent in February 2015, down from 27.1 per cent in September 2014. One of the major components of monetary base, namely, the annual growth of liabilities to ODCs fell from 47.2 per cent in September 2014 to 12.8 per cent in February 2015. Broad Money multiplier fell to 5.7 in February 2015, down from 5.9 in September 2014.

The growth rate of bank credit to the private sector (excluding GBCs), which declined to negative 0.6 per cent in September 2014, has shown signs of recovery since December 2014. Growth rates of 1.4 per cent and 1.2 per cent have been recorded in December 2014 and February 2015, respectively (Table 6.4 & Chart 6.11). The deceleration in corporate credit growth contributed mainly to the credit

Table 6.2: Bank of Mauritius: Balance Sheet, 2011-2015

	2011	2012	2013	2014				Feb-15
				March	June	September	December	
(In millions of Rupees)								
Net Foreign Assets	**80,100.9**	**91,559.8**	**103,497.9**	**110,343.1**	**119,619.6**	**120,753.0**	**122,735.5**	**126,047.6**
Net Domestic Claims	**(23,223.7)**	**(32,414.4)**	**(24,504.0)**	**(27,227.8)**	**(33,925.2)**	**(38,150.2)**	**(31,099.7)**	**(34,916.3)**
Claims on ODCs	1,138.7	1,804.6	2,715.7	3,529.4	2,414.3	2,089.3	2,467.9	2,382.3
Net Claims on Central Government [1]	(5,754.7)	(9,721.1)	(6,903.8)	(9,566.7)	(14,427.2)	(20,479.9)	(16,238.5)	(17,831.1)
Claims on Other Sectors	187.7	184.5	172.7	154.8	159.6	134.7	152.2	126.0
Other items (net)	(18,795.4)	(24,682.3)	(20,488.5)	(21,345.3)	(22,071.9)	(19,894.3)	(17,481.4)	(19,593.4)
Monetary Base	**48,280.9**	**52,622.9**	**62,350.0**	**62,483.5**	**62,137.0**	**63,788.9**	**67,933.6**	**70,440.6**
Currency in circulation	24,469.8	26,961.3	30,127.7	26,769.0	26,344.9	26,570.9	32,530.9	28,537.3
Liabilities to ODCs	23,811.1	25,661.6	32,222.4	35,714.5	35,792.1	37,218.0	35,402.7	41,903.3
BoM securities	**8,596.3**	**6,522.5**	**16,644.0**	**20,631.8**	**23,557.3**	**18,813.9**	**23,702.2**	**20,690.7**
Held by banks	5,539.8	3,916.3	10,796.4	15,184.0	17,166.0	12,898.7	17,219.3	13,041.8
Held by Social Security Funds	2,082.6	1,745.8	4,028.9	3,820.9	4,485.1	4,101.3	4,505.0	4,518.3
Other holders	973.9	860.3	1,818.7	1,626.9	1,906.2	1,813.9	1,977.8	3,130.6
(Contribution to Monetary Base growth; in Per cent)								
Net Foreign Assets	**4.9**	**23.7**	**22.7**	**26.1**	**30.2**	**39.5**	**30.9**	**27.3**
Net Domestic Assets/Claims	**9.3**	**-19.0**	**15.0**	**8.3**	**-2.5**	**-13.1**	**-10.6**	**-13.6**
Claims on ODCs	0.3	1.4	1.7	2.7	1.6	-1.8	-0.4	-1.7
Net Claims on Central Government	5.4	-8.2	5.4	-1.3	-2.2	-15.8	-15.0	-14.0
Claims on Other Sectors	-0.2	0.0	0.0	0.0	-0.1	-0.1	0.0	0.0
Other items (net)	3.8	-12.2	8.0	6.9	-1.8	4.5	4.8	2.2
Monetary Base	**7.4**	**9.0**	**18.5**	**20.2**	**17.0**	**27.1**	**9.0**	**9.9**
Currency in circulation	4.2	5.2	6.0	3.5	3.7	3.3	3.9	2.5
Liabilities to ODCs	3.3	3.8	12.5	16.8	13.4	23.8	5.1	7.4
BoM securities	-6.7	4.3	-19.2	-14.2	-10.7	0.8	-11.3	-3.8
Held by banks	-4.3	3.4	-13.1	-15.1	-13.1	-2.3	-10.3	0.1
Held by Social Security Funds	-1.3	0.7	-4.3	-0.5	0.7	1.4	-0.8	-1.4
Other holders	-1.1	0.2	-1.8	1.3	1.7	1.7	-0.3	-2.5
(Growth Rate in per cent)								
Net Foreign Assets	**2.8**	**14.3**	**13.0**	**14.0**	**15.5**	**19.6**	**18.6**	**16.1**
Net Domestic Assets/Claims	**-15.2**	**39.6**	**-24.4**	**-13.7**	**4.0**	**20.9**	**26.9**	**33.1**
Claims on ODCs	14.8	58.5	50.5	67.4	56.2	-29.7	-9.1	-31.1
Net Claims on Central Government	-29.7	68.9	-29.0	7.5	9.0	63.2	135.2	101.3
Claims on Other Sectors	-35.1	-1.7	-6.4	7.0	-19.4	-17.2	-11.8	-13.8
Other items (net)	-8.3	31.3	-17.0	-14.3	4.5	-10.2	-14.7	-6.6
Monetary Base	**7.4**	**9.0**	**18.5**	**20.2**	**17.0**	**27.1**	**9.0**	**9.9**
Currency in circulation	8.3	10.2	11.7	7.3	7.9	6.7	8.0	5.9
Liabilities to ODCs	6.6	7.8	25.6	32.2	24.8	47.2	9.9	12.8
BoM securities	54.1	-24.1	155.2	56.0	31.9	-2.0	42.4	13.5
Held by banks	53.8	-29.3	175.7	106.5	68.2	9.9	59.5	-0.4
Held by Social Security Funds	38.9	-16.2	130.8	6.9	-8.0	-14.5	11.8	25.3
Other holders	104.0	-11.7	111.4	-29.3	-31.5	-31.8	8.8	106.1
Memo item:								
End-period exchange rate (Rs/US$)	29.3	30.5	30.1	30.1	30.2	30.9	31.7	33.3

[1] *Excludes BOM securities holdings by social security funds*

Source: Statistics Division, Bank of Mauritius.

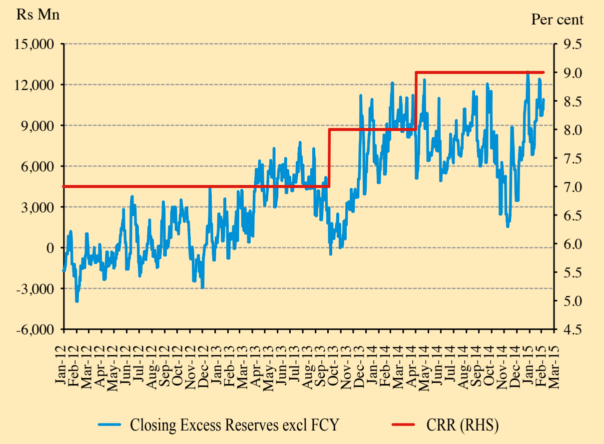
slowdown, while growth in household credit slowed during the last quarter of 2014. Sectors contributing to the deceleration have been financial and business services, tourism, and manufacturing. Consumer credit to households has also slowed down, possibly reflecting cautious spending patterns by consumers and tightened lending practices by banks. However, the housing sector is still driving the growth in bank credit.

Domestic Stock Market

The SEMDEX retreated after reaching an all-time high of 2,170.7 points in October 2014 (Chart 6.12). During the period under review, in the hotel sector, New Mauritius Hotels Ltd, Sun Resorts Ltd and LUX Island Resort Ltd fell by 24.1 per cent, 13.9 per cent and 2.4 per cent, respectively. In the banking and insurance sector, Bramer Banking Corporation Ltd, SBM Holdings Ltd, MCB and Mauritius Union Assurance Ltd lost 43.0 per cent, 9.3 per cent, 7.1 per cent and 7.3 per cent, respectively. Other companies, Automatic Systems Limited, Lottotech Ltd, Compagnie des Magasins Populaires Ltée, Gamma group and Air Mauritius Ltd shed 53.6 per cent, 50.8 per cent, 36.0 per cent, 24.2 per cent and 20.9 per cent, respectively.

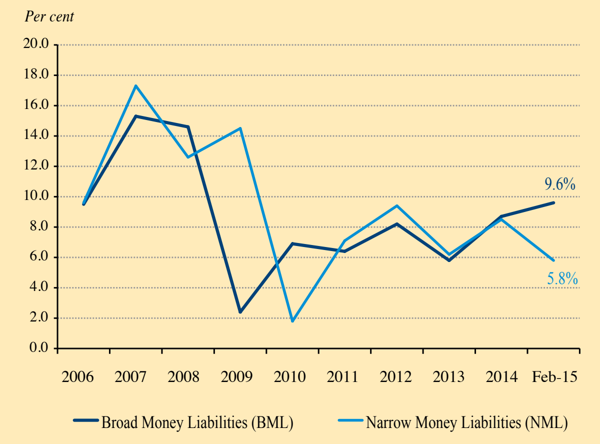
Local investors supported the domestic market while foreign investors remained net sellers to the tune of Rs2,322.9 million between October 2014 and March 2015.

Chart 6.9: Banks' Excess Liquidity and CRR



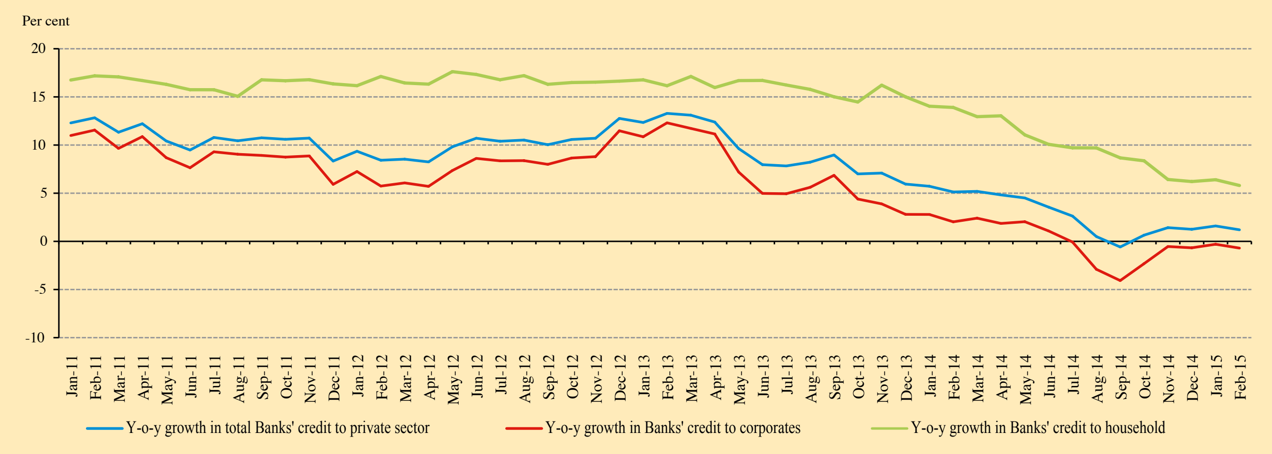
Source: Bank of Mauritius.

Chart 6.10: BML and NML, Annual Growth Rates



Source: Bank of Mauritius.

Chart 6.11: Y-o-y Growth in Banks' Credit to Private Sector [1]



[1] *Excludes loans to GBC entities.*

Source: Statistics Division, Bank of Mauritius.

Table 6.3. Mauritius: Depository Corporations Survey*, 2011-2015 [1]

	2011	2012	2013	2014				2015
				March	June	Sep	Dec	Feb
(Rs million)								
Net Foreign Assets	**370,755.1**	**401,320.9**	**396,299.9**	**371,676.9**	**382,241.5**	**440,686.4**	**457,823.2**	**485,169.9**
BOM (net)	80,100.9	91,559.8	103,497.9	110,343.1	119,619.6	120,753.0	122,735.5	126,047.6
ODCs (net)	290,654.2	309,761.1	292,802.0	261,333.9	262,621.9	319,933.4	335,087.7	359,122.3
Domestic Claims	207,767.5	214,348.0	242,531.1	235,803.6	228,878.2	230,871.1	253,324.3	251,488.3
Net Claims on Central Government	**30,173.4**	**26,748.3**	**34,759.0**	**35,853.6**	**34,504.0**	**34,106.5**	**44,771.5**	**46,331.1**
Claims on Central Government	60,487.7	61,251.3	65,605.5	68,621.4	74,354.5	76,768.8	78,031.4	79,381.8
Liabilities to Central Government	-30,314.2	-34,503.0	-30,846.5	-32,767.8	-39,850.5	-42,662.3	-33,259.9	-33,050.8
Claims on Other Sectors	**311,128.6**	**364,273.6**	**413,415.5**	**402,940.8**	**391,977.3**	**390,326.3**	**402,034.6**	**406,708.6**
of which loans to various sectors of the economy	272,268.8	306,043.5	336,942.4	336,684.6	338,473.8	341,061.8	350,895.8	352,585.0
Other claims (net)	-133,534.5	-176,673.9	-205,643.5	-202,990.7	-197,603.1	-193,561.6	-193,481.8	-201,551.4
Broad Money Liabilities	**319,536.7**	**345,617.2**	**365,608.7**	**371,778.4**	**378,456.3**	**379,536.1**	**397,556.5**	**404,452.5**
Currency Outside Depository Corporations	20,307.8	22,169.7	23,316.7	22,090.4	21,685.0	21,848.2	25,391.2	24,013.6
Transferable Deposits	69,425.5	74,630.8	80,391.4	80,761.7	85,000.1	83,803.2	92,719.2	96,562.4
Savings Deposits	114,277.7	123,940.2	137,028.6	143,389.4	145,274.2	147,441.8	151,721.3	157,687.3
Time Deposits	113,563.8	122,902.1	121,803.1	122,623.4	123,269.5	123,280.6	124,366.9	121,654.1
Securities other than Shares	1,961.8	1,974.3	3,069.0	2,913.5	3,227.4	3,162.3	3,358.0	4,535.1
GBC deposits	**258,985.9**	**270,051.7**	**273,222.3**	**235,702.2**	**232,663.4**	**292,021.5**	**313,590.9**	**332,205.7**
(Annual growth rate; in Per cent)								
Net Foreign Assets	**-6.4**	**8.2**	**-1.3**	**-6.2**	**-3.0**	**15.4**	**15.5**	**29.6**
BOM (net)	2.8	14.3	13.0	14.0	15.5	19.6	18.6	16.1
ODCs (net)	-8.6	6.6	-5.5	-12.8	-9.6	13.8	14.4	35.0
Domestic Claims	**9.7**	**3.2**	**13.1**	**11.1**	**6.7**	**4.4**	**4.5**	**5.8**
Net Claims on Central Government	1.1	-11.4	29.9	27.8	40.9	18.1	28.8	33.1
Claims on Central Government	-4.3	1.3	7.1	8.7	17.6	16.2	18.9	17.4
Liabilities to Central Government	-9.1	13.8	-10.6	-6.6	2.9	14.7	7.8	0.8
Claims on Other Sectors	11.5	17.1	13.5	9.0	5.5	-4.8	-2.8	1.4
of which Loans to various sectors of the economy	12.4	12.4	10.1	8.4	7.7	4.8	4.1	4.8
Other claims (net)	11.7	32.3	16.4	9.4	8.9	-11.0	-5.9	1.7
Broad Money Liabilities	**6.4**	**8.2**	**5.8**	**6.8**	**7.7**	**8.3**	**8.7**	**9.6**
GBC deposits	-9.2	4.3	1.2	-9.5	-9.6	15.5	14.8	36.6
Memo items:								
Nominal GDP (market prices)	323,011.0	343,835.0	366,228.0	370,755.0	377,020.0	381,025.0	386,336.0	386,336.0
BML + GBC deposits	578,522.6	615,668.9	638,831.0	607,480.6	611,119.7	671,557.5	711,147.5	736,658.1
Velocity of Broad money (BM)	1.04	1.03	1.03	1.04	1.04	1.03	1.03	1.01
Velocity of BM plus GBC	0.56	0.58	0.58	0.54	0.55	0.56	0.57	0.58
Velocity of Narrow Money Liabilities(NML)	5.03	4.95	4.89	5.11	5.05	5.00	4.96	4.91
Money multiplier	6.6	6.6	5.9	6.0	6.1	5.9	5.9	5.7

** Includes the accounts of Banks and Non-bank deposit taking institutions*

[1] Data up to February 2015

Source: Statistics Division, Bank of Mauritius

Table 6.4. Bank Credit to Private Sector, 2011-2015 [1]

	2011	2012	2013	2014				2015
				March	June	Sep	Dec	Feb
(Average annual growth rates; in Per cent)								
Total credit to private sector	**8.3**	**12.8**	**5.9**	**5.2**	**3.6**	**-0.6**	**1.3**	**1.2**
Corporates	5.9	11.5	2.8	2.4	1.1	-4.1	-0.7	-0.7
Construction	11.5	32.1	10.9	7.3	1.0	1.7	3.4	5.5
Tourism	6.6	4.1	8.8	6.9	4.9	-1.7	-2.4	-4.3
Traders	19.2	9.0	-7.6	-4.4	13.6	7.2	9.0	9.7
Financial services	**2.8**	**5.9**	**5.4**	**3.6**	**-7.5**	**-23.3**	**-7.0**	**-6.4**
Manufacturing	1.7	3.6	2.2	4.2	-1.3	-1.1	-2.2	0.5
Agriculture & Fishing	11.5	12.0	5.0	11.9	7.1	-3.5	0.7	-3.7
Other	**-10.8**	**23.3**	**-7.4**	**-12.4**	**-14.0**	**-8.5**	**-6.7**	**-6.3**
Households	16.4	16.6	15.0	12.9	10.1	8.7	6.2	5.8
Personal credit	7.6	14.1	21.3	19.3	9.6	9.3	2.1	-0.1
Mortgages	22.6	18.3	11.1	9.1	10.4	8.2	8.9	9.8
(Contribution to growth of total credit to private sector; in Per cent)								
Total credit to private sector	**8.3**	**12.8**	**5.9**	**5.2**	**3.6**	**-0.6**	**1.3**	**1.2**
Corporates	4.5	8.6	2.1	1.8	0.8	-3.0	-0.5	-0.5
Construction	1.0	2.9	1.1	0.8	0.1	0.2	0.4	0.6
Tourism	1.3	0.8	1.5	1.2	0.9	-0.3	-0.4	-0.8
Traders	**2.2**	**1.1**	**-0.9**	**-0.5**	**1.4**	**0.8**	**1.0**	**1.0**
Financial services	0.3	0.6	0.5	0.4	-0.7	-2.6	-0.7	-0.6
Manufacturing	0.1	0.3	0.2	0.3	-0.1	-0.1	-0.2	0.0
Agriculture & Fishing	0.8	0.9	0.4	0.8	0.5	-0.2	0.0	-0.3
Other	-1.2	2.1	-0.7	-1.2	-1.3	-0.7	-0.6	-0.5
Households	3.8	4.1	3.9	3.4	2.8	2.4	1.7	1.7
Personal credit	0.7	1.4	2.1	1.9	1.1	1.0	0.2	0.0
Mortgages	3.1	2.8	1.8	1.5	1.7	1.4	1.5	1.7

[1] *Data up to February 2015*

Source: Statistics Division, Bank of Mauritius.

Chart 6.12: Evolution of SEMDEX

Source: Stock Exchange of Mauritius.

7. Inflation: Recent Developments and Outlook

7.1 Recent Trends

Inflationary pressures remained subdued in the economy amidst negative imported inflation while inflation expectations appeared well contained. The disinflation momentum was potent on the 12-month moving average basis, showing further easing of the various derived inflation indicators (Table 7.1). The weakening trend in headline inflation has been sustained, shifting from 3.8 per cent in October 2014 to 2.4 per cent in March 2015.

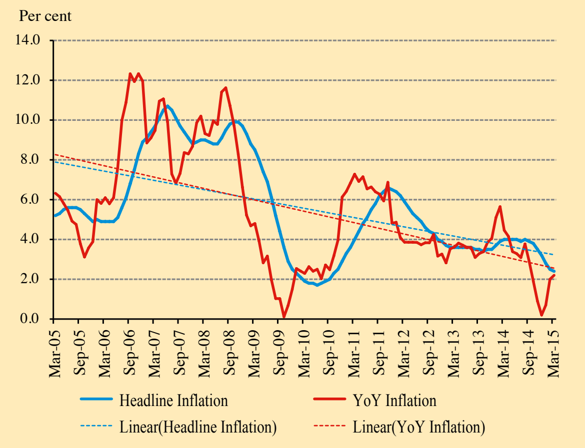
Reflecting the inherent dynamics in the CPI (chart 7.1), the y-o-y inflation indicators showed contrasting paths as a result of the impact of climatic conditions affecting the prices of fresh vegetables in the first quarter of 2015. Y-o-y inflation fell systematically from 2.9 per cent in September 2014 to 0.2 per cent in December 2014 before picking up in the first three months of 2015.

'Food and non-alcoholic beverages', which carries the largest weight in the CPI basket, remained the principal factor behind overall CPI inflation in March 2015 (Table 7.2). Between March 2014 and March 2015, "food and non-alcoholic beverages" contributed 2.0 percentage points to the year-on-year inflation while 'transport' has a negative contribution of 0.4 percentage points, reflecting the decrease in the prices of petroleum products under the Petroleum Pricing Committee in the second half of 2014.

While price pressures remained more or less stable on a relatively broad-based level, the dynamics of food inflation and goods inflation in the first quarter of 2015 firmed up on account of the domestic supply shock. However, the transitory supply shock to food inflation is anticipated to fade with time as soon as vegetable prices re-adjust to their equilibrium levels, ceteris paribus.

Barring food price shocks, CORE1 inflation recorded historically low and negative inflation rate at 0.4 per cent. Y-o-y CORE2 inflation declined to 1.6 per cent in March 2015 while Y-o-y CORE1 inflation dropped to 0.3 per cent. The two CORE measures maintained their diverging path, swayed by existing price rigidity. Deflationary episodes prevailing within some trade partner countries are being reflected through successive periods of negative imported inflation (December 2014-March 2015).

Chart 7.1: Inflation Dynamics



Source: Bank of Mauritius staff calculations.

Table 7.1: Measures of Inflation							
Period	**Food price inflation**	**CPIX_M**	**Imported inflation**	**Goods inflation**	**Services inflation**	**Core1**	**Core2**
Dec-14	-0.7	0.3	-0.2	-0.6	1.9	0.8	2.1
Jan-15	3.1	0.6	-0.4	0.9	-0.1	-0.4	0.8
Feb-15	7.2	2.1	-0.4	2.7	0.7	0.2	1.6
Mar-15	7.9	2.3	-0.7	3.0	0.7	0.3	1.6

** Refers to CPI excluding mortgage payments in inflation.*

Source: Bank of Mauritius.

Inflation expectations remained moderate for different time horizons in line with the lower dynamism observed in headline inflation. The Bank's February 2015 Inflation Expectations Survey displayed consistent patterns as the previous surveys and showed that expectations were well contained (Table 7.3).

7.2 Inflation projection and output gap in baseline scenario

Assumptions

The broad-based weakness in commodity prices is expected to persist in 2015 according to the World Bank's January 2015 Commodity Markets Outlook. Oil prices are estimated at about US$53/bbl in 2015, while agricultural prices are projected to decline by about 5 per cent on account of current good crop prospects.

The global growth picture remains blurred amidst the flurry of macroeconomic uncertainties characterising various regions of the world. Global growth is currently being estimated at 3.5 per cent and 3.7 per cent for 2015 and 2016, respectively. Global inflation is expected to remain benign.

The US dollar looks poised to strengthen further vis-à-vis the euro and the odds are high that the US currency will be at par with the euro. The US dollar is expected to strengthen further in the foreseeable future against major currencies given the robustness of the US economy and as the Fed heads towards interest rate normalisation. Any downside risks would emanate from the sizeable US twin deficits and the authorities' desire to tone down a strong dollar policy. The euro is expected to lose ground as the ECB's QE works through its way while the outlook for the Pound sterling is also negative in the short term reacting to UK's large

Table 7.2: Contribution to Y-o-y Inflation

DIVISIONS	Weights	Consumer Price Index		Contribution to Inflation(%): Year-on-year Inflation *(per cent)*
		Mar-14	Mar-15	
Food and Non Alcoholic Beverages	273	111.3	119.5	2.0
Alcoholic Beverages and Tobacco	96	116.6	116.4	0.0
Clothing and Footwear	45	109.0	112.6	0.1
Housing, Water, Electricity, Gas and Other Fuels	120	101.3	101.7	0.1
Furnishings, Household Equipment and Routine Household Maintenance	61	102.8	103.4	0.0
Health	40	108.4	113.1	0.2
Transport	151	105.9	103.0	-0.4
Communication	39	99.9	96.6	-0.1
Recreation and Culture	44	104.8	107.4	0.1
Education	45	103.3	105.6	0.1
Restaurants and Hotels	45	111.3	113.0	0.1
Miscellaneous Goods and Services	41	104.7	104.7	0.0
Consumer Inflation (%)	**1000**	**107.7**	**110.1**	**2.2**

Sources: Statistics Mauritius and BoM staff calculations.

Table 7.3: Inflation Expectations

Survey Period	Jun-15	Dec-15	1-yr Ahead
Nov-14	4.1	4.4	4.2
Feb-15	3.2	3.6	3.7

* *Refers to CPI excluding mortgage payments in inflation.*

Source: Bank of Mauritius.

balance of payments and budget deficits. The economic fundamentals of the UK economy currently do not point to an interest rate hike by the BoE.

Domestic shocks underpinning the baseline scenario incorporate the aggregate demand impulses emanating from the 2015-16 Budget. In particular, it is expected that private investment will pick up following measures announced on the construction of smart cities and real estate activities. In addition, the Budget is neutral to the CPI. The pass-through of the weakening domestic exchange rate vis-à-vis the US dollar has also been factored in during the projection.

Inflation Projection

The low current rate of inflation is a reflection of subdued energy prices and tame global food price inflation. Recent external price developments indicate downward pressures originating from energy and food prices as well as from the negative output gap. The current slack in the domestic economy and tame commodity prices will prevent a substantial pick-up in inflation in the short term.

Headline inflation is projected to remain subdued in the near term, stabilizing at about 3.0 per cent in 2015. The projected inflation dynamics would reflect trends of food and non-food inflation, modest growth of domestic absorption, moderate global growth and subdued global inflation (that would lower imported inflation), and an improvement in Mauritius' terms of trade on account of the stability of international commodity prices at their current levels. It is not expected that the depreciation of the rupee would have a notable impact on inflation given the current international economic environment.

Real GDP Growth Projection

Recent economic developments aided by budgetary measures have confirmed that the expected recovery in the domestic economy is gaining momentum. Uncertainty over a firm global growth outcome for 2015 clouds the macroeconomic projection, raising some concerns on the performance of the domestic economy.

Real GDP growth is estimated at 4.3 per cent for 2015 as several economic fundamentals remain positive and provide support for a projected pick-up. Following the general elections, the feel-good factor is expected to drive a sense of optimism among consumers and businesses in the near term. Domestic demand should rise from the awarded wage compensation (public and private sector) and increased pension benefits, equivalent to a gross injection of about Rs10 billion in the domestic economy. Private consumption should definitely benefit from the increase in real disposable income. With the eventual strengthening of the Euro area, exports to our main trading partners (UK, France, Italy, Spain and Belgium) are expected to pick up moderately in the course of 2015, thereby bolstering domestic net exports The recent depreciation of the rupee vis-à-vis the US dollar and euro would eventually be beneficial to the export sectors of the economy and the announced budgetary measures, if implemented as planned, would stimulate private investment and bolster the performance of the economy.

Chart 7.2: Headline Inflation Projection

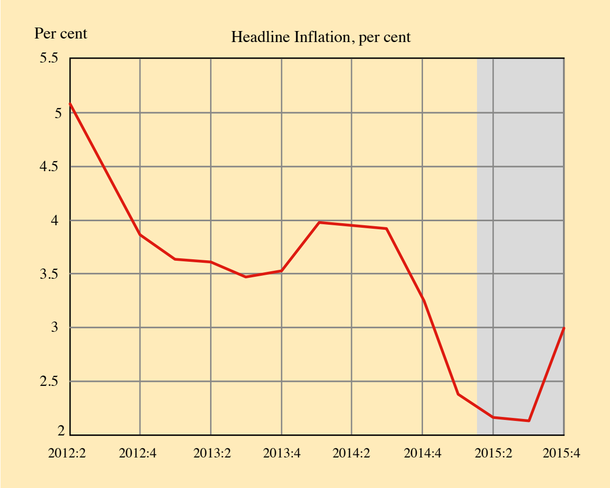
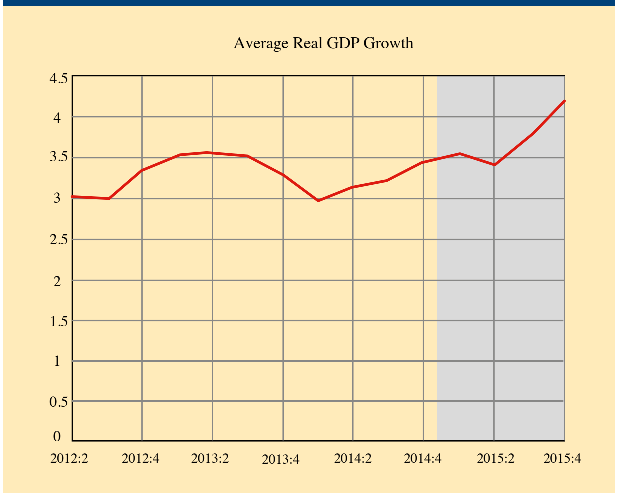


Chart 7.3: Real GDP Growth Projection



8. Balance of Risks vis-à-vis the Baseline Scenario

Upside and downside risks to inflation that may potentially trigger a deviation from projected inflation rate (i.e., the baseline scenario) are:
(i) weaker-than-expected EU economic growth; (ii) unforeseen demand-pull factors; (iii) unforeseen cost-push factors; and (iv) increased volatility in international capital markets.

(i) **Weaker-than-expected EU economic growth would result in a larger negative output gap in Eurozone** and this would affect domestic exports. The overall impact would be a widening domestic negative output gap but would result in lower domestic inflation outcome.

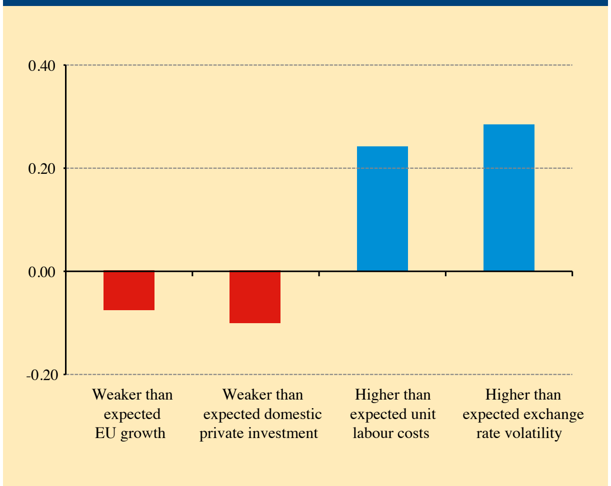
(ii) **Unforeseen demand-pull factors reflected through lower-than-expected private investment** would lower domestic growth compared to the baseline scenario. This would lead to a more negative domestic output gap and thus lower inflation rate.

(iii) **Unforeseen cost-push factors brought about by higher-than-expected growth in unit labour costs than in the baseline scenario** would affect business expenditure and create cost-push inflationary pressures, which would affect the output gap adversely.

(iv) **Increased volatility in international capital markets would be induced with the Fed's interest rate normalisation later during 2015.** In that event, there would be sharp movements in capital outflows, leading to nominal exchange rate depreciations, which would enhance inflationary pressures.

The Bank's staff assessment is that, for the year 2015, based on alternative projections, the balance of risks to the inflation outlook appears tilted on the upside. Specifically, the probability that inflation will be higher than in the baseline scenario (due to higher-than-expected unit labour costs and depreciated exchange rate) is greater than the probability that inflation will be lower than in the baseline scenario (due to a higher negative output gap in the Eurozone and weaker private investment). Chart 8.1 shows the impact of the individual risk factors on inflation outcome for 2015, measured as the difference between the inflation projection under the baseline scenario and the inflation projection subject to the specific shock, adjusted by the probability that such specific shock does occur. The balance of risk, taken as the sum across the various impacts indicates how these factors, taken as a whole, would deviate the inflation projection from the baseline scenario.

Chart 8.1: Balance of Risks vis-à-vis the Baseline Inflation Outlook



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List of Acronyms

AVG	Average
BML	Broad Money Liabilities
BoE	Bank of England
BoJ	Bank of Japan
CIF	Cost, Insurance and Freight
CPI	Consumer Price Index
CRR	Cash Reserve Requirements
DCS	Depository Corporations Survey
ECB	European Central Bank
FAO	Food and Agriculture Organisation
FED	Federal Reserve
FOB	Free on Board
FOMC	Federal Open Market Committee
GBC1s	Global Business Companies with a Type 1 Licence
GDFCF	Gross Domestic Fixed Capital Formation
GDP	Gross Domestic Product
GNDI	Gross National Disposable Income
GOIR	Gross Official International Reserves
IMF	International Monetary Fund
KRR	Key Repo Rate
MERI	Mauritius Exchange Rate Index
MOFED	Ministry of Finance and Economic Development
MPC	Monetary Policy Committee
NEER	Nominal Effective Exchange Rate
NML	Narrow Money Liabilities
ODCs	Other Depository Corporations
OPEC	Organisation of the Petroleum Exporting Countries
PBoC	People's Bank of China
PDMA	Public Debt Management Act

List of Acronyms

PMI	Purchasing Managers' Index
REER	Real Effective Exchange Rate
RBI	Reserve Bank of India
SARB	South African Reserve Bank

Glossary

CORE1 inflation excludes food, beverages and tobacco and mortgage interest on housing loan from the CPI basket. Both headline and year-on-year CORE1 inflation measures are available.

CORE2 inflation excludes food, beverages and tobacco, mortgage interest, energy prices and administered prices from the CPI basket. Both headline and year-on-year CORE2 inflation measures are available.

Fiscal consolidation is a policy aimed at reducing government deficits and debt accumulation.

GBC1s are resident corporations which conduct business outside Mauritius. The law has recently been amended to allow them to transact with residents provided that their activities in Mauritius are ancillary to their core business with non-residents.

Headline inflation is measured by the change in the average Consumer Price Index (CPI) over a twelve-month period compared with the corresponding previous twelve-month period.

Key Repo Rate is the key policy rate used by the Bank of Mauritius to signal changes in its monetary policy stance.

MERI1 is the Mauritius Exchange Rate Index, a nominal effective exchange rate introduced in July 2008, based on the currency distribution of merchandise trade.

MERI2 is the Mauritius Exchange Rate Index, a nominal effective exchange rate introduced in July 2008, based on the currency distribution of merchandise trade and tourist earnings.

Other investment, which is a category in the Balance of Payments, includes all debt liabilities between unaffiliated non-residents and residents, which are not securitised. It can be classified by institutional sector: general government, monetary authorities, banks, and other sector, and sub-classified between short-term and long-term.

PMI refers to the Purchasing Managers' Index of financial activity, reflecting purchasing managers' acquisition of goods and services.

Seasonally-adjusted data are derived by removing the seasonal component of a time series in order to understand the underlying trends of the series.

Y-o-y change compares the value of a variable at one period in time to the same period the previous year.

Y-o-y inflation is measured by the change in the CPI for a given month compared with the corresponding month of the preceding year.

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