BANK OF MAURITIUS

Inflation Report

October 2011 | Issue No.7

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The Inflation Report is published twice a year by the Bank of Mauritius in accordance with Section 33(2)(b) of the Bank of Mauritius Act 2004. The Inflation Report is released to the public in April and October. It provides an analysis of inflation developments as well as the assessment underpinning monetary policy, and concludes with the outlook for inflation. This issue of the Inflation Report refers to information for the semester ended 30 June 2011 unless otherwise stated.

Acknowledgement

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The Report was cleared by the Publications Review Committee of the Bank of Mauritius.

The Report is available in PDF format on the Bank’s website at http://bom.intnet.mu under the menu item Research and Publications. The Bank of Mauritius welcomes any comments or suggestions on this publication, which may be sent to publications.ead@bom.intnet.mu.

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ISBN: 978-99903-36-59-7

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List of Acronyms

AFD	Agence Française de Développement
APM	Automatic Pricing Mechanism
BDI	Baltic Dry Index
BoE	Bank of England
BoJ	Bank of Japan
BML	Broad Money Liabilities
CIF	Cost, Insurance and Freight
CIPS	Chartered Institute of Purchasing Suppliers
CPI	Consumer Price index
ECB	European Central Bank
EIA	Energy Information Administration (of the US Department of Energy)
FAO	Food and Agriculture Organisation
FFPI	FAO Food Price Index
GDFCF	Gross Domestic Fixed Capital Formation
GDP	Gross Domestic Product
IBRD	International Bank for Reconstruction and Development
ICE	Intercontinental Exchange
IES	Inflation Expectations Survey
IMF	International Monetary Fund
IPI	Import Price Index
MCCI	Mauritius Chamber of Commerce and Industry
MERI	Mauritius Exchange Rate Index
MPC	Monetary Policy Committee
NML	Narrow Money Liabilities
NYMEX WTI	New York Mercantile Exchange West Texas Intermediate
ODCs	Other Depository Corporations
OECD	Organisation for Economic Co-operation and Development
ONS	Office for National Statistics
OPEC	Organisation of the Petroleum Exporting Countries
PMI	Purchasing Managers' Index
PPI-A	Producer Price Index-Agriculture
PPI-M	Producer Price Index-Manufacturing
PPS	Petroleum Pricing System
REER	Real Effective Exchange Rate
SEMDEX	Stock Exchange of Mauritius Index
WEO	(IMF's) World Economic Outlook
WRI	Wage Rate Index

1. Overview

1.1 International Developments

The global economy was subject to a number of shocks in the first half of 2011. Japan was hit by a devastating earthquake and tsunami, which led to disruptions in global supply chains; unrest increased in the Middle-East and North Africa, further driving up oil prices; and the euro area ran into major financial turbulence.

By mid-2011, clear signs of a slowdown had emerged and high frequency indicators started to reflect the worsening external environment. Global PMI data in June 2011 pointed to deceleration in output growth in both the manufacturing and service sectors. The rate of expansion in manufacturing production slowed for the fourth consecutive month to its weakest since June 2009 and service sector business activity growth also eased. GDP releases for the second quarter of 2011 confirmed the decline in economic activity. US economic growth was weaker than expected. In Europe, growth slowed significantly, with a particularly sharp deterioration in Germany. Japan contracted and, given its essential link in the global industrial system, its production losses due to the earthquake were contagious. In the UK, the plan for consolidation of public finance continued to weigh on consumption. Among emerging economies, China and India continued to post robust growth in the first half of 2011, but purchasing manager surveys indicated that growth in manufacturing activity had slowed across Asia.

The economic situation deteriorated further in July and August, with the sovereign credit downgrade of the US by Standard & Poor's and the euro area crisis affecting spreads in countries like Spain and Italy. By early September, further sign of weakness in the US economy led the US President to propose a U$447 billion fiscal stimulus package to Congress. Developments in financial markets also reflected substantial downward revision of forecasters' expectation of growth in several major economies. In its September 2011 World Economic Outlook, the IMF downgraded its global growth forecast and projected a growth rate of 4 per cent for the world economy in both 2011 and 2012.

Global inflation started to pick up in the first quarter of 2011, before rising sharply in the second quarter, mainly on account of higher commodity prices. Headline CPI inflation continued to be pushed up by surging food and energy prices in advanced economies despite high unemployment rate and excess capacity. The impact was felt more by emerging economies where the share of commodity related products in household's consumption is much higher than for advanced countries. In a context of close-to-potential growth and high inflation, central banks in emerging economies tightened further their monetary policy in the first half of 2011. In the developed world, some central banks such as the ECB started raising their interest rates. Other central banks such as the Fed and the BoE considered inflation as temporary and preferred to stick to their very accommodtive stance to support growth.

1.2 Domestic Developments

Growth in real domestic economic activity in the first semester of 2011 was relatively more upbeat compared to the growth rates in the first semester of 2010. In the second quarter of 2011, all sectors recorded positive growth rates except *Mining and quarrying* and *Construction*, which contracted by 29.1 per cent and 6.2 per cent, respectively. The most important contributors to the GDP growth rate of 3.9 per cent were *Real estate, renting and business activities* (0.8 percentage point), *Financial intermediation* (0.7 percentage point) and *Manufacturing* (0.6 percentage point). On the demand side, growth in final consumption expenditure slowed down significantly, from 3.1 per cent in the first quarter of 2011 to 1.5 per cent in the second quarter, due to more subdued growth in household consumption expenditure and general government consumption expenditure from 3.3 per cent and 2.0 per cent in the first quarter of 2011 to 1.6 per cent and 1.1 per cent, respectively in the second quarter. Overall, investment spending contracted by 3.1 per cent and 16.1 per cent in the first and second quarters of 2011, respectively, reflecting negative growths in both *Building and construction work and Machinery and equipment*.

Headline inflation remained on an uptrend to reach 5.1 per cent in June 2011. Year-on-year inflation which had started rising in the second half of 2010, rose further to peak at 7.2 per cent in March 2011, before easing to 6.6 per cent in June 2011. The outlook for inflation has improved in comparison to the previous forecast published in the Inflation Report of April 2011, reflecting muted price increases in a range of commodities and the tightening of the monetary policy stance.

1.3 Monetary Policy

In the first half of 2011, the Fed maintained the federal funds rate within a range of zero to 0.25 per cent and continued the asset purchase programme of acquiring US$600 billion worth of longer-term Treasuries targeted for completion by the end of the second quarter of 2011. The ECB was the first, among major central banks, to tighten monetary policy on inflation concerns, increasing its key policy rate by 25 basis points to 1.25 per cent on 7 April and again raising it by 25 basis points on 7 July 2011. In contrast, the BoE kept its policy rate unchanged at 0.5 per cent and maintained the asset purchase programme. The BoJ took several initiatives in response to the earthquake that hit the country in March 2011. The central bank announced a liquidity injection of ¥55.6 trillion into the banking system and doubled the size of its asset purchase programme to buy government and corporate bonds to ¥10 trillion. In addition, the BoJ introduced a one-year ¥1 trillion lending programme at a rate of 0.1 per cent to assist companies in the affected regions.

Domestic monetary policy stance

In Mauritius, the Monetary Policy Committee (MPC) tightened the monetary policy stance in the first semester of 2011, on the back of rising upside risks to inflation and anticipated economic recovery in 2011.

When the MPC convened on 28 March 2011, there was further evidence that the global economic recovery had continued to improve though the pace of growth remained uneven across different regions of the world. Growth in several advanced economies had been better than expected but remained subdued. In emerging and developing economies, strong growth was sustained by robust domestic demand, rising demand for commodities on the international front, still accommodative monetary policies and resurgent capital flows. The pace of economic growth in the US had reportedly quickened, driven by private consumption while growth in the euro area remained steady with persisting growth differences between core and peripheral member countries. Growth in the UK had remained sluggish, with lower activity in the services and construction sectors. The MPC noted that, on the back of rising inflationary pressures due to sharply rising food and energy prices, many central banks had already tightened or were considering to tighten monetary policy.

Activity on the domestic front had remained buoyant in the second half of 2010 and was better than expected. Though the expansion has been broad-based, the growth momentum had slowed, to some extent, in the *Hotels and restaurants* and *Construction* sectors. As the world recovery progressed further, business confidence had improved. The negative output gap was estimated to be closing rapidly and the economy was forecast to grow at 4.6 per cent in the year 2011.

However, there was clear evidence that inflationary pressures had accentuated, driven to a large extent by external price developments. From November 2010 to February 2011, the year-on-year inflation had almost doubled and the headline inflation had increased from 2.5 per cent to 3.6 per cent. These were reflected in the core inflation measures, which also increased rapidly, signalling that second-round effects were developing. In addition, expectations for higher prices had risen and, on a no-policy change basis, year-on-year and headline inflation were forecast to reach 7.8 per cent and 5.0 per cent, respectively, by mid-2011. The MPC was of the view that extreme prudence in price-setting behaviour and wage compensation policies was warranted to prevent cascading price effects. It was also noted that a co-ordination of monetary and fiscal measures could help in better containing inflation.

Weighing the risks to the outlook for growth and inflation over the policy relevant horizon, the MPC considered that the balance of risks had tilted towards the inflation outlook. The MPC considered it important to start a normalisation process of the Key Repo Rate to anchor inflation expectations and prevent the observed rise in inflation from generating second-round effects and voted with a majority to raise the policy interest rate by 50 basis points to 5.25 per cent.

At its next meeting on 13 June 2011, the MPC noted that the pace of global economic recovery had slowed down since its previous meeting, mainly as a result of high energy prices and the repercussions of the earthquake in Japan on production and spending. Geo-political tensions in the Middle-East and North Africa had also contributed to dent the widespread optimism of the world recovery. While global inflationary pressures had receded on moderate increases in commodity prices, the underlying strength of the global economy supported the view that commodity prices would resume their uptrend in the medium term. The growth outlook continued to remain positive but investors were gripped by increased risks from the sovereign debt woes of the euro area and the massive debt overhang in the US, leading to more volatility in markets that clouded the economic outlook. In its April 2011 World Economic Outlook, the IMF had kept growth projection for the year 2011 unchanged at 4.4 per cent but downgraded the growth forecast for advanced economies to 2.4 per cent and maintained the rate of growth of emerging and developing economies at 6.5 per cent. Manufacturing and services data were consistent with the global economic slowdown and forward-looking indicators like the purchasing managers' indices and confidence indicators pointed to slower rates of expansion.

In Mauritius, however, the economy had continued to recover with activity in key sectors remaining at appreciable levels and overall business confidence continuing to improve. GDP data available up to March 2011 had shown that the economy was growing at a commendable rate. The negative output gap was estimated to be closing gradually, thereby indicating potential build-up of inflationary pressures from the demand side. The MPC noted that private sector investment had been stagnant in 2010 and that foreign direct investment had slowed down significantly in the first quarter of 2011.

Inflationary pressures had shown no signs of abating and were still present in the economy, notwithstanding the temporary negative price shock in April 2011 following administrative measures taken by Government. Headline inflation had maintained its uptrend and was forecast to remain strong until the end of the year, while year-on-year inflation was above 7 per cent in May 2011. In addition, expectations for higher prices one year ahead had continued to rise. The evolution of the rupee was seen as a determining element of the future course of inflation. Though risks to growth remained in the medium term given dim global economic prospects, the balance of risks remained tilted towards the inflation outlook as inflationary pressures showed no signs of fading. The MPC considered important to continue the normalisation process of the Key Repo Rate started in March and, with a majority vote, decided to increase the Key Repo Rate by 25 basis points to 5.50 per cent.

Decisions on the Key Repo Rate are summarised in Table 1.1.

Table 1.1: Decisions of the MPC on the Key Repo Rate

Date of MPC meeting and effective date of decision	Decision on the Key Repo Rate	Key Repo Rate (*post*-decision level, per cent per annum)	Voting pattern
28 March 2011	50 basis points increase	5.25	Majority vote
13 June 2011	25 basis points increase	5.50	Majority vote

2. The External Environment

The global economy expanded in the first quarter of 2011, but data in the second quarter pointed to a slowdown in economic activity. The natural calamity in Japan as well as the political turmoil in the Middle-East and North Africa contributed to decelerating global industrial production and trade, while inflation kept increasing in the first half of the year. Volatility in financial markets increased in June due to market concerns about sovereign risks related to developments in the euro area periphery and the softening activity as well as persistent housing market weakness in the United States.

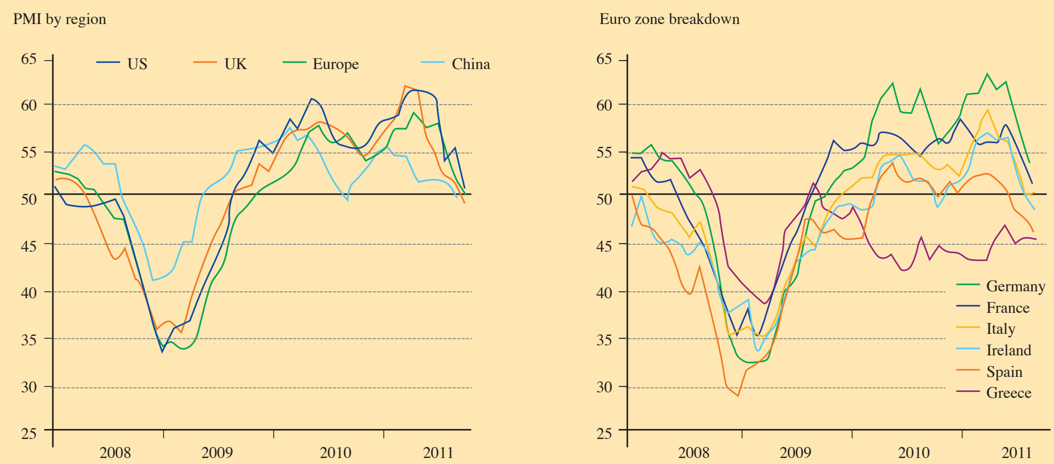
The IMF's September 2011 World Economic Outlook projected that global growth would moderate to about 4 per cent through 2012, down from 5.1 per cent in 2010. The forecasts were worst for advanced economies, for which growth was revised downwards, from 3.1 per cent in 2010 to 1.6 per cent in 2011 and 1.9 per cent in 2012. Emerging and developing economies were projected to grow by 6.4 per cent in 2011 and 6.1 per cent in 2012, down from 7.3 per cent in 2010. The IMF noted that both Europe's debt woes and the painfully slow US recovery could undermine global expansion and warned that, without action, those economies could tip back into recession.

Chart 2.1 depicts the evolution of the Global Manufacturing Purchasing Managers' Index (PMI).

2.1 Global Economic Activity

Growth in the US economy slowed down sharply in the first quarter of 2011, falling back to an annualised growth rate of 0.4 per cent. Since February 2011, business surveys pointed to more moderate growth in activity and GDP numbers for the second quarter confirmed that the economy remained on a slow growth track. GDP grew at an annual rate of 1.3 per cent in the second quarter, helped by consumer spending and export growth. The unemployment rate in June 2011 was 9.2 per cent compared to 9.0 per cent in January 2011, indicating a persistently weak labour market. The PMI for the manufacturing sector stood at 55.3 in June 2011, down from 60.8 in January 2011. The non-manufacturing index, which covers the rest of the economy, also fell heavily over the same period and reached 53.3 in June. Retail sales remained subdued in the first half of the year as higher consumer prices slowed growth in real disposable income. Given the very weak economic performance in the first half of 2011 and increased uncertainties, the US growth forecast for 2011 has been revised down by most international forecasters. The IMF, in its September 2011 World Economic Outlook, projected the US economy to grow by 1.5 per cent and 1.8 per cent in 2011 and 2012, respectively.

Chart 2.1: Global Manufacturing Purchasing Managers' Index



*A reading over 50 indicates expansion of activity in the manufacturing sector.

Source: Courtesy of Thomson Reuters.

Japan's economy contracted by a quarter-on-quarter rate of 0.9 per cent in the first quarter of 2011 due to the impact of the natural disaster. By June 2011, however, economic indicators suggested that the negative impact from the supply-chain disruptions had eased substantially. Industrial activity accelerated and the rebuilding of the shattered infrastructure made considerable progress with the support of the government. Investment from the private sector also helped to revive the economy. While the surge in June exports was broad-based, auto exports jumped by 34.6 per cent month-on-month after an increase of 71.8 per cent in May. Department store sales also increased in the second quarter of 2011, suggesting that private consumption had been picking up on the whole, although weakness remained in some aspects of consumer behaviour. The economy contracted by 0.5 per cent in the second quarter of 2011 and the employment and income situation continued to be severe with the unemployment rate at 4.7 per cent in June 2011. According to the IMF, Japan's economy is expected to grow by 2.3 per cent in 2012 compared to a contraction of 0.5 per cent in 2011.

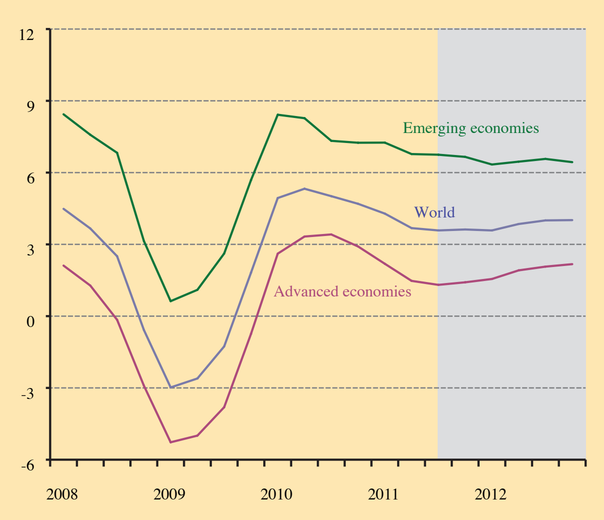
The euro zone grew by a quarter-on-quarter rate of 0.8 per cent in the first quarter of 2011, with Germany showing strong expansion. However, real growth in the euro zone slowed down considerably to 0.2 per cent in the second quarter. France registered no growth in the second quarter after growing by 0.9 per cent in the first quarter, while the German economy grew by only 0.1 per cent, compared to 1.3 per cent in the first quarter. Euro zone manufacturers, who had provided the driving momentum behind the region's recovery, also reported much slower growth in June. The Markit Eurozone Manufacturing PMI fell to a one-and-a-half year low of 52.0 in June, down from 57.3 in January 2011 while the services PMI fell to an eight-month low of 53.7. The rate of job creation hit an eight-month low in June 2011, reflecting the slower rates of growth of both new orders and backlogs of work. The unemployment rate stood at 10.0 per cent in June 2011. The recovery in Europe continues to face substantial headwinds from sovereign debt crisis in several euro area members, and a wide-reaching but necessary process of fiscal consolidation. In its September 2011 World Economic Outlook, the IMF projected the euro zone to grow by 1.6 per cent in 2011 and 1.1 per cent in 2012.

The British economy grew at quarter-on-quarter rates of 0.4 per cent and 0.1 per cent in the first and second quarters of 2011, respectively. There were a number of special events associated with the second quarter including the additional April bank holiday; the royal wedding and the after effects of the Japanese tsunami. Analysis carried out by the Office for National Statistics (ONS) indicated that these events might have had a net downward impact on the second quarter growth rate. Even though the volume of retail sales increased by 0.7 per cent in June, sales continued to be under huge pressure from the squeeze on disposable income resulting from rising inflation and low wage growth. The CIPS/Markit services business activity index was broadly unchanged in June, while the manufacturing index fell to a 21-month low as order inflows declined and jobs growth slowed sharply. Consumer confidence surveys also remained at low levels. The unemployment rate stood at 7.9 per cent for the three months ended June 2011. The IMF expects the UK economy to grow by 1.1 per cent in 2011 and 1.6 per cent in 2012.

Developing economies continued to expand at a promising pace in the first half of 2011, despite some moderation in the second quarter. China grew by a year-on-year rate of 9.7 per cent in the first quarter of 2011. On an annual basis, both retail sales and industrial production registered double-digit increases in the first half of 2011. However, manufacturing PMIs eased to some extent by June and the economy grew by 9.5 per cent in the second quarter. India reverted to the high real GDP growth trajectory during the first half of 2011, growing by 7.8 per cent and 7.7 per cent in the first and second quarters of 2011, respectively. This robust rate of expansion reflected a rebound in agriculture and sustained levels of activity in industry and services. Nevertheless, the main concern remained high inflation, particularly after the government's decision to increase prices of petroleum products. According to the IMF's September 2011 World Economic Outlook, China is expected to grow by 9.5 per cent in 2011 and 9.0 per cent in 2012, while India is forecast to grow by 7.8 per cent and 7.5 per cent in 2011 and 2012, respectively.

Chart 2.2 and Table 2.1 show actual and projected real GDP growth rates in advanced and emerging and developing economies.

Chart 2.2: Global Growth and Outlook
(Real GDP: quarterly per cent change from one year earlier)



Source: IMF's September 2011 World Economic Outlook.

2.2 Inflation and Commodity Prices

During the first half of 2011, unrest in North Africa and the Middle East as well as supply constraints have led to a general increase in commodity prices, which have in turn contributed to fuel inflationary pressures. In several inflation-targeting countries, headline inflation has risen above target.

Underlying inflationary pressures remained relatively elevated in emerging and developing economies, as both headline and core inflation rose in many parts of the world. In the major advanced economies, however, headline and core inflation appeared to be losing some momentum. In advanced economies, headline inflation is forecast at around 2.5 per cent in 2011 before receding to 1.5 per cent in 2012, assuming that energy and food prices evolve as the markets expect. In emerging and developing economies, headline inflation is expected to settle at around 6 per cent in 2012, down from over 7.5 per cent in 2011.

Inflation in the United States, the euro area and the United Kingdom stood at 3.6 per cent, 2.7 per cent and 4.2 per cent, respectively, in June 2011, up from 1.5 per cent, 2.2 per cent and 3.7 per cent, respectively, in December 2010. Inflation in South Africa rose from 3.5 per cent in December 2010 to 5.0 per cent in June 2011. Among emerging economies, China's inflation picked up from 4.6 per cent to 6.4 per cent, while inflation in India declined from 9.7 per cent to 8.6 per cent over the same period.

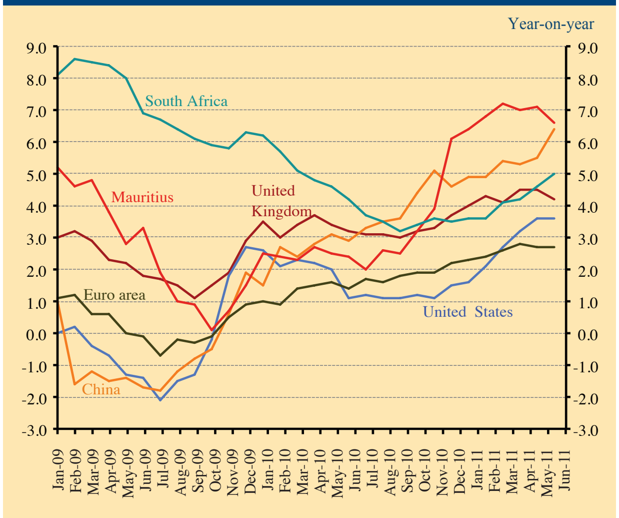
Table 2.1: Real GDP Growth Rates in Selected Economies

								Per cent
	Q3-2010	Q4-2010	Q1-2011	Q2-2011	2009	2010	2011	2012
	Quarter-on-quarter Growth Rates. seasonally adjusted						*Projections*	
World output					**-0.7**	**5.1**	**4.0**	**4.0**
Advanced economies					**-3.7**	**3.1**	**1.6**	**1.9**
of which								
United States	0.6	0.6	0.1	0.3	-3.5	3.0	1.5	1.8
Euro Area	0.4	0.3	0.8	0.2	-4.3	1.8	1.6	1.1
Japan	-0.1	-0.6	-0.9	-0.5	-6.3	4.0	-0.5	2.3
United Kingdom	0.6	-0.5	0.4	0.1	-4.9	1.4	1.1	1.6
	Q3-2010	**Q4-2010**	**Q1-2011**	**Q2-2011**				
	Year-on-year Growth Rates							
Emerging market and developing economies					2.8	7.3	6.4	6.1
Sub Saharan Africa					2.8	5.4	5.2	5.8
Developing Asia					7.2	9.5	8.2	8.0
of which								
China	9.6	9.8	9.7	9.5	9.2	10.3	9.5	9.0
India	8.9	8.3	7.8	7.7	6.8	10.1	7.8	7.5

Sources: IMF's September 2011 World Economic Outlook; offices of national statistics' websites; central banks' websites and OECD website.

Chart 2.3 shows the path of year-on-year inflation in some selected countries, including Mauritius and Table 2.2 depicts inflation rates in selected countries.

Chart 2.3: Inflation Rates in Selected Countries



Sources: Statistics Mauritius and Bank of Mauritius; central banks' and offices of national statistics' websites.

Commodity prices

Commodity prices maintained a generally upward trend in the first semester of 2011 against the backdrop of strong demand and supply constraints.

Oil prices

Oil prices witnessed an uptrend beginning January 2011 and even surpassed the psychological barrier of US$100 per barrel, its two-year high, driven by improving macroeconomic sentiment, cold weather as well as geo-political concerns. However, oil prices started to retreat in May and June 2011 on concerns about global economic growth and oil demand.

International oil prices have, in general, hovered between US$89.6 and US$123.1 per barrel in the first six months of 2011 compared to a range of US$75.4 to US$92.3 per barrel in the second half of 2010. NYMEX WTI averaged US$96.3 a barrel in June 2011, up from US$89.2 a barrel in December 2010. Likewise, ICE Brent averaged US$113.9 a barrel in June 2011, up from US$92.3 a barrel in December 2010.

The US Energy Information Administration (EIA) report released in September 2011 projects that WTI spot prices, which averaged US$79 per barrel in 2010, will average US$94 per barrel in 2011 and US$95 per barrel in 2012, while the US refiner average crude oil acquisition cost is projected to average US$100 and US$103 per barrel in 2011 and 2012, respectively.

Table 2.2: Inflation Rates in Selected Countries

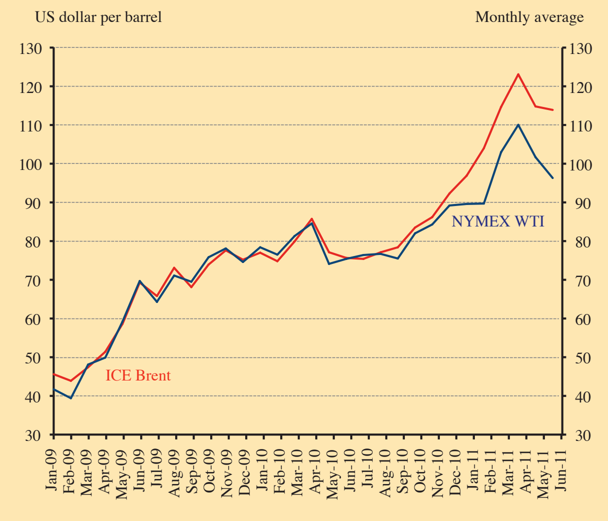
Per cent

	2007	2008	2009	2010	January 2011	June 2011
China	4.8	5.9	-0.7	3.3	4.9	6.4
Euro area	2.1	3.3	0.3	1.6	2.3	2.7
Hong Kong	2.0	4.3	0.6	2.3	3.6	5.6
Hungary	7.9	6.1	4.2	4.9	4.0	3.5
India	6.4	8.3	10.9	12.0	9.3	8.6
Indonesia	6.0	9.8	4.8	5.1	7.0	5.5
Philippines	2.8	9.3	3.2	3.8	3.5	5.2
Singapore	2.1	6.6	0.6	2.8	5.5	5.2
South Africa	7.1	11.5	7.1	4.3	3.7	5.0
South Korea	2.5	4.7	2.8	3.0	4.1	4.4
Thailand	2.2	5.5	-0.8	3.3	3.0	4.1
Turkey	8.8	10.4	6.3	8.6	4.9	6.2
United Kingdom	2.3	3.6	2.1	3.3	4.0	4.2
United States	2.9	3.8	-0.3	1.6	1.6	3.6

Sources: IMF's September 2011 World Economic Outlook. The Economist and central banks' websites.

Chart 2.4 shows movements in monthly average oil prices.

Chart 2.4: NYMEX WTI and ICE Brent



Source: Thomson Reuters.

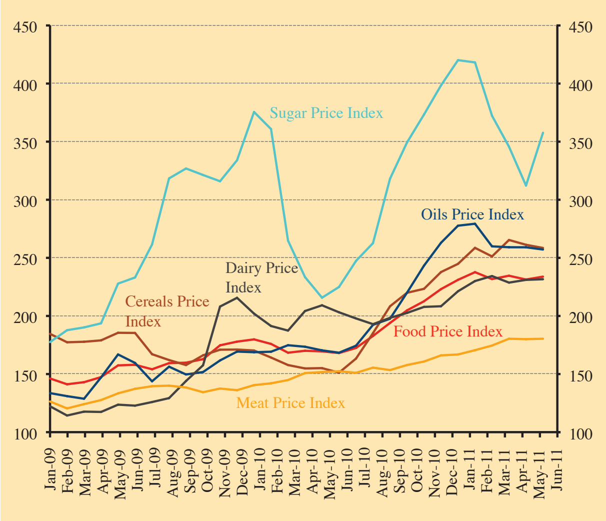
Food prices

Early in 2011, most agricultural prices had either reached or exceeded their summer 2008 peaks. The FAO Food Price Index (FFPI), which in February 2011, recorded its historical peak of 238 points since its inception in 1990, remained strong in the first half of 2011. Adverse weather conditions, strong demand from emerging countries and inventory declines were among the main factors that contributed to the volatility in food prices.

The FFPI stood at 233 points in June 2011, 4.5 per cent higher than in December 2010 on account of increases in international prices of meat, dairy and cereals more than offsetting decreases in oils and fats and sugar prices.

The Meat Price Index averaged 178 points, up from 166 points in December 2010. The Cereals Price Index, which includes prices of main food staples such as wheat, rice and corn, rose to an average of 259 points in June 2011, from 238 points in December 2010. The Dairy Price Index increased from 208 points to 232 points. In contrast, the Oilseed Price Index edged down to 257 points in June 2011, from 263 points in December 2010, while the Sugar Price Index declined from 398 points in December 2010 to 358 points in June 2011. The FAO Food Price Index and other food commodity price indices are shown in Chart 2.5.

Chart 2.5: FAO Food Price Index and its Components



Source: FAO.

Other commodity prices

Most of the non-energy commodities have firmed up in the first half of 2011 compared to the second half of 2010, reflecting increased demand and supply constraints. However, price increases were more moderate in commodities where supplies were ample, in particular prices of aluminium in China, which is a net exporter. Over the first half of 2011, non-energy commodity prices rose 3 per cent, with fertilizer prices surging 26 per cent on strong demand; agriculture prices rose 3 per cent, led by an 11 per cent gain in grains, while metal prices were just 1 per cent higher, with silver up 22 per cent.

Table 2.3 shows the quarterly averages of selected non-energy commodities for the second half of 2010 and the first semester of 2011.

Freight costs

The Baltic Dry Index (BDI), which is the benchmark for tracking commodity shipping costs, remained subdued in the first half of 2011, reflecting overcapacity in the shipping market. The BDI, which averaged 2,031 points in December 2010, slowed down to 1,433 points in June 2011.

Chart 2.6 shows the evolution of the Daily Baltic Dry Index between June 2009 and June 2011.

Chart 2.6: Baltic Dry Index

Source: Dowjonesclose website.

2.3 Financial Markets

Volatility in international financial markets was generally contained in the first half of 2011. Global stock markets maintained their upward trend in the first quarter of 2011 but lost momentum by the end of the first semester, weighed by concerns about the sustainability of several euro area countries' debt position, the wider implications for already strained banking sector and by general worries about global growth prospects.

Stock markets

The major stock markets continued their uptrend in the first two months of 2011, supported by an economic rebound in the US, stronger-than-expected corporate earnings and easing euro zone debt worries, although fears of further monetary tightening in China prompted renewed concerns about the sustainability of the global economic recovery. Stocks, with the exception of Japanese equities, were resilient throughout the first quarter of 2011 despite Japan's earthquake and nuclear crisis and a series of uprisings in North Africa and the Middle East. Towards the end of the first quarter, there were increasing signs that the rally in the major stock markets was coming to an end on renewed concerns about euro zone debt and the continuing crisis in Libya.

In the second quarter of 2011, further monetary tightening in some emerging markets, a spate of weak US economic data and fear of flagging Chinese growth, compounding worries about the global economic recovery, all weighed on markets. Concerns that a Greek default could spark

Table 2.3: Non-Energy Commodities

Commodity	Unit	Quarterly Averages			
		Q3-2010	Q4-2010	Q1-2011	Q2-2011
Cotton A Index	c/kg	205	330	457	391
Aluminum	$/mt	2,090	2,343	2,501	2,611
Copper	$/mt	7,243	8,637	9,642	9,173
Gold	$/toz	1,227	1,367	1,384	1,507
Iron ore	c/dmtu	137	156	179	176
Lead	c/kg	203	239	260	255
Nickel	$/mt	21,191	23,609	26,870	24,355
Silver	c/toz	1,901	2,647	3 179	3 857
Steel (cold rolled) coilsheet	$/mt	850	850	867	900
Steel (hot rolled) coilsheet	$/mt	750	750	767	800
Tin	c/kg	2,055	2,601	2,986	2,885
Zinc	c/kg	201	231	239	226
Cocoa	c/kg	306	297	334	307
Plywood	c/sheets	572	581	589	603
Tea, auctions (3) average	c/kg	295	304	289	299

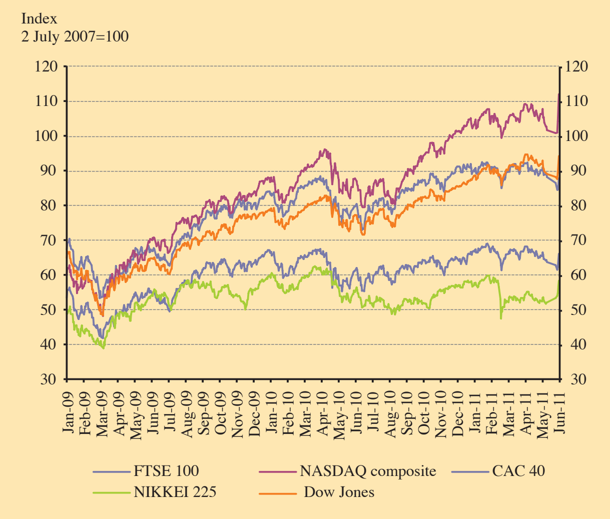
$ = US dollar   c = US cent   mt = metric ton   kg = kilogram   dmtu = dry metric ton unit   toz = troy oz

Source: World Bank.

another global credit freeze were a major headwind for stocks in May and June 2011, before the temporary resolution of Greece's debt crisis at the end of the semester. The major stock markets, with the exception of the Japanese market, ended a volatile quarter with losses. Japanese stocks closed the second quarter slightly higher, supported by signs that Japanese companies were recovering after the natural disaster that hit the country in March 2011.

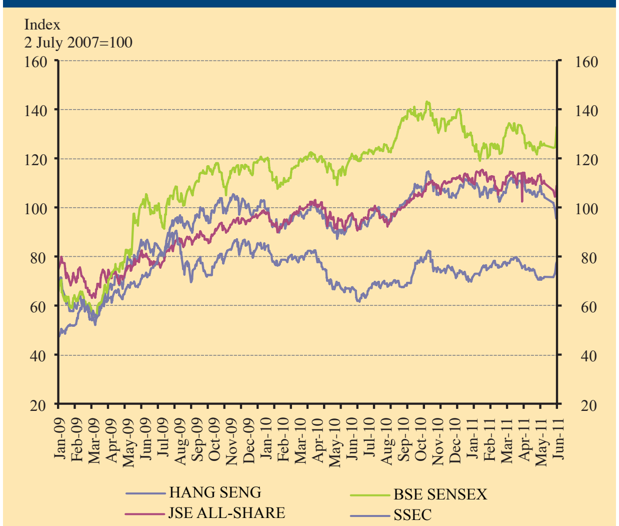
Charts 2.7 and 2.8 depict the evolution of equity indices of selected major international and emerging stock markets.

Chart 2.7: Equity Indices of Selected Major International Stock Markets



Source: Thomson Reuters.

Chart 2.8: Equity Indices of Selected Emerging Stock Markets



Source: Thomson Reuters.

Exchange rate

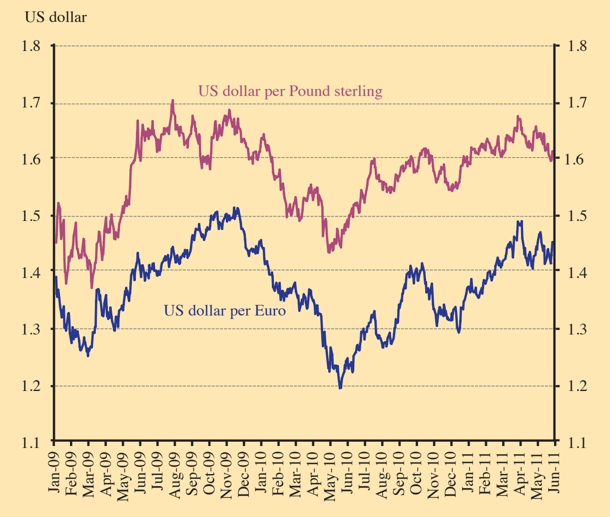
The US dollar was on a downtrend during the first half of 2011. Early 2011, a fragile US recovery leading the Federal Reserve to maintain its commitment to exceptionally low interest rates for an 'extended period' weighed on the dollar. The US currency also tumbled on the view that higher oil prices, due to renewed tensions in the Middle East and North Africa, would push other central banks to raise interest rates faster than the Fed. Interest rate differentials between the euro zone and the US, in particular, and the Fed's statement that it would complete its US$600 billion bond-buying programme in June 2011, also put broad-based pressure on the dollar. In May 2011, a spate of soft US economic data, which raised concerns about the global economic recovery, triggered a decline in global risk appetite, leading investors to seek refuge in currencies such as the US dollar and the Japanese yen, considered as safe havens. The greenback, benefiting from broad-based weakness of the single currency due to euro zone debt worries, strengthened after the Fed gave no hint that it could be providing any further economic stimulus. However, the dollar lost ground towards the end of June 2011 on optimism over a resolution of the Greek debt crisis.

The euro strengthened against the US dollar during most of the period January to June 2011. The single currency was supported after successful securities auctions by indebted euro zone members calmed fears of the credit crisis and on speculation that the ECB could lift lending rates before the Fed on rising euro zone inflation risks. As expected, the ECB raised rates on 7 April 2011 for the first time since July 2008. However, lingering euro zone debt woes and the release of a series of weak US economic data raising concern about the global economic recovery started to weigh on the single currency. The euro rallied against the US dollar towards the end of June 2011.

The Pound sterling appreciated against the US dollar during the period under review, benefiting from expectations that UK interest rates could rise due to sticky inflation and on the back of the dollar's broad-based weakness. Tensions in North Africa and the Middle East, a spike in oil prices driving investors into safe haven currencies and concerns about a fragile British economy somewhat adversely impacted on the British currency.

Chart 2.9 shows the evolution of the US dollar against the euro and Pound sterling.

Chart 2.9: Evolution of the US dollar against the Euro and Pound sterling



Source: Thomson Reuters.

2.4 Monetary Policy

In the first semester of 2011, some central banks in advanced economies ended their interest rate easing cycle on account of rising inflationary pressures resulting from surging food and energy prices, while other major central banks left rates unchanged on growth concerns. In emerging and developing economies, most central banks continued to tighten policy to contain rising inflation and prevent overheating of their economies.

The US Federal Reserve maintained the federal funds rate in the target range of zero to 0.25 per cent with a view to promoting economic recovery and kept the asset purchase programme of acquiring US$600 billion worth of longer-term Treasuries targeted for completion by end-June 2011. With increased downside risks to economic growth and a subdued inflation outlook over the medium term, the Fed pledged that rates would be kept at exceptionally low levels for an extended period, at least through mid-2013.

The ECB was the first among major central banks in advanced economies to tighten monetary policy, increasing the interest rate on main refinancing operations by 25 basis points to 1.25 per cent in April 2011, after keeping it unchanged for almost two years at historically low level. In its communiqué, the ECB highlighted that the adjustment of the very accommodative monetary policy stance was warranted in light of rising upside risks to price stability. Though the ECB considered monetary policy to be still accommodative after the rate hike, it was of the view that the start of a normalisation process was necessary to anchor inflation expectations with the aim of maintaining inflation rates below but close to 2 per cent over the medium term. The ECB subsequently raised the key interest rate by another 25 basis points to 1.50 per cent in July 2011 on account of continued upward pressure on overall inflation and the positive momentum of economic activity in the euro area.

The BoE kept its policy rate unchanged at 0.5 per cent in the first six months of 2011 and completed its £200 billion asset purchase programme as GDP growth and consumer spending remained weak. Slowing world demand growth and heightened tension in financial markets shifted the balance of risks of the medium-term inflation outlook to the downside. Thus, despite inflation remaining above target at end-June 2011, the BoE was expected to maintain an overly loose monetary policy stance rather than risk overly rapid tightening. There were also consideration to increase the degree of monetary stimulus by undertaking a further programme of asset purchases if downside risks were to materialise.

With its policy rate near zero, the BoJ took several initiatives in response to the earthquake which hit the country in March 2011. The central bank announced a liquidity injection of ¥55.6 trillion into the banking system and doubled the size of its asset purchase programme to buy government and corporate bonds to ¥10 trillion. In addition, the BoJ introduced a one-year ¥1 trillion lending programme at a rate of 0.1 per cent to assist companies in the affected regions.

In striking contrast to advanced economies, emerging market economies have generally been dealing with rising inflation, caused by a combination of elevated commodity prices and robust domestic demand. Most central banks in emerging markets in Asia and Latin America have raised interest rates as the regions emerged strongly from the global financial crisis.

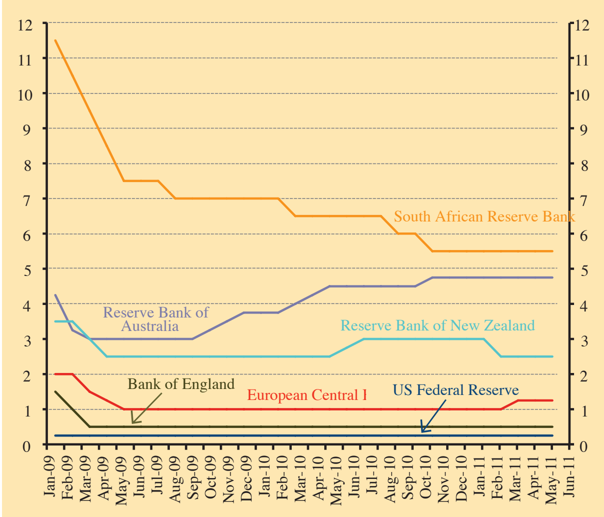
China's central bank increased interest rates twice in the first half of 2011. In April 2011, the benchmark one-year deposit and lending rates were raised by 25 basis points to 3.25 per cent and 6.31 per cent, respectively. China's rate rise in April added to six increases in bank cash reserve requirement since October 2010 and highlighted the country's determination to clamp down on inflation, which leaders have declared as their most important task this year to keep the world's fastest growing major economy on track. China is also very concerned about rising prices that might stir social unrest.

The Reserve Bank of India has also been among the most aggressive central banks in tightening monetary policy stance. In June 2011, the central bank raised interest rates for the tenth time in just over a year to combat stubbornly high inflation. However, its gradual policy tightening failed to cool inflation driven by high commodity prices and demand pressures.

Looking ahead, the US Federal Reserve has indicated that economic conditions are likely to warrant exceptionally low levels for the federal funds rate at least through mid-2013. Furthermore, some additional accommodation may be expected as there are expectations for the unemployment rate to remain well above, and inflation to be at or below, trend levels. In the UK, the outlook for inflation remains sensitive to movements in commodity and energy prices. However, there is now less risk of further pronounced rises in commodity prices as a result of global demand conditions, although the possibility of disruptions to the supply of commodities remains a risk to the upside. Consequently, there remain substantial risks to inflation in the medium term in both directions. In the euro area, fears over the recovery and the deepening debt crisis are still weighing on the euro. The ECB has reassessed the outlook for inflation as dovish. Thus, it is expected that the ECB may reduce rates in the foreseeable future. In emerging markets, it increasingly appears that inflation is being reined in and interest rates are expected to remain on hold.

Chart 2.10 shows end-of-month policy interest rates of selected central banks.

Chart 2.10: Selected Central Banks' Policy Interest Rates



Sources: Central banks' websites.

3. Recent Developments in Domestic Inflation

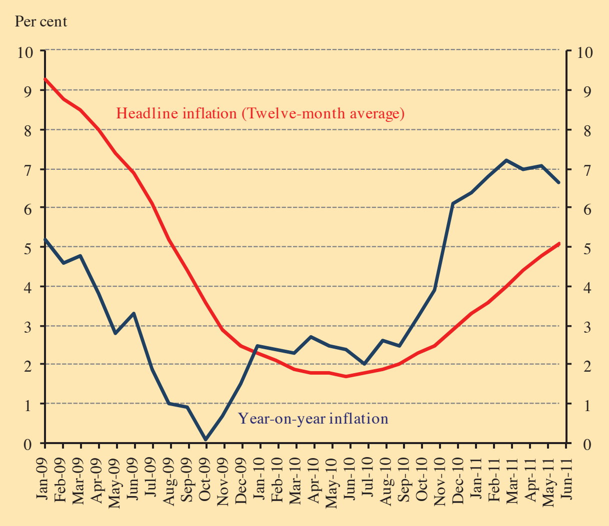
The course of domestic inflation in the first six months of 2011 was influenced by international commodity prices, inflation in supplier countries, exchange rate developments and administrative measures. While external price developments continued to impact on domestic prices, administrative measures taken by Government to cut prices of selected food items and reduce petroleum prices in April 2011 and the strengthening of the rupee exchange rate vis-à-vis major currencies contributed to limit increases in the CPI. The CPI rose from 124.4 in December 2010 to 127.4 in March 2011 and slightly further to 127.8 in June 2011.

3.1 Inflation: Headline and Core

Both headline and year-on-year inflation firmed up in the first half of 2011. Headline inflation, measured by the percentage change between the average CPI during a twelve-month period and the average CPI during the corresponding previous twelve-month period, remained on the uptrend to reach 5.1 per cent in June 2011. Year-on-year inflation, defined as the percentage change in the CPI of a given month compared to the same month of the preceding year, which had started rising in the second half of 2010, rose further to a peak of 7.2 per cent in March 2011 before easing to 6.6 per cent in June 2011.

Chart 3.1 depicts the evolution of headline and year-on-year inflation. Chart 3.2 depicts movements of inflation and core inflation.

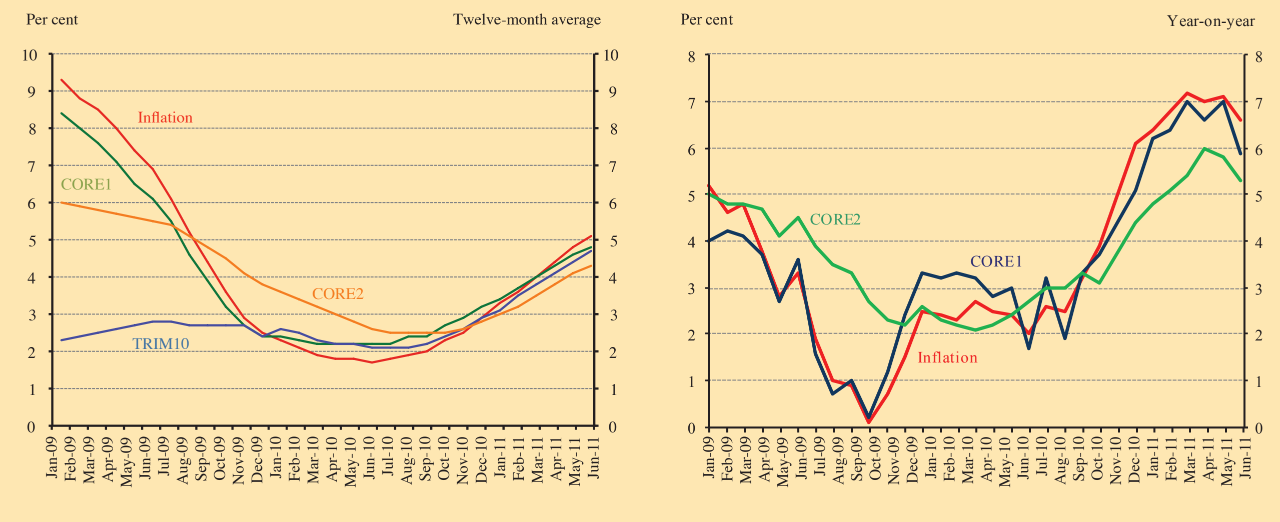
Chart 3.1: Inflation Rate



Sources: Statistics Mauritius and Bank of Mauritius.

The behaviour of all three underlying measures of inflation in the first half of 2011 showed that inflationary pressures had formed an integral part of the general price structure of the economy. Based on the twelve-month average methodology, CORE1 inflation, which excludes food, beverages, tobacco and mortgage interest on housing loan from the CPI basket, rose from 3.2 per cent in December 2010 to 4.0 per cent in March 2011 and further to 4.8 per cent in June 2011. CORE2 inflation, which excludes food, beverages, tobacco, mortgage interest, energy prices and administered prices from the CPI

Chart 3.2: CPI Inflation and Core CPI Inflation Rate



Sources: Statistics Mauritius and Bank of Mauritius.

basket, rose from 2.8 per cent in December 2010 to 3.5 per cent in March 2011 and further to 4.3 per cent in June. TRIM10 inflation, which truncates 5 per cent of each tail of the distribution of price changes, also rose from 2.9 per cent in December 2010 to 4.7 per cent in June 2011.

On a year-on-year basis, CORE1 inflation picked up for three months in a row to reach 7.0 per cent in March 2011 but eased to 5.9 per cent in June. CORE2 inflation, which reflects the second-round effects, was down to 5.3 per cent in June 2011 after it had increased to 6.0 per cent in April 2011, from 4.4 per cent in December 2010.

3.2 Evolution of Major Commodity Group Indices

In absolute terms, the CPI increased from 124.4 in December 2010 to 127.8 in June 2011. The largest increase was registered in the *Food and non-alcoholic beverages* division, which contributed around 1.4 index points to the increase of the CPI. *Transport* accounted for around 1.0 index point of the CPI increase. *Clothing and footwear, Health, Education* and *Restaurants and hotels* contributed around 0.2 index point each, while four divisions, namely, *Alcoholic beverages and tobacco*, *Housing, water, electricity, gas and other fuels, Furnishings, household equipment and routine household maintenance* and *Miscellaneous goods and services* recorded respective contributions of around 0.1 index point. The remaining divisions recorded negligible positive contributions.

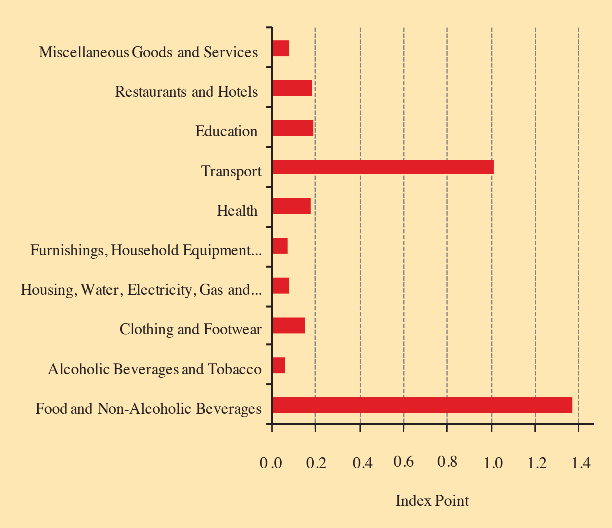
Chart 3.3 illustrates the weighted contribution of the main divisions of the CPI basket to the increase in the CPI between December 2010 and June 2011.

Domestic prices of mogas and diesel oil

The Automatic Pricing Mechanism (APM), which was introduced in April 2004, was replaced by the Petroleum Pricing System (PPS) in January 2011 to determine the domestic selling price of petroleum products, with the exception of fuel oil. Under the PPS, the retail prices of mogas and diesel oil were adjusted upwards at the two subsequent meetings. In January 2011, the retail price of mogas and diesel oil were raised by 8.5 per cent and 12.4 per cent, respectively. In March, the retail prices of mogas and diesel oil were further raised by 5.8 per cent and 9.0 per cent, respectively.

However, effective 29 March 2011, the prices of mogas and diesel oil were reduced by 3.9 per cent and 5.3 per cent, respectively, on the back of administrative measures taken by Government. Thus, at the close of June 2011, the prices of mogas and diesel oil stood at Rs49.30 per litre and Rs41.20 per litre, respectively.

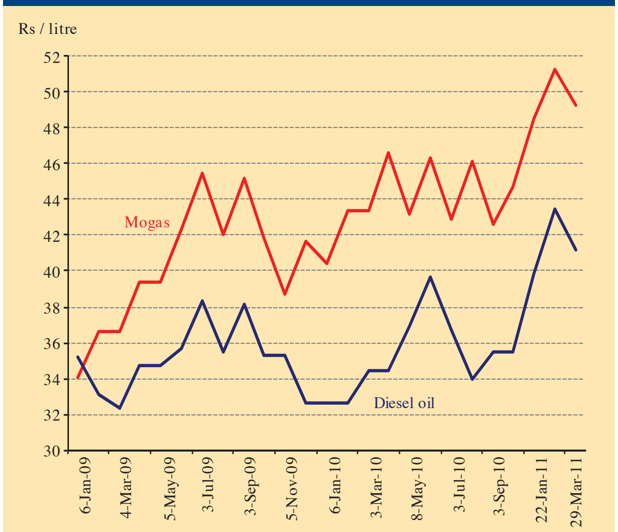
Chart 3.3: Weighted Contributions to the Change in CPI: December 2010 - June 2011



Sources: Statistics Mauritius and Bank of Mauritius.

Chart 3.4 illustrates the movements of retail prices of mogas and diesel oil since January 2009.

Chart 3.4: Domestic Prices of Mogas and Diesel Oil



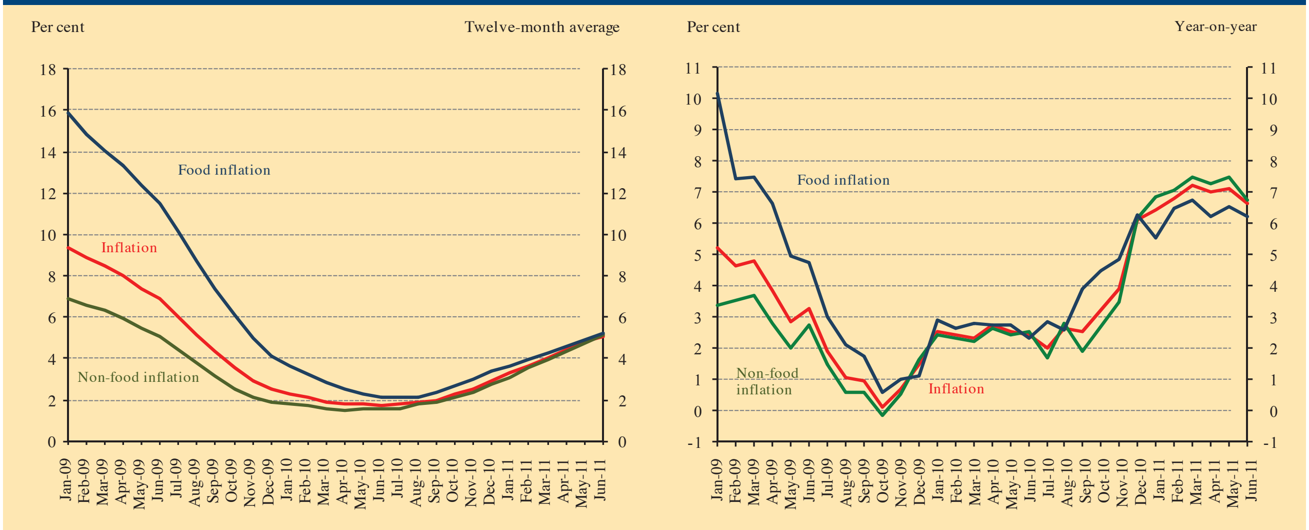
Source: State Trading Corporation.

Food and non-food inflation

Food inflation, with food carrying a weight of 26.5 per cent in the CPI basket, went up from 3.4 per cent in December 2010 to 5.2 per cent in June 2011, reflecting strong international prices of agricultural commodities. Non-food inflation steadily rose from 2.7 per cent in December 2010 to 5.1 per cent in June 2011. A large part of the CPI non-food inflation resulted from increases in prices of petroleum products.

Based on the year-on-year methodology, food inflation fluctuated between 5.5 per cent and 6.7 per cent and stood at 6.2 per cent in June 2011, unchanged from the level reached in December 2010. Non-food inflation picked up from 6.1 per cent in December 2010 to 6.7 per cent in June 2011. Chart 3.5 shows movements in food and non-food inflation.

Chart 3.5: Food and Non-Food Inflation



Sources: Statistics Mauritius and Bank of Mauritius.

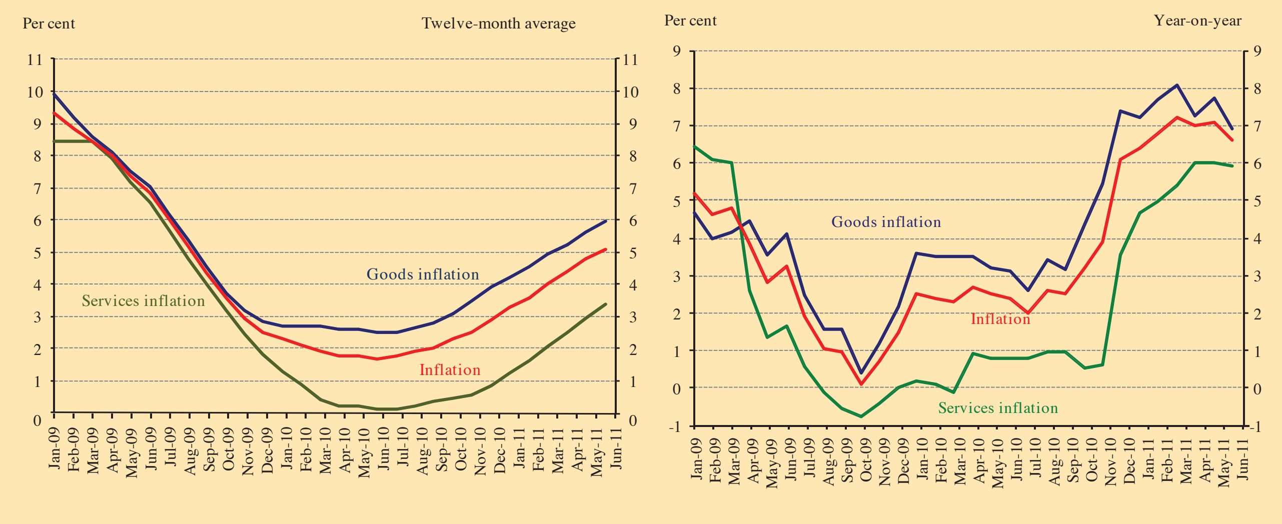
Goods and services inflation

On a twelve-month average basis, goods inflation rose from 3.9 per cent in December 2010 to 5.9 per cent in June 2011, reflecting the firming up of goods prices in the first quarter of 2011. Services inflation, mirroring the trend observed in goods inflation, went up from 0.8 per cent in December 2010 to 3.4 per cent in June 2011.

Based on the year-on-year methodology, goods inflation remained volatile and hovered between 6.9 per cent and 8.1 per cent during the period under review while services inflation went up from 3.5 per cent in December 2010 to 5.9 per cent in June 2011.

Chart 3.6 illustrates the movements in goods and services inflation.

Chart 3.6: Goods and Services Inflation



Sources: Statistics Mauritius and Bank of Mauritius.

3.3 Evolution of Other Price and Cost Indices

Import Price Index

The Import Price Index (IPI), a key indicator of price movements of imported goods in Mauritius, was on an upward trend since the fourth quarter of 2010. The IPI increased by 1.9 per cent between the fourth quarter of 2010 and the first quarter of 2011. It further rose by 2.7 per cent between the first and second quarters of 2011, mainly on account of an increase in the prices of *Mineral fuels, lubricants and related materials* and *Manufactured goods classified chiefly by material*.

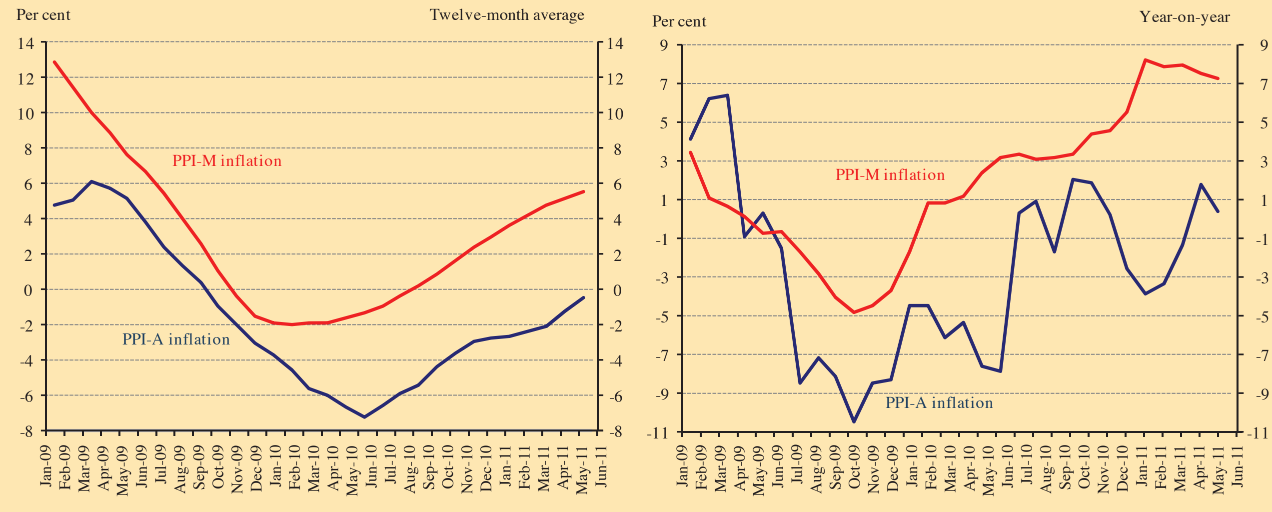
Over the year to June 2011, the IPI went up from 112.5 to 117.7, representing an increase of 4.6 per cent. The growth in the indices of the sub-components of *Animal and vegetable oils*, *Minerals fuels, lubricants and related materials, Food and live animals, Manufactured goods classified chiefly by material*, and *Crude materials, inedible, except fuels* largely contributed to the rise in the IPI.

Producer Price Indices

Price pressures at the production level firmed up in the first half of 2011. The Producer Price Index-Agriculture (PPI-A) inflation for the twelve-month average period rose from -2.9 per cent in December 2010 to -0.5 per cent in June 2011. On a year-on-year basis, PPI-A inflation edged up from 0.2 per cent in December 2010 to 0.4 per cent in June 2011.

The Producer Price Index-Manufacturing (PPI-M) inflation went up from 2.4 per cent in December 2010 to 5.5 per cent for the twelve-month period ended June 2011. The year-on-year PPI-M inflation increased from 4.6 per cent in December 2010 to 7.3 per cent in June 2011. The rise largely reflected the increase in the sub index for *Manufacture of food products and beverages*, which accounts for nearly 50 per cent of the overall weight. The producer price inflation for manufacturing and agricultural products based on the twelve-month average and year-on-year methodologies are illustrated in Chart 3.7.

Chart 3.7: Producer Price Inflation



Sources: Statistics Mauritius and Bank of Mauritius.

Table 3.1: Import Price Index

Description	Weights	Quarterly Percentage Change			Annual Percentage Change	
		Between Q3-2010 and Q4-2010	Between Q4-2010 and Q1-2011	Between Q1-2011 and Q2-2011	Between Q1-2010 and Q1-2011	Between Q2-2010 and Q2-2011
Food and live animals	1,808	3.8	0.9	3.8	9.1	2.3
Beverages and tobacco	138	1.3	-1.2	1.0	-3.1	-1.9
Crude materials. inedible. except fuels	288	3.3	-2.7	6.2	2.3	2.3
Mineral fuels. lubricants and related materials	2,004	3.7	8.2	11.0	20.2	19.8
Animal and vegetable oils. fats and waxes	104	6.8	32.0	0.0	40.1	41.5
Chemical materials & related products. n.e.s	851	1.7	-2.7	0.1	-1.2	-3.1
Manufactured goods classified chiefly by material	2,141	-1.2	1.0	5.1	4.7	2.5
Machinery and transport equipment	1,800	-2.6	0.2	-9.8	7.1	-2.0
Miscellaneous manufactured articles	866	0.0	-2.2	-0.8	0.5	-3.8
Overall Index	**10,000**	**1.1**	**1.9**	**2.7**	**8.3**	**4.6**

n.e.s: not elsewhere specified.
Sources: Statistics Mauritius and Bank of Mauritius.

Wage Rate Index

The Wage Rate Index (WRI) rose by 4.4 per cent from 137.9 in the first semester of 2010 to 144.0 in the first semester of 2011. On a quarterly basis, following an increase of 0.8 per cent in the first quarter of 2011, the growth in the WRI slowed down to 0.3 per cent in the second quarter. A comparison of wage rate increases by industrial group between the first and second quarters of 2011 shows that the largest increases were recorded in *Wholesale & retail trade; repair of* *motor vehicles, motorcycles, personal & household goods* (2.5 per cent), *Financial intermediation* (1.1 per cent), *Agriculture, hunting, forestry and fishing* (0.9 per cent), *Education* (0.9 per cent) and in *Public administration and defence; compulsory social security* (0.4 per cent). In the *Construction* and *Health & social work* sectors, the growth in the WRI was flat. By contrast, the WRI of *Hotels and restaurants* and *Real estate, renting and business activities*, dropped by 1.1 per cent and 0.8 per cent, respectively. Other sectors registered decreases ranging between 0.1 per cent and 0.3 per cent.

Table 3.2 shows the quarterly change in WRI by industry group.

Table 3.2: Wage Rate Index by Industry Group

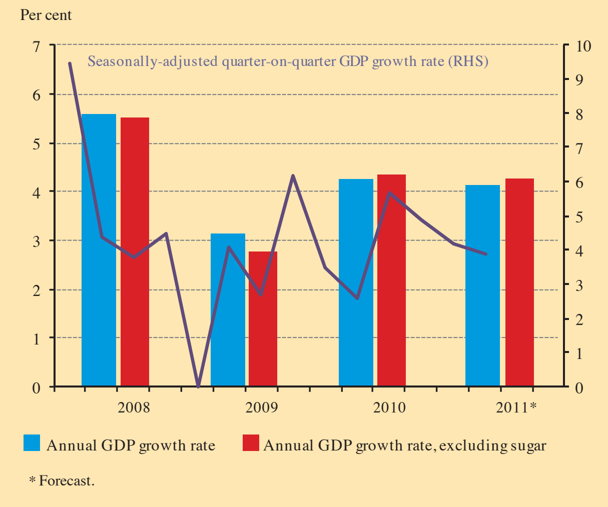
INDUSTRY GROUPS	2010 Q1	2010 Q2	2010 Q3	2010 Q4[1]	2011 Q1[1]	2011 Q2[2]	Weighted contribution between Q4- 2010 and Q1-2011 (Index points)	Weighted contribution between Q1-2011 and Q2-2011 (Index points)	Percentage change between Q4-2010 and Q1-2011 (Per cent)	Percentage change between Q1-2011 and Q2-2011 (Per cent)
Agriculture. hunting. forestry and fishing	134.5	133.6	170.5	155.0	146.9	148.2	-0.5	0.1	-5.2	0.9
Manufacturing. mining and quarrying	127.5	131.1	133.7	136.1	138.7	138.4	0.4	-0.1	1.9	-0.2
Electricity and water	135.6	136.9	138.7	138.4	136.8	136.7	0.0	0.0	-1.2	-0.1
Construction	129.4	137.6	138.7	139.5	139.4	139.4	0.0	0.0	-0.1	0.0
Wholesale and retail trade; repair of motor vehicles. motorcycles. personal and household goods	133.5	132.3	128.7	134.1	135.1	138.5	0.1	0.2	0.7	2.5
Hotels and restaurants	140.2	137.3	141.4	144.1	141.6	140.1	-0.2	-0.1	-1.7	-1.1
Transport. storage and communications	138.4	138.9	139.1	139.4	141.9	141.8	0.2	0.0	1.8	-0.1
Financial intermediation	125.3	126.5	126.8	129.1	127.8	129.2	-0.1	0.1	-1.0	1.1
Real estate. renting and business activities	155.0	154.8	157.8	169.2	170.2	168.9	0.1	-0.1	0.6	-0.8
Public administration and defence; compulsory social security	143.7	146.9	146.8	146.4	150.7	151.3	0.7	0.1	2.9	0.4
Education	143.5	143.6	147.8	143.9	146.0	147.3	0.3	0.2	1.5	0.9
Health and social work	138.3	140.2	139.9	141.0	144.0	144.0	0.2	0.0	2.1	0.0
Other community. social and personal services	134.1	133.7	137.0	140.4	144.6	144.1	0.1	0.0	3.0	-0.3
ALL GROUPS	**137.2**	**138.6**	**142.2**	**142.5**	**143.8**	**144.2**	**1.3**	**0.4**	**0.9**	**0.3**

[1] *Revised.* [2] *Provisional.*
Sources: Statistics Mauritius and Bank of Mauritius.

4. Demand and Output

On a seasonally-adjusted quarter-on-quarter basis, the economy contracted by 1.2 per cent in the first quarter of 2011 but grew marginally by 0.2 per cent in the second quarter of 2011. Year-on-year, growth eased steadily from 4.9 per cent in the last quarter of 2010 to 4.2 per cent and 3.9 per cent in the first and second quarters of 2011, respectively. Chart 4.1 illustrates annual and seasonally-adjusted quarterly GDP growth rates.

Chart 4.1: Real GDP Growth Rate



Source: Statistics Mauritius.

The *Export-oriented enterprises* sector continued to expand at a strong pace of 12.0 per cent in the second quarter of 2011 following robust growth rates of 12.4 per cent and 13.0 per cent in the third and fourth quarters of 2010, respectively and 13.2 per cent in the first quarter of 2011.

All economic sectors recorded positive growth rates in the second quarter of 2011 except *Mining and quarrying and Construction* which contracted by 29.1 per cent and 6.2 per cent, respectively.

The *Manufacturing* sector, which had gathered momentum between the third quarter of 2010 and the first quarter of 2011, slowed to 3.6 per cent in the second quarter. However, the sector performed relatively better compared to the second quarter of 2010 when output had contracted by 2.8 per cent.

Within *Manufacturing*, growth in *Textile* accelerated from 9.5 per cent in the first quarter of 2011 to 17.0 per cent in the second quarter as against contractions of 7.8 per cent and 12.2 per cent in the first two quarters of 2010. Real activity in *Food processing* slowed from 4.1 per cent in the fourth quarter of 2010 to 1.5 per cent in the first quarter of 2011 and stagnated in the second quarter. *Other manufacturing* slowed sharply from 6.3 per cent in the first quarter of 2011 to 1.0 per cent in the second quarter.

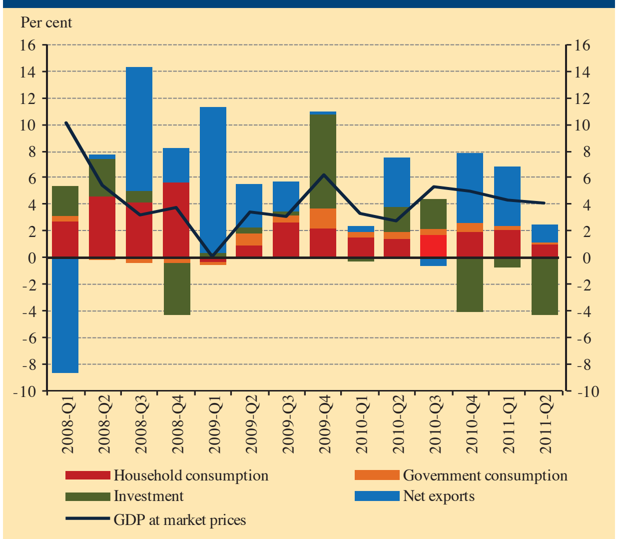
Real activity in the *Hotels and restaurants* sector, which had slowed from 6.3 per cent in the fourth quarter of 2010 to 3.1 per cent in the first quarter of 2011, picked up in the second quarter to 5.1 per cent. Comparatively, the sector had underperformed in the second quarter of 2010 with a growth rate of only 1.9 per cent. Tourist arrivals increased by 5.8 per cent in the first semester of 2011 compared to the first semester of 2010, while gross tourism earnings rose by 7.5 per cent over the same period.

Following an easing of the growth momentum in the *Construction* sector from 11.1 per cent in the third quarter of 2010 to 5.0 per cent in the final quarter of 2010, the sector registered contractions of 4.3 per cent and 6.2 per cent in the first and second quarters of 2011, respectively. The performance of the sector was adversely affected by the completion of some major projects such as commercial and office buildings, new hotels and hotel renovations.

Real activity in the distributive trade sector slowed to 3.1 per cent and 2.8 per cent in the first two quarters of 2011, from 4.7 per cent and 5.1 per cent in the last two quarters of 2010. The *Transport, storage and communications* sector expanded at a lower rate of 4.4 per cent in the second quarter of 2011, from 5.7 per cent in the previous quarter and 6.1 per cent in the same quarter a year ago. Growth in the *Financial intermediation* sector strengthened from 6.4 per cent in the first quarter of 2011 to 7.3 per cent in the second quarter. The *Real estate, renting* and *business activities* sector continued to register robust growth rates of 6.1 per cent and 6.2 per cent in the first two quarters of 2011.

Chart 4.2 shows the contributions of selected aggregate demand components to growth of GDP at market prices.

Chart 4.2: Contributions to Growth of GDP at market prices



Sources: Statistics Mauritius and Bank of Mauritius.

Risks to growth prospects

In its September 2011 WEO, the IMF downgraded the global growth forecast for 2011 to 4.0 per cent from 4.3 per cent projected in its June 2011 WEO Update. Advanced economies were expected to grow by 1.6 per cent in 2011, sharply lower compared to 2.2 per cent projected in June 2011. Emerging and developing economies, on the other hand, were forecast to expand by 6.4 per cent, slightly lower than the previous forecast of 6.6 per cent. Downside risks to the global growth outlook emanate mainly from more pronounced sovereign debt problems in the euro area and higher than expected vulnerabilities in US economic activity.

On the domestic front, it is projected that the *Textile* sector will grow at a robust pace in 2011 after flat growth in 2010. Tourist arrivals are projected to reach 980,000, representing an increase of nearly 5.0 per cent over the figure of 2010. Growth in 2011 is expected to be driven by robust activity in the *Manufacturing, Transport, storage and communications, Financial intermediation* and *Real estate and business activities* sectors. However, the *Construction* sector is forecast to register flat growth on account of completion of major projects. According to the September 2011 issue of the National Accounts Estimates, the economy is now projected to grow by 4.1 per cent in 2011. The downside risks to the growth oulook would stem mainly from rising uncertainty surrounding the euro area debt crisis, deteriorating growth prospects in the main trading partner countries and volatile commodity prices and financial markets.

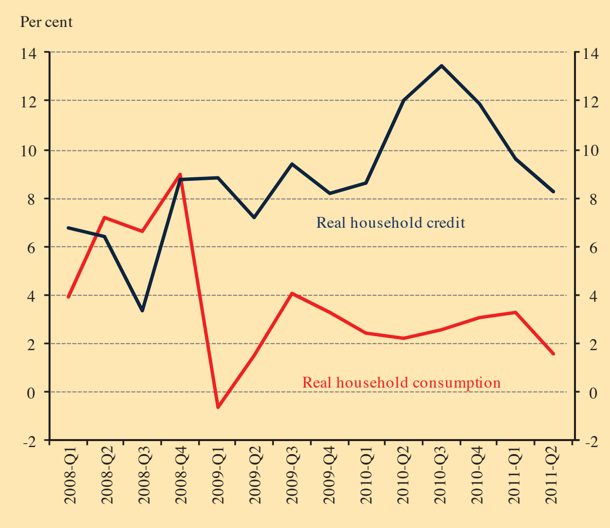
The latest survey of business confidence published by the MCCI pointed to a substantial decline in business confidence from 111.0 in June 2011 to 99.0 in September after successive increases in the past three quarters. The main factors behind the deterioration of the business climate included, among others, weak economic conditions in key export markets, unfavourable exchange rate movements and increase in borrowing costs.

4.1 Consumption

Final consumption expenditure growth slowed from 3.3 per cent in the fourth quarter of 2010 to 3.1 per cent in the first quarter of 2011 and further to 1.5 per cent in the second quarter. Both components of final consumption expenditure grew at a slower pace in the second quarter of 2011 compared to the previous quarter and to the corresponding quarter of the preceding year. Growth in household consumption expenditure, which accounts for around 75 per cent of aggregate consumption expenditure, eased sharply from 3.3 per cent in the first quarter of 2011 to 1.6 per cent in the second quarter possibly as a result of a decline in real bank credit to households which persisted through the first two quarters of 2011, after peaking in the third quarter of 2010. Government consumption expenditure growth stood at 2.0 per cent and 1.1 per cent in the first and second quarters of 2011, respectively compared to 3.1 per cent and 3.0 per cent in the corresponding period of 2010.

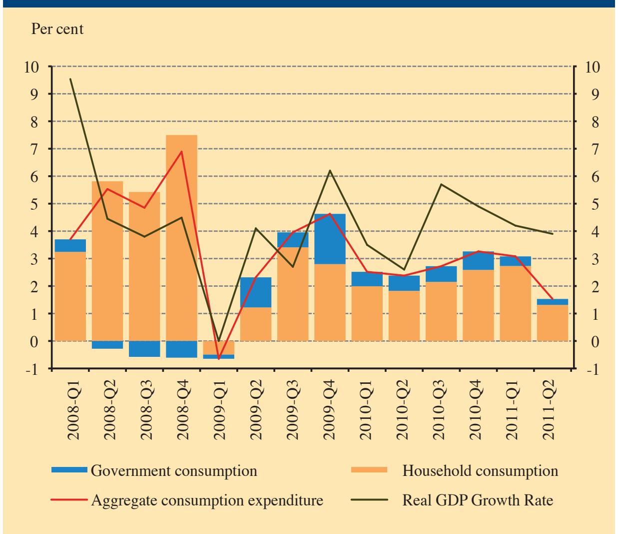
Chart 4.3 depicts the real growth rates of household consumption expenditure and household credit and Chart 4.4 illustrates the evolution of real GDP growth rate and contributions of household and government consumption to aggregate consumption growth.

Chart 4.3: Real Household Consumption and Credit Growth Rates



Sources: Statistics Mauritius and Bank of Mauritius.

Chart 4.4: Real GDP and Consumption Growth Rates



Sources: Statistics Mauritius and Bank of Mauritius.

Uncertain economic prospects and high inflationary pressures in the economy could weigh on consumer confidence and spending in the quarters ahead. Growth in household consumption expenditure is forecast to remain flat at 2.6 per cent in 2011, while government consumption expenditure is expected to decline significantly from 3.4 per cent in 2010 to 2.6 per cent in 2011. Overall, final consumption expenditure is projected to register a slightly lower growth rate of 2.6 per cent in 2011 compared to 2.7 per cent in 2010.

4.2 Investment

Investment contracted for the third consecutive quarter in the second quarter of 2011. A negative growth rate of 16.1 per cent was recorded in the second quarter compared to a more moderate contraction of 3.1 per cent in the first quarter of 2011. The decline in investment spending in the first semester of 2011 was the result of contractions in *Building and construction work* and *Machinery and equipment*. *Building and construction work* posted negative growth rates of 3.4 per cent and 6.8 per cent in the first and second quarters of 2011. Contractions in *Non-residential building* due to the completion of major projects more than offset positive growth rates in *Residential building* and *Other construction work*.

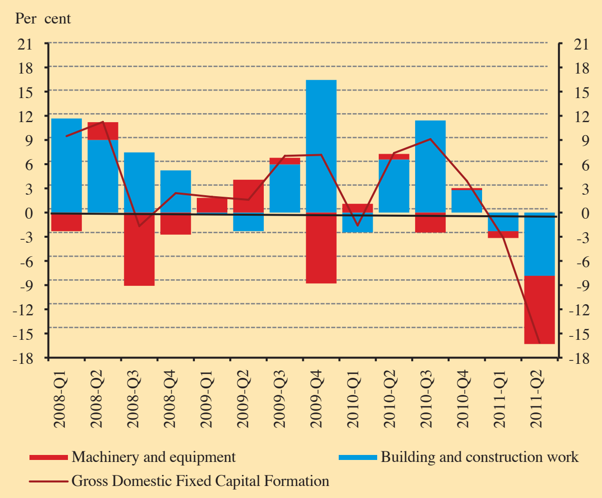
Investment in *Machinery and equipment* contracted by 2.6 per cent and 24.2 per cent in the first and second quarters of 2011, respectively, as against positive growth rates of 4.5 per cent and 2.5 per cent in the first two quarters of 2010. Significant contraction in *Other machinery and equipment* in the first semester of 2011 more than offset positive growth rates registered in the other two components, namely *Passenger car* and *Other transport equipment*.

According to the forecast made by Statistics Mauritius, total investment spending for the year 2011 is expected to expand by 2.1 per cent, driven by public sector investment growth of 9.9 per cent on the back of significant investment in road infrastructure and extension of the airport. In contrast, private investment spending is forecast to contract by 0.6 per cent. The highly uncertain economic environment prevailing in main export markets could weigh on the private sector's investment decisions.

Chart 4.5 shows the growth rate of Gross Domestic Fixed Capital Formation (GDFCF) and the contributions made by its two components, namely *Building and construction work* and *Machinery and equipment* exclusive of aircraft and marine vessel.

Table 4.1 gives details on real growth in the components of aggregate demand.

Chart 4.5: Contributions to Growth in Gross Domestic Fixed Capital Formation



Sources: Statistics Mauritius and Bank of Mauritius.

4.3 Foreign Trade and External Demand

The first half of 2011 was characterised by a significant boost in export earnings and considerable pressure on the import bill caused by rising food and energy prices on the international market. The growing merchandise deficit was, nonetheless, mitigated by higher surpluses emanating from the services, income and current transfers accounts. As a result, the current account deficit improved slightly but its financing showed greater reliance on debt creating net financial flows due to a slowdown in foreign direct investment net flows. As a percentage of GDP at market prices, the current account deficit decreased to around 7.8 per cent in the first half of 2011 compared to 8.5 per cent in the corresponding period of 2010.

Current account

The current account recorded a deficit of Rs11.9 billion in the first six months of 2011. The shortfall, which represented a slight improvement of Rs0.05 billion year-on-year, was mostly attributable to a higher surplus in the net invisibles accounts that partly offset the deteriorating merchandise trade deficit.

Table 4.1: Real Growth in the Components of Aggregate Demand

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

	2009 [1]	2010 [1]	2011 [2]	2010 [1]				2011	
				Q1	Q2	Q3	Q4	Q1[1]	Q2[3]
Final Consumption Expenditure	2.4	2.7	2.6	2.5	2.4	2.7	3.3	3.1	1.5
of which:									
Household consumption	2.1	2.6	2.6	2.4	2.2	2.6	3.1	3.3	1.6
Government consumption	5.1	3.4	2.6	3.1	3.0	3.5	4.1	2.0	1.1
Investment	8.9	-0.7	2.1	-1.3	7.6	9.4	-14.3	-3.1	-16.1
Investment (exclusive of the acquisition of aircraft & marine vessel)	5.5	3.7	1.9	n.a	n.a	n.a	n.a	n.a	n.a
Exports of goods and services	-3.5	13.5	4.0	11.7	18.4	10.1	14.2	16.0	5.5
Imports of goods and services	-10.7	9.5	5.0	11.7	10.8	12.1	4.1	8.6	3.4

[1] : Revised. [2] : Forecast. [3] :First estimates. n.a.: not available.

Source: Statistics Mauritius.

BOX 1 – MEASUREMENT OF POTENTIAL OUTPUT AND OUTPUT GAP

Measuring the level of an economy's potential output and output gap is essential in the assessment of the medium-term economic outlook and in the implementation of macroeconomic policies. The estimation of potential output helps to determine the pace of sustainable growth while that of the output gap provides a key benchmark to assess inflationary or disinflationary pressures, suggesting when to tighten or ease monetary policy.

Potential output, also referred to as trend output or the production capacity of the economy, is defined as the maximum level of goods and services an economy can produce on a sustained basis with existing resources (labour, capital equipment, technological and entrepreneurial know-how) without generating inflation pressures. Consequently, potential output is determined by how successful an economy is in utilising its factors of production.

In the short run, aggregate demand of the economy can cause it to operate at a production level different from its potential. The difference between actual and potential output is known as the output gap. If the level of output is above capacity, a positive output gap develops, which is reflected in excess demand for goods and labour. Eventually, the positive output gap forces up wages and prices, causing inflation to rise. An economy operating below its output capacity, on the other hand, develops a negative output gap which, all things being equal, eases inflationary pressures.

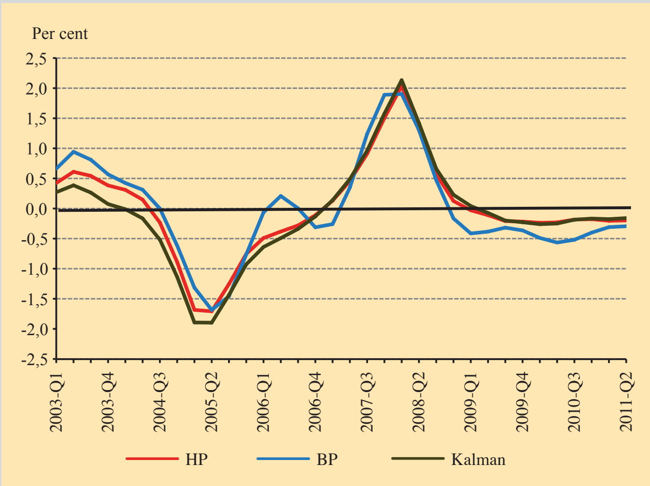
It is important for a central bank to be able to assess the current state of the economy in order to implement appropriate policies. Other things being equal, when demand is expected to exceed capacity in an economy (positive output gap), the central bank may raise interest rates to cool down demand and inflation pressures. When demand is expected to fall short of capacity (negative output gap), the central bank may lower interest rates to boost demand and prevent disinflation pressures.

The problem, however, is that the potential output is an unobserved variable. Both potential output and the output gap need to be estimated. In general, there are two different approaches to estimating potential output: statistical detrending and the estimation of structural relationship. The difference between the two approaches is that the former attempts to separate output into permanent and cyclical components using statistical filters, while the latter uses a structural relationship between economic variables to isolate the effects of structural and cyclical influences.

The most commonly used method of statistical filtering used to decompose the real output of an economy into a trend and a cyclical component is the Hodrick-Prescott (HP) filter. The trend is interpreted as a measure of the economy's potential output and the cycle is interpreted as a measure of the output gap. The filter is a two-sided smoothing method that minimises both the fluctuations of the cycle and the trend, conditional on a smoothing parameter, lambda. The parameter lambda determines to what extent variability in the trend as compared to the cycle is allowed for; the higher the lambda, the smoother the trend. Another statistical filter that can be used is the band-pass (BP) filter. In contrast to the HP filter, the BP filter allows suppression of both the low frequency trend components and the high frequency components in an economic series. The BP filter is a linear filter that takes a two-sided weighted moving average of the data where cycles in a "band", given by a specified lower and upper bound, are extracted, and the remaining cycles are "filtered" out.

Also widely used, the method of Kalman filtration, uses observed data and an economic structure to estimate the potential output and the resulting output gap. The estimation therefore takes into account additional economic information such as past output, real interest rates and real exchange rates. Estimates of potential output vary depending on the model and data used, and there is no general consensus on which model is best.

The figure below shows an estimate of the output gap for the Mauritian economy up to the second quarter of 2011 using the HP, BP and Kalman filtration methods. As the chart shows, alternative methods yield different estimations of the output gap, although the business cycle component is quite similar. The output gap was negative for most of 2005 and 2006. This was mainly on account of the loss of preferential access to European markets for sugar and textiles and for textiles to the United States, which had led to rising unemployment, balance of payments difficulties, falling government revenue and ultimately lower growth rates. The economy fared better in 2007 and the first half of 2008 leading to a positive output gap but the international financial meltdown severely constrained growth in 2009 with the result that the output gap turned negative. While the output gap is expected to close, it might be at a slower pace than previously projected, reflecting developments in major export markets.



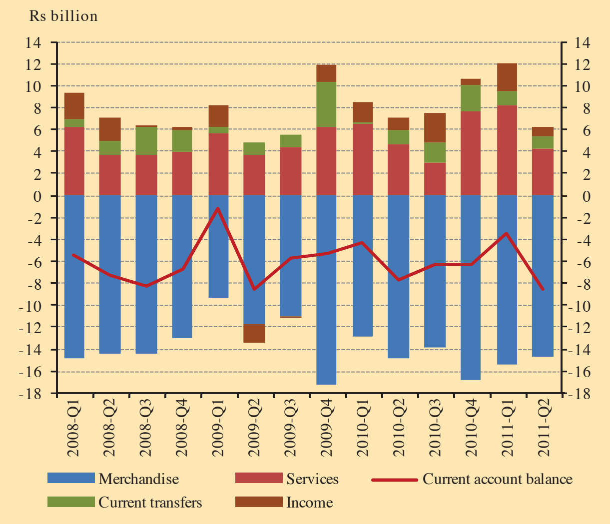
Even though export growth surged by 15.1 per cent in the first semester of 2011 relative to the corresponding period of 2010, the expansion in nominal imports, in absolute terms, led to further widening of the merchandise trade deficit. The trade in goods deficit widened by Rs2.6 billion to Rs30.2 billion in the first six months of 2011. While the increase in exports over the six month period ended June 2011 was mainly driven by a sharp growth in external demand, with export volume largely outweighing the rise in export prices, the expansion in imports accelerated primarily on account of higher import prices relative to volume.

The services account showed a surplus of Rs12.5 billion in the first half of 2011, representing a year-on-year increase of 10.1 per cent. Overall growth in services account was mostly as a result of a rise in net travel receipts coupled with a decline in net transportation payments. Net receipts on travel registered a significant increase of 18.3 per cent in the first half of 2011 to reach Rs15.7 billion as inbound tourism expanded by 7.1 per cent.

Net receipts in the income account attained Rs3.3 billion in the first semester of 2011, an improvement of Rs0.4 billion or 12.5 per cent, compared to the same period in the preceding year. The increase was mostly attributed to higher net income earned by banks on net external assets, which more than compensated the surge in direct investment income payments. Current transfers recorded a higher surplus of Rs2.5 billion compared to Rs1.4 billion in the corresponding period of 2010.

The components of the current account are depicted in Chart 4.6.

Chart 4.6: Components of the Current Account



Capital and financial account

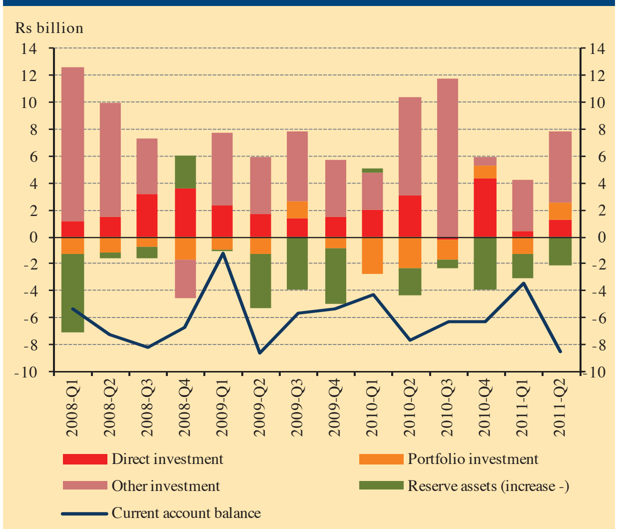
The capital and financial account registered net inflows of Rs6.9 billion in the first semester of the year, lower than the Rs8.2 billion net inflows recorded in the same period of 2010. The declining net flows in the capital and financial account were driven largely by the slowdown in net direct investment and, to some extent, lower other investment flows.

Private long term net capital inflows associated with foreign direct investment, which amounted to Rs5.1 billion in the first semester of 2010, decelerated to Rs1.7 billion in the corresponding period of 2011. Foreign direct investment in Mauritius lost pace to reach Rs2.8 billion in the first semester of 2011. Residents' direct investment abroad also slowed to Rs1.1 billion in the first semester of 2011 relative to a net outflow of Rs2.5 billion last year.

Portfolio investment witnessed a sharp turnaround, from a net outflow of Rs5.1 billion a year earlier to a net inflow of Rs0.04 billion for the first six months of 2011. The overall net inflow was largely brought about by substantial repatriation of residents' portfolio assets from abroad, which more than outweighed the lower net non-resident investors' purchases of shares on the domestic stock market. Net non-residents' purchases of shares on the Mauritius Stock Exchange were sluggish in the first half of this year, amounting to Rs0.2 billion compared to Rs0.8 billion in the corresponding period of 2010. The other investment account showed slightly lower net inflows of Rs9.1 billion during the first semester of 2011. In year-on-year terms, this was mostly associated with a slower increase in banks' foreign liabilities and lower flows related to both short-term and long-term debt. Government external borrowing was, however, higher in the first six months of 2011 relative to 2010 due to loans contracted from Exim Bank of India and China, ADB, IBRD and AFD.

The financing of the current account deficit is depicted in Chart 4.7.

Chart 4.7: Financing of the Current Account



The country's overall balance of payments for the first two quarters of 2011, as measured by the change in reserve assets excluding valuation change, recorded a surplus of Rs3.9 billion.

Details on the balance of payments are provided in Table 4.2.

Net external demand

The year-on-year growth in net exports of goods and services slowed to 8.7 per cent in the first half of 2011 after posting a brisk expansion of 37.7 per cent in the corresponding semester of the previous year. In the first half of 2011, exports of goods and services grew by 13.5 per cent while imports of goods and services increased by 12.6 per cent.

Chart 4.8 depicts the growth in external trade from first semester 2007 to first semester 2011.

Exports

Total nominal exports of goods, excluding Ship's Stores and Bunkers, increased by 12.1 per cent, year-on-year, to Rs31.5 billion in the first semester of 2011. Domestic exports, which accounts for nearly 73 per cent of total exports, expanded by a higher 15.4 per cent despite an appreciation of the rupee vis-à-vis the currencies of our main export markets. However, re-exports of goods registered a negative growth of 2.4 per cent.

Chart 4.8: Growth in External Trade

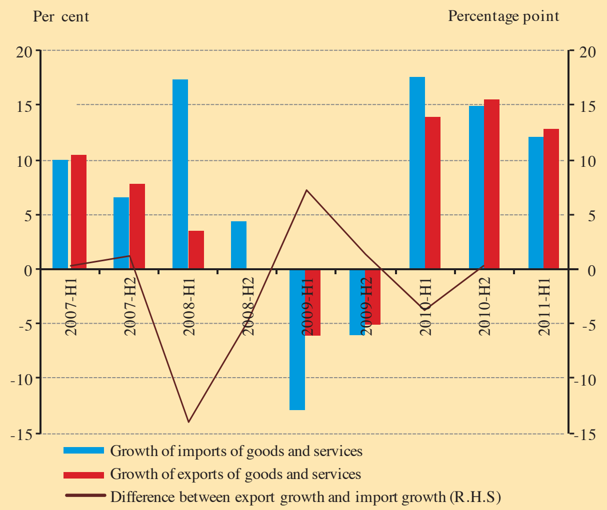


Table 4.2: Balance of Payments Summary

			Rs million
	2010 [1]		2011 [2]
	Semester 1	*Semester 2*	*Semester 1*
Current Account	**-11,992**	**-12,541**	**-11,942**
Exports (f.o.b)	31,461	38,095	3, 188
Imports (f.o.b)	-59,076	-68,793	-66,368
of which: aircrafts/marine vessels	-	-	-
Trade balance	-27,615	-30,698	-30,180
Services, net	11,328	10,620	12,469
of which:travel, net	*13,294*	*13,928*	*15,724*
Income, net	2,937	3,266	3,303
Current transfers, net	1,358	4,271	2,466
Capital and Financial Account	**8,221**	**11,442**	**6,945**
Capital account, net	-115	-33	-25
Direct investment, net	5,063	4,211	1,710
Portfolio investment, net	-5,060	-669	40
Other investment, net	10,022	12,421	9,131
Balance of Payments Surplus (-)/ Deficit (+)	-1,689	-4,488	-3,911
Net Errors and Omissions	**3,771**	**1,099**	**4,997**

[1] Revised estimates. [2] Provisional.

Figures may not add up to totals due to rounding.

The commodity breakdown showed that exports of Manufactured goods classified chiefly by material witnessed the highest growth rate of 22.3 per cent, followed by exports of *Food and live animals* (12.0 per cent) and *Miscellaneous manufactured articles* (10.5 per cent).

Europe remained our main export market with its share climbing further to 64.5 per cent in the first semester of 2011 compared to 63.8 per cent in the first semester of 2010. Exports to all the main European countries increased with the share of the United Kingdom, France, Spain and Italy, respectively at 21.8 per cent, 15.9 per cent, 7.7 per cent and 7.6 per cent. The share of exports to the African continent increased to 19.4 per cent as exports to South Africa and Madagascar went up by 62.3 per cent and 21.9 per cent, respectively. The export share to the USA remained constant at 9.9 per cent while the export share to the Asian continent dropped by 2.2 percentage points to 5.0 per cent.

The main export destinations are illustrated in Chart 4.9.

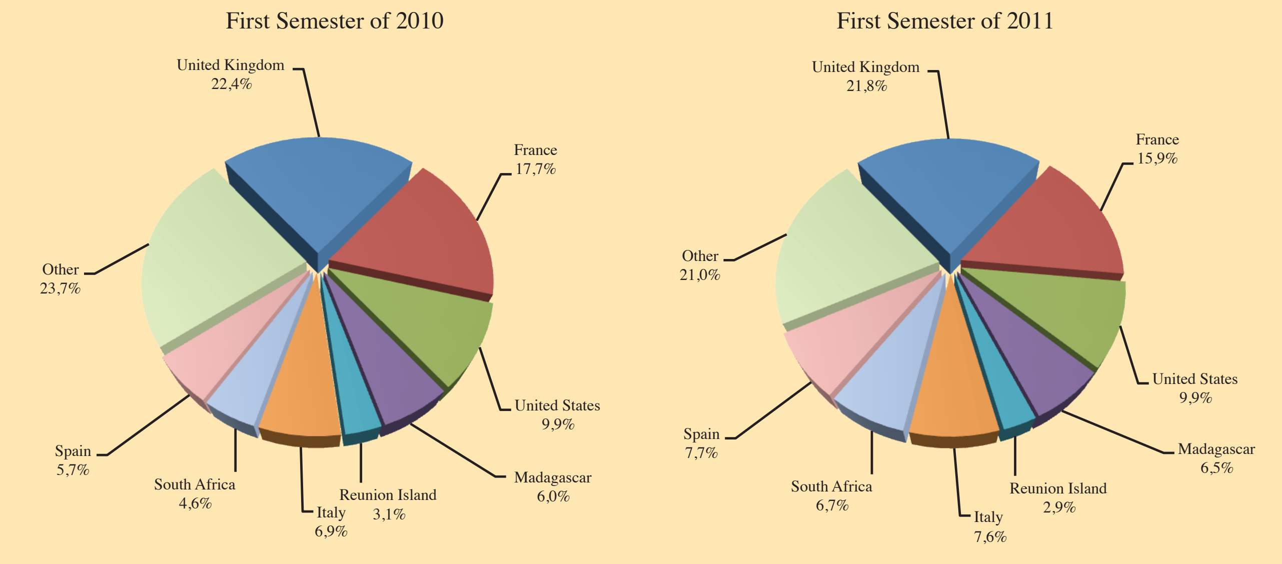
Imports

Imports of goods (*cif*) rose by 10.6 per cent to Rs69.5 billion in the first semester of 2011. With demand for foreign goods softening amid escalating world prices and weak growth prospects, growth in nominal imports was largely driven by higher import prices rather than volume increase.

The growth in imports reflected mainly increases of 35.8 per cent in *Minerals fuels, lubricants and related materials*, 15.6 per cent in *Manufactured goods classified chiefly by material* and 8.1 per cent in *Food and live animals*. The significant increase in import bill for *Mineral fuels, lubricants and related products* coincided with a rise in both price and volume of imports of refined petroleum products. The average price of crude oil (NYMEX) on the world market stood at US$98.4 per barrel in the first semester of 2011 compared to US$78.4 per barrel in the same period of 2010.

The Asian continent accounted for 53.7 per cent of total imports in the first semester of 2011, up from 52.8 per cent in the corresponding semester of the previous year. Imports originated mainly from India, China, France, South Africa and Spain, with shares of 25.5 per cent, 12.8 per cent, 9.1 per cent, 7.5 per cent and 3.2 per cent, respectively. Share of imports to India witnessed the greatest increase due to the significant rise in the import bill for petroleum products.

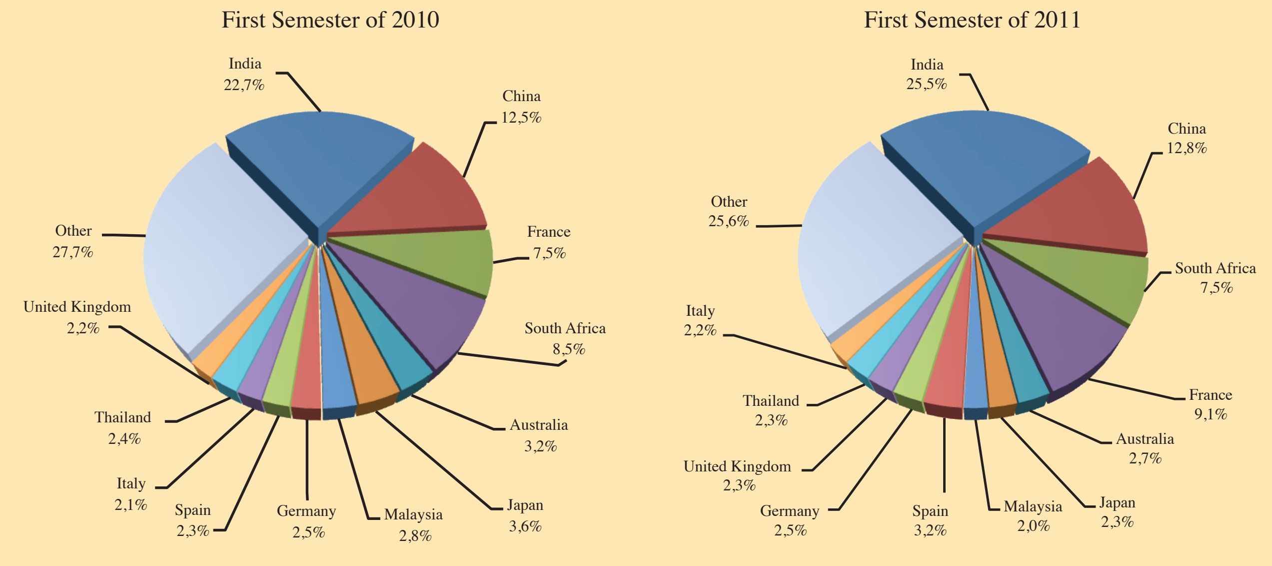
Chart 4.9: Main Export Destinations



Source: Statistics Mauritius.

Chart 4.10 shows the main sources of imports.

Chart 4.10: Main Sources of Imports



Source: Statistics Mauritius.

Box 2: External Indicators

		June-10	June-11
		Rs million	
Gross External Debt [1]	as at end	33,175	42,300
External Debt Service	year ended	4,439	7,101
Exports of Goods	year ended	64,129	74,283
Exports of Goods and Services	year ended	141,563	161,976
Imports of Goods and Services	year ended	175,443	199,765
Gross Official International Reserves [2]	as at end	70,105	81,667
GDP at market prices	year ended	288,973	313,572
Broad Money Liabilities	as at end	302,944	320,818
Indicators		Per cent	
I. Solvency			
Gross External Debt/GDP		11.5	13.5
Gross External Debt/Exports		51.7	56.9
Gross External Debt/Exports of Goods and Services		23.4	26.1
External Debt Service/Exports		6.9	9.6
External Debt Service/Exports of Goods and Services		3.1	4.4
II. Reserve Adequacy			
Reserves/Imports of Goods and Services		40.0	40.9
Reserves/ Broad Money Liabilities		23.1	25.5
Reserves/Gross External Debt		211.3	193.1

[1] Gross External Debt outstanding as at end of period comprises Central Government, public corporations, monetary authorities and private sector.

[2] Gross Official International Reserves as at end of period comprise gross foreign assets of the Bank of Mauritius, reserve position in the IMF and the foreign assets of Government.

The gross external debt of the country rose by Rs9,125 million, or 27.5 per cent, from Rs33,175 million as at end-June 2010 to Rs42,300 million as at end-June 2011, driven by the increase in Central Government external debt as a result of government reliance on external debt to finance its deficit.

As a percentage of GDP at market prices, gross external debt of the country went up from 11.5 per cent as at end-June 2010 to 13.5 per cent as at end-June 2011, reflecting a higher increase in debt compared to nominal GDP. Reflecting the increase in the stock of external debt, its ratio to the exports of goods and services rose from 23.4 per cent to 26.1 per cent over the same period. The ratio of external debt service to exports of goods and services increased from 3.1 per cent as at end-June 2010 to 4.4 per cent as at end-June 2011.

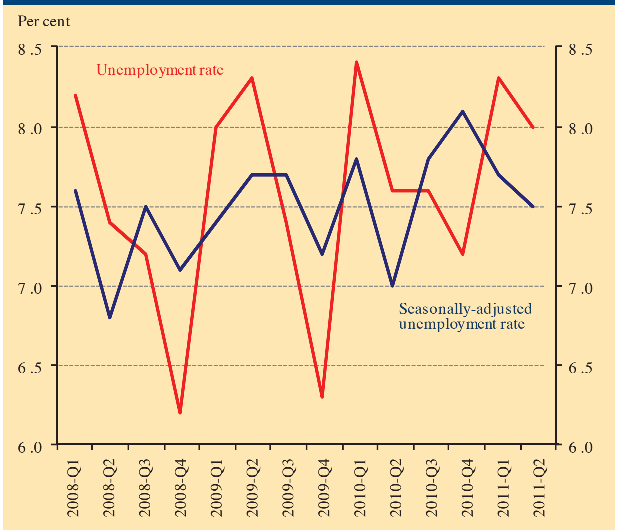
Between end-June 2010 and end-June 2011, the ratio of reserves to imports of goods and services increased from 40.0 per cent to 40.9 per cent but the ratio of reserves to gross external debt decreased from 211.3 per cent to 193.1 per cent as a result of higher increase in debt.

4.4 Labour Market

The unemployment rate increased from 7.2 per cent in the fourth quarter of 2010 to 8.3 per cent in the first quarter of 2011, partly due to seasonal factors such as school leavers joining the labour market. As expected, in the second quarter of 2011, the unemployment rate dropped to 8.0 per cent. Comparatively, in the first and second quarters of 2010, the unemployment rate was 8.4 per cent and 7.6 per cent, respectively. On a seasonally-adjusted basis, the unemployment rate fell from 8.1 per cent in the fourth quarter of 2010 to 7.7 per cent in the first quarter of 2011 and further to 7.5 per cent in the second quarter of 2011. In the first and second quarters of 2010, the seasonally-adjusted unemployment rate was 7.8 per cent and 7.0, respectively. For 2011, the unemployment rate is forecast at 7.8 per cent, same as in the previous year.

Chart 4.11 shows the evolution of the quarterly unemployment rate.

Chart 4.11: Quarterly Unemployment Rate



Source: Statistics Mauritius.

On a year-on-year basis, some sectors registered gains in employment, while other sectors shed jobs. The highest number of jobs was created in the *Hotels and restaurants* sector, followed by *Financial intermediation* and *Real estate, renting and business activities* sectors. Other sectors recording a rise in employment include *Health & Social work* and *Public administration and defence; compulsory social security*. In the remaining sectors, job losses or no job creation were recorded. Quarter-on-quarter data indicate that jobs were created in the second quarter of 2011, namely in the *Manufacturing, Hotels and restaurants, Real estate, renting and business activities, Public administration and defence; compulsory social security*, and *Health & Social work* sectors. Job losses were recorded in *Agriculture, forestry and fishing, Construction, Wholesale and retail trade; repair of motor vehicles, motorcycles and personal household goods, Transport, storage and communications, Education* and *Other community, social and personal service*. Employment in the remaining sectors was flat.

Employment in *Export-oriented enterprises* decreased by 1,564, from 58,084 at the end of June 2010 to 56,520 at the end of June 2011. The major decline in employment to the tune of 2,451 was registered in the Wearing apparel group, from 40,691 at the end of June 2010 to 38,240 at the end of June 2011.

In 2010, both labour productivity and average compensation for the whole economy increased at a lower rate than in the previous year. Labour productivity and average compensation grew by 2.1 per cent and 3.0 per cent, respectively, in 2010 compared to 2.6 per cent and 5.6 per cent, respectively, in 2009. The lower growth in productivity in 2010 was the result of a GDP growth of 4.4 per cent compared to 3.3 per cent in 2009, coupled with higher growth in labour inputs of 2.3 per cent against a rise of only 0.5 per cent in 2009. With the relatively lower growth in average compensation of employees, unit labour cost grew at 0.9 per cent in 2010, lower than the increase of 2.9 per cent in 2009. In 2010, capital productivity declined by 0.6 per cent, lower than the contraction of 2.5 per cent in 2009, while multifactor productivity contracted by 0.1 per cent in 2010 compared to a decline of 0.9 per cent in 2009. Both labour and capital productivity in the *textile* sector registered sizeable increases of 8.5 per cent and 16.9 per cent, respectively, in 2010, while unit labour cost increased by only 2.9 per cent.

Labour market outlook

Unemployment in Mauritius is mostly of a structural nature, as there is a mismatch between the skills of the labour force and the types of jobs available. Looking ahead, the outlook for the labour market would depend to some extent on the performance of key employment sectors of the economy, which, except the *Construction* sector, are projected to record fairly robust growth momentum. However, uncertainties generated by the euro area debt crisis have intensified in main markets and could impact negatively on the performance of external demand-led sectors. The September 2011 issue of the MCCI Business Sentiment survey pointed to a decline in business confidence, which could have a direct impact on employment. The short-to-medium term challenge remains the supply of skilled labour such as technicians, line managers and other professionals. The Mauritian economy is therefore expected to continue to create jobs in coming months, albeit at a decreasing rate.

5. Monetary and Financial Developments

5.1 Monetary and Credit Developments

Growth in money and credit aggregates were subdued in the first half of 2011. A sector-wise breakdown of credit indicates that credit to the household sector maintained its growth momentum, while growth of credit to the corporate sector was moderate.

Monetary base

The monetary base declined by Rs2.6 billion between end-December 2010 and end-June 2011, mainly reflecting contractions of 9.5 per cent and 2.8 per cent, respectively, in both currency in circulation and deposits held by Other Depository Corporations (ODCs) with the central bank. The rupee counterpart of the Bank's substantial net purchases on the domestic foreign exchange market was partly offset by the Bank's net issuance of its own securities.

On the sources side of the monetary base, net foreign assets of the Bank rose moderately by 3.2 per cent in the first semester of 2011 in contrast to a marginal fall of 0.1 per cent in the first semester of 2010. Domestic claims by the Bank went down mainly on account of a moderate fall in net claims on central government following a rise in Government deposits at the Bank of Mauritius in the first half of 2011.

Broad Money Liabilities

Broad Money Liabilities (BML) grew at a slower pace in the first semester of 2011 compared to the same period of 2010. BML edged up by 0.5 per cent in the first semester of 2011 compared to a rise of 2.2 per cent in the first semester of 2010.

Chart 5.1 shows the evolution in the growth rates of the monetary base and BML, while Chart 5.2 depicts the evolution in the growth rates of BML and credit to private sector as well as the inflation rate.

Components of Broad Money Liabilities

Subdued growth of BML in the first half of 2011 was mainly due to a moderation in the growth of both Narrow Money Liabilities (NML) and quasi-money liabilities. NML dropped by 3.8 per cent in the six months ended June 2011, higher than the fall of 2.7 per cent in the six months ended June 2010, reflecting lower demand for both currency by the public and rupee transferable deposits.

Chart 5.1: Growth in Monetary Base and Broad Money Liabilities
(Percentage change over corresponding month of previous year)

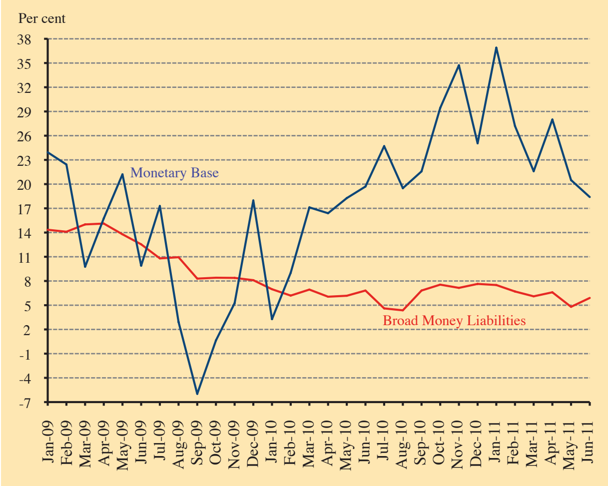
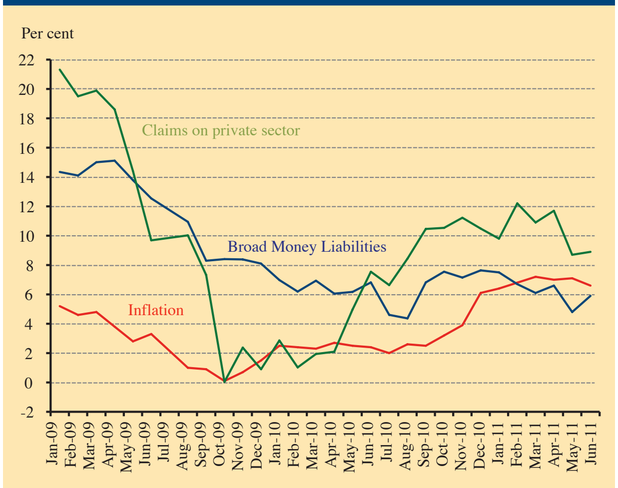


Chart 5.2: Growth in Broad Money Liabilities and Credit to Private Sector and Inflation Rate
(Percentage change over corresponding month of previous year)



Quasi-money liabilities rose by 1.2 per cent in the first semester of 2011 compared to 3.4 per cent in the first semester of 2010. The lower growth in quasi-money liabilities mainly reflected a larger drop of 2.1 per cent in rupee time deposits in the first semester of 2011 relative to a marginal fall of 0.2 per cent in the first semester of 2010. The growth rate of rupee savings deposits and foreign currency deposits went down from 7.1 per cent and 3.9 in the first semester of 2010 to 4.0 per cent and 1.4 per cent, respectively, in the first semester of 2011. Securities other than shares increased sharply by 41.0 per cent in the first half of 2011 compared to only 9.0 per cent in the first half of 2010.

Table 5.1 provides details on growth rates of the components of BML and credit.

Sources of Broad Money Liabilities

The net foreign assets of depository corporations decreased marginally by 0.1 per cent in the first semester of 2011 compared to a fall of 3.2 per cent in the six months ended June 2010, mainly as a result of a decrease in net foreign assets held by ODCs. The net foreign assets of the Bank went up by 3.2 per cent in the first half of 2011, mainly due to valuation changes and intervention on the interbank foreign exchange market, while those of ODCs went down by 7.5 per cent on account of a greater increase in liabilities to non-residents.

Domestic credit extended by depository corporations expanded at a reduced pace of 2.5 per cent in the first semester of 2011 compared to 6.2 per cent in the first semester of 2010. Net credit to budgetary central government contracted by 9.3 per cent in the first half of 2011 as against an expansion of 4.9 per cent in the corresponding period of 2010. Credit to the private sector by ODCs continued to expand, albeit at a slower rate of 5.0 per cent compared to 6.5 per cent in the first semester of 2010.

Sector-wise distribution of credit by banks

Bank credit to the private sector rose modestly by 3.3 per cent in the first half of 2011 compared to a rise of 7.1 per cent in the corresponding period of 2010. The construction, tourism, traders and financial and business services sectors made up 47.7 per cent, 26.1 per cent, 15.9 per cent and 15.7 per cent of the increase in bank credit.

Credit to the household sector went up by 7.0 per cent in the first half of 2011 compared to a rise of 7.9 per cent in the first half of 2010. Credit to the housing sector continued to grow robustly at 9.2 per cent in the first semester of 2011 compared to growth of 8.2 per cent recorded in the corresponding period of the previous year. Corporate credit went up by 4.4 per cent in the first semester of 2011 compared to a rise of 8.0 per cent in the corresponding semester of the previous year.

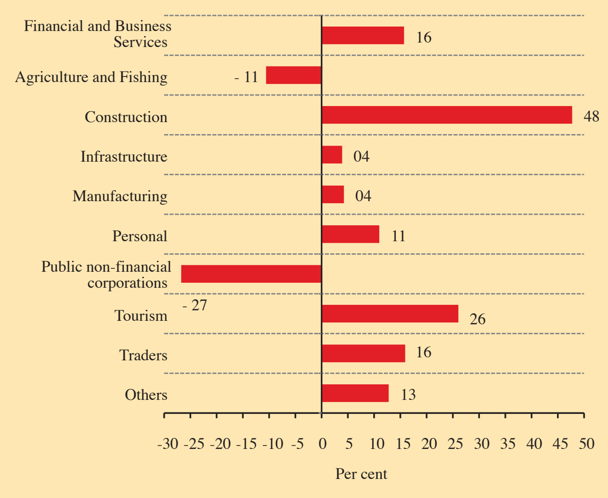
Table 5.1: Broad Money Liabilities, Domestic Credit and Net Foreign Assets

Rs million

	June-09	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11
Broad Money Liabilities	**283,613**	**296,480**	**297,312**	**302,944**	**300,567**	**319,124**	**315,401**	**320,818**
Narrow Money Liabilities	53,920	60,904	58,847	59,262	57,086	63,835	60,012	61,402
Currency with public	*14,683*	*17,153*	*15,845*	*15,905*	*16,242*	*18,975*	*17,492*	*17,517*
Transferable deposits	*39,237*	*43,751*	*43,002*	*43,357*	*40,844*	*44,860*	*42,519*	*43,886*
Quasi-Money Liabilities	228,137	234,805	237,659	242,841	240,519	252,420	251,912	255,371
Savings deposits	*79,604*	*84,477*	*87,452*	*90,513*	*96,748*	*102,349*	*106,417*	*106,470*
Time deposits	*92,051*	*94,251*	*93,113*	*94,073*	*91,399*	*94,150*	*90,280*	*92,196*
Foreign currency deposits	*56,482*	*56,077*	*57,093*	*58,255*	*52,372*	*55,921*	*55,215*	*56,705*
Securities other than shares	1,556	772	806	842	2,962	2,869	3,477	4,045
Domestic Credit	**275,223**	**277,412**	**280,145**	**294,721**	**294,963**	**304,164**	**301,430**	**311,742**
Credit to private sector	225,439	227,569	229,303	242,449	246,778	251,432	254,240	263,933
Net Foreign Assets	**97,146**	**105,124**	**103,539**	**101,733**	**96,509**	**106,951**	**106,633**	**106,826**

The distribution of the change in bank credit to the private sector over the period December 2010 to June 2011 is shown in Chart 5.3.

Chart 5.3: Sectorwise Contribution to the Change in Bank Credit to the Private Sector – End-Dec 2010 to End-June 2011



5.2 Money Market

Liquidity management

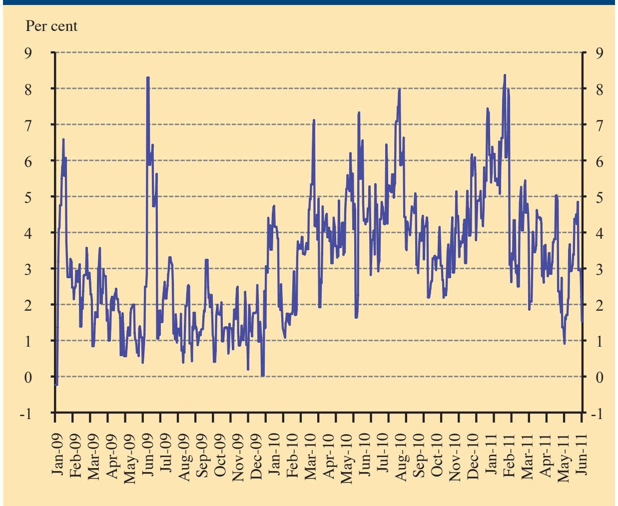
Banks' excess reserves trended upwards, from Rs4.8 billion at the start of January 2011 to peak at Rs8.4 billion around mid-February 2011, largely on account of maturing Government securities exceeding its issuance of securities. To bring down excess reserves, the Bank raised the Cash Reserve Ratio from 6.0 per cent to 7.0 per cent in February 2011, thereby mopping up around Rs2.8 billion from the system. In addition, it stepped up its open market operations to further reduce the level of excess reserves, which reached a trough of Rs0.9 billion towards end-May 2011 before closing June 2011 at around Rs1.5 billion. In the first half of 2011, total issuance of BoM Bills and BoM Notes amounted to Rs3.7 billion and Rs2.5 billion, respectively, while banks' excess reserves averaged Rs4.1 billion.

Chart 5.4 depicts the evolution of banks' daily excess reserves.

Interbank interest rates

Interbank interest rates maintained a downward trend, pressured by excess liquidity conditions during the period January 2011 through the third week of May 2011. Thereafter, the rates started to rise on account of tighter liquidity conditions. The overnight interbank market rates remained on a downward trend to reach a low of 1.20 per cent in the first week of May 2011. Thereafter, following a decline in the level of excess liquidity and reflecting the hikes in the Key Repo Rate by a total of 75 basis points in the first semester of 2011, the overnight interbank rates started to rise to peak at 3.50 per cent in the first week of June 2011. However, at the end of June 2011, the overnight weighted average interbank rate fell to 1.90 per cent. During the period January to June 2011, the overnight interbank interest rates hovered between a low of 1.20 per cent and a high of 3.50 per cent compared to a range of 3.00 per cent to 4.25 per cent in the period January to June 2010. Interest rates on short notice and term transactions on the interbank market hovered in a range of 1.35 per cent to 4.00 per cent during the first six months of 2011 compared to a range of 3.25 per cent to 4.65 per cent in the corresponding period of 2010. The overall weighted average interbank rate ranged from 1.20 per cent to 3.08 per cent during the first half of 2011 compared to a range of 3.19 per cent to 4.74 per cent in the corresponding period of 2010.

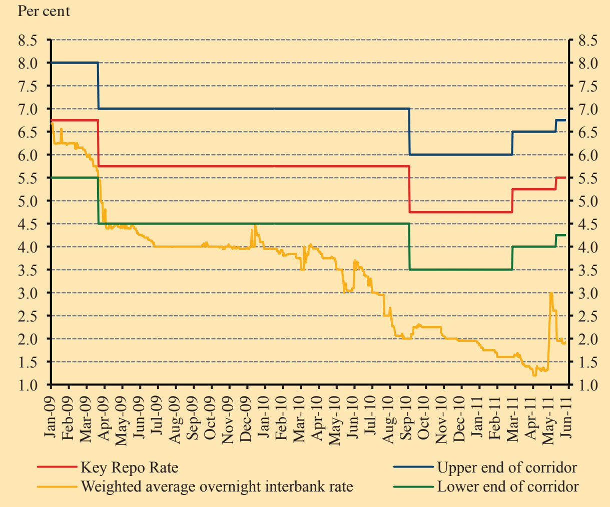
Chart 5.4: Banks' Daily Excess Reserves



The volume of interbank transactions rose over the first semester of 2011. Interbank transactions during the period January through June 2011 totalled Rs137,439 million, representing a daily average of Rs759.3 million compared to Rs355.4 million during the period January to June 2010.

The evolution of the overnight weighted average interbank interest rate is depicted in Chart 5.5.

Chart 5.5: Overnight Weighted Average Interbank Interest Rate



Yields on Government debt instruments

In general, the primary auctions of Treasury Bills remained oversubscribed during the period January to June 2011 owing to the excess liquidity situation. The bid-cover ratio averaged 2.38 for the first six months of 2011 compared to 2.32 for the corresponding period of 2010. Yields on Treasury Bills were on a generally downward trend due to aggressive bidding behaviour of market participants.

Following the hike of 50 basis points in the KRR on 28 March 2011 and a series of measures taken by the Bank to mop up excess liquidity in the system, yields on Government of Mauritius Treasury Bills started to rise as from April 2011. As at end-June 2011, with the exception of the weighted yield of the 91-day GMTB, the weighted average yield of the two other maturities hovered above the lower bound of the Key Repo Rate corridor of 4.25 per cent.

The weighted average yield on 91-Day Treasury Bills went up by 217 basis points, from 2.02 per cent at end-December 2010 to 4.19 per cent at end-June 2011. The weighted average yield on 182-Day Treasury Bills increased by 142 basis points, from 3.04 per cent at end-December 2010 to 4.44 per cent at end-June 2011, while the weighted average yield on 364-Day Treasury Bills increased by 123 basis points, from 3.49 per cent at end-December 2010 to 4.72 per cent at end-June 2011.

At the monthly issues of 2, 3 and 4-Year Treasury Notes, the coupon rates were raised in line with the hikes in the Key Repo Rate. The coupon on the 2-Year, 3-Year and 4-Year Treasury Notes, which were maintained at 4.50 per cent, 4.75 per cent and 5.00 per cent per annum, since October 2010 rose to 5.00 per cent, 5.25 per cent and 5.50 per cent per annum, respectively, at the auction of April 2011. Thereafter, the coupon rates were again raised to 5.25 per cent, 5.50 per cent and 5.75 per cent per annum, respectively, in June 2011.

The weighted yield of the 2-Year and 3-Year Treasury Notes increased from 5.20 per cent and 5.48 per cent, as at end December 2010, to 5.34 per cent to 5.62 per cent, respectively, as at end-June 2011. The weighted yield of the 4-Year Treasury Notes went down from 6.27 per cent to 5.85 per cent during the same period.

Two re-openings of the Five-Year Government of Mauritius Bond issued for the first time in June 2010 with amounts of Rs1,500 million put on tender at a coupon rate of 6.69 per cent, were made on 18 February and 22 April 2011, respectively. The re-opening of the Ten-Year Government of Mauritius Bond for an amount of Rs2,000 million bearing a coupon rate of 8.75 per cent, took place on 18 March 2011. As compared to the first issue, the weighted yield went down by 23 basis points to 8.23 per cent.

The weighted yield of the Five-Year Government of Mauritius Bond decreased from 6.81 per cent as at end- December 2010 to 6.57 per cent as at end-June 2011.

Chart 5.6 illustrates movements in Treasury Bills yields and Chart 5.7 depicts movements in Treasury Notes.

Chart 5.6: Yields on Treasury Bills

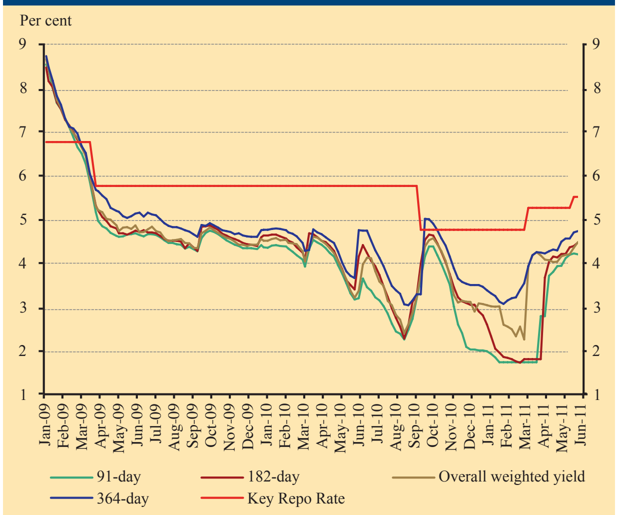
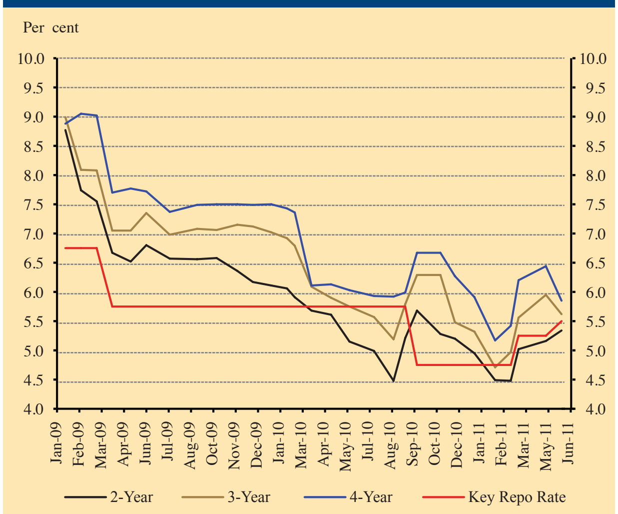


Chart 5.7: Yields on Treasury Notes

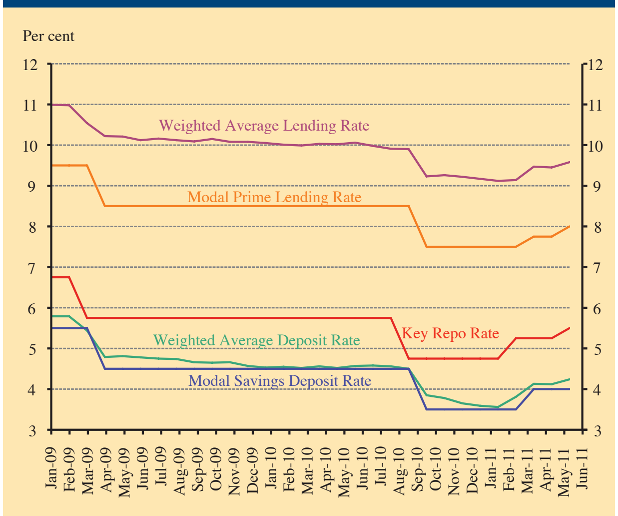


5.3 Interest Rates

During the first semester of 2011, almost all banks had adjusted their deposit and lending rates in line with changes in the Key Repo Rate. The savings deposit rates (SDR) rose from a range of 3.00-4.00 per cent to a range of 3.50-4.25 per cent and prime lending rates (PLR) went up from a range of 7.05-8.50 per cent to a range of 7.30-9.00 per cent. The magnitude of the hike in the policy rate was also mirrored into banks' modal SDR and modal PLR, which increased from 3.50 per cent and 7.50 per cent to 4.00 per cent and 8.00 per cent, respectively, in the first semester of 2011. The weighted average deposit rate fell from a range of 4.52-4.57 per cent during the first six months of 2010 to a range of 3.56-4.25 per cent during the first six months of 2011 and the weighted average lending rate went down from a range of 9.99-10.06 per cent to a range of 9.12-9.58 per cent over the same period.

During the first semester 2011, given that inflation rate was higher than the modal SDR, the real interest rate on savings deposit moved into negative territory. Deposit and lending rates as well as Key Repo Rate are shown in Chart 5.8.

Chart 5.8: Key Repo Rate and Deposits and Lending Rates

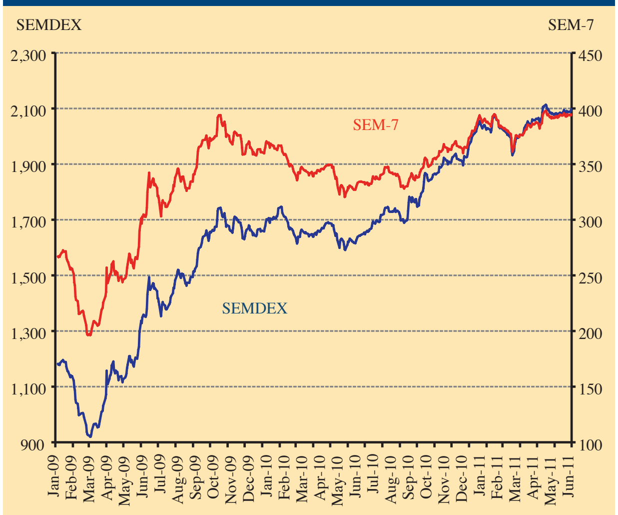


5.4 Stock Market

In the first half of 2011, the SEMDEX and SEM-7 rose by 6.6 per cent and 5.8 per cent, respectively. The local stock market, like major international stock markets, was affected by the events in Japan and the ensuing uncertainty that gripped markets for a while. However, it recovered quite rapidly with the SEMDEX and the SEM-7 reaching all-time highs of 2,113.61 and 397.89, respectively, on 16 May 2011, before resuming their downtrend. The SEMDEX outperformed the SEM-7 on account of the strong performance of non-blue chip companies from the Commerce, Industry and Insurance sectors.

For the period January to June 2011, net foreign investment on the domestic stock market amounted to Rs136.8 million, with purchases and sales totalling Rs1,592.2 million and Rs1,455.4 million, respectively. Transactions in the two banking stocks, namely MCB and SBM, made up around 68 per cent of total transactions by foreign investors but were almost nil on a net basis. The hotel sector attracted the highest net foreign investment to the tune of Rs277 million. Chart 5.9 illustrates the evolution of the SEMDEX and SEM-7.

Chart 5.9: SEMDEX and SEM-7



Source: The Stock Exchange of Mauritius Ltd.

5.5 Foreign Exchange Market and Exchange Rates

Activity on the domestic foreign exchange market

Transactions on the domestic foreign exchange market remained buoyant during the first half of 2011. Total turnover of spot and forward transactions amounted to US$3,752 million, representing a daily average of US$30.5 million compared to a daily average of US$28.4 million in the previous six months. Monthly transactions on the interbank foreign exchange market averaged US$39.2 million during the period under review compared to US$42.1 million in the second half of 2010.

The foreign exchange position of banks fell in the first semester of 2011. The Bank intervened on the domestic foreign exchange market to buy a total of US$272.4 million, €53.5 million and £1.0 million and sell an amount of US$10.7 million.

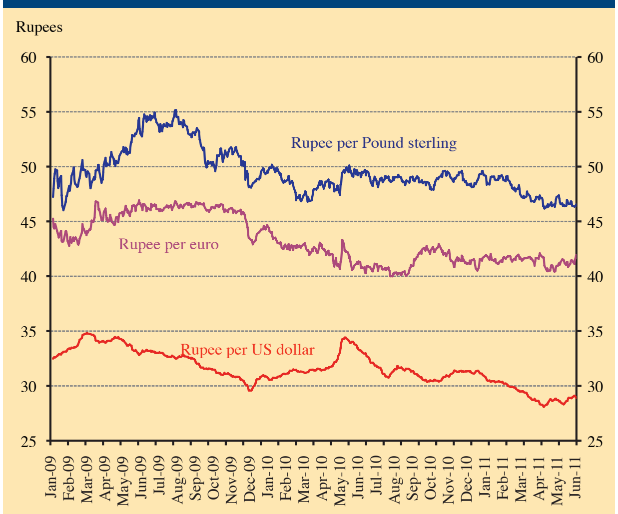
During the first half of 2011, the exchange rate of the rupee continued to reflect movements of major currencies on international markets as well as liquidity conditions on the domestic foreign exchange market. The rupee rallied vis-à-vis the US dollar during most of the semester before reaching a high of Rs28.08 in early May 2011 amid the US currency's broad-based weakness on international markets. Thereafter, the Rs/US dollar exchange rate depreciated as the greenback recovered internationally on safe haven demand.

The rupee depreciated against the euro, during the period under review, trading within a wide range given heightened euro volatility on international markets amid persistent concerns about the euro zone debt crisis and mixed data releases triggering risk appetite/aversion flows at different points in time.

The rupee appreciated vis-à-vis the Pound sterling in the first half of 2011 but reflected the British currency's volatility on the back of patchy economic recovery in the UK. On a point-to-point basis, between end-December 2010 and end-June 2011, the rupee depreciated by 1.1 per cent against the euro but appreciated by 7.9 per cent and 3.4 per cent, respectively, against the US dollar and Pound sterling.

The evolution of the rupee exchange rate against the US dollar, Pound sterling and euro is shown in Chart 5.10.

Chart 5.10: Rupee Exchange Rate Movements



Movements in MERIs and REER

On a nominal effective basis, both MERI1 and MERI2 appreciated in the six months to June 2011. The MERI1, which uses the currency distribution of trade as weights, showed an appreciation of 5.8 per cent. MERI2, which includes currency distribution of trade combined with that of tourism receipts as weights, showed an appreciation of 5.6 per cent.

The Real Effective Exchange Rate (REER), calculated with weights based on trade distribution with countries that make up at least 80 per cent of total trade and adjusted for price differentials, appreciated by 6.4 per cent.

Chart 5.11 shows the evolution of MERI1 and MERI2 and Chart 5.12 depicts the movements of the REER.

Chart 5.11: MERI1 and MERI2

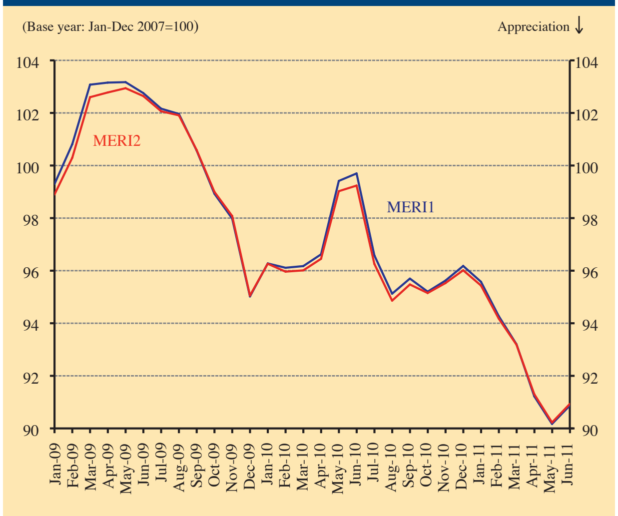
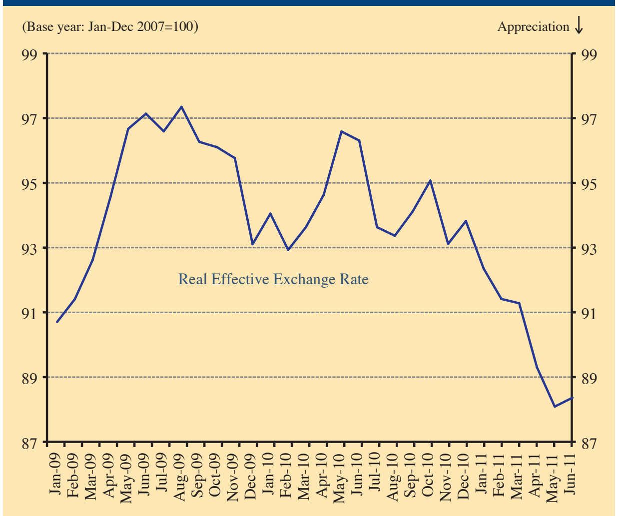


Chart 5.12: Real Effective Exchange Rate



6. The Outlook for Inflation

6.1 Risks to the Inflation Outlook

Developments regarding global economic activity and the uncertainties surrounding the pass-through of the rupee exchange rate would continue to be among the main factors driving domestic inflation dynamics in the short to medium term.

On the external front, the main inflationary risk still comes from commodity prices behaviour. This risk appears to have lessened since the last Inflation Report, although the prospects for international commodity prices, including oil, remain shrouded in uncertainty. Indeed, lower optimism about the pace of growth of the global economy has contributed to break the surge in commodity prices and to reduce the possibility of a new round of significant price increases – such as the one experienced at the end of last year and earlier this year. According to the US Energy Information Administration report released in September 2011, the pace of global oil demand growth is projected to be lower due to less optimistic assumptions about global economic growth. Nonetheless, without a significant change in the outlook for supply, the EIA expects markets to draw upon inventories to meet at least some of the growth in consumption over the fourth quarter of 2011 and beyond. In 2012, oil demand growth from countries outside the Organisation for Economic Cooperation and Development (OECD) is projected to outpace the growth in supply from producers that are not members of the Organisation of the Petroleum Exporting Countries (OPEC), implying a need for OPEC producers to increase their output to balance the market.

Among the major upside risks to the crude oil price outlook are the on-going unrest in oil-producing regions and the possibility that non-OECD demand will be more resilient than expected. Yet, downside risks arguably predominate, as fears persist about the rate of global economic recovery, contagion effects of the debt crisis in the European Union and other fiscal issues facing national and sub-national governments. The EIA expects that WTI spot prices, which averaged US$79 per barrel in 2010, will average US$94 per barrel in 2011 and US$95 per barrel in 2012, while the US refiner average crude oil acquisition cost is projected to average US$100 and US$103 per barrel in 2011 and 2012, respectively.

With regard to agricultural commodities, declining stocks indicate that the price decline seen recently may not be sustained for a prolonged period of time. The FAO-OECD Agricultural outlook for 2011-20 indicates that short-term supply response may temporarily ease price pressures but food prices "... on an average are projected to remain on a higher *plateau* compared to the previous decade in both nominal and real terms." Rising income, diversification of dietary pattern to more protein-rich items as well as attraction of bio-fuel as an alternative source of energy could contribute to market tightness.

According to the IMF's September 2011 World Economic Outlook, headline inflation in advanced economies is forecast to recede to 1.5 per cent in 2012, from around 2.5 per cent in 2011, assuming that energy and food prices evolve as the markets expect. In emerging and developing economies, headline inflation is expected to settle at about 6 per cent in 2012, down from over 7.5 per cent in 2011.

On the domestic front, the output gap is still negative and domestic demand and wage pressures remain subdued. The pace of monetary and credit expansion does not suggest any major inflation risks. The measures undertaken in the first half of 2011 by the authorities to request importers/wholesalers to cut down prices on certain food items seem to have contributed to muted price increases. However, recent inflation expectations surveys carried out by the Bank showed that the proportion of respondents that expect inflation to go up over the next twelve months remained high. Against the backdrop of persistently high inflationary pressures in the economy, the risk of a pick-up in inflation expectations still remains and this can ultimately be reflected in the price-setting behaviour and demand for higher wage compensation at a later stage. Also, the MERIs have been relatively stable and this has been a positive development that has helped to mitigate the pass-through of external price pressures. However, any sustained weakening of the rupee exchange rate vis-à-vis major currencies is likely to fuel potential inflationary pressures arising from the increased cost of imports in the short-term.

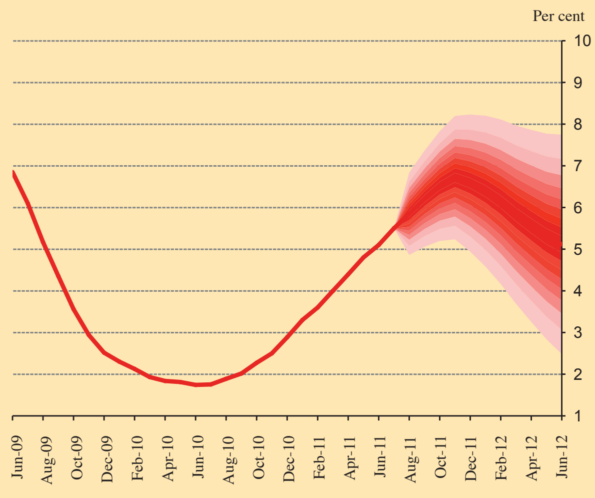
Inflation fan chart

The risks to the inflation outlook over the forecast time horizon are presented graphically in the inflation fan chart depicted in Chart 6.1. A fan chart shows the increasing uncertainty surrounding the central projection of twelve-month average inflation as the time horizon is extended up till June 2012. The central projection corresponds to the darkest band in the fan chart. The uncertainty around the central projection of inflation is reflected in the additional bands surrounding the central projection. The central projection covers 10 per cent of the forecast and each successive pair of bands is drawn to cover a further 10 per cent probability until 90 per cent of the probability distribution is covered.

The fan chart shows that the central projection for headline inflation will remain strong for calendar year 2011 based on the assumptions of the baseline scenario with regard to the external economic environment, domestic economic conditions, administered prices and the fiscal stance and eventually decline as the effects of higher prices of goods and services wane off, *ceteris paribus*. It is assumed that movements in commodity prices will continue to condition the price pressures dynamics, albeit the pace being uncertain. The fiscal stance is assumed unchanged and the negative domestic output gap is still estimated to close although it might be at a slower pace than previously expected, reflecting developments in major export markets. However, there are significant uncertainties around the outlook for inflation in the near-term horizon, as reflected in the widening bands on both sides of the central projection beyond 2011.

The outlook has changed in comparison to the previous forecast published in the Inflation Report of April 2011. In particular, the central projection of headline inflation is much lower, reflecting muted price increases in a range of commodities and the tightening of the monetary policy stance. Headline inflation is forecast to reach around 6.6 per cent by the end of 2011 and decline subsequently, on a no-policy-change basis, to around 5.1 per cent by June 2012.

Chart 6.1: Inflation Fan Chart



Inflation expectations

Inflation expectations surveys carried out by the Bank since December 2010 showed that the proportion of respondents who expected inflation to go up over the next twelve months remained high. This suggests that the sustained increase in the headline inflation rate has placed further upward pressure on inflation expectations. The 12th Inflation Expectations Survey, which the Bank carried out in August 2011, revealed that 73.9 per cent of respondents expected prices to go up over the next twelve months. The mean inflation rates expected by respondents were 6.1 per cent, 6.3 per cent, 6.3 per cent and 6.4 per cent respectively, for the twelve months ending December 2011, June 2012, a year ahead and December 2012. Moreover, external factors were viewed by 87.0 per cent of respondents as the primary source of inflation in Mauritius.

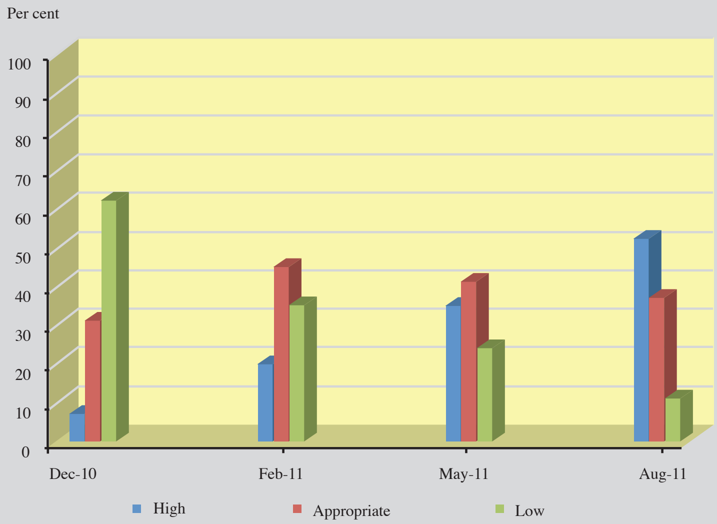
The evolution of inflation expectations over the four surveys carried out by the Bank between December 2010 and August 2011 is presented in Box 3.

BOX 3: EVOLUTION OF INFLATION EXPECTATIONS

This Box describes the evolution of the results of the inflation expectations surveys carried out by the Bank in December 2010, February, May and August 2011.

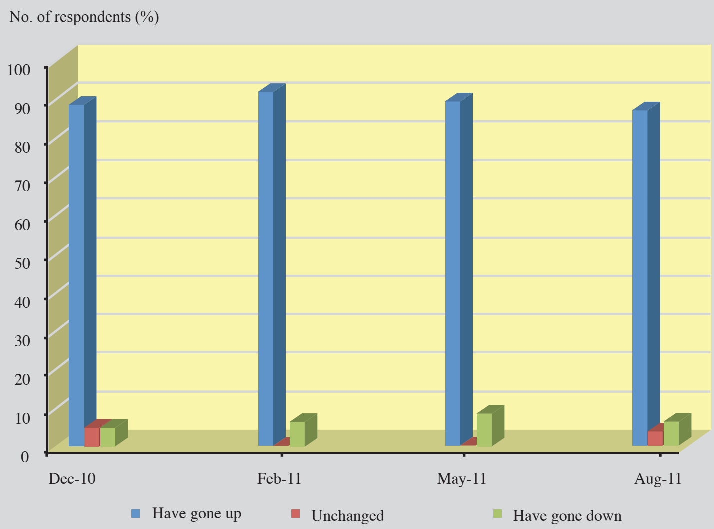
Q.1. How do you perceive the inflation rate in the twelve-month period ending in the month preceding the survey ***[Note: at 2.5 per cent in December 2010, 3.3 per cent in February 2011, 4.4 per cent in May 2011 and 5.5 per cent in August 2011]?***

The proportion of respondents who perceived inflation to be high increased from 7 per cent in December 2010 to 52 per cent in August 2011. Conversely, in August 2011, only 11 per cent of respondents thought inflation was low compared to 62 per cent in December 2010. Respondents who perceived the inflation rate to be appropriate rose from 31 per cent in December 2010 to 37 per cent in August 2011.



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

Between December 2010 and August 2011 surveys, respondents who described prices as having gone up during the past 12 months declined from 91 per cent to 89 per cent. In August 2011, 6.5 per cent of respondents were of the view that inflation had gone down.



Q.3. How do you rank the factors accounting for the current inflation pattern?
[Note: factors to be ranked were External Factors, Change in Aggregate Demand, Monetary Policy, Fiscal Policy, Wage Policy and Other]

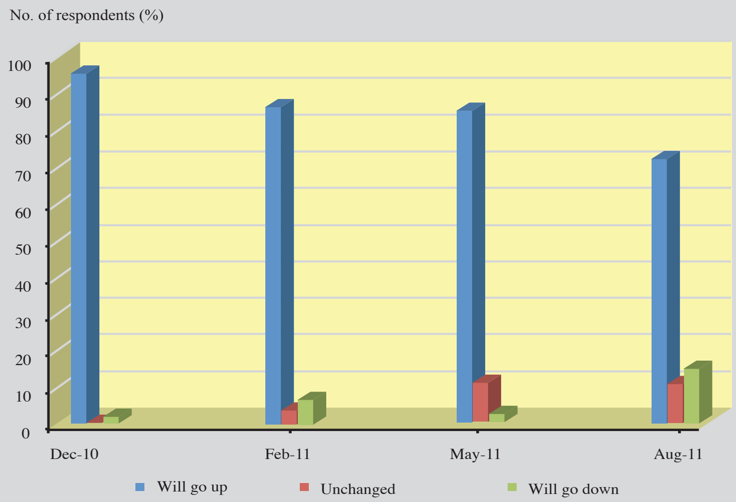
External factors were perceived as the most important cause of inflation in the four surveys carried out since December 2010. The second most important factor explaining inflation had been the change in aggregate demand and fiscal policy in December 2010 and February 2011 but in the August 2011 survey, monetary policy was seen as being the second most important cause of inflation. While monetary policy was regarded as the third most important factor in the December 2010 and February 2011 surveys, the change in aggregate demand was seen as the third most important cause of inflation in the later surveys.

Ranking	Dec-10		Feb-11		May-11		Aug-11	
	Factor	% of respondents	Factor	% of respondents	Factor	% of respondents	Factor	% of respondents
First most important factor	External	79%	External	89%	External	89%	External	87%
Second most important factor	Change in AD FP	29% 29%	FP	35%	FP MP	30% 28%	MP FP	33% 28%
Third most important factor	MP	40%	MP	33%	Change in AD	37%	Change in AD	30%

Note: AD - Aggregate Demand MP - Monetary Policy FP - Fiscal Policy

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

The proportion of respondents who believed prices would go up declined from 98 per cent in December 2010 to 74 per cent in August 2011. About 15 per cent of respondents anticipated a decrease in prices in August 2011 compared to 4 per cent in December 2010.



Q.5 Mean expectation of inflation in December 2011 and June 2012:

Mean inflation rates expected by respondents for December 2011 increased steadily from 5.1 per cent in December 2010 to 5.6 per cent in February 2011 and further to 5.8 per cent and 6.1 per cent in May and August 2011, respectively. The mean inflation rates expected by respondents for June 2012 rose from 5.6 per cent in December 2010 to 6.2 per cent in February 2011 but eased marginally to 6.1 per cent in May 2011 before rising further to 6.3 per cent in August 2011.

Printed by Précigraph Limited

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Website http://bom.intnet.mu
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ISBN: 978-99903-36-59-7