BANK OF MAURITIUS

Inflation Report

April 2013

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INFLATION REPORT

April 2013

This Inflation Report is published twice a year by the Bank of Mauritius in accordance with Section 33(2) of the Bank of Mauritius Act 2004. The Inflation Report is released to the public in April and October. It provides an assessment of factors underpinning monetary policy and concludes with an economic outlook. This issue of the Inflation Report refers to information from September 2012 to end-February 2013 unless otherwise stated.

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List of Acronyms

BML	Broad Money Liabilities
CIF	Cost, Insurance and Freight
CPI	Consumer Price Index
CRB	Commodity Research Bureau
DXY	Trade Weighted US Dollar Index
ECB	European Central Bank
EU	European Union
FAO	Food and Agriculture Organisation
FOB	Free on Board
GBC1s	Global Business Companies of Category 1
GDFCF	Gross Domestic Fixed Capital Formation
GDP	Gross Domestic Product
ICE	Intercontinental Exchange
IMF	International Monetary Fund
IPI	Import Price Index
KRR	Key Repo Rate
MERI	Mauritius Exchange Rate Index
MPC	Monetary Policy Committee
NYMEX WTI	New York Mercantile Exchange West Texas Intermediate
ODCs	Other Depository Corporations
OECD	Organisation for Economic Co-operation and Development
PE	Price Earnings
PMI	Purchasing Managers' Index
PPC	Petroleum Pricing Committee
PPI-A	Producer Price Index-Agriculture
PPI-M	Producer Price Index-Manufacturing
REER	Real Effective Exchange Rate
SDR	Special Drawing Rights
SEMDEX	Stock Exchange of Mauritius Index
VIX	Volatility Index
WEO	(IMF's) World Economic Outlook
WRI	Wage Rate Index

Abbreviations and Definitions

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

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

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

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

Dealt exchange rate is the weighted average rupee selling rate derived from transactions of US$30,000, and above, or equivalent.

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

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

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

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

Y-o-y refers to year-on-year changes.

Q-o-q refers to quarter-on-quarter changes.

1. Overview

Global financial markets sentiment recovered towards the end of 2012 as major advanced economies central banks put in place measures to improve the workings of their domestic financial systems. However, this improvement in sentiment did not effectively translate into better business and consumer confidence. Economic activity weakened in a number of advanced and developing economies in 2012Q4. Downside risks to the global growth outlook from the unresolved Eurozone sovereign debt crisis and uncertainty over the duration of the recession in this region still persist, with the recent turmoil in Cyprus serving as a case in point of the fragility of the financial system. The possibility of further fiscal tightening in the US would add to the downside risks to global growth.

In its World Economic Outlook (WEO) of April 2013, the IMF downgraded its initial growth forecast by 0.2 percentage point to 3.3 per cent, leaving the pace of growth broadly unchanged from 2012. Growth in advanced economies was downgraded to 1.2 per cent for 2013 while it kept its 2014 forecast at 2.2 per cent. Emerging and developing economies were expected to progress by 5.3 per cent in 2013 and 5.7 per cent in 2014. Economic expansion in the US, which slowed considerably in 2012Q4, is expected to continue at a gradual pace with real GDP growth of about 2.0 per cent in 2013. The Eurozone economy, which contracted steeply in 2012Q4, may face a somewhat more protracted downturn than expected in 2013 while the UK economy would appear to be on the brink of a triple-dip recession. The outlook for emerging economies is mixed, with a possible rebound in Chinese growth and sub-par growth in India. The most recent leading economic indicators seem consistent with the moderate global economic growth projections for 2013.

With a few exceptions, notably the UK, inflationary pressures generally remained subdued in advanced economies where significant economic slack restricted domestic demand. Inflation was, however, sustained in some emerging market economies faced with better growth prospects. Looking ahead, global commodity prices are broadly expected to be upheld at around the current high levels. Supply shocks, especially in countries where the weight of food and oil commodities in the CPI basket is high, thus have the potential to raise price pressures though the latter may be mitigated by the muted global growth outlook. The absence of underlying inflationary pressures in advanced economies helped their central banks to maintain accommodative monetary policy stances, engaging in additional unconventional quantitative easing measures to boost growth. The US Federal Reserve and Bank of Japan, also reviewed and clarified their monetary policy targets to better deal with their respective current macroeconomic challenges.

The domestic economy lost some momentum in 2012Q4, with growth of 0.2 per cent q-o-q compared to 1.2 per cent in 2012Q3. For 2012 as a whole, however, it was estimated to have held up relatively well to the external headwinds though the slowdown in main trading-partner countries restrained activity in major export sectors and led to a slight decline in growth to 3.3 per cent, from 3.5 per cent in 2011. The output gap was assessed to have remained negative throughout the year. The domestic growth outlook for 2013 rests on a number of premises. Going forward, the economy could be supported by the diversification efforts undertaken to boost the textile and tourism sectors as well as the consolidation of the information and communication and seafood industries. On the downside, however, growth would be affected by subdued growth prospects in main trading-partner countries, muted public and private investment and sub-par consumption growth. The Bank has accordingly forecast growth for 2013 within a range of 3.4-3.9 per cent. Downside risks arising from a protracted recession in the Eurozone would remain. According to the IMF, the Mauritian economy would grow by 3.7 per cent in 2013.

While headline inflation continued to trend downward to close at 3.6 per cent in February 2013, y-o-y inflation receded to 2.9 per cent in January 2013 before increasing back to 3.6 per cent in February 2013 on account of hikes in the prices of vegetables and alcoholic beverages. On a no policy-change basis, the Bank has projected y-o-y inflation to be within a range of 5.5-5.9 per cent for December 2013, equivalent to a headline inflation forecast of 4.7-4.9 per cent.

Upside risks to the inflation outlook are viewed as significant, notably as a result of elevated global commodity prices, the recent public sector wage award and the latest increase in retail petroleum prices. The expected second-round effects of these increases, as well as a projected rise in other administered prices, could amplify inflationary pressures in the foreseeable future. The Bank's *Inflation Expectations Survey*, which was carried out in February 2013, indicated that around 75 per cent of respondents anticipated prices to go up over the next twelve months, with the mean inflation rate projected at 4.5 per cent, 5.0 per cent and 5.2 per cent, respectively, for the twelve months ending June 2013, December 2013 and a year ahead.

Since the last Inflation Report, the decisions of the MPC on the stance of monetary policy were for the most part guided by the perceived risks to the growth outlook, which were seen to outweigh the threats to the inflation outlook by a majority of members. Monetary policy remained accommodative, with the Key Repo Rate kept unchanged at 4.90 per cent at the meetings held in November 2012 and March 2013.

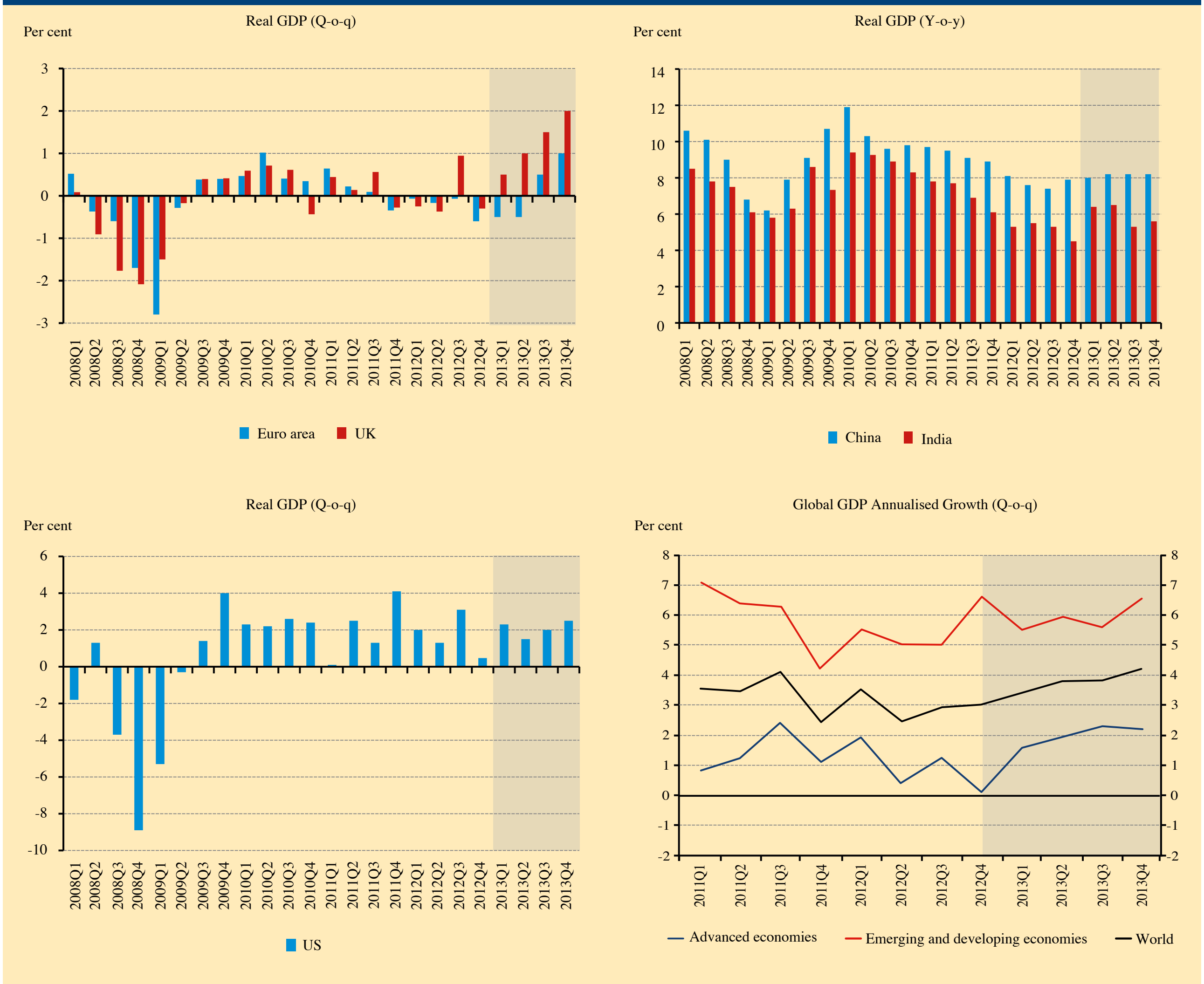
2. The Global Economy

Since the last Inflation Report, global economic conditions have remained fragile. Growth in the US has been moderate while the Eurozone slid deeper into recession and the UK appeared on the brink of its third recession in four years. The performance of emerging economies has been mixed although they have continued to perform better than advanced economies. Leading indicators pointed to a loss of momentum in the global economy at the start of 2013. Significant economic slack has contributed to contain inflation in advanced economies and allowed them to maintain accommodative monetary policy stances. In contrast, inflationary pressures have increased in some emerging economies. Global commodity prices have remained elevated.

2.1 Demand and Output

While global financial markets sentiment improved to some extent towards the end of 2012 following a number of policy initiatives by several major central banks, some advanced and developing economies experienced weakening economic activity in 2012Q4. Going forward, global economic conditions would be expected to remain subdued as uncertainty over the resolution of the Eurozone sovereign debt crisis and the duration of the recession in this region linger. The recent developments in Cyprus underscore the vulnerability of the Eurozone financial system and the fragile business and consumer confidence in the euro area. Moreover, concerns about fiscal tightening in the US are also projected to weigh on the global growth outlook.

Chart 2.1: Growth in Selected Economies



Sources: OECD, IMF and JPMorgan.

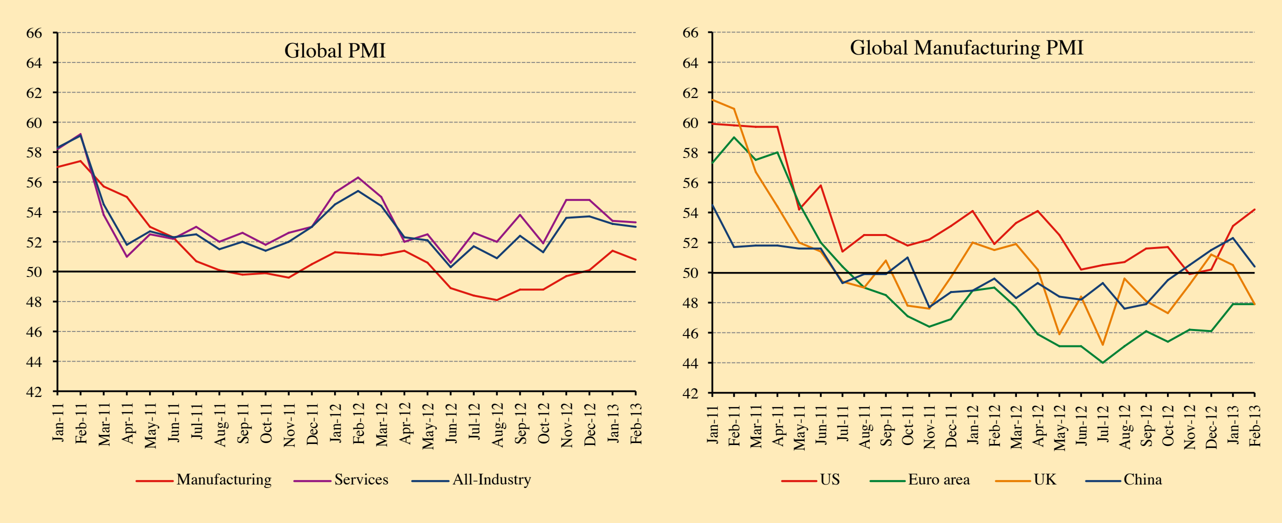
In its April 2013 World Economic Outlook (WEO), the IMF downgraded its initial global growth forecast by 0.2 percentage point to 3.3 per cent for 2013. In 2014, the world economy was expected to grow by 4.0 per cent. Growth in advanced economies was revised down to 1.2 per cent for 2013 while growth forecast for 2014 was kept unchanged at 2.2 per cent, as public spending cutbacks and persistently weak financial conditions were likely to curtail economic activity. In emerging and developing economies, which were expected to be affected by the weakness in advanced countries, growth was marked down to 5.3 per cent and 5.7 per cent in 2013 and 2014, respectively (Chart 2.1).

Leading indicators, which pointed to a slowdown in manufacturing production and services business activity in February 2013, were consistent with a moderate global economic growth outlook. The JPMorgan Global All-Industry Output Index fell to a four-month low of 53.0 in February 2013 although the loss of momentum was marginal compared to January 2013. The global manufacturing PMI also declined in February 2013, ending a string of four straight advances and indicating that the strong bounce in manufacturing that took hold in late 2012 might be tapering off. The services PMI remained at a four-month low (Chart 2.2).

Global economic conditions and outlook varied across countries and regions. After annual growth of 3.1 per cent recorded in 2012Q3, the US economy decelerated significantly to record a growth of 0.4 per cent in 2012Q4 reflecting sharp drops in inventory investment, federal government spending and lower exports. For 2012 as a whole, the economy expanded by 2.2 per cent and data at the start of 2013 showed that underlying demand from consumers and businesses were growing at a moderate pace. The US housing sector continued to recover, with considerable gains in residential construction and home prices, while consumer sentiment improved along with the stronger labour market, which showed a drop in the unemployment rate to a four-year low of 7.7 per cent in February 2013. Nevertheless, growth prospects remained contingent on the extent of fiscal consolidation in 2013. The IMF has forecast US GDP growth to be lower at 1.9 per cent in 2013.

The Eurozone slid deeper into recession in 2012Q4, with GDP contracting by 0.6 per cent following a 0.1 per cent drop in 2012Q3. This deterioration in output was led by the largest economies: Germany and France, where output shrank by 0.6 per cent and 0.3 per cent, respectively, whereas Italy and Spain continued to contract. Business and consumer confidence remained weak across the region while the unemployment rate stood at 12.0 per cent in February 2013, unchanged from January 2013. The

Chart 2.2: JPMorgan Global Purchasing Manager's Index



Source: JPMorgan.

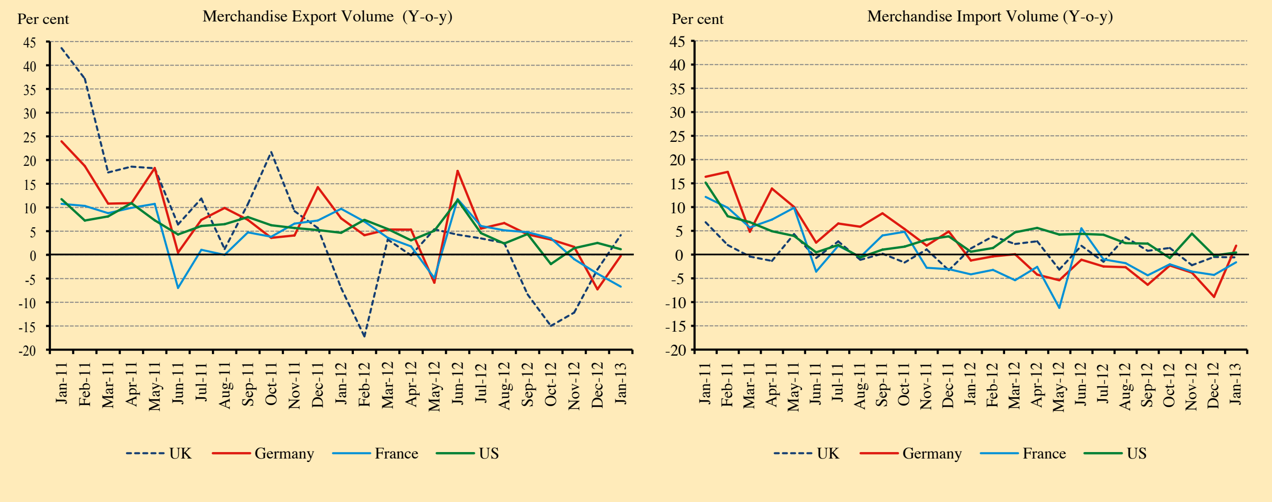
Eurozone composite PMI estimate for February 2013 signalled a steepening of the downturn in business activity, driven by a slowdown in activity in the services sector. The economic outlook for the Eurozone has been generally revised downward, with the IMF predicting activity to contract by 0.3 per cent in 2013.

The British economy emerged briefly from recession in 2012Q3, registering growth of 0.9 per cent q-o-q, but appeared on the brink of its third recession in four years as it contracted again by 0.3 per cent in 2012Q4, partly as the Olympics effect unwound. Recent data indicated that the UK manufacturing sector lost considerable momentum in February 2013 as output, new orders and employment indices all posted net reduction compared to the previous month. The labour market, however, continued to stabilise, with the unemployment rate steady at 7.8 per cent throughout the period November 2012 to January 2013. According to the IMF's WEO released in April 2013, the economy is expected to grow by 0.7 per cent in 2013.

Growth in a number of emerging economies subsided in response to the economic weakness in developed countries, but by end-2012, many of the economic indicators in emerging countries had stabilised. China's economy grew by 7.9 per cent in 2012Q4, rebounding from 7.4 per cent in the previous quarter, mainly driven by an acceleration in industrial output and a jump in exports. The manufacturing PMI for February 2013 suggested a slower pace of expansion although the economy would continue to be supported by improving domestic demand and labour market conditions. India's economy slowed further to 4.5 per cent in 2012Q4, compared to 5.3 per cent in the previous quarter, hurt by a slowdown in 'agriculture', 'mining' and 'manufacturing'. While the momentum in the manufacturing sector appeared to pick up in February 2013 on the back of stronger growth in domestic orders, it remained below its long-run average. The IMF was expecting China and India to grow by 8.0 per cent and 5.7 per cent, respectively, in 2013.

Global trade conditions generally improved during 2012 and at the start of 2013. Latest data from the Netherlands Bureau of Economic Research indicated that global trade volumes were up by 3.3 per cent in the year to January 2013, with an 8.5 per cent expansion in imports of emerging economies being the main driver of higher trade volumes. As a partial indicator of potential demand from main trading-partner countries, data for January 2013 showed that import volume growth picked up in the US but remained negative in France and the UK (Chart 2.3). In April 2013, the IMF downgraded the 2013 forecast for world trade volume growth by 0.2 percentage point to 3.6 per cent.

Chart 2.3: Exports and Imports of Selected Economies



Sources: Eurostat and Netherlands Bureau of Economic Research.

2.2 Recent Developments in Inflation

2.2.1 Inflation in Selected Key Countries

Significant economic slack has contributed to contain inflation in advanced economies while inflationary pressures have increased in some emerging economies facing better growth prospects.

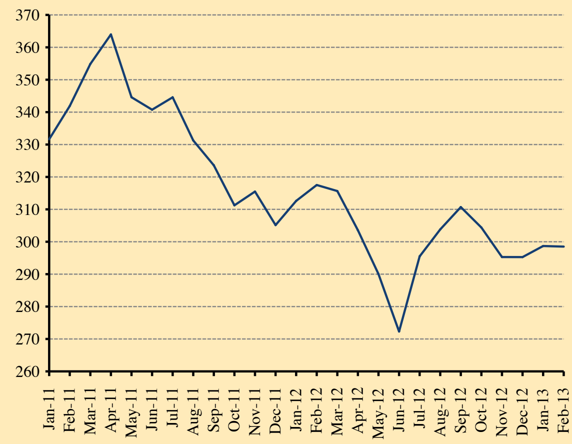
Consumer prices in the OECD area eased to 1.8 per cent in February 2013, from 2.2 per cent in September 2012. Amongst major economies, headline inflation in the US stood at 2.0 per cent in February 2013, unchanged from its reading of September 2012, while inflation in the Eurozone eased from 2.6 per cent to 1.8 per cent over the same period amid lower energy prices. In contrast, annual inflation in the UK rose from 2.2 per cent in September 2012 to 2.8 per cent in February 2013, following a broad-based increase in most components. Among the major emerging and developing economies, inflation in India increased from 9.1 per cent in September 2012 to 12.1 per cent in February 2013, partly as a result of higher food prices, while inflation in China went up from 1.9 per cent to 3.2 per cent (Table 2.1).

According to the April 2013 IMF WEO, consumer price inflation for 2013 is projected at 1.4 per cent for advanced economies and at 5.9 per cent for emerging economies. The inflation outlook would remain uncertain, with upside risks from supply shocks that could intensify price pressures, especially in countries where the weight of food and oil commodities in the CPI basket is high. On the downside, however, persistent subdued global growth could lead to some easing in price pressures.

2.2.2 Commodity Prices

The Thomson Reuters-Jefferies Commodity Research Bureau (CRB) index showed that commodity prices, which generally increased amid rising agricultural and precious metal prices in

Chart 2.4: Thomson Reuters-Jefferies CRB Index



Source: Thomson Reuters.

Table 2.1: Consumer Price Inflation in Selected Countries

Per cent

	2009	2010	2011	2012	January 2013	February 2013
China	-0.7	3.3	5.4	3.0	2.0	3.2
Euro area	0.3	1.6	2.7	2.3	2.0	1.8
Hong Kong	0.6	2.3	5.3	3.8	3.8	4.4
Hungary	4.2	4.9	3.9	5.6	3.7	2.8
India	10.9	12.0	8.9	10.2	11.6	12.1
Indonesia	4.8	5.1	5.4	4.4	4.6	5.3
Mauritius	2.5	2.9	6.5	4.5	2.9	3.6
Philippines	4.2	3.8	4.7	3.5	3.0	3.4
Singapore	0.6	2.8	5.2	4.5	3.6	4.9
South Africa	7.1	4.3	5.0	5.6	5.4	5.9
South Korea	2.8	2.9	4.0	2.2	1.5	1.4
Thailand	-0.8	3.3	3.8	3.2	3.4	3.2
Turkey	6.3	8.6	6.5	8.7	7.3	7.0
United Kingdom	2.1	3.3	4.5	2.7	2.7	2.8
United States	-0.3	1.6	3.1	2.0	1.7	2.0

Sources: IMF, OECD and The Economist.

2012Q3, declined in 2012Q4 as falls in agricultural and energy prices offset increases in industrial metal and precious metal prices. While commodity markets started 2013 strongly on signs of better economic recovery in the US, Europe and China, they stalled by the end of February 2013 as uneven business and growth data raised market uncertainty (Chart 2.4).

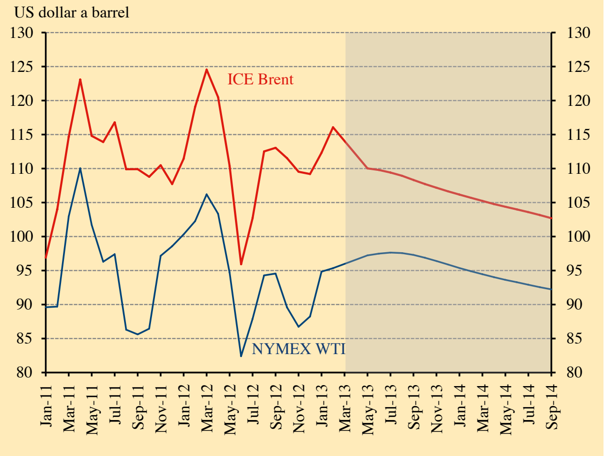
Oil Prices

Both supply and demand-side developments were instrumental in the downward movement of oil prices in 2012Q4. Their recovery, thereafter, in the two months to February 2013, was mainly on account of more optimism about the state of the world economy, increased speculative buying in the oil futures market and accelerating oil demand.

International oil prices have, in general, fluctuated between US$86.7 and US$116.1 a barrel between September 2012 and February 2013. NYMEX oil fell from US$94.6 a barrel in September 2012 to US$86.7 a barrel in November 2012 before rising to US$95.3 a barrel in February 2013. Likewise, ICE Brent subsided to US$109.2 a barrel in December 2012 before trending upwards to US$116.1 a barrel in February 2013 (Chart 2.5).

Looking forward, Brent crude oil prices, which averaged US$112 a barrel in 2012, are projected to average US$108 a barrel in 2013 according to the US Energy Information Administration. Crude oil supply is not projected to pose major upside pressure

Chart 2.5: Monthly Average NYMEX WTI and ICE Brent and Futures Prices



Sources: Thomson Reuters, ICE and the Wall Street Journal.

on prices as the US crude oil stocks would hover at around their highest levels since the first Gulf War and the level of production in the Organisation of the Petroleum Exporting Countries would be expected to be maintained. However, persistent political risks stemming from the Middle East would have the potential to affect oil supply. Sustained demand in emerging markets and the relatively inelastic oil consumption in power generation may provide continued support to crude oil prices throughout 2013 amid rising price volatility.

Food Prices

Global food prices stabilised in recent months following the sudden spike that occurred at the beginning of 2012H2 as a result of severe droughts in several producer regions. However, the current level of food prices remains significantly high compared to historical levels and, according to the Food and Agriculture Organisation (FAO), food prices remain extremely vulnerable to shocks induced by weather-related disturbances.

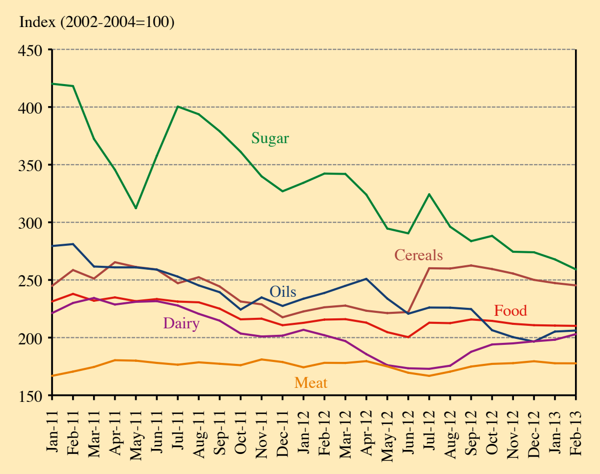
Since the October 2012 Inflation Report, the FAO Food Price Index has varied within a narrow range of 210 to 215 points as increases in the prices of dairy products were largely balanced out by declines in the prices of oils/fats, cereals and sugar. The Dairy Price Index increased from 187.7 points in September 2012 to 203.0 points in February 2013 while the Cereals Price Index fell to 245.3 points over the same period. Declines were also registered in Oilseed Price Index and Sugar Price Index, which fell to 206.1 points and 259.2 points, respectively, in February 2013. The Meat Price Index has remained largely unchanged since September 2012, standing at 179.2 points in February 2013 (Chart 2.6).

Food prices are expected to increase by 3 to 4 per cent in 2013, according to the US Department of Agriculture. The drought that affected crops impacted on prices of corn and soybeans as well as other field crops, which should, in turn, drive up retail food prices. The transmission of commodity price changes into retail prices typically takes several months to occur, and most of the impact of the 2012 drought is expected to be realised in 2013. This would be most reflected in prices of cereals, baked goods and other grain-based food while higher feed prices would be expected to directly affect the cost of meat and any other animal-based product.

Other Commodity Prices

Most metal prices remained low until November 2012, reflecting macroeconomic uncertainty, weakening demand by China and high stocks for most metals. However, they firmed up thereafter on China's better-than-expected growth. Between September 2012 to February 2013, nickel and zinc prices rose by 2.3 per cent and 6.0 per cent, respectively. In contrast, gold prices fell by 6.7 per cent and reached a seven-month low in February 2013 on the back of weaker investment demand while long-term investor interest showed increasing signs of waning. Copper prices fell by 0.3 per cent over the same period. Among the other non-energy commodities, cotton prices increased by 6.7 per cent over the period under review, surging after China announced additional import quotas and sharp increases in demand from India and Pakistan. Cocoa prices fell by 16.0 per cent between September 2012 and February 2013, as the release of weak grinding data from Europe and North America raised concerns over the stagnant global economy and its impact on cocoa demand in developed countries (Table 2.2).

Chart 2.6: FAO Food Price Index and its Components



Source: FAO.

According to the January 2013 World Bank Global Economic Prospects, overall metal prices would be expected to increase marginally in 2013 on account of rising energy costs and environmental issues. The outlook for soft commodities, such as cocoa and cotton, would be neutral to slightly bearish in 2013. Global cotton prices are forecast to plateau in 2013H1, as the market faces its largest-ever period of oversupply, while cocoa prices are expected to move sideways to slightly higher amid tightening fundamentals.

Freight Costs

Since the last Inflation Report, the Baltic Dry Index, which is the benchmark for tracking commodity

Table 2.2: Non-Energy Commodities

Commodity	Unit	Sep-12	Dec-12	Feb-13	Percentage Change Between Sep 12 - Feb 13
Cotton A Index	c/kg	186	184	198	6.7
Aluminum	$/mt	2,064	2,087	2,054	-0.5
Copper	$/mt	8,088	7,966	8,061	-0.3
Gold	$/toz	1,745	1,685	1,628	-6.7
Iron ore	c/dmtu	100	129	155	55.8
Lead	c/kg	218	228	237	8.8
Nickel	$/mt	17,288	17,449	17,690	2.3
Silver	c/toz	3,361	3,187	3,033	-9.8
Tin	c/kg	2,077	2,288	2,421	16.6
Zinc	c/kg	201	204	213	6.0
Cocoa	c/kg	262	241	220	-16.0
Plywood	c/sheets	608	613	586	-3.6
Tea, auctions (3) average	c/kg	312	308	293	-6.1

$ = US dollar c = US cent bbl = barrel mt = metric ton

kg = kilogram dmtu = dry metric ton unit toz = troy oz

Source: World Bank's Commodity Price Data.

shipping costs, remained within a range of 707 to 1,025 on average (Chart 2.7). The shipping outlook appears grim as the industry is still plagued by the low demand for commodities in the Greater China Region, while the oversupply of vessels has led to pressure on the freight rates in the dry bulk market.

2.3 Exchange Rates

Movements in currency markets were largely related to investors' assessment of near-term risks in the euro area and other major economies. As sentiment recovered and investors moved back into risky assets, the safe haven US dollar came under pressure. It lost 1.7 per cent against the euro since the last Inflation Report but appreciated by 7.2 per cent against the Pound sterling. The trade-weighted US dollar index (DXY) appreciated by 2.5 per cent (Chart 2.8).

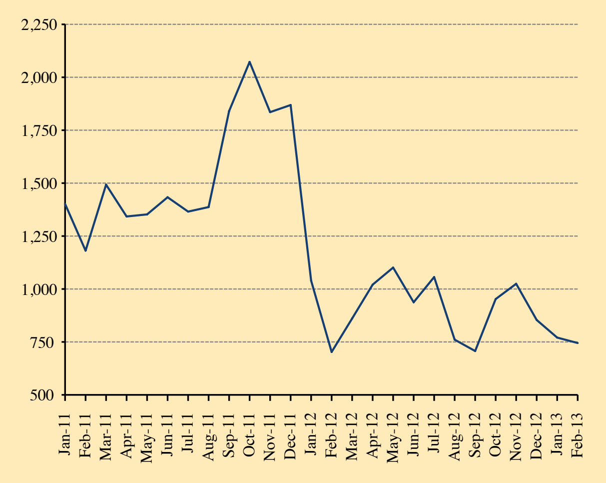
The euro was mostly supported by steps taken by the ECB to resolve the debt crisis although uncertainty about Greece and a bleak economic outlook for the Eurozone contributed to the single currency closing lower at US$1.2723 at around mid-November 2012. The euro reached a 15-month high of US$1.3711 at the start of February 2013 but retreated thereafter on renewed worries about the health of the Eurozone economy. The recent Cyprus bailout agreement would not eliminate the near-term risks for Europe, which would likely maintain the euro under pressure.

The Pound sterling maintained a downward movement following the release of weak economic data that pushed back the prospect of a recovery in the UK economy. Since January 2013, the Pound sterling has depreciated against a broad range of currencies. It fell to its lowest level since July 2010 against the US dollar towards end-February 2013 after Moody's cut the UK's AAA credit rating on account of the country's weak growth outlook and challenges to the government's plan to reduce the deficit. Currency investors were further deterred by a plan to hold a referendum by 2017 on Britain's membership of the EU.

Amid growing tensions over exchange rates, prompted largely by Japan's new government pressing for an aggressive expansion of monetary policy, the Japanese yen declined. The G-7 intervened and reiterated their commitment to market-determined exchange rates. They reaffirmed that their fiscal and monetary policies would not target exchange rates.

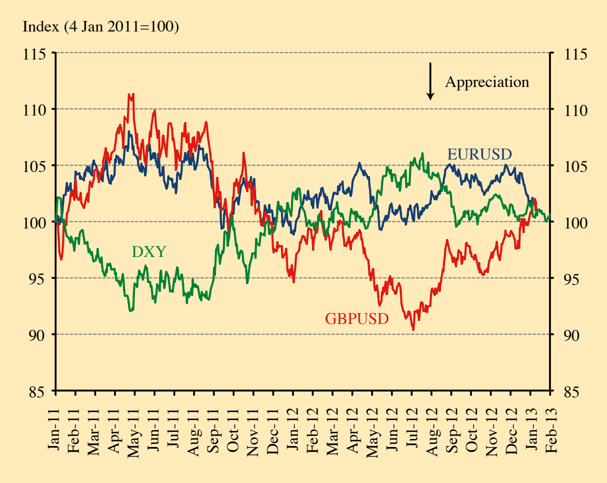
Many emerging-market currencies strengthened as markets found comfort that the US economy was still growing while the US Federal Reserve accommodative policies helped fuel investors' hunt for higher-yielding assets. Some emerging Asian currencies lagged these gains, however, as the threat of central bank intervention loomed (Chart 2.9).

Chart 2.7: Baltic Dry Index



Source: Hellenic shipping news.

Chart 2.8: Evolution of the EURUSD, GBPUSD and DXY Indices



Source: Thomson Reuters.

2.4 Global Monetary Policy

With sluggish growth, moderate inflation and stubbornly high unemployment, central banks across major advanced economies continued to maintain an accommodative monetary policy stance, with a number of them engaging in significant quantitative easing and revamping their monetary frameworks to supplement historically low interest rates.

While the US Federal Reserve has held a dual mandate of low inflation and full employment since 1977, it specifically announced, in December 2012, that its policy rate would remain low as long as the unemployment rate would be above 6.5 per cent and inflation below 2.5 per cent. Concurrently, the US Federal Reserve also stated that it would continue to purchase agency mortgage-backed securities and replace the maturity extension programme with an outright purchase of long-term Treasuries at an initial amount of US$45 billion a month.

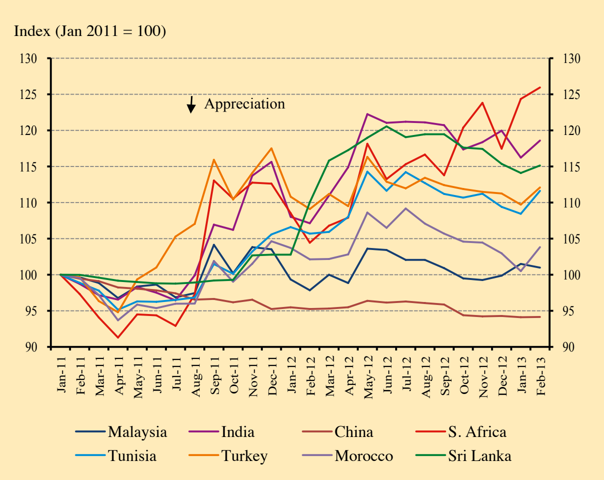
In the Eurozone, the ECB left its policy interest rate unchanged at 0.75 per cent in February 2013, highlighting that economic weakness in the euro area was expected to prevail in the early part of 2013 before economic activity gradually recovered later in 2013. The Bank of England maintained its key policy rate at 0.5 per cent and held its quantitative easing target at 375 billion Pound sterling. The Bank of England signalled that it was willing to tolerate persistently high inflation in an attempt to protect and boost the recovery of the economy.

The Bank of Japan adopted a 2.0 per cent inflation target as part of its commitment to eliminate deflation while interest rates remained unchanged between zero and 0.1 per cent. Moreover, the Bank of Japan announced a new liquidity programme aimed at increasing lending by the Japanese banking sector. It further indicated that there was still room to boost the asset purchase programme that could further improve economic conditions.

Among emerging economies, the People's Bank of China raised its deposit reserve requirement ratio by 0.5 percentage point in January 2013 in a move to manage inflationary expectations and avoid a recurrence of the lending boom. In contrast, Brazil's central bank reduced interest rates by 25 basis points to bring the Selic rate to 7.25 per cent in October 2012 and held rates steady thereafter as domestic economic activity was less intense than expected. The Reserve Bank of India cut the Cash Reserve Ratio by a cumulative 75 basis points to 4.00 per cent between September 2012 and January 2013 and further reduced its benchmark repo rate to 7.75 per cent in January 2013 after the government took steps to bring its finances under control and inflation moderated. The South African Reserve Bank kept its repo rate unchanged at 5.00 per cent in January 2013, with a further deterioration in the inflation outlook expected for 2013.

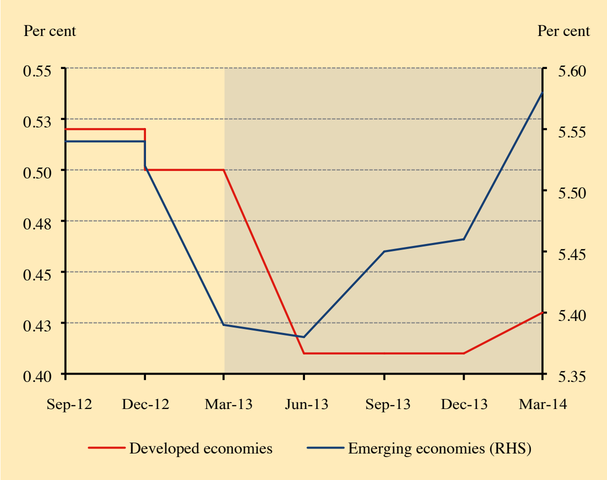
Looking ahead, monetary policy in advanced economies would be expected to remain accommodative until end-2013, with the normalisation process projected to start towards March 2014. In emerging economies, the monetary policy stance is forecast to remain easy until June 2013 before central banks embark on a tightening cycle (Chart 2.10).

Chart 2.9: Evolution of Emerging Markets' Currencies Indices against the US dollar



Source: Thomson Reuters.

Chart 2.10: Expected Policy Rates in Developed and Emerging Economies



Source: JPMorgan.

3. Recent Developments in Inflation

While headline inflation maintained a continuous downward trend, y-o-y inflation declined till January 2013 before picking up in February 2013, mainly as a result of a hike in the price of vegetables and alcoholic beverages. Underlying inflation pressures, as reflected by core inflation measures, appeared to have stabilised in February 2013. Going forward, there are upside risks to consumer price inflation from potentially higher consumer spending in the aftermath of the public sector wage award and the latest rise in retail petroleum prices. The expected second-round effects of these increases, as well as the projected rise in other administered prices, could amplify inflationary pressures in the foreseeable future. The Bank's latest Inflation Expectations Survey revealed that a high proportion of respondents would expect inflation to go up over the next twelve months.

3.1 Inflation

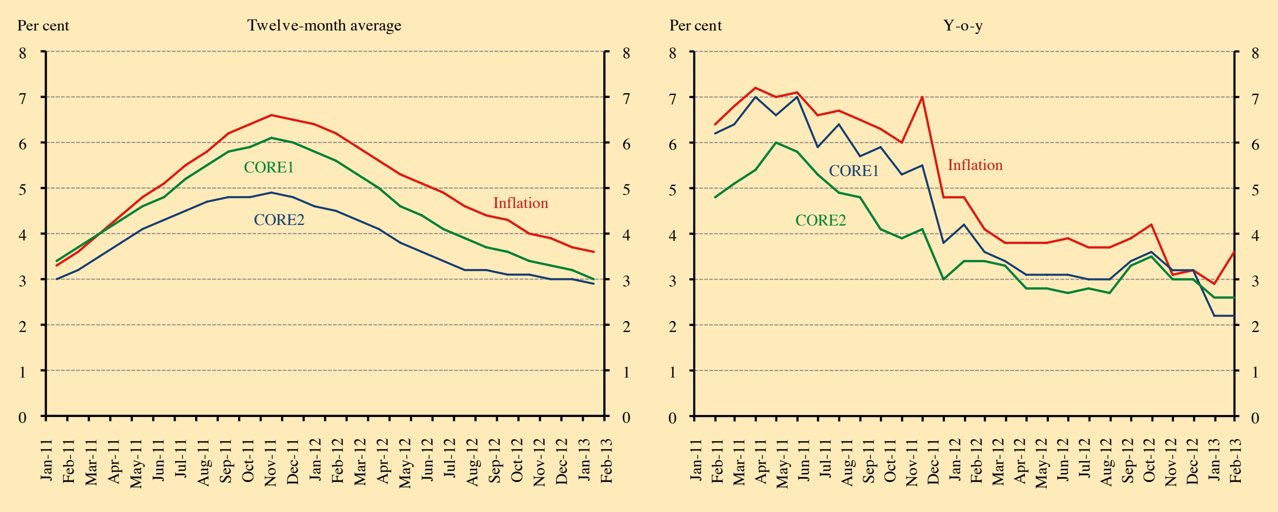
Headline inflation maintained the downward trend observed since December 2011 and closed at 3.6 per cent for the twelve-month period ended February 2013. Following an uptick in September and October 2012, y-o-y inflation receded to 2.9 per cent in January 2013 on account of favourable base effects, subdued external price pressures and a stable rupee exchange rate. However, it increased to 3.6 per cent in February 2013, reflecting the hikes in the prices of vegetables and alcoholic beverages (Chart 3.1).

Underlying inflation pressures, which had moderated since September 2012, appeared to stabilise in February 2013. On a twelve-month average basis, CORE1 and CORE2 inflation decreased from 3.7 per cent and 3.2 per cent in September 2012 to 3.0 per cent and 2.9 per cent, respectively, in February 2013. Y-o-y CORE1 inflation also maintained a downward trend to reach a low of 2.2 per cent in February 2013 while y-o-y CORE2 inflation moderated further to 2.6 per cent.

3.2 Evolution of Major Commodity Group Indices

In absolute terms, the CPI increased from 133.2 in Augsut 2012 to 136.6 in February 2013. The largest contributor to the CPI increase was the 'alcoholic beverages and tobacco' division, with a contribution of 1.7 index points. 'Food and non-alcoholic beverages' contributed 0.7 index point to the CPI increase while 'restaurants and hotels' and 'furnishings, household equipment and routine household maintenance' each contributed 0.2 index point. 'Clothing and footwear', 'housing, water, electricity, gas and other fuels', 'health', 'transport', 'education' and 'miscellaneous goods and services' each added 0.1 index point to the CPI while the remaining divisions made negligible contributions (Chart 3.2).

Chart 3.1: CPI Inflation



Sources: Statistics Mauritius and Bank of Mauritius.

3.2.1 Retail Petroleum Prices

Domestic retail petroleum prices were kept unchanged for nearly two years before the Petroleum Pricing Committee (PPC) decided to increase the domestic prices of mogas and diesel oil by 6.0 per cent and 6.7 per cent, respectively, on 1 March 2013. This decision was taken after the PPC reached the conclusion that the *Price Stabilisation Account*, which aims at mitigating the effects of world oil price movements on domestic retail prices over a period of time, was no longer able to sustain rising international oil prices. The expected second-round effects of this adjustment in retail petroleum prices would altogether increase the upside risks to inflation in Mauritius (Chart 3.3).

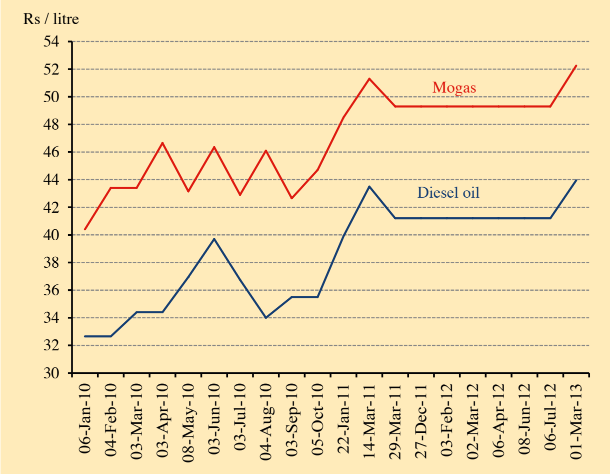
3.2.2 Food and Non-Food Inflation

Y-o-y food inflation initially declined to 1.1 per cent in December 2012 before rising sharply to 3.5 per cent in February 2013, reflecting increases in the prices of vegetables and other food products on the domestic market. Non-food inflation firmed up to 4.8 per cent in September 2012 before moderating to 3.6 per cent in February 2013. The contribution of food to y-o-y inflation almost doubled, from 0.5 percentage point in September 2012 to 0.9 percentage point in February 2013. In contrast, the contribution of non-food to total inflation declined from 3.6 percentage points to 2.6 percentage points over the same period (Chart 3.4).

3.2.3 Goods and Services Inflation

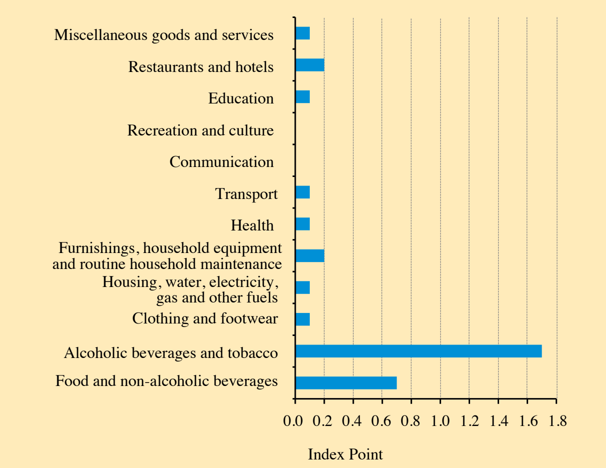
Y-o-y goods inflation declined to 2.6 per cent in November 2012 before increasing steadily to 4.3 per cent in February 2013 while services inflation, which picked up in the last months of 2012, decreased to 1.9 per cent in February 2013. Goods inflation continued to explain the most part of overall y-o-y inflation. Its contribution picked up to 2.9 percentage points in February 2013, from 1.7 percentage points in November 2012. Services inflation contributed 0.6 percentage point to y-o-y inflation in February 2013 compared to 1.3 percentage points in September 2012 (Chart 3.5).

Chart 3.3: Domestic Prices of Mogas and Diesel Oil



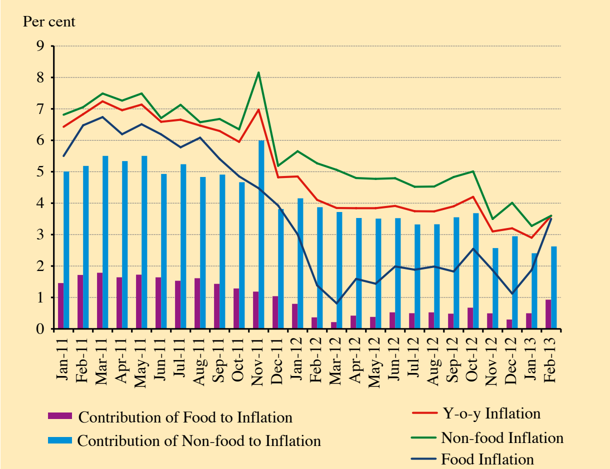
Source: State Trading Corporation.

Chart 3.2: Weighted Contributions to the Change in CPI: August 2012 - February 2013



Sources: Statistics Mauritius and Bank of Mauritius.

Chart 3.4: Y-o-y Food and Non-Food Inflation



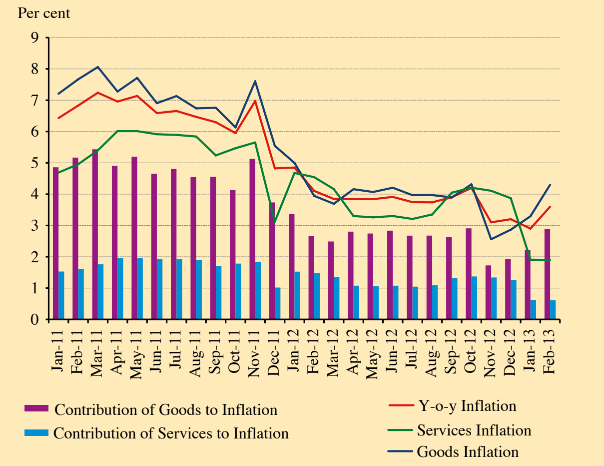
Sources: Statistics Mauritius and Bank of Mauritius.

3.3 Evolution of Other Price and Cost Indices

3.3.1 Import Price Index

The Import Price Index (IPI) rose continuously to 127.6 in 2012Q4, representing a 6.7 per cent y-o-y increase. The growth in the IPI was mainly due to steep increases in the prices of 'food and live animals', 'mineral fuels, lubricants and related materials', and 'beverages and tobacco', which rose by 13.0 per cent, 8.6 per cent and 6.9 per cent y-o-y, respectively (Table 3.1).

Chart 3.5: Y-o-y Goods and Services Inflation



Sources: Statistics Mauritius and Bank of Mauritius.

3.3.2 Producer Price Indices

Price pressures at the production level moderated in 2012Q4. The Producer Price Index-Agriculture (PPI-A) inflation for the twelve-month average period eased from 9.4 per cent in June 2012 to 3.0 per cent in December 2012 (Chart 3.6). On a y-o-y basis, PPI-A inflation declined from 6.8 per cent in June 2012 to -0.6 per cent in December 2012. In absolute terms, the PPI-A rose marginally from 107.4 in June 2012 to 107.7 in December 2012 on account of an increase in 'crop products', fully offsetting a decline in 'animals and animal products'.

Based on a twelve-month average, the Producer Price Index-Manufacturing (PPI-M) inflation declined from 6.2 per cent in June 2012 to 3.2 per cent in December 2012. Over the same period, y-o-y PPI-M inflation edged up from 2.8 per cent to 2.9 per cent. In absolute terms, the PPI-M rose from 127.1 in June 2012 to 130.9 in December 2012, reflecting an increase in 'manufacture of food products and beverages'.

3.3.3 Wage Rate Index

The Wage Rate Index (WRI) increased by 4.7 per cent y-o-y in 2012Q4, indicating some cost pressures in the economy. The increase in the WRI was higher than the y-o-y inflation rate which stood at 3.9 per cent in 2012Q4 (Chart 3.7).

Table 3.1: Import Price Index

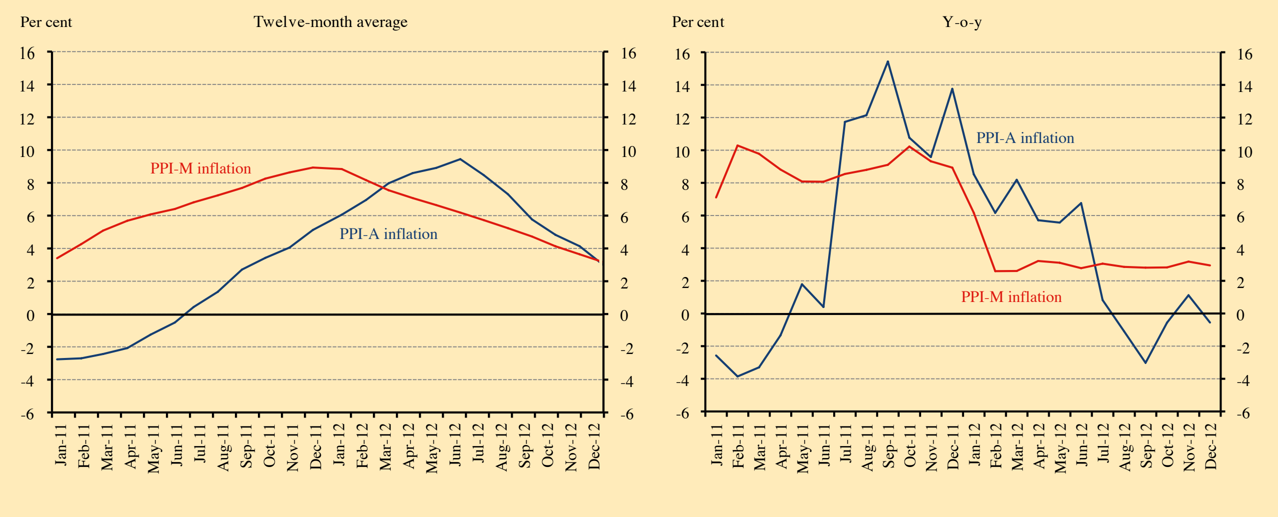
Description	Weights	Annual Percentage Change	
		Between 2011Q3 and 2012Q3	Between 2011Q4 and 2012Q4
Food and live animals	1,808	8.9	13.0
Beverages and tobacco	138	3.9	6.9
Crude materials, inedible, except fuels	288	4.5	2.9
Mineral fuels, lubricants and related materials	2,004	4.0	8.6
Animal and vegetable oils, fats and waxes	104	3.3	2.6
Chemical materials and related products, n.e.s	851	2.3	3.1
Manufactured goods classified chiefly by material	2,141	7.1	4.5
Machinery and transport equipment	1,800	17.4	4.7
Miscellaneous manufactured articles	866	6.2	2.8
Overall Index	10,000	7.6	6.7

Source: Statistics Mauritius.

On a q-o-q basis, the WRI rose by 0.2 per cent in 2012Q4. The highest increases were recorded in 'administrative and support service activities' (1.2 per cent), 'water supply, sewage, waste management and remediation activities' (1.1 per cent), 'transport and storage' (1.0 per cent) and 'accommodation and food service activities' (0.9 per cent). Sectors such as 'financial and insurance activities', 'information and communication' and 'manufacturing' recorded relatively moderate growth of 0.6 per cent, 0.3 per cent and 0.2 per cent, respectively in 2012Q4. Within 'manufacturing', the WRI for *'textile'* increased by 2.1 per cent. 'Agriculture, forestry and fishing', 'mining and quarrying', 'education', 'arts and entertainment and recreation' and 'other services' registered decreases in their WRI. In 'agriculture, forestry and fishing', the WRI declined by 2.4 per cent in 2012Q4 after a steep increase of 23.1 per cent in 2012Q3, as a result of the seasonal increase in the sugar sector wage rate, corresponding to the planting and harvesting cycle (Chart 3.8).

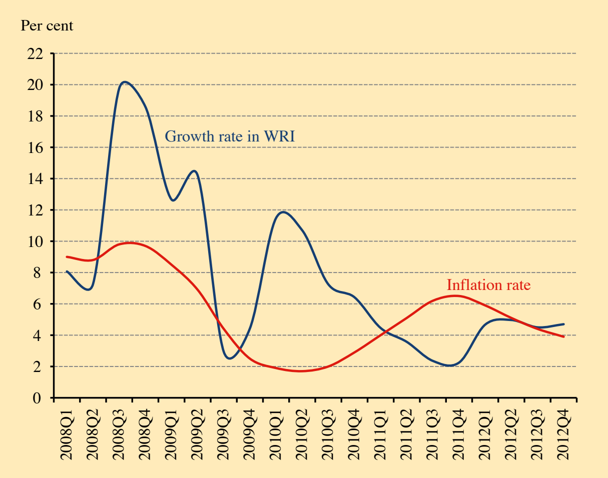
Gauging from past trends, the public sector wage award, which took effect in January 2013, is expected to lead to a sharp increase in the WRI in 2013Q1 before its effects dissipate in subsequent quarters. For instance, in

Chart 3.6: Producer Price Inflation



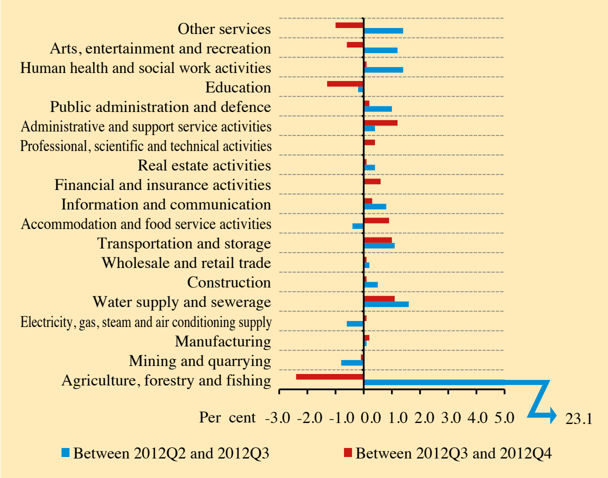
Source: Statistics Mauritius.

Chart 3.7: Wage Rate Index and Headline Inflation Rate



Source: Statistics Mauritius.

Chart 3.8: Q-o-q Change in the Wage Rate Index



Source: Statistics Mauritius.

2008, when the last increase in public sector wages was awarded, the WRI for the General Government sector increased by 18.1 per cent y-o-y while the overall WRI went up by 13.9 per cent.

3.4 Inflation Expectations

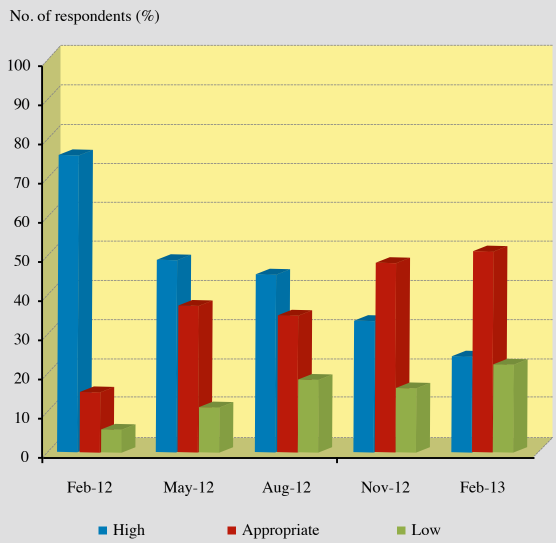
The Inflation Expectations Survey carried out by the Bank in February 2013 revealed that 79.2 per cent of respondents expected prices to go up over the next twelve months. The mean inflation rates expected by respondents were 4.5 per cent, 5.0 per cent and 5.2 per cent, respectively, for the twelve months period ending June 2013, December 2013 and a year ahead. External factors were viewed as the primary source of inflation in Mauritius by 60.4 per cent of respondents (Box I).

BOX I: EVOLUTION OF INFLATION EXPECTATIONS

This Box describes the evolution of the results of the five inflation expectations surveys carried out by the Bank between February 2012 and February 2013.

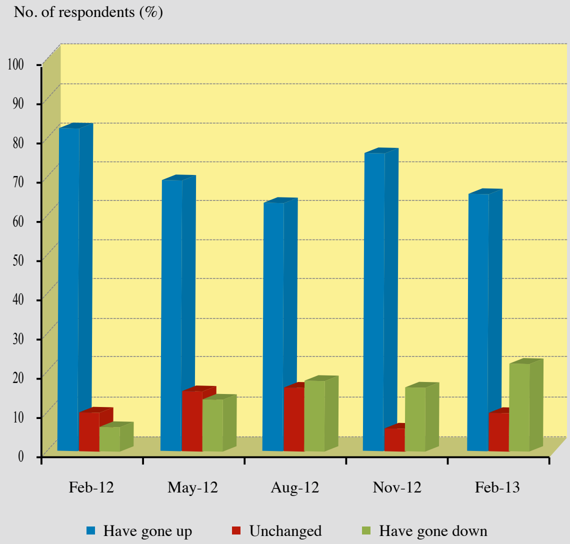
Q.1. How do you perceive the inflation rate in the twelve-month period ending in the month preceding the survey? [*Note: at 6.4 per cent in January 2012, 5.6 per cent in April 2012, 4.9 per cent in July 2012, 4.3 per cent in October 2012 and 3.7 per cent in January 2013*]

With headline inflation declining steadily from 6.5 per cent in December 2011 to 3.7 per cent in January 2013, the proportion of respondents perceiving inflation to be low increased significantly from 6.4 per cent in the February 2012 survey to 22.9 per cent in the February 2013 survey. In parallel, the proportion of respondents who perceived inflation to be high fell from 76.6 per cent to 25.0 per cent.



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

The share of respondents who described prices as going down during the past twelve months rose from 6.4 per cent in February 2012 to 22.9 per cent in February 2013. Concurrently, the proportion of respondents who believed that prices had gone up declined from 83.0 per cent to 66.7 per cent over the same period. Some 10.5 per cent of respondents viewed inflation to have remained unchanged over the past twelve months both in February 2012 and February 2013.



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 (AD), Monetary Policy (MP), Exchange Rate, Fiscal Policy, Wage Policy and Other*]

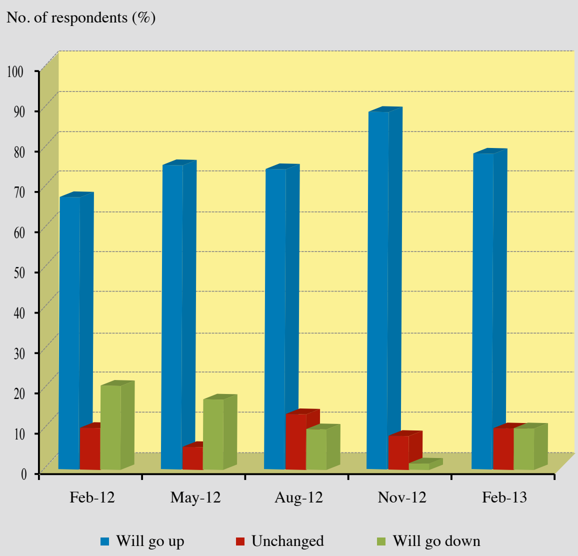
External factors followed by changes in aggregate demand (AD) were seen as the two most important reasons for inflation across all the five surveys carried out between February 2012 and February 2013. However, the proportion of respondents viewing external factors as the most significant cause of inflation declined from 79 per cent to 60 per cent while the share of respondents believing that change in AD was the second most important factor increased from 30 per cent to 40 per cent. Monetary Policy was regarded as the third most important cause of inflation in the surveys carried out in February, May and August 2012, while the following two surveys carried out in November 2012 and February 2013 indicated that the exchange rate was the third most important factor affecting the inflation pattern.

Ranking of Factors by Order of Importance	Feb-12		May-12		Aug-12		Nov-12		Feb-13	
	Factor	% of Respondents	Factor	% of Respondents	Factor	% of Respondents	Factor	% of Respondents	Factor	% of Respondents
First	External	79%	External	80%	External	73%	External	64%	External	60%
Second	Change in AD	30%	Change in AD	36%	Change in AD	42%	Change in AD	40%	Change in AD	40%
Third	MP	32%	MP	36%	MP	40%	Exchange Rate	26%	Exchange Rate	31%

Note: AD - Aggregate Demand MP - Monetary Policy

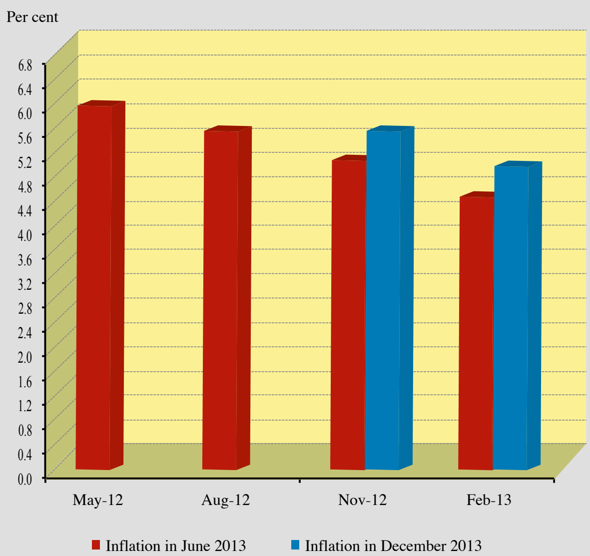
Q.4. Which of the following would best describe the movement of prices over the next twelve months?

The results of the surveys carried out between February 2012 and February 2013 showed that an overwhelming majority of respondents (around 78 per cent on average) expected inflation to go up over the next twelve months. The share of respondents expecting prices to go down declined continuously from 21 per cent in February 2012 to 2 per cent in November 2012, before picking up to 10 per cent in February 2013. The remaining respondents expected prices to remain unchanged.



Q.5. Mean expectation of inflation in June 2013 and December 2013:

The mean inflation rate expected by respondents by June 2013 declined gradually from 6.0 per cent in the May 2012 survey to 4.5 per cent in the February 2013 survey. The mean inflation rate expected by respondents by December 2013 fell from 5.6 per cent in the November 2012 survey to 5.0 per cent in the February 2013 survey. For a year ahead, February 2013, however, the mean inflation rate is projected to increase to 5.2 per cent.



4. The Domestic Economy

Despite restrained activity in major export sectors and a loss of momentum in 2012Q4, the domestic economy was assessed to have withstood the external headwinds relatively well in 2012. Data for 2012Q4 showed that some sectors continued to record strong growth while certain external-oriented sectors struggled amid the difficult international environment and the construction sector lost steam due to the completion of major projects. Consumption and investment growth continued to be subdued. The labour market displayed fairly stable conditions. Looking ahead, the growth momentum in the domestic economy is expected to remain positive though the economy would continue to operate below trend in the short to medium term.

4.1 Economic Activity

National accounts data released by Statistics Mauritius in March 2013 suggested that economic activity lost momentum in 2012Q4 to grow at 0.2 per cent q-o-q compared to 1.2 per cent in 2012Q3. On an annual basis, the domestic economy slowed to 3.2 per cent in 2012Q4, from 3.6 per cent in 2012Q3 (Chart 4.1). Overall, the domestic economy held up relatively well to the external headwinds in 2012 although the slowdown in main trading-partner countries led to a slight decline in growth to 3.3 per cent, from 3.5 per cent in 2011.

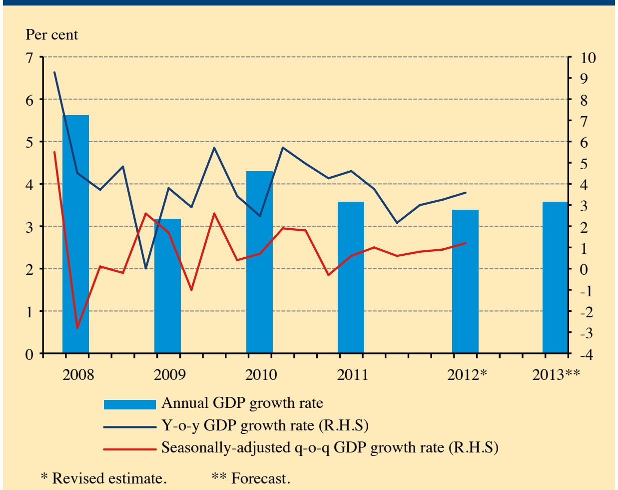
4.1.1 Output Gap

The output gap was estimated using a number of different methods that provided for a consistency check. In addition to the Hodrick-Prescott (HP) filter, the band-pass filter - which uses the statistical properties of the data to separate trend from cycles - and the Kalman filter - which uses an economic structure to yield an assessment of potential output and deviations therefrom - were also utilised. Based on these methodologies and taking into consideration the latest national accounts data, the output gap was estimated to be closing in negative territory (Chart 4.2).

4.1.2 Performance of Main Sectors

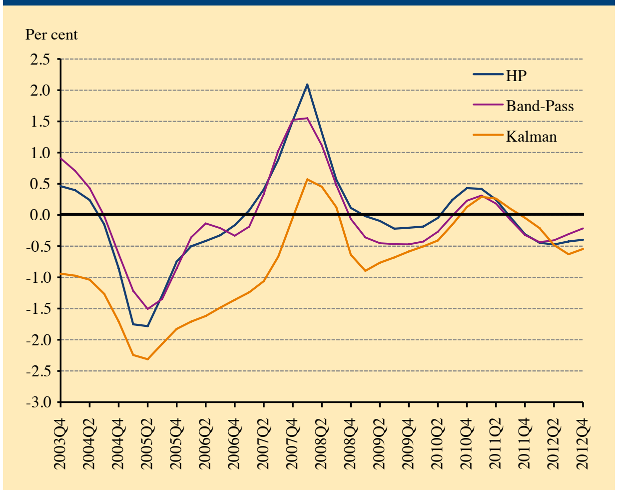
According to the revised industrial classification (Box II) of the national accounts estimates, which did not affect overall GDP, the deceleration of output in 2012Q4 was partly driven by a slowdown in 'manufacturing' growth, which fell to 2.8 per cent, from 3.9 per cent in 2012Q3. The manufacturing sector contributed 0.5 point to GDP growth in 2012Q4 (Chart 4.3). Within 'manufacturing', the *'textile'* sub-sector turned around after four consecutive quarters of contraction, with growth of 7.4 per cent registered in 2012Q4. This significant rebound in *'textile'* was, however, offset by lower output growth of 4.7 per cent in *'food'*, from 12.5 per cent in 2012Q3, and a contraction of 2.5 per cent in *'other manufacturing'* following positive growth of 0.8 per cent in the preceding quarter. *'Sugar'* continued to contract at a pace of 6.3 per cent in 2012Q4. For 2012, 'manufacturing' is estimated to have grown by 1.5 per cent and, for 2013, growth is forecast to be higher at 2.0 per cent, partly reflecting growth of 2.2 per cent and 2.0 per cent in *'food'* and *'textile'*, respectively.

Chart 4.1: Real GDP Growth Rate



Source: Statistics Mauritius.

Chart 4.2: Domestic Output Gap



Sources: Statistics Mauritius and Bank of Mauritius.

BOX II – REVISION OF THE INDUSTRIAL CLASSIFICATION OF NATIONAL ACCOUNTS ESTIMATES

New technologies and new divisions of labour between organisations over the past years have led to the emergence of new types of activities and new forms of industries, posing a challenge for both providers and users of statistical data. In response to the above, the UN International Standard Industrial Classification (ISIC) Rev 3 of 1990 was revised in 2008 (Rev.4 2008) to better reflect changed structures and analytical requirements. The main purpose of ISIC is to provide a set of activity categories that can be utilised for the collection and reporting of statistics according to such activities.

As from the December 2012 issue of the National Accounts Estimates, Statistics Mauritius revised industrial classifications according to the National Standard Industrial Classification (NSIC) Revision 2 based on the ISIC Rev.4 of 2008. This has resulted in some changes in value added estimates at industrial group level, but not in overall GDP. Value added figures at industry level are therefore not strictly comparable with those published earlier.

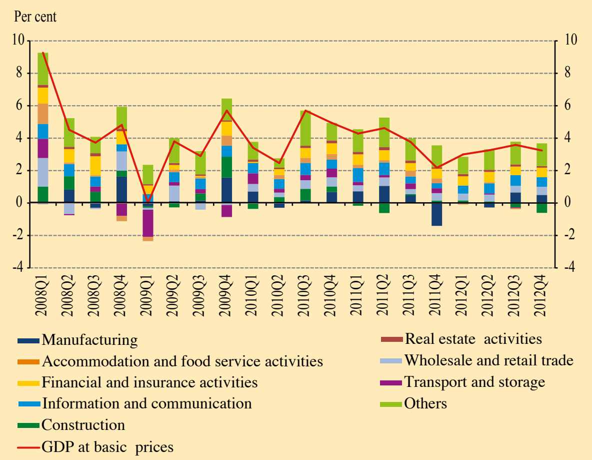
Source: Statistics Mauritius.

Several other sectors continued to record positive growth rates in 2012Q4. Among the highest growing sectors, 'information and communication' expanded by 9.7 per cent in 2012Q4 compared to 10.1 per cent in the preceding quarter while 'financial and insurance activities' grew by 5.5 per cent, up from 5.0 per cent in 2012Q3. The expansion of these sectors is expected to be sustained in 2013, with an estimated growth of 8.6 per cent and 5.7 per cent in 'information and communication' and 'financial and insurance activities', respectively. In the remaining sectors, growth in 'wholesale and retail trade' accelerated to 4.0 per cent in 2012Q4, following growth of 3.7 per cent in 2012Q3. 'Transport and storage' as well as 'real estate activities' also picked up momentum in 2012Q4, with growth of 2.6 per cent and 3.3 per cent, respectively, compared to 1.5 per cent and 2.7 per cent, respectively, in 2012Q3. Real output in export-oriented enterprises increased by 3.8 per cent in 2012Q4 compared to 2.0 per cent in 2012Q3.

In contrast, the construction sector continued to deteriorate in 2012Q4, with a further contraction of 9.4 per cent following negative growth of 4.0 per cent in 2012Q3. Statistics Mauritius estimated that the sector contracted by 3.0 per cent in 2012 and forecast that it would contract even more, by 6.9 per cent, in 2013 as a result of the completion of major projects, such as the airport extension, shopping complexes and prison, and delays expected in some major road decongestion programmes.

Mostly as a result of the prevailing difficult economic conditions in main European markets 'accommodation and food service activities' stagnated in 2012Q4, after contracting by 0.6 per cent in 2012Q3. For 2012 as a whole, activity also stagnated in 'accommodation and food service activities'. Total tourist arrivals grew marginally by 0.1 per cent y-o-y in 2012, compared to 3.2 per cent in 2011, to reach 965,441. Arrivals from the European market contracted by 8.0 per cent, with the dominant French market retreating by 13.2 per cent, while growth of over 14 per cent was registered in

Chart 4.3: Contribution of Selected Sectors to GDP Growth



Source: Statistics Mauritius.

arrivals from the African and Asian markets. Tourist earnings increased by 3.9 per cent y-o-y to reach Rs44,378 million in 2012 (Chart 4.4).

Latest data show that tourist arrivals totalled 174,079 in the first two months of 2013, that is, a decrease of 2.3 per cent compared to the corresponding period of 2012, while tourist earnings fell by 14.4 per cent to Rs8.2 billion. For 2013 as a whole, Statistics Mauritius has forecast total tourists arrivals of one million, with gross tourism receipts projected at around Rs47 billion. Growth in 'accommodation and food service activities' is accordingly forecast to pick up to 3.5 per cent.

Overall, for 2013, Statistics Mauritius forecast that the economy will grow by 3.5 per cent, down from a previous forecast of 3.7 per cent made in December 2012. The slightly better economic performance in 2013 compared to the growth of 3.3 per cent in 2012 is expected to be driven by improvements in 'accommodation and food service activities' and 'manufacturing'.

4.2 Domestic Demand

4.2.1 Consumption

Despite a pick-up noted in 2012Q4, household consumption expenditure has remained subdued, consistent with sub-par growth in the economy. Growth improved to 3.2 per cent in 2012Q4, from 2.5 per cent in 2012Q3 (Chart 4.5). In 2012, household consumption expenditure is estimated to have expanded by 2.7 per cent compared to 2.5 per cent in 2011, and is forecast to grow at a slightly higher pace of 2.9 per cent in 2013, partly because of the effect of the public sector wage award and the potential upward pull that it could exercise on private sector wages.

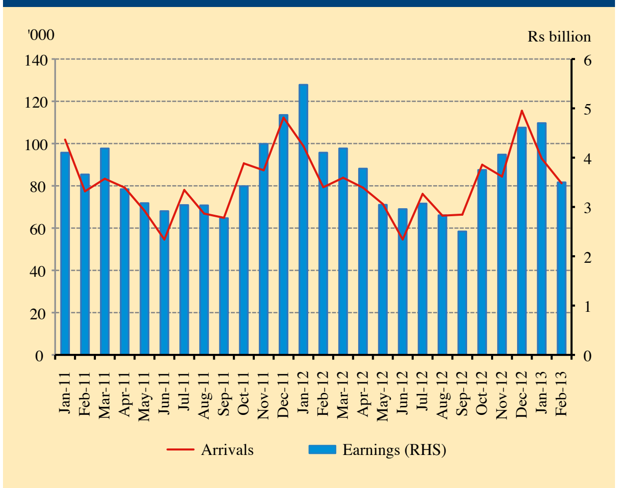
Government consumption expenditure grew at a higher rate of 3.9 per cent in 2012Q4 compared to growth of 3.4 per cent in 2012Q3. For 2012, Statistics Mauritius estimated that general government consumption expenditure growth accelerated to 3.1 per cent, from 2.3 per cent in 2011. For 2013, growth is forecast at 3.7 per cent.

The combination of higher household and government expenditure growth in 2012Q4 led to an increase in final consumption expenditure growth to 3.3 per cent, from 2.7 per cent in 2012Q3. For 2012, final consumption expenditure is estimated to have grown by 2.9 per cent compared to 2.5 per cent in 2011, driven mainly by higher general government consumption expenditure. A slight uptick in growth to 3.0 per cent is expected for 2013 (Chart 4.5).

4.2.2 Investment

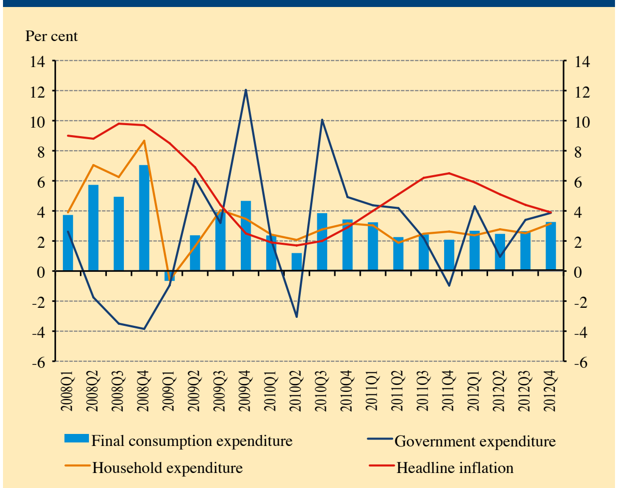
Gross Domestic Fixed Capital Formation (GDFCF) recorded a second consecutive quarter of negative growth in 2012Q4. It contracted heavily by 14.3 per cent compared to 3.4 per cent in 2012Q3, reflecting

Chart 4.4: Tourist Arrivals and Earnings



Sources: Statistics Mauritius and Bank of Mauritius.

Chart 4.5: Final Consumption Expenditure and Inflation Rate



Source: Statistics Mauritius.

shrinking investment in both 'building and construction work' and 'machinery and equipment'. Following positive, albeit declining, growth rates in 2012H1, 'building and construction work' contracted by 2.2 per cent in 2012Q3 and further by 8.3 per cent in 2012Q4, mainly driven by a noticeable fall of 20.2 per cent in *'other construction'* and declines of 2.9 per cent and 4.9 per cent in *'non-residential building'* and *'residential building'*, respectively.

Investment in 'machinery and equipment' was tightened by an additional 27.5 per cent in 2012Q4 after a pull-back of 6.4 per cent noted in 2012Q3. This was led by falls of 35.4 per cent in *'other machinery and equipment'* investment and 15.1 per cent in *'other transport equipment'* investment, which were partly offset by positive growth of 3.1 per cent in *'passenger car'* (Chart 4.6).

For 2012, a contraction of 2.5 per cent in private investment, partly offset by an increase of 2.7 per cent in public investment, contributed to an overall contraction of 1.3 per cent in GDFCF. The decline in investment was partly attributable to the uncertain economic climate, which also impacted on business confidence.

The Mauritius Chamber of Commerce and Industry (MCCI) business confidence survey carried out towards end-November 2012 showed a second consecutive decline in business confidence in 2012Q4 to 85.4, with around 23 per cent of enterprises surveyed indicating that their financial and economic situation had deteriorated and that their orders had declined during this period (Chart 4.7).

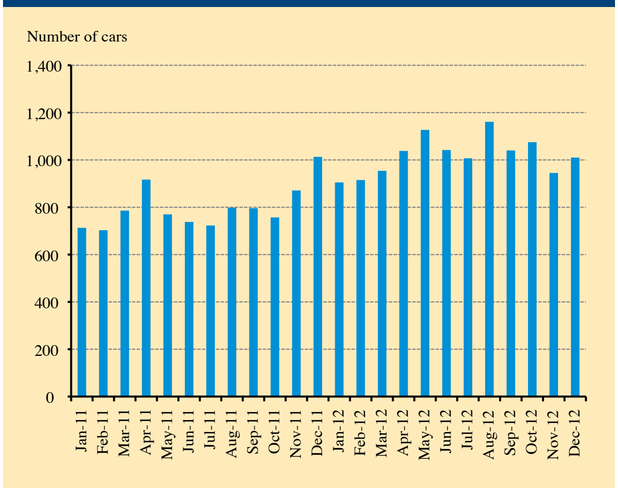
The latest business confidence survey undertaken in March 2013 has shown a return in confidence for all the three sectors surveyed, that is, manufacturing, services and distributive trade, with the overall index increasing by 6.2 points to reach 91.6 points. Around 28 per cent of entrepreneurs interviewed expected an improvement in business conditions, partly as a result of diversification into new markets.

GDFCF is projected to grow marginally by 0.4 per cent in 2013. Excluding *'aircraft and marine vessel'*, however, GDFCF is forecast to contract by 2.6 per cent, with private investment expected to pick up by 1.9 per cent, whereas public investment is forecast to contract by 4.3 per cent.

4.3 External Demand

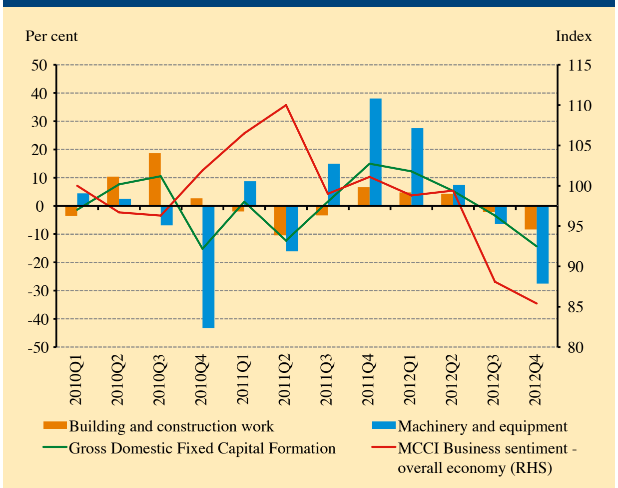
With domestic demand muted, external demand was the main driver of GDP growth in the first three quarters of 2012. Its contribution, however, fell into negative territory in 2012Q4 (Chart 4.8).

Chart 4.6: Number of Cars Registered



Source: National Transport Authority.

Chart 4.7: Gross Domestic Fixed Capital Formation and MCCI Business Sentiment Index



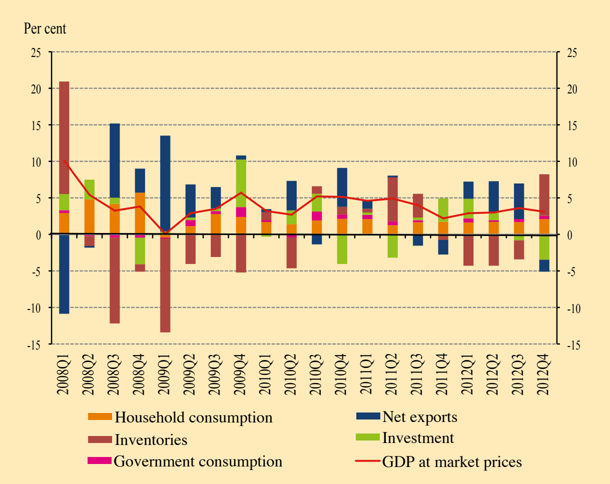
Sources: Statistics Mauritius and MCCI.

4.3.1 Exports

Total exports of goods, excluding ship's stores and bunkers, increased by 9.6 per cent y-o-y to Rs35.5 billion in 2012H2. The rise in exports was mainly driven by 'food and live animals' exports, which grew by 16.8 per cent mainly on account of an expansion of 29.5 per cent in the exports of '*fish and fish preparations*'. Among the remaining main commodity groups, 'machinery and transport equipment' and 'miscellaneous manufactured goods' registered growth of 79.7 per cent and 3.0 per cent, respectively (Chart 4.9).

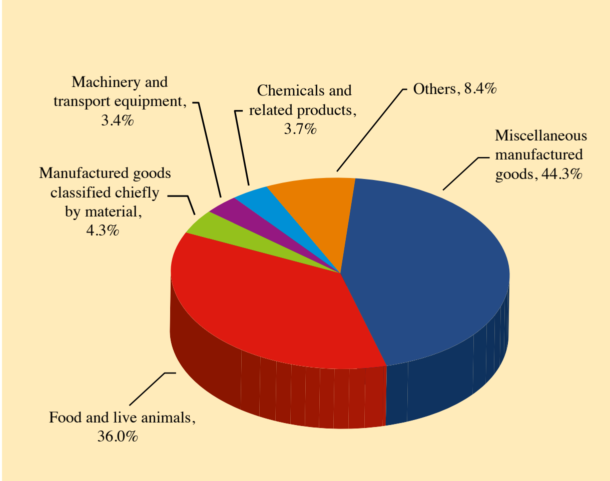
In 2012H2, 'miscellaneous manufactured goods' still made up most of total exports (44.3 per cent) followed by 'food and live animals' (36.0 per cent) (Chart 4.10). Europe's share in total exports dropped to 56.0 per cent in 2012H2 from 59.9 per cent in 2011H2. The share of exports to main European markets, namely UK, France and Italy, decreased to 18.5 per cent, 11.8 per cent and 6.9 per cent, respectively, while the share of exports to Spain increased to 7.0 per cent. Export share to the US also declined to 10.3 per cent. In contrast, export share to South Africa increased to 10.9 per cent, as a result of market diversification efforts (Chart 4.11).

Chart 4.8: Contribution of Components of Aggregate Demand to Growth



Source: Statistics Mauritius.

Chart 4.10: Exports by Main Commodities

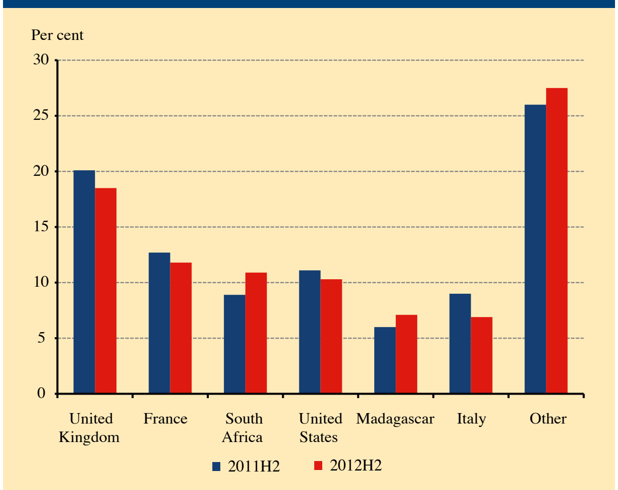


Source: Statistics Mauritius

Chart 4.9: Y-o-y Growth in Exports

Source: Statistics Mauritius.

Chart 4.11: Main Export Destinations



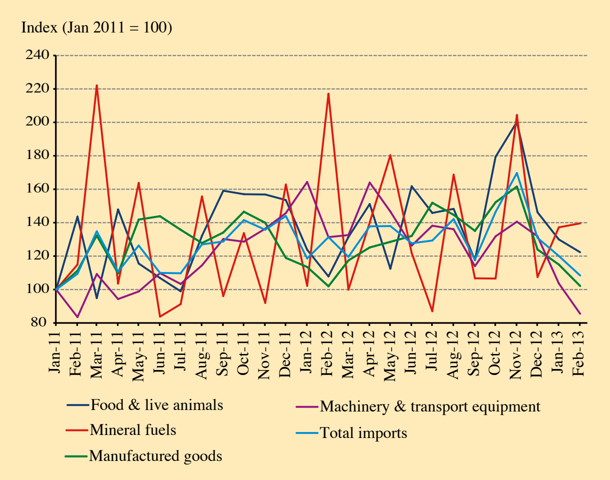
Source: Statistics Mauritius.

4.3.2 Imports

Imports of goods *c.i.f.* grew by 6.4 per cent y-o-y to Rs83.7 billion in 2012H2. This mainly reflected increases of 9.6 per cent in 'food and live animals', 8.3 per cent in 'manufactured goods classified chiefly by material', 6.7 per cent in 'mineral fuels, lubricants and related products' and 4.5 per cent in 'machinery and transport equipment' (Chart 4.12).

'Mineral fuels, lubricants and related products' made up the bulk of imports (19.6 per cent) in 2012H2 while 'food and live animals' was the second highest import commodity, accounting for 19.3 per cent of total imports (Chart 4.13). The Asian continent remained the major source of total imports in 2012H2, with a share of 55.9 per cent, while imports from France, South Africa, Spain and Germany accounted for 8.5 per cent, 6.8 per cent, 3.9 per cent and 2.6 per cent of total imports, respectively (Chart 4.14).

Chart 4.12: Y-o-y Growth in Imports



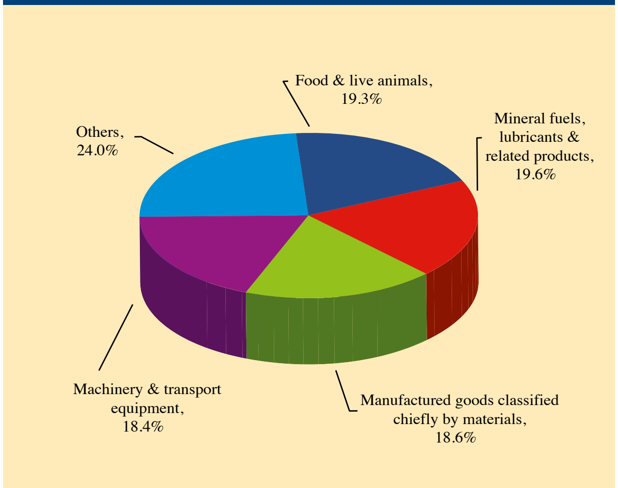
Source: Statistics Mauritius.

4.4 Balance of Payments Developments

The current account deficit narrowed to Rs22.7 billion in 2012H2, from Rs26.8 billion in 2011H2. The improvement was largely due to higher surpluses on the services and current transfers accounts as well as from net gains in the income account, which contributed to partly offset the widening merchandise trade deficit. As a percentage of GDP at market prices, the current account deficit remained at a persistently high level of 12.5 per cent, indicating a need for demand to rebalance towards net exports.

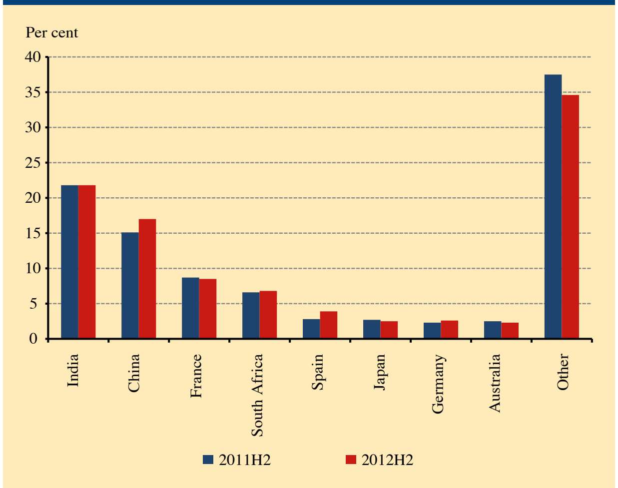
The merchandise trade deficit widened to Rs37.8 billion in 2012H2, from Rs36.2 billion in 2011H2, on account of a larger increase in nominal absolute imports than in merchandise exports. The services account surplus rose by 14.4 per cent y-o-y to Rs11.9 billion, mostly on a reversal in *'other services'* from a deficit of Rs2.1 billion in 2011H2 to a surplus of Rs0.7 billion in 2012H2. Net travel receipts registered

Chart 4.13: Imports by Main Commodities



Source: Statistics Mauritius.

Chart 4.14: Main Sources of Imports



Source: Statistics Mauritius.

a decline of 3.0 per cent in 2012H2 to Rs15.0 billion while inbound tourism marginally fell by 0.3 per cent.

The income account, inclusive of GBC1s transactions, posted a surplus of Rs1.1 billion in 2012H2, as against a deficit of Rs2.1 billion in 2011H2. The turnaround was largely attributable to net inflows being recorded in direct investment income and other investment income. The current transfers account posted a higher surplus of Rs2.1 billion in 2012H2, mainly on account of lower private net outflows (Table 4.1).

4.4.1 Capital and Financial Account

The capital and financial flows remained largely adequate to finance the current account deficit in 2012H2 although there were lower net inflows relative to 2011H2 (Chart 4.15). Inclusive of cross-border transactions of GBC1s, the capital and financial account posted a surplus of Rs22.3 billion in 2012H2 compared to a surplus of Rs23.1 billion in 2011H2 as other investment posted higher net outflows that outweighed the higher net inflows recorded in portfolio investment and direct investment.

Direct investment, inclusive of cross-border transactions of GBC1s, posted net inflows of Rs20.6 billion in 2012H2 as against net outflows of Rs65.4 billion in 2011H2. Excluding cross-border transactions of GBC1s, foreign direct investment in Mauritius, net of repatriation, gained momentum to reach Rs7.5 billion in 2012H2 compared to Rs3.5 billion in 2011H2. Residents' direct investment

Chart 4.15: Financing of the Current Account Deficit

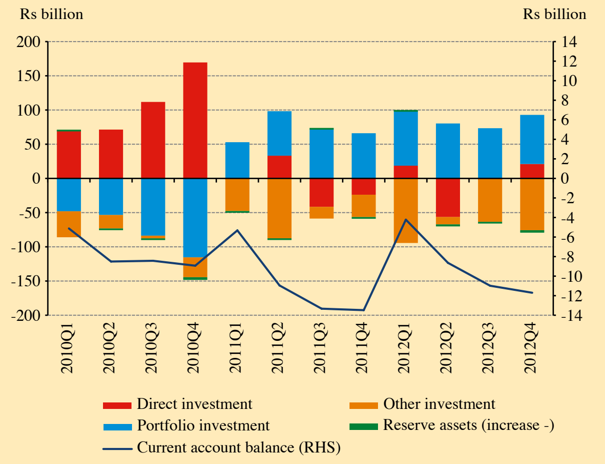


Table 4.1: Balance of Payments Summary

(Rs million)

	2011 [1]		2012 [2]	
	Semester 1	**Semester 2**	**Semester 1**	**Semester 2**
Current Account	**-16,272**	**-26,814**	**-12,862**	**-22,688**
Exports (f.o.b)	34,695	38,891	38,836	41,523
Imports (f.o.b)	-66,049	-75,122	-74,125	-79,332
of which: aircrafts/marine vessels	-	-	-	-
Trade balance	-31,354	-36,231	-35,289	-37,809
Services, net	12,468	10,401	17,084	11,902
of which:travel, net	*15,725*	*15,509*	*18,341*	*15,041*
Income, net	295	-2,140	3,218	1,085
Current transfers, net	2,319	1,156	2,125	2,135
Capital and Financial Account	**12,072**	**23,121**	**15,655**	**22,260**
Capital account, net	-25	-28	-113	-128
Direct investment, net	33,833	-65,446	-37,870	20,552
Portfolio investment, net	117,365	139,607	160,091	145,150
Other investment, net	-135,190	-49,676	-105,097	-138,629
Balance of Payments Surplus (-)/ Deficit (+)	-3,911	-1,336	-1,356	-4,685
Net Errors and Omissions	**4,200**	**3,693**	**-2,793**	**428**

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

Figures may not add up to totals due to rounding.

abroad, excluding cross-border transactions of GBC1s, remained constant at Rs1.4 billion.

Portfolio investment, inclusive of cross-border transactions of GBC1s, recorded higher net inflows of Rs145.2 billion in 2012H2 compared to Rs139.6 billion a year earlier. Excluding cross-border transactions of GBC1s, portfolio investment posted net inflows of Rs0.8 billion compared to Rs1.9 billion in 2011H2. The expansion in net portfolio inflows was largely driven by substantial repatriation of residents' portfolio assets from abroad. On the liabilities side, non-residents carried out net purchases of Rs0.3 billion on the Stock Exchange of Mauritius, including the Development Enterprise Market, in 2012H2 as against net sales of Rs0.6 billion in 2011H2.

Other investment, inclusive of GBC1s' cross-border transactions, posted significantly higher net outflows of Rs138.6 billion during 2012H2 compared to net outflows of Rs49.7 billion in 2011H2. The higher deficit was largely attributable to a larger decline in banks' foreign liabilities relative to their drawdown in foreign assets.

The country's overall balance of payments for 2012H2, as measured by the change in reserve assets excluding valuation change, recorded a surplus of Rs4.7 billion compared to Rs1.3 billion in 2011H2.

BOX III – SAVINGS, INVESTMENT AND THE CURRENT ACCOUNT BALANCE

The current account deficit as a percentage of GDP in Mauritius has grown over time and has, for the past three years, stood at above 10 per cent of GDP, raising concerns about its sustainability.

Usually, a current account deficit implies that the imports of goods and services exceed the exports of goods and services. However, the current account can also be expressed as the difference between national savings and investment (both public and private) such that a current account deficit would therefore reflect low savings relative to investment. This can be represented through simple national accounting identities, based on equilibrium in the output market that requires that gross domestic production (Y) equals private consumption (C), government consumption (G), investment (I) and net demand from abroad i.e. net exports (NX):

$$Y = C + G + I + NX$$

A country's current account (CA), or net exports, is the difference between total income and the sum of private consumption, investment and government consumption:

$$CA = Y - C - G - I$$

Concurrently, national savings (S), that is, the part of income that is not allocated for consumption can be labelled as:

$$S = Y - C - G$$

Thus:

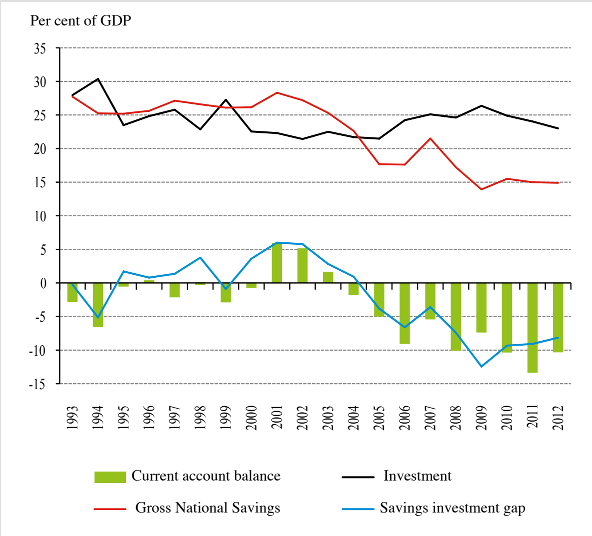
$$CA = S - I$$

The saving-investment identity shows the intertemporal nature of the current account and is vital for analysing the impact of economic policies and shocks, particularly when the current account balance is viewed as the change in the value of net claims on the rest of the world.

From this perspective, national savings in excess of domestic capital formation flows into net foreign asset accumulation. A current account deficit implies that national savings are not sufficient to meet domestic capital formation and that the country must be borrowing at least an equal amount to finance its deficit with foreigners.

In Mauritius, Gross National Savings as a percentage of GDP has been on a declining trend for the past twelve years or so. Whereas the savings rate fluctuated around between 25-30 per cent throughout most of the 1990s, it has remained almost constant at around 15 per cent since 2009. In parallel, investment as a percentage of GDP has continued to be mostly in a range of 20-25 per cent since the 1990s. While it was moving closely with the savings rate during the 1990s, the decline in the savings rate over time led to a wide difference between them, which was mirrored in the current account deficit (Figure 1).

Figure 1: Investment, Savings and Current Account Balance



Sources: Statistics Mauritius and Bank of Mauritius.

The current account deficit has so far been financed by net inflows of direct investment, portfolio investment and other investment on the capital and financial account. The key question is whether the level of current account deficit is sustainable over time and the extent to which monetary policy can contribute in the rebalancing of the country's external position.

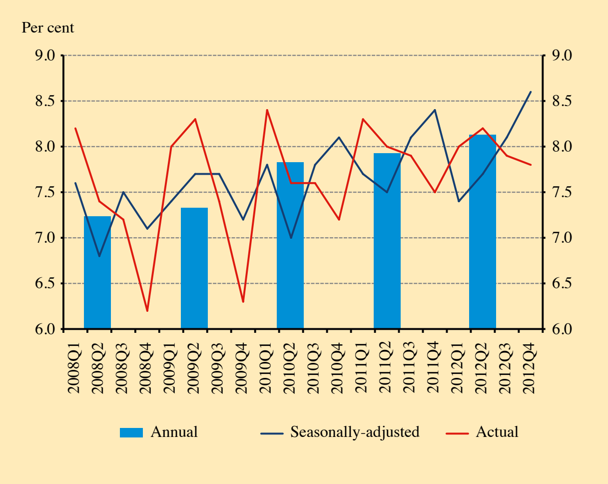
Since the current account is an intertemporal phenomenon, gains can be made from trade. However, the financing of the current account deficit represents a risk that needs to be contained through increasing savings. While a tighter monetary policy might affect consumption behaviour to some extent through substitution and wealth effects, it would also be necessary to implement longer-term structural policies that foster productivity and competitiveness as well as maintain a prudent fiscal policy.

4.5 Labour Market Developments

The unemployment rate fell to 7.8 per cent in 2012Q4, from 7.9 per cent in 2012Q3, but was higher by 0.3 percentage point compared to 2011Q4. On a seasonally-adjusted basis, the unemployment rate increased to 8.6 per cent in 2012Q4, from 8.1 per cent in 2012Q3 and 8.4 per cent in 2011Q4. For the year 2012, Statistics Mauritius has estimated the unemployment rate to be slightly higher at 8.1 per cent compared to 7.9 per cent in 2011 (Chart 4.16).

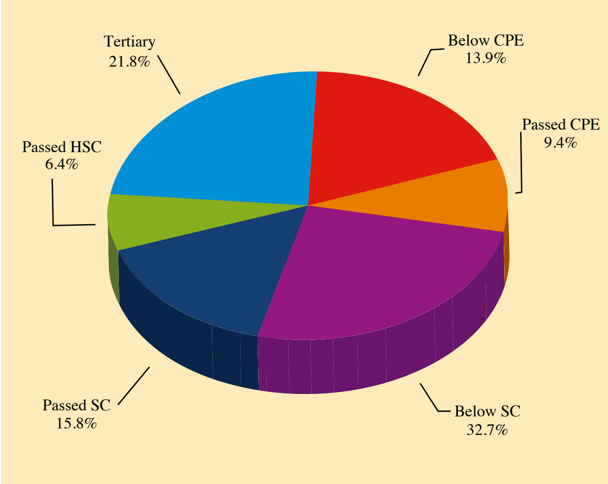
In 2012Q4, the female unemployment rate (12.0 per cent) continued to outpace the male unemployment rate (5.1 per cent). Among the 46,800 unemployed, 41 per cent were below the age of 25 years. Among them, there were 10,000 young unmarried persons, aged 16 to 24 years, who were looking for a first job. Around 13.9 per cent of the unemployed had not reached the Certificate of Primary Education and a further 32.7 per cent did not possess the Cambridge School Cetificate while 21.8 per cent had reached tertiary level (Charts 4.17 and 4.18).

Chart 4.16: Unemployment Rate



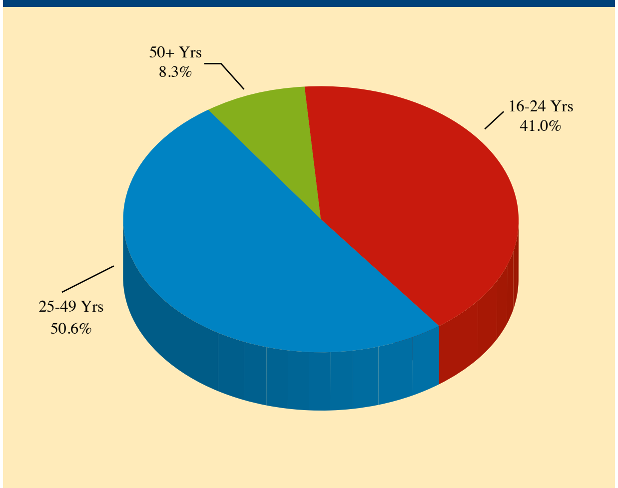
Source: Statistics Mauritius.

Chart 4.18: Unemployment by Educational Attainment



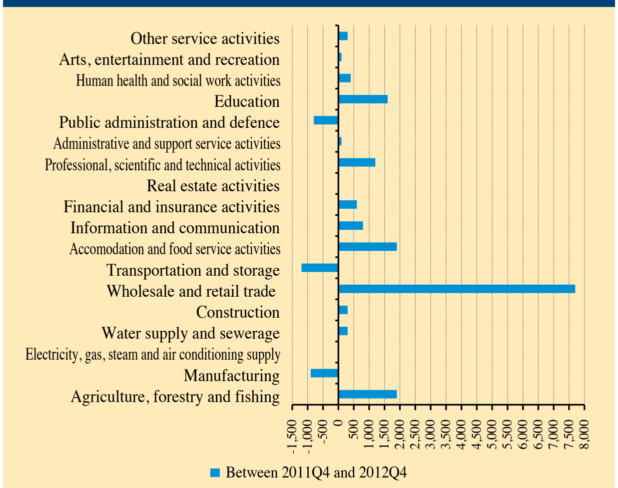
Source: Statistics Mauritius.

Chart 4.17: Unemployment by Age



Source: Statistics Mauritius.

Chart 4.19: Change in Employment



Source: Statistics Mauritius.

Over the year to 2012Q4, 14,300 jobs were created in the domestic economy, mainly in 'wholesale and retail trade' (+7,700) followed by 'accommodation and food services' (+1,900) and 'agriculture, forestry and fishing' (+1,900). In 'construction', 300 jobs were created. In 'manufacturing', 900 jobs were lost and, within manufacturing, '*textiles*' shed 1,700 jobs. 'Transportation and storage' lost 1,200 jobs (Chart 4.19).

The outlook for the labour market remains basically unchanged since the October 2012 Inflation Report. The structural skills mismatch that has hampered the development of the domestic labour market and constrained productivity growth continue to prevail. The vulnerable economic conditions are expected to impact on the job-creation capacity of enterprises, with firms projected to be cautious in expanding capacity and recruiting new workers in the short to medium term. A recent survey conducted by the Mauritius Employers Federation highlighted the difficulties faced by companies to find candidates with the appropriate skills and competencies. It identified the 'construction', export-oriented 'manufacturing' and 'wholesale and retail trade' sectors as the ones where confidence was low. On the other hand, the 'financial and insurance activities' and 'information and communication' sectors were expected to increase employment in anticipation of an expansion of their business activities and investment.

5. Monetary and Financial Developments

Since September 2012, Broad Money Liabilities (BML) growth recorded a slight uptrend while claims on other sectors expanded more rapidly. Excess liquidity in the banking system increased somewhat while interbank interest rates and yields on Government securities trended downwards. The stock market recovered strongly as investors' risk appetite improved. Activity stayed buoyant on the domestic foreign exchange market. On a weighted dealt average basis, the rupee appreciated against the US dollar and Pound sterling but depreciated against the euro.

5.1 Monetary and Credit Aggregates

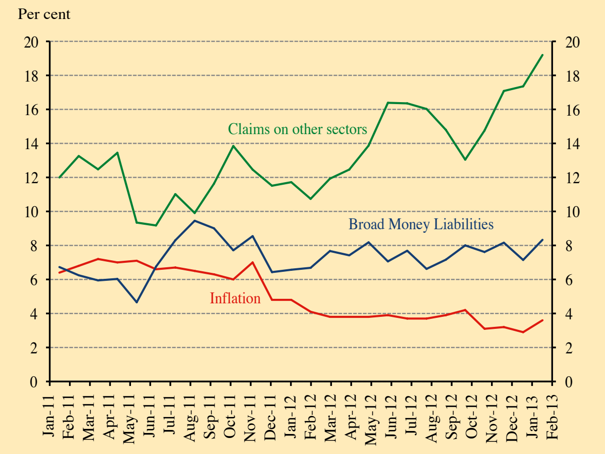
5.1.1 Broad Money Liabilities

A slight uptrend in the annual growth rate of Broad Money Liabilities (BML) has been noted since the October 2012 Inflation Report, with an expansion of 8.3 per cent y-o-y recorded in February 2013 compared to 7.2 per cent in September 2012. Overall, however, BML growth remained subdued, in line with domestic economic conditions (Chart 5.1).

The growth in BML was driven by an increase in quasi-money liabilities, which rose by 8.3 per cent y-o-y in February 2013, up from 7.2 per cent in September 2012, as time rupee deposits and savings deposits expanded by 10.5 per cent and 9.7 per cent, respectively. Foreign currency deposits grew by 0.4 per cent in February 2013. Narrow Money Liabilities increased by 8.3 per cent in February 2013 up from 7.7 per cent in September 2012, reflecting higher growth in currency with public. Securities other than shares increased by 17.8 per cent as against a contraction of 11.8 per cent in September 2012.

Of the sources of BML, the net foreign assets of depository corporations increased by 4.9 per cent y-o-y in February 2013, as a result of increases in the net foreign assets of both the Bank of Mauritius and Other Depository Corporations (ODCs) by 17.0 per cent and 1.3 per cent, respectively. Domestic credit increased by 17.3 per cent y-o-y in February 2013, up from 13.2 per cent in September 2012, reflecting growth of 19.2 per cent in claims on other sectors by ODCs, which more than offset a reduction of 4.0 per cent in net credit to central Government.

Chart 5.1: Y-o-y Growth in Broad Money Liabilities and Claims on Other Sectors and Inflation Rate



BOX IV: REVISIONS TO MONETARY AND FINANCIAL STATISTICS

Following an IMF Statistics Mission's recommendations in January 2013, several components of the monetary and financial statistics have been recast since January 2010 in accordance with international guidelines. The main changes include the reclassification of deposits of extra-budgetary units and social security funds from Broad Money Liabilities to central Government deposits, the reclassification of SDR allocation as a foreign liability of Government rather than as a foreign liability of the central bank and holdings of Bank of Mauritius securities.

5.1.2 Sectorwise Distribution of Credit by Banks

Claims on other sectors registered stronger growth mainly on account of banks' credit to the private sector which increased by 13.3 per cent y-o-y in February 2013, up from 10.0 per cent in September 2012. The major share of total banks' credit was channelled to the construction sector, which accounted for 33.1 per cent of total banks' credit followed by the 'financial and business services' (15.2 per cent), 'public non-financial corporations'(11.4 per cent,), 'tourism' (10.7 per cent), and 'personal' (9.0 per cent). Credit to the household sector rose by 16.2 per cent y-o-y in February 2013 while corporate credit expanded by 11.2 per cent, up from 9.4 per cent in September 2012 (Chart 5.2).

5.1.3 Monetary Base

The monetary base went up by 16.6 per cent y-o-y in February 2013, from 11.8 per cent in September 2012. Reserve deposits held by ODCs at the Bank grew by 23.0 per cent up from 17.3 per cent in September 2012. The growth in the monetary base reflected positive contributions of the Bank's net foreign assets and domestic claims.

5.2 Money Market

5.2.1 Liquidity Management

The overall excess liquidity in the banking system averaged Rs3.4 billion over the period September 2012 to February 2013. Net redemption of Government securities, deposits of a public fund with banks and net intervention by the Bank on the domestic foreign exchange market contributed to the overall excess liquidity. The Bank of Mauritius issued its own Bills for a total nominal amount of Rs5.0 billion during this period to reduce excess liquidity (Chart 5.3).

5.2.2 Money Market Interest Rates

Interbank interest rates trended downwards since the last Inflation Report, partly reflecting excess liquidity on the domestic money market. The overall weighted average interbank interest rate ranged between 1.33 per cent and 1.84 per cent during this period (Chart 5.4).

Chart 5.2: Sectorwise Contribution to Change in Banks' Credit to the Private Sector – end-September 2012 to end-February 2013

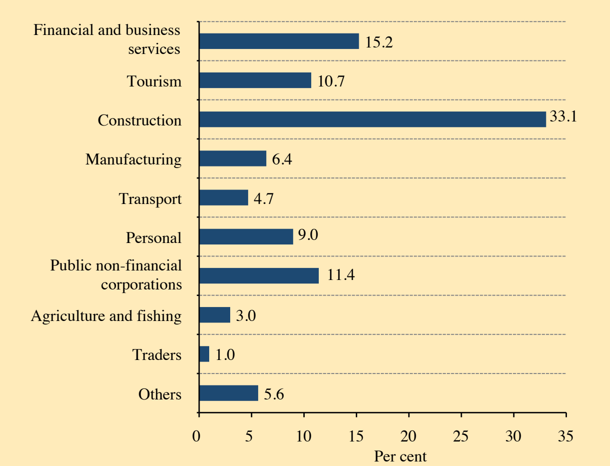


Chart 5.3: Banks' Monthly Average Excess Reserves

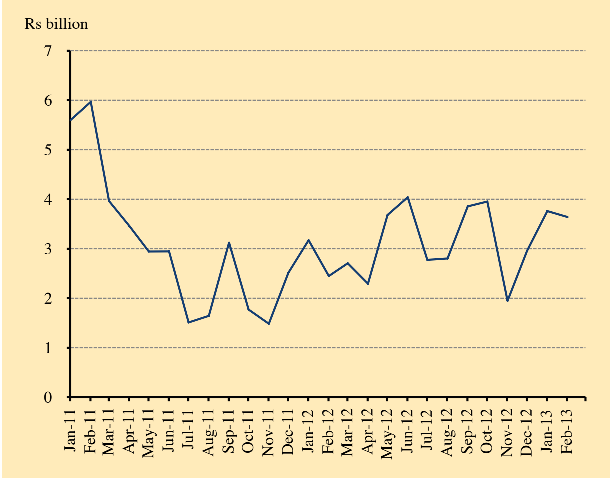
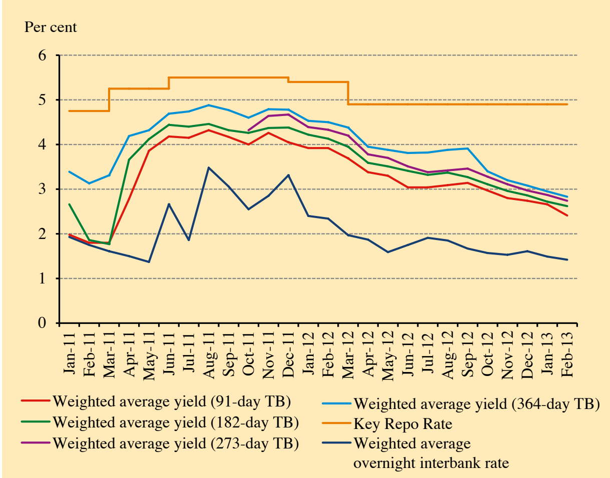


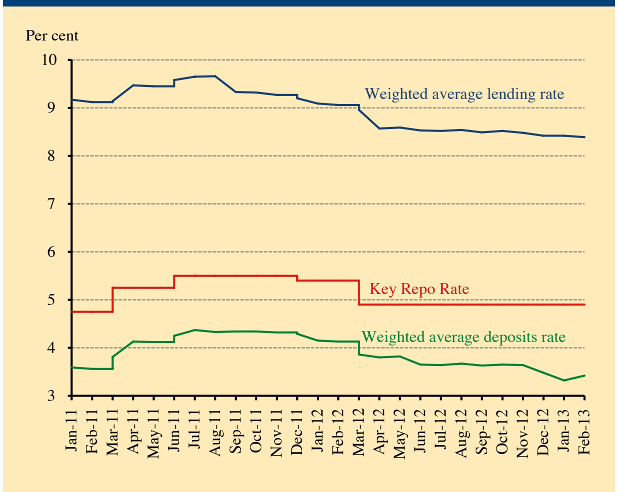
Chart 5.4: Money Market Interest Rates



Yields on Government instruments of all maturities broadly followed a similar declining trend given excess liquidity conditions. The overall weighted yield on Treasury Bills declined from 3.60 per cent in September 2012 to 2.67 per cent in February 2013 while the weighted yield on Three-Year Treasury Notes fell from 4.73 per cent to 4.06 per cent over the same period.

With regard to longer-term instruments, the weighted yield on Five-Year Government of Mauritius Bonds issued at primary auctions decreased from 6.11 per cent in September 2012 to 4.34 per cent in February 2013 while the weighted yield on Ten-Year Government of Mauritius Bonds fell from 7.49 per cent to 7.06 per cent over the same period. The weighted yield on Fifteen-Year Government of Mauritius Bonds declined from 8.38 per cent in September 2012 to 7.50 per cent in February 2013. The reductions in yields have lowered Government's financing costs.

Chart 5.5: Key Repo Rate and Deposit and Lending Rates



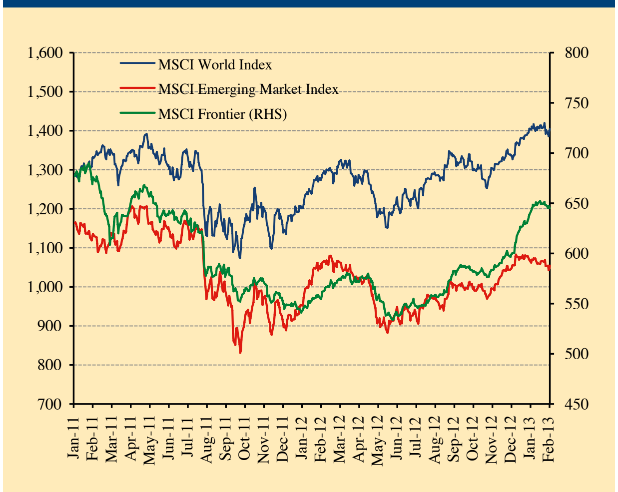
5.3 Deposit and Lending Rates

The weighted average interest rate on rupee deposits hovered within a range of 3.32-3.65 per cent between September 2012 and February 2013 while the weighted average interest rate on rupee advances varied within a range of 8.39-8.52 per cent (Chart 5.5). The real interest rate on savings deposits using y-o-y inflation moved into marginal positive territory to stand at 0.1 per cent in February 2013, from negative 0.2 per cent in September 2012.

5.4 Stock Market

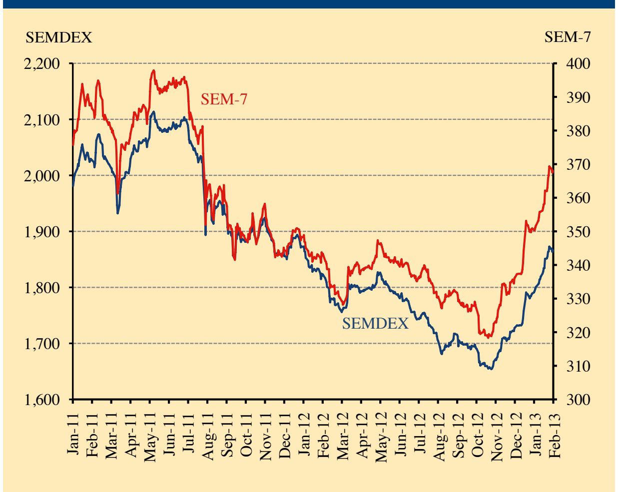
Global financial markets witnessed significant improvement, as reflected in a declining Volatility Index (VIX) that hit its lowest level since April 2007, as investors' perception of near-term risks diminished and their willingness to hold risky assets increased. Mirroring developments in global stock markets, domestic equities increased sharply since the last Inflation Report. The SEMDEX rose by 9.6 per cent while the SEM-7, which comprises

Chart 5.6: MSCI Regional Equity Indices



Source: Thomson Reuters.

Chart 5.7: SEMDEX and SEM-7



Source: Stock Exchange of Mauritius.

the seven largest companies in terms of market capitalisation, recorded an increase of 11.9 per cent (Charts 5.6 and 5.7).

Net investment by foreigners on both the Official and Development & Enterprise Markets of the stock exchange amounted to Rs693.4 million, largely driven by net inflows into the banking and hotel sectors and acquisition of shares in two newly listed companies. The market price-earnings (PE) ratio increased to 12.2 as at end-February 2013, with a significant rise in the PE ratio of the leisure and hotel sector to 26.9.

While the outlook for domestic equities appears to have brightened recently, adverse developments on the global front, particularly with regard to the Eurozone financial system, may still trigger price swings in the near term.

5.5 Domestic Foreign Exchange Market

5.5.1 Activity on the Domestic Foreign Exchange Market

Activity on the domestic foreign exchange market has remained buoyant since the October 2012 Inflation Report. Banks maintained a daily average overbought position of US$7.9 million. Total turnover of spot and forward transactions amounted to US$3,856 million, representing a daily average of US$37.4 million, while daily average transactions on the interbank foreign exchange market amounted to US$5.19 million. The Bank bought an aggregate amount of US$195.1 million and €70.0 million from banks and foreign exchange dealers over the period September 2012 to February 2013.

5.5.2 Exchange Rates

The exchange rate of the rupee vis-à-vis the three major currencies namely the US dollar, the Pound sterling and the euro reflected both international currency movements and demand and supply conditions on the domestic market.

Since the end of September 2012, the weighted average dealt rupee initially weakened against the US dollar to reach Rs31.30 near the end of October 2012 but appreciated, thereafter, in line with the greenback's broad-based weakness on international markets. It lost some momentum at the start of February 2013 and closed the month at Rs30.85.

The Rs/euro dealt exchange rate depreciated from Rs39.46 at the beginning of October 2012 to Rs41.39 at the start of February 2013. However, as renewed worries linked to political uncertainty in two of the major economies of the Eurozone weighed on the euro, the rupee reversed gear to close at Rs40.48 at the end of February 2013.

The rupee initially depreciated against the Pound sterling, sliding from Rs50.14 at the start of October 2012 to Rs50.42 towards the end of the month.

Chart 5.8: Rupee Exchange Rate Movements

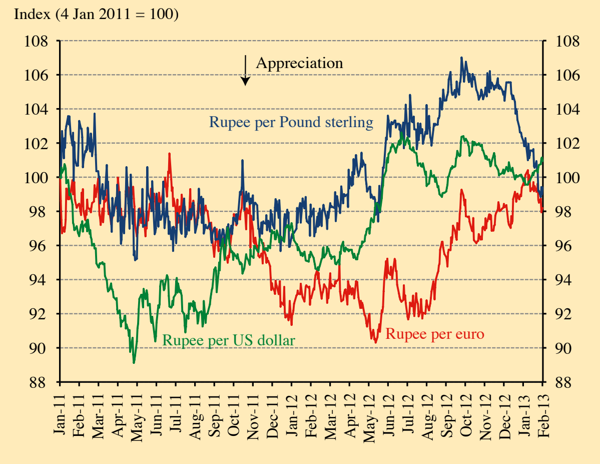
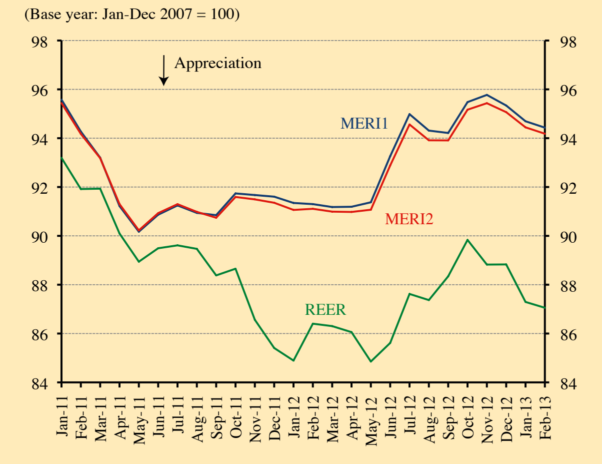


Chart 5.9: MERI1, MERI2 and REER



Thereafter, the rupee maintained an appreciating trend to reach a high of Rs46.68 towards end-February 2013 as the British currency depreciated on the international front due to a bleak UK economic outlook and expectations of continued monetary easing by the Bank of England (Chart 5.8).

Overall, since end of September 2012, the weighted average dealt rupee exchange rate appreciated by 0.9 per cent and 6.2 per cent against the US dollar and Pound sterling, respectively, but depreciated by 0.5 per cent against the euro. In nominal effective terms, the currency-weighted value of the domestic currency, as measured by MERI1 and MERI2, appreciated by 1.1 per cent and 1.0 per cent, respectively, while, in real effective terms, the rupee appreciated by 3.2 per cent (Chart 5.9).

6. Monetary Policy Decisions

Domestic monetary policy has remained accommodative since the last Inflation Report as the downside risks to the domestic growth outlook were seen to outweigh the upside risks to inflation by a majority of MPC members. The Key Repo Rate was left unchanged at 4.90 per cent per annum at the regular interest-rate setting meetings held on 26 November 2012 and 11 March 2013. The IMF, in its Article IV Consultation Mission Report noted that monetary policy was supportive of the overall policy mix and the policy rate was kept unchanged in light of the continued uncertainty in the global outlook.

At its meeting on 26 November 2012, the MPC noted that the international economic situation had remained precarious due to the uncertainty over the resolution of the Eurozone debt crisis and the extent of fiscal contraction that might eventually take place in the US at the beginning of 2013. Marginal positive growth was expected in the Eurozone in 2013. In the UK, a rebound from recessionary conditions was expected and growth was forecast to be around 1 per cent. The US economy was expected to overcome its fiscal cliff, with growth of around 2 per cent in 2013. Moreover, there was evidence that China and other emerging Asian economies were picking up momentum, thereby raising expectations that emerging economies would continue to outperform advanced ones in 2013.

Despite a slowdown in growth dynamics and restrained activity in major export sectors, the domestic economy was assessed to have withstood external headwinds relatively well. While the output gap had remained negative, the economy was expected to be propped up by market diversification efforts and the relatively good performance of emerging sectors. The growth estimtate for 2012 had been maintained at 3.3 per cent and preliminary Bank of Mauritius staff forecasts had shown growth picking up to a range of 3.6-3.9 per cent for 2013.

The MPC noted that global inflationary pressures had remained contained but that commodity prices, in particular food prices, could still represent a major upside risk to inflation. On the domestic front, y-o-y underlying measures of inflation had seemed to indicate some emerging upward pressure on the price level as both CORE1 and CORE2 inflation had risen at a faster pace than y-o-y inflation. Upside risks to inflation had arisen from elevated global food prices, the recent rupee depreciation, the expected impact of the PRB award, the anticipated adjustment in retail petroleum prices and recent budgetary measures. Members had collectively recognised the upside risks to inflation and expressed strong concerns over a possible resurgence of inflation but views had differed on the extent to which monetary policy should react to those threats in the context of a global economic slowdown. The Committee voted with a majority of 5-4 to keep the Key Repo Rate unchanged at 4.90 per cent while underlining its strong concerns on the inflation outlook.

At its next meeting on 11 March 2013, the MPC noted that economic conditions in main trading partner countries had remained fragile. The Eurozone was expected to continue to be in recession in 2013, with France's ratings being downgraded; the US economy was projected to record a modest expansion; and the UK, also having suffered a ratings downgrade, was seen as possibly facing a triple-dip recession. Downside risks from a prolonged recession in the euro area and uncertainty about the US fiscal situation were considered as still significant. However, recovery had been more robust among emerging economies.

On the domestic front, growth had picked up slightly as activity rebounded in some key sectors. The MPC members assessed that despite the underlying growth momentum, domestic activity in 2013 was likely to be dampened by disappointing global economic developments. Together with muted domestic consumption and negative investment growth, the output gap was likely to remain negative. Bank staff forecast growth to be within a range of 3.4-3.9 per cent for 2013. The MPC, however, noted that important downside risks, stemming mainly from weak and uncertain economic conditions in main export markets as a result of the threat of a prolonged recession in the euro area, would continue to weigh on the domestic growth outlook.

Global inflationary pressures had remained contained although elevated commodity prices, in particular food and oil prices, still represented a major upside risk. The MPC noted that there had been a rise to 3.6 per cent in domestic y-o-y inflation in February 2013, from the January 2013 reading of 2.9 per cent. Although the negative output gap pointed to moderate demand pressures on prices, there were persistent upside risks to the inflation outlook as a result of elevated global commodity prices, the impact of the recent PRB award to the public sector, the recent increase in retail petroleum prices and the expected second-round effects of these increases, as well as the projected rise in administered prices. Bank staff had forecast y-o-y inflation within a range of 5.5-5.9 per cent while headline inflation was forecast within a range of 4.7-4.9 per cent by December 2013. The Bank's latest *Inflation Expectations Survey* also pointed to a rise in the mean headline inflation rates expected by respondents.

Taking into consideration the continued uncertainty on the global growth outlook, the MPC noted that downside risks to the domestic growth outlook were still present, despite the underlying positive growth momentum. Although it was acknowledged that there were upside risks to inflation, a majority considered that it was too early to start tightening monetary policy, as opposed to some members who considered that it was time to signal an end to the easing cycle. The likelihood of subdued domestic and external economic conditions restraining inflationary pressures was also considered.

Members noted that, with domestic and external economic conditions still fragile, and possibly capping upward inflationary pressures, the threats to the growth outlook were seen to continue outweighing inflation worries. The MPC decided by majority vote of 5-3 that the Key Repo Rate remained broadly appropriate at the current juncture and left it unchanged at 4.90 per cent (Table 6.1).

Table 6.1: MPC Decisions 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
26 November 2012	Unchanged	4.90	Majority of 5-4
11 March 2013	Unchanged	4.90	Majority of 5-3

7. Growth and Inflation Outlook

7.1 Growth Outlook

Global economic conditions are expected to remain fragile in 2013. While recent data releases in 2013Q1 provided some evidence of strength, particularly with regard to consumption in the US and China, there is more dispersion among growth rates of advanced countries as the recession in the Eurozone appears more pronounced than previously expected. A number of factors underscores the numerous challenges that the global economy is expected to face in 2013 on its way to recovery, notably the recurring Eurozone debt strains, highlighted by the recent banking sector troubles in Cyprus; continuing deleveraging of highly indebted household sectors and fiscal consolidation in a number of advanced countries; on-going structural adjustments in some emerging market economies; and lingering geopolitical problems around the world.

Amid these headwinds, global growth projections by the IMF and a number of other institutions tend to converge. The recession in the Eurozone is expected to persist in 2013, with the bleak outlook in the core economies, while the UK faces bleak growth prospects and the risk of experiencing its third recession since the 2008 financial crisis. Comparatively, the US economy is projected to perform better although continuing uncertainty about the debt ceiling may curb growth somewhat (Table 7.1).

Reflecting the soft international economic environment, the pace of domestic economic activity is projected to remain sub-par, with low consumption and investment growth. Although the output gap is expected to remain negative over the forecast horizon, the underlying growth momentum is likely to stay positive as real activity would find support from the diversification efforts undertaken by the authorities to boost the textile and tourism sectors as well as the consolidation of the information and communication and seafood industries. The Bank staff forecast for 2013 is within the range of 3.4-3.9 per cent (Chart 7.1). Comparatively, according to the IMF, the Mauritian economy is projected to grow by 3.7 per cent in 2013, reflecting still weak demand from Mauritius' main markets and modest private investment.

The lower end of the Bank staff forecast takes into consideration the significant downside risks arising mainly from the lack of an effective resolution to the Eurozone crisis, which sustains vulnerable financial markets conditions, and the threat of a prolonged recession in this region. These risks continue to weigh on the domestic growth outlook by constraining consumption, investment and production. Though risks are skewed to the downside, there is a possibility that international macroeconomic developments during the year could partially alleviate the threats to the growth outlook, in which case domestic growth might turn out to be nearer to the higher end of the forecast range.

Table 7.1: IMF World Economic Outlook Projections

Per cent

	July 2012 Update		October 2012 Outlook		January 2013 Update		April 2013 Outlook	
	2012	**2013**	**2012**	**2013**	**2013**	**2014**	**2013**	**2014**
World	**3.5**	**3.9**	**3.3**	**3.6**	**3.5**	**4.1**	**3.3**	**4.0**
United States	2.0	2.3	2.2	2.1	2.0	3.0	1.9	3.0
Euro area	-0.3	0.7	-0.4	0.2	-0.2	1.0	-0.3	1.1
Germany	*1.0*	*1.4*	*0.9*	*0.9*	*0.6*	*1.4*	*0.6*	*1.5*
France	*0.3*	*0.8*	*0.1*	*0.4*	*0.3*	*0.9*	*-0.1*	*0.9*
United Kingdom	0.2	1.4	-0.4	1.1	1.0	1.9	0.7	1.5
Japan	2.4	1.5	2.2	1.2	1.2	0.7	1.6	1.4
China	8.0	8.5	7.8	8.2	8.2	8.5	8.0	8.2
India	6.1	6.5	4.9	6.0	5.9	6.4	5.7	6.2
Brazil	2.5	4.6	1.5	4.0	3.5	4.0	3.0	4.0
Russia	4.0	3.9	3.7	3.8	3.7	3.8	3.4	3.8

Source: IMF.

7.2 Inflation Outlook

While the global inflation picture is largely benign, its outlook for 2013 is subject to a number of uncertainties. Upside risks from elevated global commodity prices persist, particularly in the light of sustained geopolitical tensions in the Middle East that are likely to continue putting a risk premium on crude oil prices. In addition, given tight food market conditions, even relatively minor supply shocks induced by weather-related disturbances, for instance, may easily cause new price spikes. While the upside risks to the global inflation outlook may be capped by moderate demand conditions in advanced economies, they may be exacerbated by the relative improvement in economic activity expected in some emerging countries.

On the domestic front, it is estimated that risks to the inflation outlook are skewed to the upside. External factors in terms of elevated global commodity prices and their potential to rise further during the year partly explain this assessment. The implementation of the public sector wage award in January 2013 is expected to add to inflationary pressures through its impact on consumption. It further raises the likelihood that private sector wages may be adjusted as well, with the risk that wage costs may be growing faster than productivity.

Additionally, the increase in retail petroleum prices in early March 2013 and its expected second-round effects, as well as the projected rise in other administered prices, may contribute to drive inflation upwards during 2013.

However, the output gap which is projected to remain negative over the forecast horizon, may alleviate price pressures, while the recent evolution of the rupee exchange rate sends mixed signals about its potential pass-through to domestic prices.

On balance, though sub-par economic activity may mitigate price pressures, an overwhelming number of domestic factors point to upside inflation risks. On a no-policy change basis, Bank staff forecast y-o-y inflation within a range of 5.5-5.9 per cent by December 2013, equivalent to a headline inflation forecast of 4.7-4.9 per cent (Chart 7.2).

Chart 7.1: Y-o-y Growth Forecast

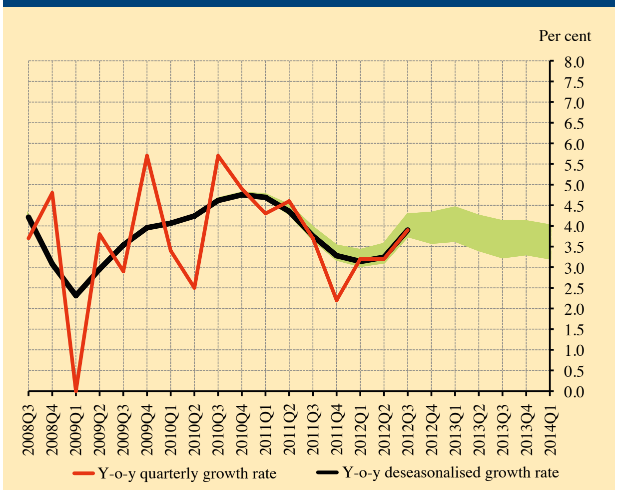
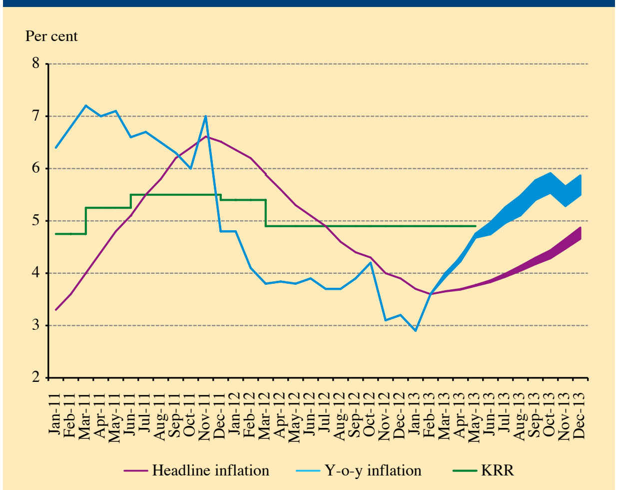


Chart 7.2: Inflation Forecast



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