BANK OF MAURITIUS

Inflation Report

April 2012

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INFLATION REPORT

April 2012

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 analysis of inflation developments as well as the assessment underpinning monetary policy, and concludes with an economic outlook. This issue of the Inflation Report refers to information for the semester ended 31 December 2011 unless otherwise stated.

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The preparation of this Report was coordinated by Mr K. Ramnauth, Mr N. Kowlessur and Mr D. Audit, Chiefs- Economic Analysis Division, with assistance from Ms M. Jhamna and Mr F. Sooklall, Analysts. Ms M. Heerah-Pampusa, Head-Economic Analysis Division, reviewed the draft Report.

The following Officers also contributed to this Report: Ms V. Soyjaudah and Ms M. Bhurtha from the Economic Analysis Division, Mr C. Ellapah, Mr J.C Chamary, Mr S. Ramrutton, Mr N. Daworaz, Mr M. Mohesh and Mr Y. Peerbocus from the Financial Markets Analysis Division; Ms P.S. Hurree Gobin, Ms P. Lo Tiap Kwong, Mr G. Beegoo, Ms F. Atchia and Mr V. Busgeeth from the Statistics Division; Ms H. Nundoochan and Mr S Ramnarainsing from the Financial Markets Operations Division.

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List of Acronyms

BDI	Baltic Dry Index
BoE	Bank of England
BML	Broad Money Liabilities
CIF	Cost, Insurance and Freight
CPI	Consumer Price index
ECB	European Central Bank
EIA	Energy Information Administration (of the US Department of Energy)
FAO	Food and Agriculture Organisation
FFPI	FAO Food Price Index
GDFCF	Gross Domestic Fixed Capital Formation
GDP	Gross Domestic Product
ICE	Intercontinental Exchange
IMF	International Monetary Fund
IPI	Import Price Index
ISM	Institute for Supply Management
MCCI	Mauritius Chamber of Commerce and Industry
MERI	Mauritius Exchange Rate Index
MPC	Monetary Policy Committee
NML	Narrow Money Liabilities
NYMEX WTI	New York Mercantile Exchange West Texas Intermediate
ODC	Other Depository Corporations
PMI	Purchasing Managers' Index
PPI-A	Producer Price Index-Agriculture
PPI-M	Producer Price Index-Manufacturing
REER	Real Effective Exchange Rate
SEMDEX	Stock Exchange of Mauritius 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, that are not securitised. It can be classified by institutional sector: general government, monetary authorities, banks, and other sector, and sub-classsified between short-term and long-term.

ISM activity indicators are manufacturing survey data collected in the United States by the Institute for Supply Management.

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 economic growth started to decelerate broadly around mid-2011 as the debt problems in advanced economies and in particular, the euro area peripheral countries continued to worsen. However, since the end of 2011, a number of positive developments have reduced to some extent the uncertainty prevailing in the global economy. The situation in global financial markets has improved somewhat after the turn of the year. Substantial long-term loans from the European Central Bank (ECB) to eurozone banks have boosted liquidity and reduced risk premiums in the European banking system and sovereign debt market. The global economy appears to be pulling out of the vulnerable phase of 2011H2 and available data from 2012Q1 point to a nascent recovery although some vulnerabilities remain.

In the US, the economy remained fragile although some positive developments were observed, indicating that the economy was on the path of recovery. The economy had grown at a pace of 3.0 per cent in 2011Q4 compared to 1.8 per cent in 2011Q3. While the eurozone is likely to have registered its second consecutive quarter of economic contraction in 2012Q1, the rate of contraction appears to be slowing relative to 2011Q4, thus indicating some signs of stabilisation. Elsewhere, economic activity appeared to be sustained. The Purchasing Managers' Indices in the United Kingdom, China and other major Asian economies strengthened recently. For emerging economies, growth would continue to be weaker in 2012Q1 on soft external demand condition but is expected to pick up in the months ahead. Assuming that this situation persists, global economic activity should strengthen in 2012H2 and in 2013.

In 2011H2 monetary policy remained accommodative in advanced economies. In the US, the Federal Open Market Committee (FOMC) maintained the federal funds rate at 0 - 0.25 per cent. In the euro area, the ECB further reduced the policy rate to 1.0 per cent in December, while the Bank of England (BoE) maintained its policy rate at 0.5 per cent in 2011H2. Some central banks across emerging markets also started loosening monetary policy in 2011H2 pre-emptively in order to avert the potential adverse impact of a global economic slowdown.

On the domestic front, the economy performed relatively well in 2011 with growth estimated at 4.0 per cent. The economy has generally been resilient to the euro area crisis so far although growth has been lower in some key sectors. Household consumption continued to expand at low pace, while investment remained subdued. Growth for 2012 has been revised slightly downwards to 3.8 per cent by the Bank.

During 2011H2, global economic activity lost momentum, prompting the Monetary Policy Committee (MPC) to mark a pause in the normalisation process. At its September 2011 meeting, the MPC kept the Key Repo Rate (KRR) unchanged at 5.50 per cent. However, in its effort to boost confidence and remaining cautious with regards to still high inflation, the MPC unanimously decided to cut the KRR by 10 basis points to 5.40 per cent at the December 2011 meeting. At its March 2012 meeting, in view of the downside risks to growth, the MPC voted with a majority of 5-4 to cut the KRR by 50 basis points to 4.90 per cent.

Y-o-y inflation receded from 6.6 per cent in June 2011 to 4.8 per cent in December 2011, while headline inflation rose from 5.1 per cent to 6.5 per cent during the same period. The moderate growth in both monetary and credit expansion and the relatively stable nominal exchange rate of the rupee in 2011 have helped to mitigate inflation risks in the economy. The output gap remained negative but close to zero for most of 2011, with a tame labour market and subdued wage pressures throughout the year. Headline inflation is expected to show a modest deceleration throughout the forecast period and is projected at around 4.7 per cent by December 2012 on a no-policy change basis.

Looking ahead, the risks to the inflation outlook emanating from any imbalance between supply and demand appear to be on the low side, while household and business confidence remain somewhat muted. However, there were increased risks to the inflation outlook from rising global food and oil prices in the medium term. Moreover, recent inflation expectations surveys carried out by the Bank showed that the proportion of respondents who expected inflation to go up over the next twelve months remained high.

2. Monetary Policy Decisions

During 2011H2, global economic activity lost momentum, prompting the Monetary Policy Committee (MPC) to mark a pause in the normalisation process. Release of data indicating slowing global activity in August 2011 led the MPC to keep the KRR unchanged at 5.50 per cent at its September 2011 meeting. The intensification of the euro area crisis and further deterioration of the global economy in the last quarter of 2011 weighed adversely on domestic consumer and business confidence. In an effort to boost confidence in the economy, the MPC unanimously decided to cut the KRR by10 basis points to 5.40 per cent at the December 2011 meeting. In view of the downside risks to growth, the MPC voted with a majority of 5-4 to cut the KRR by 50 basis points to 4.90 per cent at its March 2012 meeting.

At its September 2011 meeting, the MPC noted that global economic activity had deteriorated and global output growth was expected to recover more slowly than had previously been anticipated due to increased uncertainty. Growth forecast of major advanced economies had been trimmed down. At the time of the MPC meeting, most up-to-date available data on the US, UK and Euro zone economies showed a slowdown in activity, persistently high unemployment and declining consumer and business confidence. Growth in emerging economies had, however, stayed generally robust although there were signs of moderation. Meanwhile, global commodity prices had eased to more sustainable levels since the June MPC meeting. The Food Price Index of the Food and Agriculture Organisation (FAO) had declined from an all-time high of 237.9 in February 2011 to 230.6 in August 2011.

In Mauritius, the underlying growth momentum had remained broadly positive although it had eased on a sharp contraction in the *construction* sector and a slowdown in the *distributive trade* as well as in the *hotels and restaurants* sectors. A notable improvement was, nonetheless, registered in growth in *manufacturing* which was led by strong activity in the *textile* and *other manufacturing* sub-sectors. Household consumption expenditure growth had decelerated, underlining the loss in output growth momentum. Gross domestic fixed capital formation had declined as a result of a significant fall in building and construction work, reflecting mainly the weakening non-residential investment. The Mauritian economy was expected to continue on its growth path even though the growth projection for 2011 had been revised slightly downwards by 0.2 percentage point to 4.4 per cent. Y-o-y inflation rate had slightly eased from 7.1 per cent in May 2011 to 6.5 per cent in August 2011 while headline inflation had increased from 4.8 per cent in May 2011 to 5.8 per cent in August 2011. The MPC noted that the Inflation Expectations Survey carried out in August 2011 had shown that the mean inflation expectation one year ahead had risen.

The risks to the growth outlook were seen to have increased in the light of developments in the global economy. While the risks associated with the inflation outlook had evolved more favourably since the June MPC meeting, reflecting a gradual moderation in global commodity prices, underlying inflationary pressures still persisted. The MPC considered it important to anchor inflation expectations and to minimise the risks of second-round effects. The need to achieve a positive real rate of interest on savings deposits in the current environment was also underlined. But, the MPC was concerned with the worsening growth prospects in our main trading partners resulting from the escalation of the euro area debt. After weighing the balance of risk, the MPC unanimously voted to keep the KRR unchanged at 5.50 per cent.

At the MPC meeting on 5 December 2011, the MPC observed that the euro area sovereign debt crisis had intensified since its last meeting in September 2011, raising fears of recession in the euro zone and amplifying the downside risks to global growth. Leading economic indicators had shown a marked deterioration in activity in the euro zone such that it was expected to contract in 2012 as a result of fragile financial conditions and fiscal tightening in the monetary union. Economic data releases pointed to a better-than-expected third quarter in the US with an annual growth rate of 2 per cent, but the outlook for the US was clouded by fiscal concerns and fallouts from the euro area crisis. UK was characterised by a loss in momentum in economic activity, which looked likely to deteriorate further as a result of the spillover from euro area's woes. Growth in emerging economies, though outpacing advanced economies, had softened. Downside risks to the global growth outlook had increased. This had to some extent contributed to an abatement of global inflationary pressures.

Available data at the time of the MPC meeting suggested that domestic economic activity had performed relatively well. Growth in the textile sector had been appreciable while tourist arrivals and earnings had continued to expand. The seafood and ICT sectors had also shown resilience. However, the outlook was increasingly clouded by growing global uncertainty. MPC members expressed concerns about the decline in business and consumer confidence and observed that household consumption growth had waned while private investment growth had stagnated. GDP growth in 2011 was estimated at 4.1 per cent, lower than previous forecasts. A majority of MPC members were of the view that fiscal stimulus provided in the 2012 Budget had the potential to shore up growth and agreed with the estimate of 4.0 per cent growth in 2012.

With regard to inflation, the MPC noted a decline in externally-generated inflationary pressures. On the domestic front, the negative output gap was expected to close at a slower pace than previously estimated because of adverse developments in the global economy. This, coupled with tame monetary aggregates, supported the view that inflation risks emanating from domestic demand would remain relatively muted. While headline inflation was expected to remain strong until the end of 2011, it was projected, on a no-policy-change basis, to decline to around 5.5 per cent by June 2012 while year-on-year inflation was expected to reach 5.1 per cent. The MPC was satisfied that in terms of both measures, expected inflation was moving within a gradually narrowing range.

Weighing the balance of risks, the MPC observed that given the expected positive impact of the 2012 Budget and the fact that the growth rate was still encouraging with a projection of 4.0 per cent for 2012, the monetary policy stance was broadly appropriate. A sizeable interest rate cut was unlikely to correct the fragile external demand conditions. However, in order to signal its concern over the low level of domestic business and consumer confidence, the MPC unanimously voted to cut the KRR by 10 basis points to 5.40 per cent.

At its March 2012 meeting, the MPC noted that downside risks to the global growth outlook were still important although there were signs of stabilisation in the euro zone following the implementation of several measures by European authorities to address the sovereign debt crisis. Fears of a global recession had receded and the US economic outlook was improving while emerging economies continued to record appreciable growth rates in spite of a slight slowdown in China and India. Global inflationary pressures had eased, providing the flexibility to central banks in most advanced and some emerging economies to pursue accommodative monetary policies.

The MPC observed that the domestic economy had been resilient to the euro area crisis so far although growth had slowed in some key export sectors. Growth for 2011 was estimated at 4.0 per cent. Looking ahead, the domestic growth momentum was expected to slow a little before the signs of recovery in target markets began to change the outlook for exports. The Bank's staff forecast a growth rate of 3.8 per cent for 2012. Members were of the view that external inflationary pressures had declined slightly. The output gap, which had remained negative but close to zero for most of 2011, indicated that while some economic slack had persisted, the domestic economy had been growing close to its trend rate. Headline inflation had eased steadily, from 6.6 per cent in November 2011 to 6.2 per cent in February 2012 while y-o-y inflation had declined from 7.0 per cent in November 2011 to 4.1 per cent in February 2012.

The Committee weighed the risks to the growth and inflation outlook and observed that the global backdrop had reduced the risks to the domestic growth outlook although they remained skewed to the downside. Inflationary pressures had receded but the Committee acknowledged increased upside risks to the inflation outlook from rising commodity prices. Some in the Committee considered it important to continue to anchor inflation expectations and minimise the risk of second-round effects. They also underlined the need to achieve a positive real rate of interest to boost savings in the current environment. Other members were, however, less concerned with inflation risks, placing more emphasis on the downside risks to growth.

The Committee concurred that a cut in the KRR was warranted, but was divided with regard to the magnitude of the decrease. After a second round of voting, the Committee voted with a majority of 5-4 to cut the KRR by 50 basis points to 4.90 per cent. Decisions on the Key Repo Rate are summarised in Table 2.1.

Table 2.1: Decisions of the MPC on the Key Repo Rate			
Date of MPC meeting and effective date of decision	**Decision on the Key Repo Rate**	**Key Repo Rate** *(post-decision level, per cent per annum)*	**Voting pattern**
12 September 2011	Unchanged	5.50	Unanimous
5 December 2011	10 basis points cut	5.40	Unanimous
19 March 2012	50 basis points cut	4.90	Majority 5-4

BOX 1 – REVIEW OF THE MONETARY POLICY COMMITTEE

The Monetary Policy Committee of the Bank of Mauritius has achieved commendable credibility in a short period of time. But after four years of operation, the need for a review of the Monetary Policy Committee (MPC) was felt. The appraisal of the functioning of the MPC was entrusted to Sir Alan Budd, a former member of the Bank of England MPC and well-known figure in the world of finance in the UK with considerable experience in the matter.

Following the recommendations of Sir Alan Budd, several amendments were brought to the Bank of Mauritius Act in 2011 to enhance the functioning of the MPC and broaden transparency. The changes are summarized below.

Composition of the Monetary Policy Committee

Section 54(1) (b) now states that the MPC shall consist of 3 senior officers of the Bank appointed by the Governor, who shall be the Chairperson of the Committee. These officers shall be persons who have senior management responsibility in the fields of economic research, monetary policy operations and day-to-day administration of the Bank.

Section 54(1) (c) empowers the Minister of Finance after consultation with the Governor to appoint 5 persons, not being Directors or employees of the Bank, as members of the MPC. These appointees must have recognized experience in the field of economic, banking or finance.

Enhancing Good Governance of the MPC

Revisions to the Act introduced three new subsections under section 54 to enhance good governance of the MPC. To that effect, the MPC is now required to publish a Code of Conduct to govern its meetings. The MPC shall also report once a year to the Board of Directors of the Bank regarding its compliance with the Code of Conduct. Further, the Act provides that seven members, including at least 4 out of the 5 members appointed by the Minister, shall constitute a quorum.

Further, under section 54(3) of the Act, the MPC shall regulate its meetings and proceedings in such manner as it thinks fit.

Participation through teleconferencing

The legislation now permits the Chairperson of the MPC to authorize a member of the Committee to participate in a meeting through teleconferencing i.e. two-way communication by video, telephone or any other means using modern technology, if, prior to the meeting, the member has by notification to the Chairperson requested such an authorisation. A member who participates in a meeting through teleconferencing shall be treated as being present at the meeting and shall be entitled to vote.

Functions of the MPC

Section 55(1) of the Act has been amended to clarify the functions of the MPC. The wordings "to maintain price stability, taking into account the orderly and balanced economic developments of Mauritius" were added to this section to provide better guidance as to how the MPC shall formulate and determine the monetary policy to be conducted by the Bank.

Publication of the Minutes of the MPC

Section 55(2)(a)(ii) provides that the Bank shall, after every meeting of the MPC, publish the minutes of the meeting, not later than 2 weeks after the date of the meeting. Further, according to section 55(2)(b), the minutes must record the voting preference of the MPC members who took part in the vote on the decision. This practice aligns the Bank of Mauritius with that of central banks of many advanced and developing countries. The publication of minutes and recording of voting preference became effective as from the December 2011 MPC meeting.

3. The Global Economy

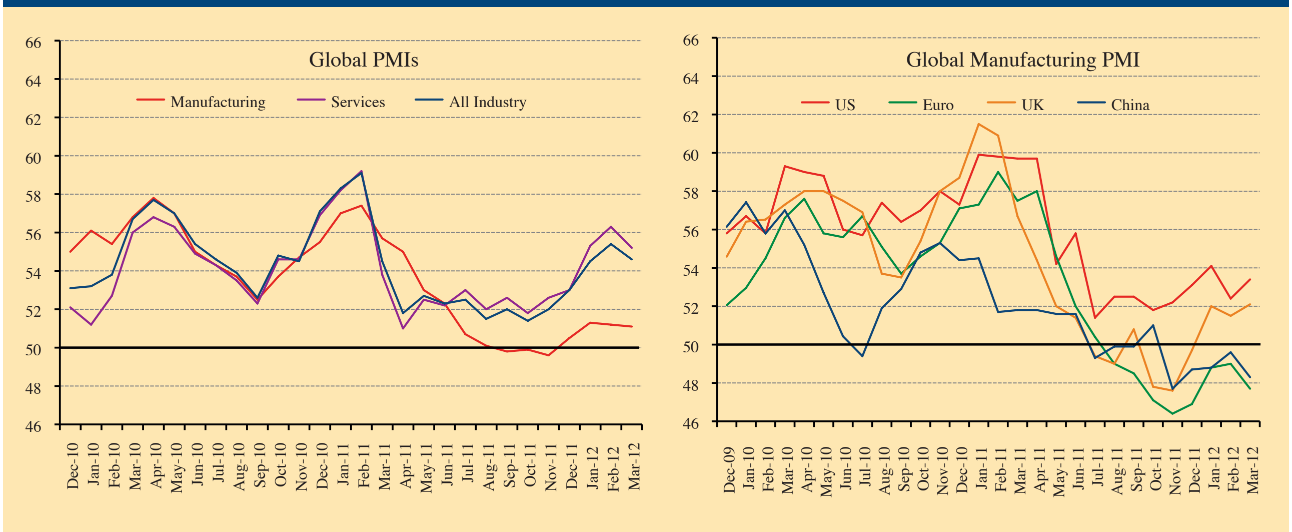
The global economy slowed noticeably in 2011H2 as the euro crisis intensified. However, growth remained uneven across regions. In the US, in spite of the fragile state of the economy, activity was better than expected. Economic activity in the euro area and UK was disappointing while emerging economies continued to record appreciable, albeit lower, growth rates. Recent developments suggest improvement in global conditions with some progress noted in relation to the euro area crisis. Inflation in most advanced economies remained subdued while they were contained in emerging economies as commodity prices moderated. Nonetheless, commodity prices remained above historical avrages and may surprise on the upside going forward.

Global economic growth decelerated on a broad front in 2011H2 but a number of positive developments since the start of 2012 have lifted some of the uncertainties prevailing in the global economy. Recent measures implemented by the European Central Bank and euro area governments have alleviated financial markets stresses and improved global funding conditions. They have also helped market confidence to recover to some extent. Economic activity continued to increase at a moderate pace in the US. The Chinese economy was projected to be sluggish in 2012H1 before picking up in 2012H2, and elsewhere, Asian growth has begun to accelerate. Signs of recovery were also evident from the JPMorgan Global All-Industry Output Index (Chart 3.1) which posted its second-highest reading in 13 months in March with output increasing in both the manufacturing and service sectors. However, the eurozone macroeconomic prospects continued to be weak and even though latest data suggested that the global economy may avert a major deterioration, the phase of sub-par world growth that became evident in the second semester of 2011 is likely to last during the year. The IMF, in its April 2012 World Economic Outlook projected global growth to drop from 4.0 per cent in 2011 to about 3.5 per cent in 2012, and to return to 4.0 per cent in 2013.

3.1 Demand and Output

The US economy performed better than anticipated in 2011H2. Economic activity in the US gained momentum in 2011Q3 and 2011Q4, after growing at a slow pace in the first half of the year. GDP increased by 3.0 per cent in annualised terms in 2011Q4, up from 1.8 per cent in the previous quarter. The expansion in 2011Q4 was driven primarily by consumer spending, as well as by the change in private inventories. The manufacturing and services sectors continued to grow in the second half of the year with the ISM PMIs for both the sectors above the 50-level mark. The labour market strengthened markedly and the unemployment rate dropped from 9.2 per cent in June 2011 to 8.2 per cent in March 2012, the lowest reading since

Chart 3.1



Source: JP Morgan

February 2009. Consumer confidence improved and the correction of the housing market excesses continued to progress although it was far from being completed. With such positive data, a third round of quantitative easing from the Federal Reserve seemed unlikely. The decline in the ISM manufacturing index in February 2012, consistent with the recent slowing in real consumer spending and core capital goods orders but contrasting with strong advances in regional survey indicators, underlined the uneven and moderate upward trend in growth. Latest available data suggest US growth in 2012 could be around 2.2 per cent while in April 2012, the IMF projected it to be around 2.1 per cent.

After growing continuously at a subpar pace for more than two years, real GDP in the euro area contracted by 0.3 per cent in 2011Q4, following growth of 0.1 per cent in 2011Q3. Declines in consumer spending and gross exports were the most important factors contributing to the economic contraction in 2011Q4. The performance of the two largest economies was poor, with real activity contracting by 0.2 per cent in Germany and growing by 0.2 per cent in France. The Italian economy contracted by 0.7 per cent, thus joining Belgium, Portugal and Greece in recession. Euro area unemployment rate hit a record high of 10.8 per cent in February 2012. Consumer confidence remained fragile amid low private sector spending and falling retail sales, while business confidence had yet to recover from the significant erosion caused by market tensions and uncertainty. The euro area manufacturing PMI, which rose for three straight months to 49.0 in February 2012, dipped to 47.7 in March 2012, indicating a modest contraction of activity in 2012Q1. Although financial markets tensions eased and a credible effort appeared underway to restore public finances, the evolution of the debt crisis was expected to continue posing downside risks to growth in the euro zone. Most forecasts of euro area real activity pointed to a mild contraction of around 0.3 to 0.5 per cent in 2012, with the European Commission predicting the recession to extend to Spain and the Netherlands.

Economic activity in UK continued to be weak in 2011H2. In 2011Q4, the economy contracted at a q-o-q rate of 0.3 per cent, mainly owing to weak industrial production and construction activity. Business and household survey indicators improved somewhat at the end of 2011 but still reflected a very sluggish recovery in economic activity. The labour market remained weak with unemployment reaching 8.2 per cent in the three months ending March 2012. The UK manufacturing PMI fell to 49.7 in December from 51.4 in June while the services PMI nudged up slightly to 54.0 in December 2011 from 53.9 in June 2011. Latest available PMI readings

Table 3.1: Real GDP Growth Rates in Selected Economies

Per cent

	2011Q1	2011Q2	2011Q3	2011Q4	2010	2011	2012	2013
	Q-o-q Growth Rates, seasonally adjusted						*Projections*	
World output					**5.3**	**3.9**	**3.5**	**4.1**
Advanced economies					**3.2**	**1.6**	**1.4**	**2.0**
of which								
United States	0.1	0.3	0.5	0.7	3.0	1.7	2.1	2.4
Euro Area	0.7	0.1	0.1	-0.3	1.9	1.4	-0.3	0.9
Japan	-1.8	-0.3	1.7	-0.2	4.4	-0.7	2.0	1.7
United Kingdom	0.2	-0.1	0.6	-0.3	2.1	0.7	0.8	2.0
	2011Q1	**2011Q2**	**2011Q3**	**2011Q4**				
	Y-o-y Growth Rates							
Emerging market and developing economies								
Sub Saharan Africa					5.3	5.1	5.4	5.3
Developing Asia					9.7	7.8	7.3	7.9
of which								
China	9.7	9.5	9.1	8.9	10.4	9.2	8.2	8.8
India	7.8	7.7	6.9	6.1	10.6	7.2	6.9	7.3

Sources: IMF's April 2012 World Economic Outlook, offices of national statistics' websites and central banks' websites.

in March 2012 suggest that economic activity is expanding again, albeit slowly. Assuming the euro area problems would not degenerate further, the IMF projected in April 2012 that the UK economy may grow at around 0.8 per cent in 2012.

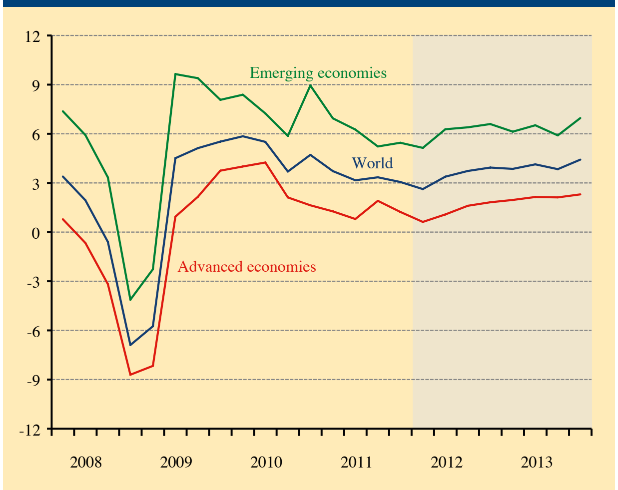
Growth in emerging economies continued to be strong throughout 2011H2. The Chinese economy continued to register high growth in 2011H2. The economy grew by 8.9 per cent in 2011Q4, down from 9.1 per cent in 2011Q3. The economy's soft-landing was expected to continue in the first part of 2012 on the back of earlier monetary tightening and weaker trading partner growth. The manufacturing PMI fell to 48.3 in March 2012 from 51.6 in June 2011, remaining in contraction territory for the fifth consecutive month. Chinese authorities announced a GDP growth of 7.5 per cent for 2012. In India, growth moderated to 6.1 per cent in 2011Q4 as uncertainty pulled back investment and exports. The March manufacturing and services PMI indexes surprised on the downside but remained at high levels. Growth is estimated at around 6.9 per cent in 2012.

Chart 3.2 and Table 3.1 show actual and projected real GDP growth rates in advanced and emerging and developing economies.

3.2 Inflation in Selected Key Countries

In contrast to the increase in global inflation in 2011H1, price pressures eased noticeably towards

Chart 3.2: Global Growth and Outlook
(Per cent, q-o-q, annualised)



Source: IMF's World Economic Outlook.

the end of the year, as global demand and economic activity slowed. Annual rates of headline inflation remained subdued in most advanced OECD countries, while it moderated in emerging market economies in 2011H2. Underlying inflationary pressures, nonetheless, were still relatively elevated since commodity prices remained around historical highs.

In the US, annual inflation moderated, dropping from 3.6 per cent in June 2011 to 3.0 per cent in December 2011, as commodity prices eased and US business and consumer sentiment remained weak during most of 2011H2. In the euro area, the slack in demand conditions and the slow growth in wages have exerted downward pressures on prices. Inflation was, nonetheless, partly influenced by the increase in the value-added tax rate in some countries and the continuing pass-through of the earlier increases in international commodity prices. Consequently, inflation in the euro area stood at 2.7 per cent in both June and December 2011, above ECB's target inflation rate of 2.0 per cent. In UK, the inflation rate fell to 4.2 per cent in December 2011 from a record high of 5.2 per cent in September 2011. Despite the weak pace of economic growth, inflation remained well above the Bank of England's target of 2 per cent.

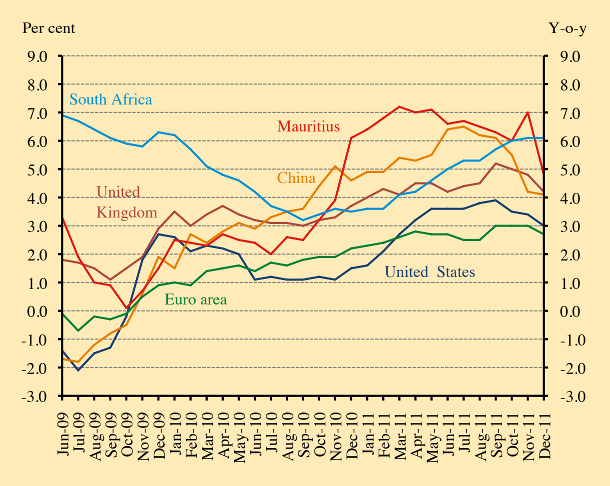
Among emerging economies, China's inflation eased from 6.4 per cent in June 2011 to 4.1 per cent in December 2011 while inflation in India fell from 8.6 per cent to 6.5 per cent during the same period partly as a result of rounds of monetary tightening pursued in 2011H1 and as commodity prices eased globally. Inflation in South Africa rose to 6.1 per cent in December 2011, from 5.0 per cent in June 2011, driven to a large extent by the depreciation of the rand. Chart 3.3 depicts y-o-y inflation in some selected countries, including Mauritius. Table 3.2 shows y-o-y inflation in selected countries.

The IMF April 2012 WEO highlighted that despite appreciable slack in the major advanced economies, other economies would operate close to or above full capacity, and thus inflation dynamics would vary. Inflation in advanced economies is projected to fall to about 2.0 per cent in the course of 2012, from a peak of about 2.7 per cent in 2011. In emerging and developing economies, inflationary pressures are also expected to drop as both growth and food price inflation moderate. Overall, consumer prices in these economies are projected to decelerate, with inflation rate around 6.2 per cent in 2012, down from over 7.1 per cent in 2011.

3.3 Monetary Policy

Monetary policy remained accommodative in advanced economies (Chart 3.4). In the US, the Federal Open Market Committee (FOMC) maintained the federal funds rate at 0 - 0.25 per cent in the second half of 2011. In addition, the FOMC announced a maturity extension programme, which consisted of purchasing USD400 billion of longer-term Treasury securities while selling an equivalent amount of short-term securities.

Chart 3.3: Inflation Rates in Selected Countries



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

In the euro area, the ECB had raised its policy rate by 25 basis points to 1.50 per cent on 7 July 2011 mainly on account of rising inflationary pressures. However, due to rising downside risks emanating from stress in the financial markets, the ECB introduced longer-term refinancing facilities in October and announced a new €40 billion covered bond purchase programme to provide additional liquidity to the financial sector. The ECB subsequently reduced its policy rate by 25 basis points to 1.25 per cent in November 2011. The weaker growth outlook forced the central bank to further reduce the policy rate to 1.0 per cent in December 2011. The ECB also announced additional credit support measures, such as the introduction of 3-year refinancing operations and a reduction in the reserve ratio, to provide liquidity to the banking sector and support lending activity in the region.

The Bank of England (BoE) maintained its policy rate at 0.5 per cent from July to December 2011. However, it announced further quantitative easing measures in October 2011 as it increased the size of its asset purchase programme by £75 billion to £275 billion to support the weak economic recovery in the UK. In Japan, the Bank of Japan maintained its extremely loose policy stance and expanded its asset purchase programme in August and October. Moreover, six major central banks (the US Federal

Table 3.2: Y-o-y Inflation in Selected Countries

	2007	2008	2009	2010	June 2011	December 2011
						Per cent
China	4.8	5.9	-0.7	3.3	6.4	4.1
Euro area	2.1	3.3	0.3	1.6	2.7	2.7
Hong Kong	2.0	4.3	0.6	2.3	5.6	5.7
Hungary	7.9	6.1	4.2	4.9	3.5	4.1
India	6.4	8.3	10.9	12.0	8.6	6.5
Indonesia	6.7	9.8	4.8	5.1	5.5	3.8
Philippines	3.0	8.2	4.2	3.8	5.2	4.2
Singapore	2.1	6.6	0.6	2.8	5.2	5.5
South Africa	7.1	11.5	7.1	4.3	5.0	6.1
South Korea	2.5	4.7	2.8	2.9	4.4	4.2
Thailand	2.2	5.5	-0.8	3.3	4.1	3.5
Turkey	8.8	10.4	6.3	8.6	6.2	10.4
United Kingdom	2.3	3.6	2.1	3.3	4.2	4.2
United States	2.9	3.8	-0.3	1.6	3.6	3.0

Sources: IMF's April 2012 World Economic Outlook, offices of national statistics' websites and central banks' websites.

Reserve, ECB, Bank of Japan, Bank of Canada, Bank of England and Swiss National Bank) acted in a co-ordinated manner to reduce the price of US dollar liquidity swap arrangements by 50 basis points.

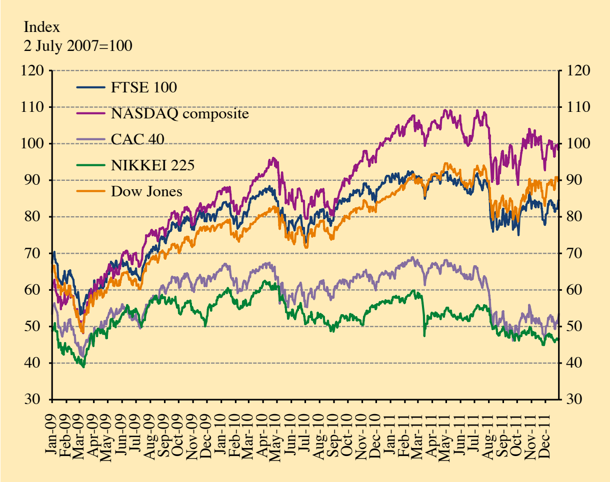
Some central banks across emerging markets started loosening monetary policy in 2011H2 pre-emptively in order to avert the potential adverse impact of a global economic slowdown. Brazil made three reductions of 50 basis points in August, October and November 2011, respectively, to bring the Selic rate to 11.0 per cent at the end of November 2011. Indonesia surprised markets by lowering its reference rate by 25 basis points in October and 50 basis points in November. However, the People's Bank of China raised its policy rate by 25 basis points to 6.56 per cent in July to contain inflationary pressures but reduced the reserve requirement ratio by 50 basis points in December to improve bank lending activity and support growth. The Reserve Bank of India also increased its repurchase rate by a cumulative total of 100 basis points in July, September and October to 8.50 per cent on higher consumer prices.

3.4 Developments in Global Financial Markets

Global Stock Markets

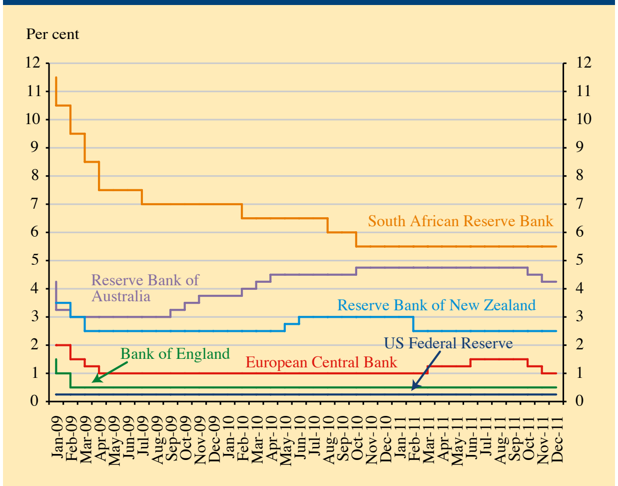
Global equity markets fell sharply in 2011Q3 on concerns over slowing growth worldwide, lingering euro zone debt woes, sovereign debt issues in US and the historic downgrade of the US credit rating. Thereafter, global stock markets rallied on better-than-expected earnings and economic data releases, and progress in resolving Europe's debt crisis. Markets came under renewed pressure, falling sharply in November 2011, on the back of on-going concerns about the euro zone sovereign debt crisis, fears of corporate and sovereign credit rating downgrades, and the absence of any prospect of new stimulus measures by the US Federal Reserve. However, signs of an improvement in the US economy following a string of unexpectedly strong economic data in December 2011, including jobs and housing data, impacted positively on markets. Over 2011H2, the Dow Jones Industrial Average,

Chart 3.5: Equity Indices of Selected Major International Stock Markets



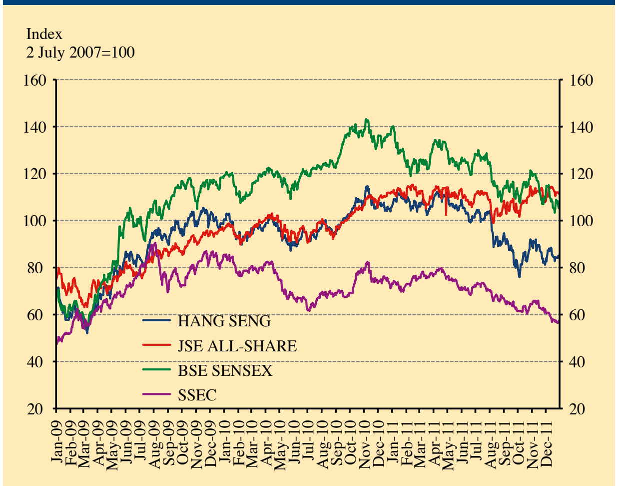
Source: Thomson Reuters.

Chart 3.4: Selected Central Banks' Policy Interest Rates



Sources: Thomson Reuters and central banks' websites.

Chart 3.6: Equity Indices of Selected Emerging Stock Markets



Source: Thomson Reuters.

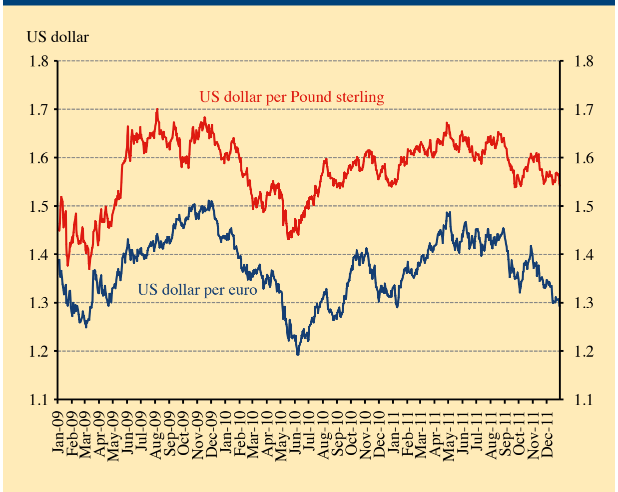
NASDAQ, FTSE, CAC-40 and Nikkei dropped 1.6 per cent, 6.1 per cent, 6.3 per cent, 20.7 per cent and 13.9 per cent, respectively. Among emerging stock markets, Shanghai SEC and Bombay SENSEX shed 20.4 per cent and 17.3 per cent, respectively, while JALSH gained 0.4 per cent. (Chart 3.5 and Chart 3.6).

Exchange Rate

At the end of August 2011, the euro moved to a high of US$1.4537 as the US dollar came under stress on account of fiscal concerns, a fragile economy and Standard & Poor's cut of the long-term US credit rating from AAA to AA+. The euro subsequently lost ground against the US dollar on concerns of contagion spreading to Italy and Spain as bond yields in these two countries climbed towards unsustainable levels. Throughout most of 2011H2, the euro remained weak, occasionally recouping some of its losses on potential solutions being worked out by EU leaders. The first-ever provision of ultra-cheap three-year loans by the ECB to euro zone banks also failed to support the euro as banks hoarded the cash obtained. The lingering fear of downgrades for some euro zone nations also weighed on the euro.

The Pound sterling edged up briefly in July and reached a high of US$1.6529 around mid-August 2011 helped by a better tone in equity markets and a higher-than-expected rise in inflation, reducing the possibility of more quantitative easing by the Bank of England. Thereafter, the UK currency came down sharply on uncertainty over the UK and euro zone economies and broadly tracked losses in the euro amid growing risk aversion. It hit a one-year low of US$1.5378 in the second half of September 2011 due to deep-rooted concerns about the euro zone debt problems while sentiment towards the UK currency remained fragile given weak economic data releases. Still, the Pound managed to recoup some of its losses in October 2011 buoyed by clearer demand and gaining in tandem with the euro and equities on hopes that EU leaders were close to resolving the euro zone debt crisis. From then on, the reduction in risk appetite and the uncertain prospects of the UK economy dragged down the Pound sterling. Chart 3.7 shows the evolution of the euro and Pound sterling against the US dollar.

Chart 3.7: Evolution of the Pound sterling and the Euro against the US dollar



Source: Thomson Reuters.

3.5 Costs and Prices

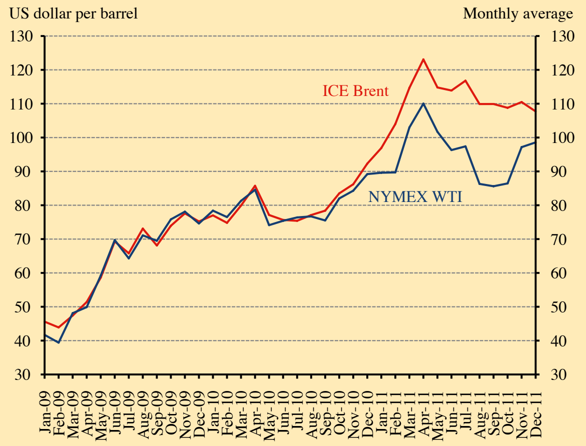
Commodity Prices

World commodity prices fell during 2011H2 but remained at elevated levels. The general softening in commodities prices reflected a combination of weakening demand mainly due to the weak global economic outlook. A relatively good global harvest results also exerted downward pressure on prices. A generally stronger US dollar also caused commodity prices to ease. However, oil prices, in particular, ICE Brent continued to trade above US$100 barrel mainly on geopolitical tensions.

Oil Prices

International oil prices, in general, remained range bound between US$85.6 and US$116.8 per barrel in 2011H2 compared to a range between US$89.6 and US$123.1 per barrel in the first six months of 2011. NYMEX WTI averaged US$98.6 a barrel in December 2011 compared to US$96.3 a barrel in June 2011. ICE Brent prices averaged US$107.7 a barrel in December 2011 compared to US$113.9 a barrel in June 2011 (Chart 3.8). The gap between NYMEX WTI and ICE Brent was significantly narrowed after disturbance in Libya that had caused ICE Brent to increase by a much higher rate was reduced considerably in 2011Q4. On the demand side, intensification of the euro crisis, weaker global economic conditions, moderating growth in China and India pressured prices downwards. A firmer US dollar further contributed to that trend. In contrast, on the supply side, rapid escalation of tensions between Iran and Western nations and disruptions in major oil supplying countries pushed prices upward.

Chart 3.8: NYMEX WTI and ICE Brent



Source: Reuters.

Food Prices

Global food prices have moderated during the second half of 2011. Compared to the corresponding period in 2010, when droughts weighed on supply and recovering global growth supported demand, 2011H2 was characterised by favourable climatic conditions resulting into better harvest and restrained demand as the global economy weakened. The FAO Food Price Index (FFPI) stood at 210.8 points in December 2011, 9.7 per cent lower than its level in June 2011, reflecting sharp declines in international prices of cereals, oils, sugar and dairy products. The Cereals Price Index, which includes prices of main food staples such as wheat, rice and corn, fell to an average of 217.6 points in December 2011, from 259.0 points in June 2011. The dairy price index decreased from 231.6 points to 201.7 points. The Oilseed Price Index eased to 227.5 points in December 2011, from 259.0 points while the sugar price index declined from 357.7 points in June 2011 to 326.9 points in December 2011. The FAO meat Price Index averaged 178.8 points, marginally up from 178.1 points in June 2011 (Chart 3.9).

Table 3.3: Non-energy Commodities

Commodity		**Quarterly Averages**			
	Unit	**2011Q1**	**2011Q2**	**2011Q3**	**2011Q4**
Cotton A Index	c/kg	457	387	259	228
Aluminum	$/mt	2,501	2,611	2,399	2,094
Copper	$/mt	9,642	9,173	8,984	7,514
Gold	$/toz	1,384	1,507	1,700	1,682
Iron ore	c/dmtu	179	176	176	141
Lead	c/kg	260	255	246	199
Nickel	$/mt	26,870	24,355	22,024	18,393
Silver	c/toz	3,179	3,857	3,885	3,182
Steel (cold rolled) coilsheet	$/mt	867	900	900	900
Steel (hot rolled) coilsheet	$/mt	767	800	800	800
Tin	c/kg	2,986	2,885	2,466	2,085
Zinc	c/kg	239	225	222	190
Cocoa	c/kg	334	307	304	247
Plywood	c/sheets	589	603	621	618
Tea, auctions (3) average	c/kg	289	300	300	280

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

Source: World Bank's Commodity Price Data.

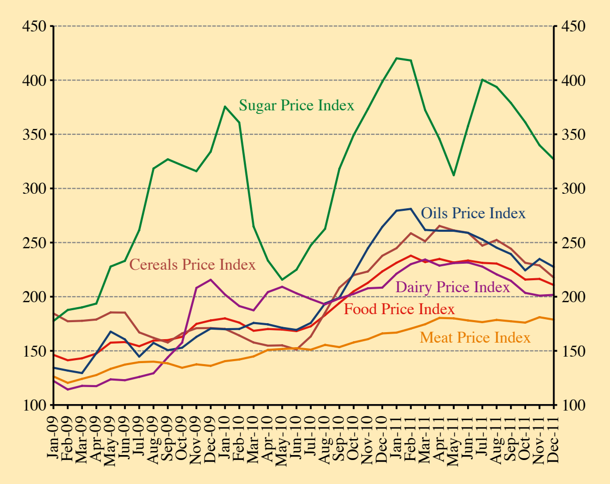
Other Commodity Prices

Prices of most of the non-energy commodities decreased in 2011Q3 and 2011Q4, reflecting a combination of weakening demand, uncertainty of global macroeconomic conditions and appreciation of the US dollar against major currencies (Table 3.3).

Freight Costs

The Baltic Dry Index (BDI) represents an average index for the cost of shipping dry commodities, such as coal, iron ore and grains. In spite of moderating global economic activity, the BDI increased noticeably in 2011H2 compared to 2011H1, as hire costs surged for Capsize vessels and haulers of iron ore and coal. The BDI, on average, climbed continuously from 1,387 points in August to peak at 2,072 points in October 2011, in spite of slowing global economic activity. However, as global economic conditions deteriorated further in 2011Q4, it fell to 1,869 points in December 2011, a level still higher than in 2011H1 (Chart 3.10).

Chart 3.9: FAO Food Price Index and its Components



Source: FAO.

Chart 3.10: Baltic Dry Index

Source: Dowjonesclose website.

BOX 2 – OUTLOOK FOR COMMODITY PRICES

Commodity prices eased noticeably during 2011H2, but remained above historical averages. Prices were pressured on improving supply prospects and weakening demand as a result of deteriorating global economic activity. Oil prices, however, remained range-bound on the high side, trading above US$100 per barrel, driven increasingly by geopolitical concerns toward the end of 2011 as tensions between Iran and the West intensified.

Outlook for food prices

According to FAO's biannual Food Outlook report, agricultural commodity market conditions remain fairly tight, in spite of improved supply prospects and weakening global demand. Moreover, fluctuations in exchange rates and uncertainties in energy markets and the global economy might contribute to sharp price swings in agricultural markets. The FAO Food Price Index (FFPI) rose continuously from 211 in December 2011 to 216 in March 2012. The commodity group *oil and fats* registered the most important gains, followed closely by cereals and sugar.

Prices of *oil and fats* are expected to remain well-supported in 2012 as markets continue to react to the prospect of growing tightness in the 2011-12 supply and demand balance for oils. Weak growth in world palm oil production, limited global soy oil export availabilities and declining rapeseed production, all contributed to the rise in oils prices and are expected to push prices up in 2012. With respect to *sugar*, prices were volatile as the market looked for direction ahead of the beginning of the new season in Brazil, the world's largest sugar producer and exporter. India, the EU and Thailand, have all reported increased output, contributing to keep prices below their high levels of last season.

An analysis of the production, utilization and stocks of cereals suggests that cereal prices would be bearish in 2012. Early indications by the FAO for the 2012-13 season point to relatively comfortable supply outlook from a global perspective. Assuming normal weather conditions, total cereal supply in 2012-13 is expected to be more than sufficient to meet projected demand. International cereal prices, however, remain at historically high levels and vulnerable to developments in other commodity markets and the global macroeconomic environment.

Among the major categories of FFPI, prices of dairy products and meat did not change much and are seen to continue to remain weak as export availabilities remain ample and import demand restrained. It may be noted that since reaching record levels in March 2011, dairy prices have followed a downward trend, as supplies rose in Oceania, Europe and North America. The current ample supply would thus keep prices of dairy products contained in 2012.

Outlook for oil prices

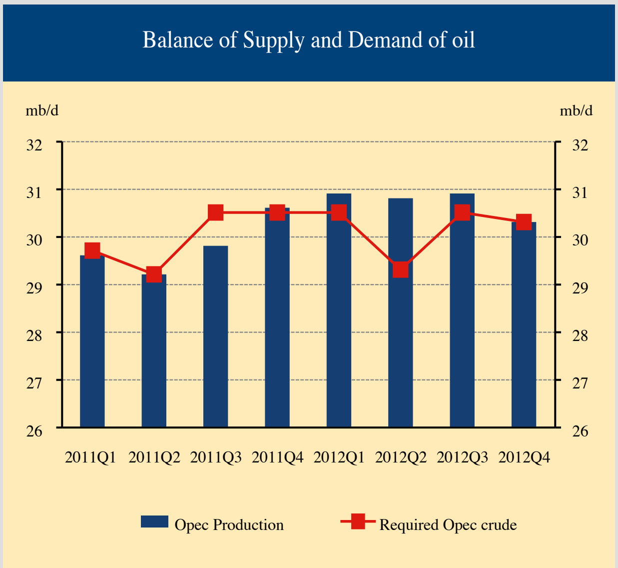
The major upside risks to oil prices would emerge from geopolitical factors, in particular, tensions in the Middle East, low stocks and limited spare capacity. On the demand side, a two-speed outlook is observed. While oil demand growth is seen to be robust in the non-OECD countries, demand continues to fall across most of the OECD countries. China and India still register solid growth rates although they moderated to some extent, keeping oil demand well-supported. Oil demand in Europe is falling and oil consumption in the United States, the world's top consumer, has hit the lowest level in nearly 15 years. Some countries are, however, building stocks pre-emptively to secure essential energy sources for future production. These moves tend to increase occasionally on news of improvement in global outlook and may cause prices to go up. Growth in global oil consumption is expected to accelerate, with consumption reaching around 90.11 million b/d in 2013.

On the supply side, OPEC remains a key player in the crude oil market as it currently provides about 40 per cent of world supply and holds about 70 per cent of proven reserves. Continued political unrest in the Middle East and North Africa could further disrupt oil supplies resulting in higher prices in the short-term, especially given low stocks and market shortages of light/sweet crude. Chart A shows the tight balance of supply and demand of oil over the quarters 2011 to 2012. With disturbances on-going in Sudan, Syria and Yemen, supply from non-OPEC countries may be vulnerable.

The US Energy Information Administration (EIA), in its report released in March 2012, projects WTI spot prices, to average US$106 per barrel in 2012 compared to US$95 in 2011 and to remain relatively flat in 2013.

The IMF estimates that a supply shock which could cause oil prices to spike by 50 per cent above its baseline forecast of US$115 a barrel could reduce global output over the next two years by 1.25 per cent.

Chart A



Source: Platts Survey.

In sum, commodity prices in 2012, while still supported by current market fundamentals, appear largely to reflect the uncertain environment and expectations about future tightness in the market. Should international food prices surge and oil prices continue to trade above US$100 per barrel, inflation in commodity-importing countries is likely to pick up, putting monetary policy under pressure.

4. Inflation

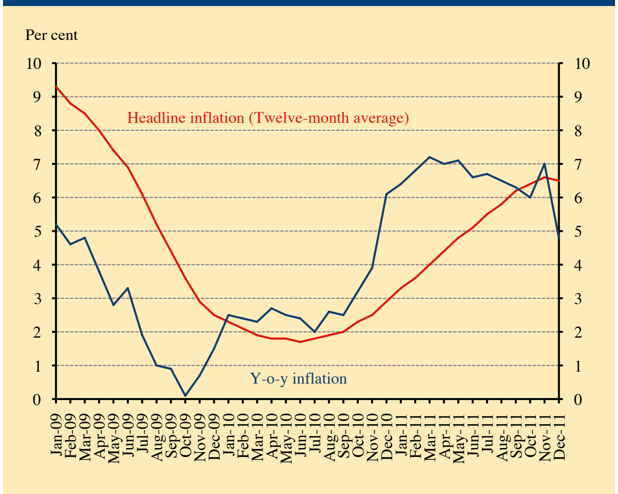
Headline inflation has continued to increase for most of 2011H2 partly on account of base effects but, as these started to fade, headline inflation began to ease as from December 2011. There was a one-off jump of 2.2 index points in the CPI in November 2011, as a result of tax increases on alcoholic beverages and tobacco.

4.1 Inflation: Y-o-y, Headline and Core

Y-o-y inflation increased slightly from 6.6 per cent in June to 6.7 per cent in July before easing continuously to 6.0 per cent by October 2011. It then increased to 7.0 per cent in November 2011 on account of a one-off increase in excise duties on alcoholic beverages and cigarettes. However, y-o-y inflation receded significantly to 4.8 per cent in December 2011 as the impact of base effects diminished. Headline inflation increased continuously from 5.1 per cent in June reaching a peak of 6.6 per cent in November 2011. It turned around in December 2011 when it edged down to 6.5 per cent (Chart 4.1).

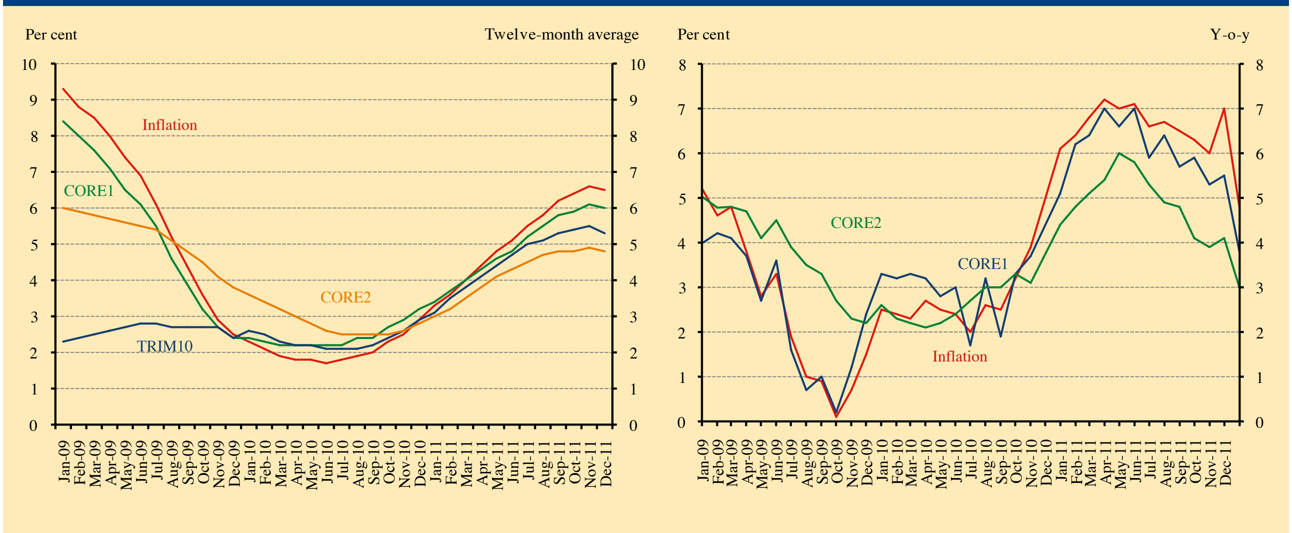
Based on the twelve-month average methodology, CORE1 inflation rose from 4.8 per cent in June 2011 to 6.1 per cent in November 2011 before edging down to 6.0 per cent in December 2011. CORE2 inflation rose from 4.3 per cent in June 2011 to 4.9 per cent in November and declined marginally to 4.8 per cent in December 2011. TRIM10 inflation remained on an uptrend from 4.7 per cent in June 2011 to 5.5 per cent in November 2011 before declining to 5.3 per cent in December 2011. On a y-o-y basis, CORE1 inflation fell from 5.9 per cent in June 2011 to 3.8 per cent in December 2011 and CORE2 inflation moderated from 5.3 per cent to 3.0 per cent (Chart 4.2).

Chart 4.1: Inflation Rate



Sources: Statistics Mauritius and Bank of Mauritius.

Chart 4.2: CPI Inflation and Core CPI Inflation

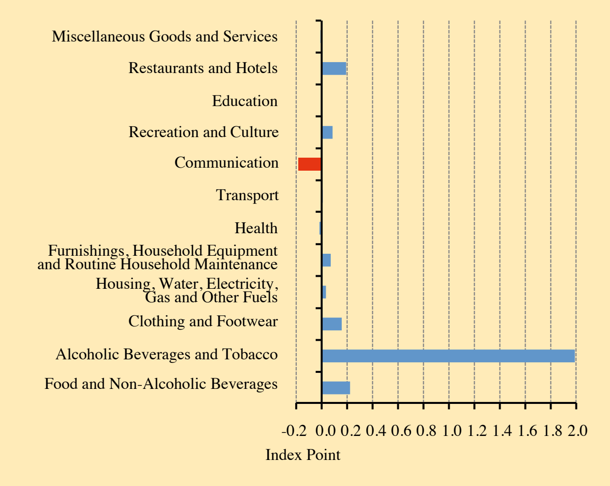


Sources: Statistics Mauritius and Bank of Mauritius.

4.2 Evolution of Major Commodity Group Indices

The CPI increased from 127.8 in June 2011 to 130.4 in December 2011. The largest index point increase was registered in the division *alcoholic beverages and tobacco*, which contributed 2.0 index points to the increase of the CPI. *Food and non alcoholic beverages*, *clothing and footwear* and *restaurants and hotels* contributed 0.2 index point each, while two divisions, namely, *furnishings, household equipment and routine household maintenance* and *recreation and culture* recorded respective contributions of 0.1 index point. *Communication* recorded a negative contribution of 0.2 index point, while the remaining divisions recorded negligible contributions (Chart 4.3).

Chart 4.3: Weighted Contributions to the Change in CPI: June 2011-December 2011



Sources: Statistics Mauritius and Bank of Mauritius.

Food and Non-Food Inflation

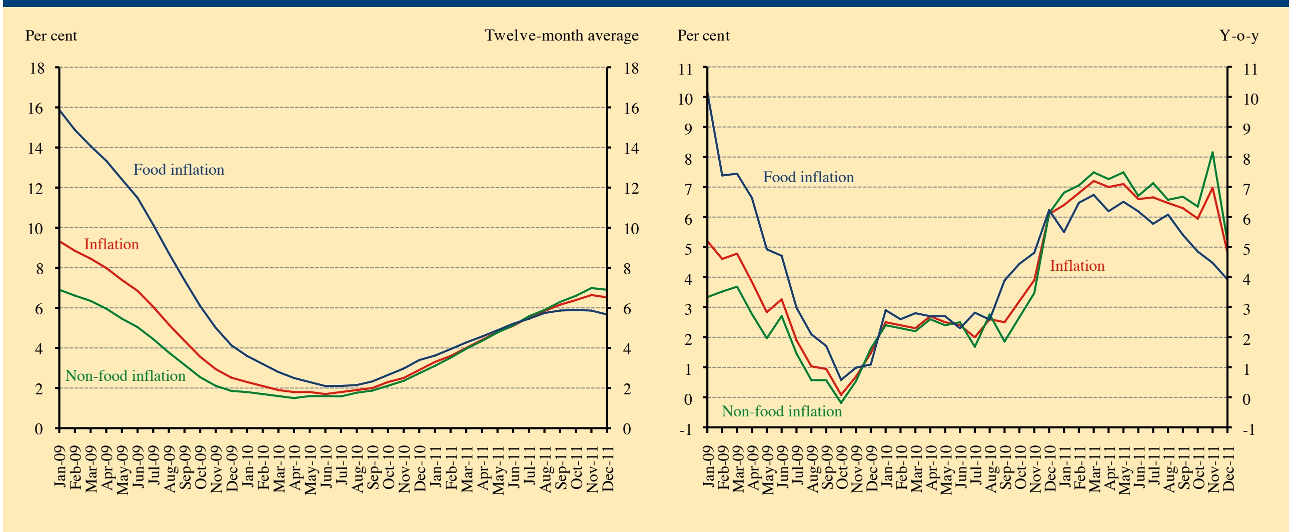
Food carries a weight of 26.5 per cent in the CPI basket. Based on 12-month average methodology, food inflation went up from 5.2 per cent in June 2011 to 5.9 per cent in September 2011 before subsiding to 5.7 per cent in December 2011. Non-food inflation rose continuously from 5.1 per cent in June 2011 to 7.0 per cent in November 2011 before edging down to 6.9 per cent in December 2011 (Chart 4.4).

Y-o-y food inflation declined from 6.2 per cent in June 2011 to 5.4 per cent in September 2011 and further to 3.9 per cent in December 2011, reflecting subdued international prices of agricultural commodities. Non-food inflation reached a peak of 8.2 per cent in November on the back of tax increases on alcoholic beverages and tobacco, before falling sharply to 5.2 per cent in December 2011 (Chart 4.4).

Goods and Services Inflation

On a 12-month average basis, goods inflation rose from 5.9 per cent in June 2011 to 7.1 per cent in December 2011, while services inflation went up from 3.4 per cent in June 2011 to 5.3 per cent in December 2011. Y-o-y goods inflation remained volatile and hovered between 5.5 per cent and 7.6 per cent, while y-o-y

Chart 4.4: Food and Non-food Inflation



Sources: Statistics Mauritius and Bank of Mauritius.

services inflation receded to 3.1 per cent in December 2011, from 5.9 per cent in June 2011. Given its higher weight and rate, goods inflation contributed more to overall inflation than services inflation (Chart 4.5).

4.3 Evolution of Other Price and Cost Indices

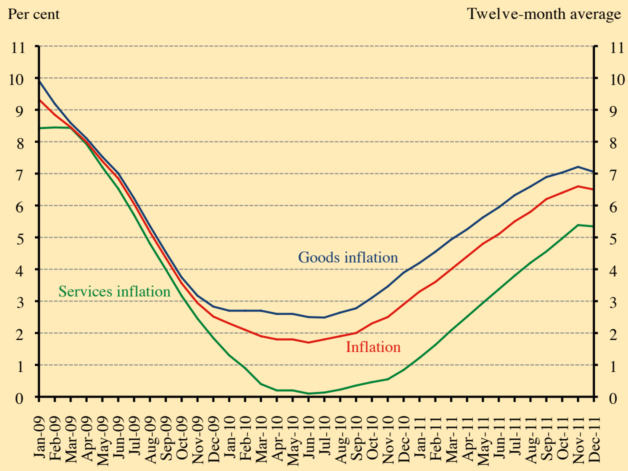
Import Price Index

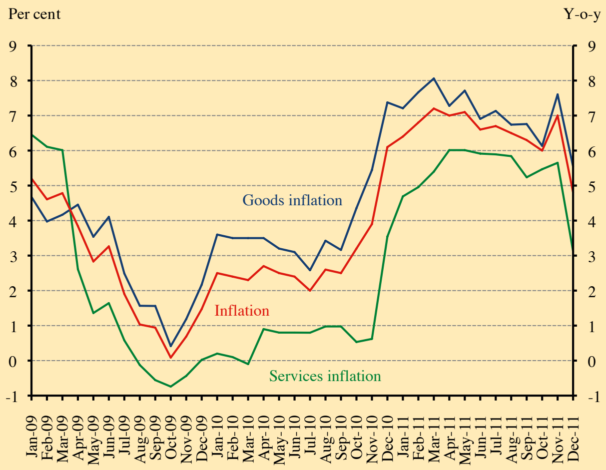
The changes in import prices have a significant influence on inflation in the country. Q-o-q changes were relatively muted in both 2011Q3 and 2011Q4, reflecting the moderation of world prices in 2011H2. Over the year, however, a sizeable 6.2 per cent increase in the Import Price Index (IPI) was recorded in both 2011Q3 and 2011Q4, driven mainly by price increases in *Mineral fuels, lubricants and related materials, Animal and vegetable oils, fats and waxes,* and *Food and live animals* (Table 4.1). Thus, while import prices moderated in 2011H2, they were still higher compared to 2011H1.

Wage Rate Index

Wages represent important costs for producers to consider when setting prices to determine their profit margins. An analysis of the wage rate index in 2011 suggests that both q-o-q and y-o-y wage increases

Chart 4.5:Goods and Services Inflation





Sources: Statistics Mauritius and Bank of Mauritius.

Table 4.1: Import Price Index

Description	Weights	Quarterly Percentage Change			Annual Percentage Change	
		Between 2011Q1 and 2011Q2	Between 2011Q2 and 2011Q3	Between 2011Q3 and 2011Q4	Between 2010Q3 and 2011Q3	Between 2010Q4 and 2011Q4
Food and live animals	1,808	3.8	0.9	-1.1	9.7	4.5
Beverages and tobacco	138	1.0	-0.3	1.1	0.9	0.6
Crude materials, inedible, except fuels	288	6.2	-0.1	0.9	6.7	4.2
Mineral fuels, lubricants and related materials	2,004	11.0	0.8	-3.4	25.5	16.8
Animal and vegetable oils, fats and waxes	104	0.0	-6.2	-0.6	32.2	23.1
Chemical materials & related products, n.e.s	851	0.1	4.6	-0.5	3.6	1.3
Manufactured goods classified chiefly by material	2,141	5.1	-1.2	0.3	3.7	5.2
Machinery and transport equipment	1,800	-9.8	-0.8	11.8	-12.7	0.2
Miscellaneous manufactured articles	866	0.2	1.1	4.2	-1.0	3.2
Overall Index	**10,000**	**2.7**	**0.3**	**1.1**	**6.2**	**6.2**

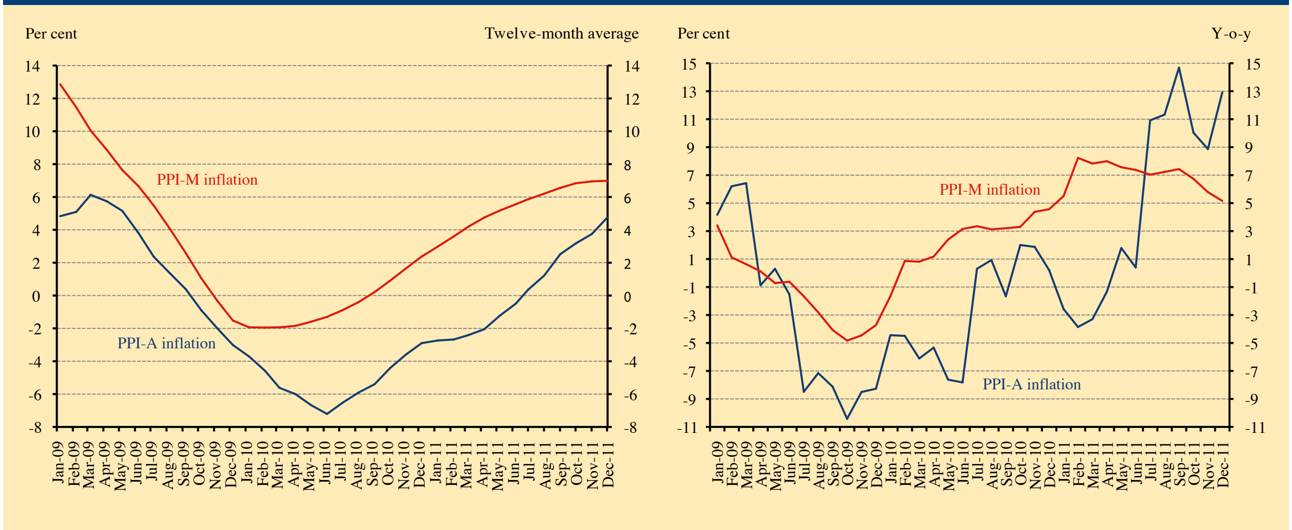
Source: Statistics Mauritius.

were modest. The wage rate index increased by only 1.5 per cent between 2011Q2 and 2011Q3 and remained unchanged at 145.6 between 2011Q3 and 2011Q4. Annual comparison shows that the increase amounted to only 2.4 per cent in 2011Q3 and 2.2 per cent in 2011Q4. Y-o-y, the most significant increases were registered in the industry groups Wholesale and retail trade and Manufacturing, mining and quarrying (Table 4.2).

Producer Price Indices

Price pressures at the production level firmed up in 2011H2. The Producer Price Index-Agriculture

Chart 4.6: Producer Price Inflation



Sources: Statistics Mauritius and Bank of Mauritius.

Table 4.2: Wage Rate Index by Industry Group

INDUSTRY GROUPS	Quarterly Percentage Change: Between 2011Q1 and 2011Q2	Quarterly Percentage Change: Between 2011Q2 and 2011Q3	Quarterly Percentage Change: Between 2011Q3 and 2011Q4	Annual Percentage Change: 2010Q3 and 2011Q3	Annual Percentage Change: 2010Q4 and 2011Q4
				(Per cent)	
Agriculture, hunting, forestry and fishing	0.7	17.7	-5.2	2.2	4.5
Manufacturing, mining and quarrying	-0.9	2.7	0.5	5.5	4.2
Electricity and water	-0.1	-0.9	3.9	-2.3	1.7
Construction	0.0	3.0	-0.8	3.5	2.1
Wholesale and retail trade; repair of motor vehicles, motorcycles, personal and household goods	3.0	-1.9	2.7	6.1	4.6
Hotels and restaurants	0.4	-0.7	0.3	-0.4	-2.0
Transport, storage and communications	-0.2	-0.1	2.8	1.7	4.3
Financial intermediation	2.0	-0.9	0.0	1.8	0.0
Real estate, renting and business activities	-2.7	-0.8	0.1	-1.3	-3.9
Public administration and defence; compulsory social security	0.4	0.7	-0.2	3.8	3.9
Education	0.9	-0.1	-1.3	-0.4	0.8
Health and social work	0.0	-0.8	-0.1	2.1	1.3
Other community, social and personal services	-1.7	-1.6	1.7	0.2	-0.6
ALL GROUPS	**0.1**	**1.5**	**0.0**	**2.4**	**2.2**

Source: Statistics Mauritius.

(PPI-A) inflation for the twelve-month average period rose from -0.5 per cent in June 2011 to 4.8 per cent in December 2011. On a y-o-y basis, PPI-A inflation increased from 0.4 per cent in June 2011 to 12.9 per cent in December 2011. The rise largely reflected the increase in the commodity group Crop Products, which accounts for nearly 76 per cent of the overall weight. The Producer Price Index-Manufacturing (PPI-M) inflation went up from 5.6 per cent in June 2011 to 7.0 per cent for the twelve-month period ended December 2011. On the other hand, y-o-y PPI-M inflation decreased from 7.4 per cent in June 2011 to 5.2 per cent in December 2011 (Chart 4.6).

5. The Domestic Economy

Amid deteriorating global economic conditions in 2011H2, the domestic economy lost momentum but continued to post positive growth rates. Final consumption expenditure expanded in 2011H2, albeit at a subdued rate, driven mainly by household consumption. Growth in investment switched to positive territory in 2011H2 following contractions in 2011H1. As regards external demand, growth in imports and exports of goods and services moderated in 2011H2 and the balance of payments was characterised by a marked deterioration in the current account deficit. The labour market was stable in 2011H2. Inflation risks emanating from any imbalance between demand and supply remained on the low side.

5.1 Economic Activity

In 2011Q4, growth slowed down to 2.4 per cent y-o-y, following higher growth rates of 5.0 per cent, 4.8 per cent and 3.9 per cent in 2011Q1, 2011Q2 and 2011Q3, respectively. Seasonally-adjusted q-o-q data also show that in 2011Q4, growth was lower at 0.1 per cent compared to 1.3 per cent and 1.1 per cent in 2011Q3 and 2011Q2, respectively. For 2011 as a whole, real output is estimated to have expanded by 4.0 per cent, slightly lower than the growth rate of 4.2 per cent registered in 2010. Statistics Mauritius forecasts a growth rate of 3.6 per cent in 2012 (Chart 5.1).

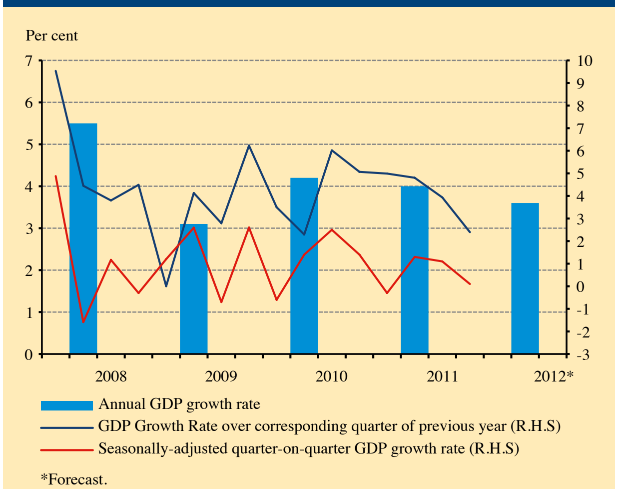
Latest data showed that in most key sectors, growth was positive in 2011H2, notwithstanding a deceleration in some cases. The *hotels and restaurants* sector recorded positive albeit weaker growth in 2011H2. In 2011Q4, the *hotels and restaurants* sector grew by 1.0 per cent y-o-y, marginally lower than the growth rate of 1.1 per cent recorded in the previous quarter. Growth was higher at 4.4 per cent and 6.5 per cent in 2011Q1 and 2011Q2, respectively. Data from Statistics Mauritius revealed that tourist arrivals for 2011 increased by 3.2 per cent to 964,642. Tourism earnings increased by 8.6 per cent to Rs42,845 million in 2011.

Other sectors that recorded slower growth during 2011H2 were *transport, storage and communications* and *financial intermediation*. In *agriculture*, growth slowed down to 1.0 per cent in 2011Q4, after growing by 8.1 per cent and 6.9 per cent in 2011Q2 and 2011Q3, respectively. However, in 2011Q1, the *agriculture* sector had contracted by 2.5 per cent.

Growth in wholesale and retail trade accelerated to 3.5 per cent and 4.1 per cent in 2011Q3 and 2011Q4, respectively, compared to slower growth of 3.0 per cent and 2.8 per cent in 2011Q1 and 2011Q2, respectively. The *real estate, renting and business activities* sector maintained buoyant growth of 6.3 per cent, 6.6 per cent and 6.4 per cent in the first three quarters of 2011 before slowing down 5.9 per cent in the last quarter.

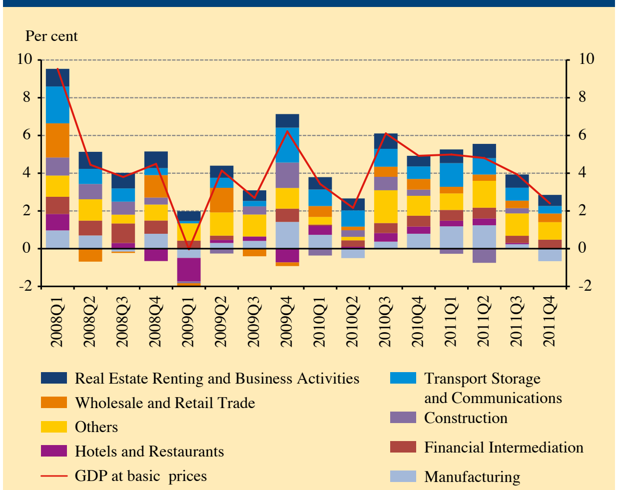
Real activity in *construction*, which contracted for two consecutive quarters in 2011H1 on account of

Chart 5.1: Real GDP Growth Rate



Sources: Statistics Mauritius and Bank of Mauritius.

Chart 5.2: Contribution of Major Sectors to GDP Growth



Sources: Statistics Mauritius and Bank of Mauritius.

completion of major infrastructure projects, switched back to positive territory in 2011H2 as new projects were initiated, with growth estimated at 4.2 per cent and 2.2 per cent in 2011Q3 and 2011Q4, respectively.

However, the *manufacturing* and *export-oriented enterprises* sectors contracted in the last quarter of 2011. In 2011Q4, the *manufacturing* sector contracted by 3.5 per cent y-o-y, after registering positive but weak growth of 1.4 per cent in 2011Q3 and from higher growth rates of 7.6 per cent and 7.4 per cent in 2011Q1 and 2011Q2, respectively. Within *manufacturing*, *textile* contracted by 4.0 per cent after expanding by 7.4 per cent in 2011Q3 and recording stronger growth of 10.2 per cent and 22.4 per cent in 2011Q1 and 2011Q2 respectively. *Other manufacturing* contracted by 7.2 per cent in 2011Q4, after growing by 2.9 per cent in the previous two quarters.

Similarly, real output of *export-oriented enterprises* contracted by 4.1 per cent y-o-y in 2011Q4, after registering growth of 8.0 per cent in 2011Q3 and after growth of 16.1 per cent and 17.0 per cent in 2011Q1 and 2011Q2, respectively.

Consumption

In 2011Q4, final consumption expenditure grew by 2.1 per cent, lower than the 2.4 per cent growth registered in the previous quarter (Table 5.1). In 2011Q1, growth in final consumption expenditure was higher at 3.2 per cent but dropped to 2.2 per cent in 2011Q2. Growth in final consumption was driven by household consumption expenditure, which increased by 2.5 per cent and 2.7 per cent in 2011Q3 and 2011Q4 respectively. Household consumption expenditure contributes around 85 per cent of final consumption expenditure.

Government consumption expenditure decelerated to 2.1 per cent in 2011Q3 and contracted by 0.9 per cent in 2011Q4, after growing by 4.3 per cent and 4.0 per cent in 2011Q1 and 2011Q2, respectively (Chart 5.3).

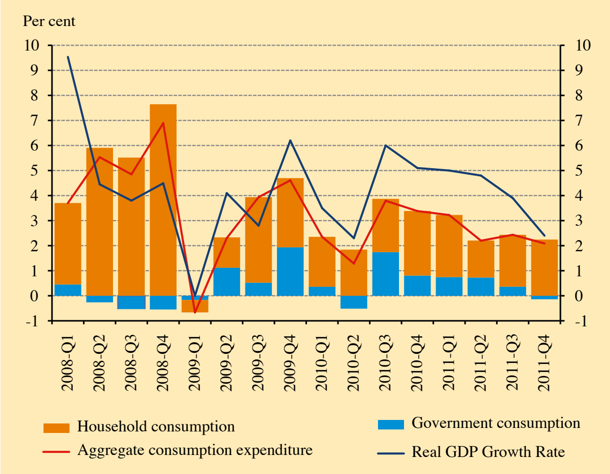
For 2011 as a whole, Statistics Mauritius estimated final consumption expenditure to have grown by 2.5 per cent, lower than previous year's growth rate of 2.7 per cent. Statistics Mauritius estimated that household consumption would grow by 2.5 per cent this year.

Investment

Growth in investment switched to positive territory in 2011H2 following contractions in 2011H1 (Table 5.1). In 2011Q4, investment growth accelerated to 12.9 per cent after expanding by 2.6 per cent in 2011Q3 and in sharp contrast to contractions of 1.2 per cent and 14.9 per cent in 2011Q1 and 2011Q2, respectively.

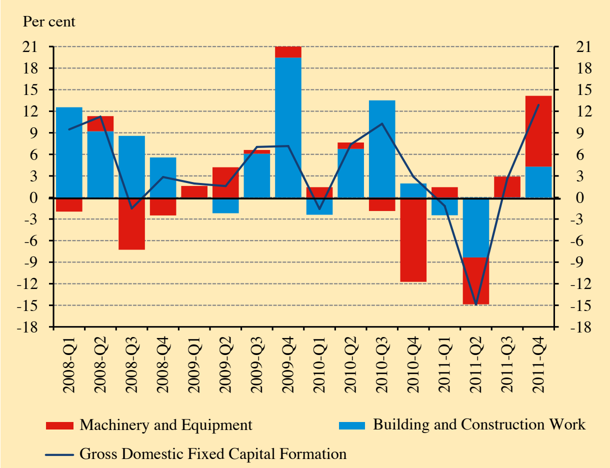
The increase in investment spending in 2011H2 was mostly led by a rise of 9.9 per cent and 31.2 per cent in *machinery and equipment* in 2011Q3 and 2011Q4, respectively (Chart5.4). In particular, the *other machinery and equipment* sub-component grew quite strongly by 14.4 per cent and 47.7 per cent in

Chart 5.3: Real GDP and Consumption Growth Rates



Sources: Statistics Mauritius and Bank of Mauritius.

Chart 5.4: Contributions to Growth in Gross Domestic Fixed Capital Formation



Sources: Statistics Mauritius and Bank of Mauritius.

2011Q3 and 2011Q4, respectively, explained by the acquisition of a power generating plant. In contrast, poor performance was recorded in the passenger car sub-component, which contracted in 2011H2. *Other transport equipment* excluding *aircraft and marine vessel* recorded a relatively lower growth rate in 2011H2, compared to 2011H1.

Building and construction work grew by 6.3 per cent in 2011Q4 after being flat in 2011Q3 and after contracting in the first two quarters of 2011. Whilst *residential building* recorded positive performance in all four quarters of 2011, *non-residential building* contracted in all four quarters. In 2011Q3 and 2011Q4, *residential building* grew strongly by 13.2 per cent and 30.1 per cent, respectively. *Non-residential building* contracted by 7.9 per cent in 2011Q3 and by 14.8 per cent in 2011Q4. *Other construction work*, which grew by an impressive 25.5 per cent in 2011Q1, contracted by 9.5 per cent in 2011Q2 and by 5.5 per cent in 2011Q3 as a result of completion of major public infrastructure projects. In 2011Q4 growth in *other construction work* picked up again to 6.8 per cent.

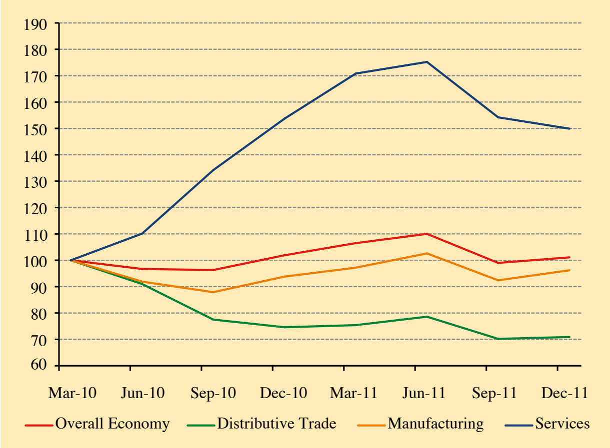
Overall, Statistics Mauritius estimated that investment stagnated in 2011, after a decline of 0.7 per cent in 2010. Investment excluding aircraft and marine vessel was flat in 2011 after expanding by 3.7 per cent in 2010.

Going forward, on the basis of information on on-going and new projects, including those announced in the Budget 2012, Statistics Mauritius forecasts that investment would grow by 0.5 per cent in 2012. Investment would be driven mostly by public sector projects such as road infrastructure, low cost housing and other public buildings.

Business Confidence

In 2011Q4, the MCCI business confidence indicator improved to 100.1 from 99.0 in 2011Q3 as a result of

Chart 5.5: MCCI Business Confidence Index



Sources: Statistics Mauritius and Bank of Mauritius.

Table 5.1: Real Growth in the Components of Aggregate Demand

												Y-o-y
	2009 [1]	2010 [1]	2011 [1]	2012 [2]	2010Q1	2010Q2	2010Q3	2010Q4	2011Q1[1]	2011Q2[1]	2011Q3[1]	2011Q4[3]
Final Consumption Expenditure	2.4	2.7	2.5	2.5	2.4	1.3	3.8	3.4	3.2	2.2	2.4	2.1
of which:												
Household consumption	2.1	2.6	2.5	2.5	2.4	2.2	2.6	3.1	3.0	1.8	2.5	2.7
Government consumption	5.1	3.4	2.3	2.2	2.1	-2.9	10.1	4.9	4.3	4.0	2.1	-0.9
Investment	8.9	-0.7	0.0	0.5	-1.3	7.6	10.5	-15.2	-1.2	-14.9	2.6	12.9
Investment *(exclusive of the acquisition of aircraft & marine vessel)*	5.5	3.7	0.0	0.1	-1.6	7.4	10.3	2.9	-1.2	-14.9	2.6	12.9
Exports of goods and services	-3.4	14.1	6.7	5.2	13.5	18.7	9.8	14.8	14.5	5.1	12.1	-3.0
Imports of goods and services	-10.7	9.5	6.4	3.5	12.1	9.8	12.1	4.4	10.2	2.8	10.2	2.4

[1]: Revised estimates. [2]: Forecast. [3]: First estimates.

Sources: Statistics Mauritius and Bank of Mauritius.

supportive Budget 2012 policy measures. However, confidence levels were still lower compared to 2011H1 (Chart 5.5).

5.2 Output Gap

Against the backdrop of a positive but slowing growth momentum in the domestic economy, the output gap was assessed as slightly negative, indicating that the domestic economy was operating with some spare capacity. The output gap derived by using the Hodrick-Prescott (HP) and Band Pass (BP) filters are presented in Chart 5.6.

5.3 Balance of Payments Developments

In the last two quarters of 2011, the country's balance of payments was characterised by a marked deterioration in the current account deficit. The worsening merchandise trade deficit and lower net invisibles account surplus brought about the higher current account deficit. As a percentage of GDP at market prices, the current account deficit widened sharply to 12.7 per cent in 2011H2, from 8.1 per cent in the corresponding period in 2010.

Current Account

The current account deficit worsened significantly to Rs21.8 billion in 2011H2 from Rs12.8 billion in 2010H2, as a result of a deteriorating merchandise account deficit and a fall in the net invisibles account surplus. As imports grew at a higher rate than exports (9.6 per cent compared to 5.2 per cent), the merchandise trade deficit deteriorated by Rs4.6 billion to a record level of Rs35.6 billion. Price-output breakdown for domestic exports showed a y-o-y decline in export volume of 5.7 per cent in 2011H2, highlighting the adverse impact of the poor economic conditions in the main export markets. As for imports, the rise in import bill was driven by more price than volume increases.

The services account posted a surplus of Rs10.5 billion in 2011H2, representing a y-o-y decrease of 1.2 per cent. The overall decline was mostly on account of the growing shortfall in other services that amounted to Rs2.1 billion. Net receipts on travel, however, registered a significant growth of 12.3 per cent in 2011H2 to reach Rs15.6 billion despite the marginal rise of only 0.9 per cent in inbound tourism.

The income account recorded a lower surplus of Rs2.0 billion in 2011H2, representing a decrease of 37.8 per cent compared to Rs3.3 billion recorded in the corresponding period of last year. The decline was mostly attributed to significantly higher direct investment income payments and lower net income earned by banks on external assets following the persistence of lower interest rates abroad that more than offset the lower net outflows under portfolio investment income. However, the decline in net invisibles was accounted mainly by the lower surplus of Rs1.3 billion recorded in current transfers on account of a major turnaround in private net transfers in 2011H2 which recorded net outflows of Rs1.0 billion (Chart 5.7).

Chart 5.6: Domestic Output Gap

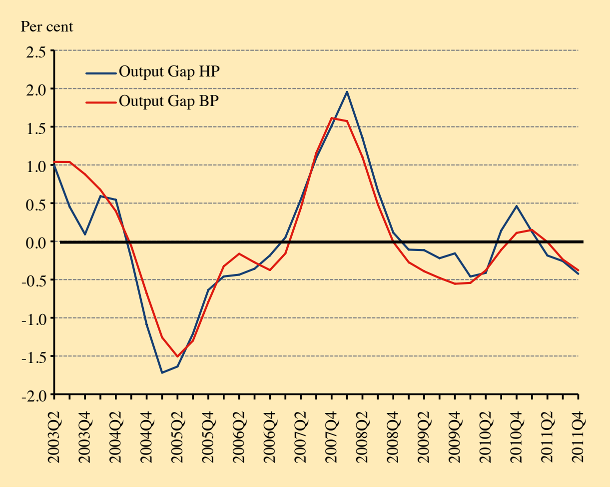
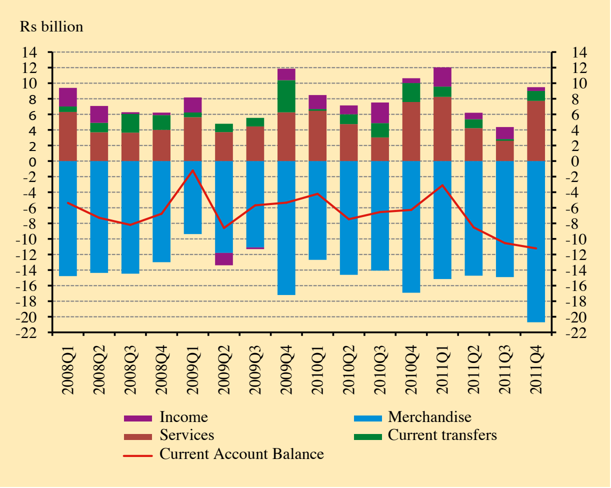


Chart 5.7: Components of the Current Account



Capital and Financial Account

There were considerably larger net financial inflows during 2011H2 to finance the current account deficit. The capital and financial account ended 2011H2 posting a surplus of Rs18.5 billion, representing a y-o-y increase of Rs6.6 billion. Compared to the corresponding semester in 2010, buoyancy in financial flows were noted in higher other investment inflows and steady portfolio investment flows.

Private long-term net capital inflows associated with foreign direct investment, which amounted to Rs4.2 billion in 2010H2, decreased to Rs2.1 billion in 2011H2. Foreign direct investment in Mauritius lost pace to stand at Rs3.5 billion in 2011H2 compared to Rs5.7 billion in 2010H2. Residents' direct investment abroad also slowed to Rs1.4 billion in 2011H2 relative to Rs1.5 billion in 2010H2.

Portfolio investment witnessed a sharp turnaround, from a net outflow of Rs0.7 billion in 2010H2 to a net inflow of Rs1.9 billion in 2011H2. The overall net inflow was largely brought about by substantial repatriation of residents' portfolio assets from abroad, which more than outweighed the net non-resident investors' sales of shares on the domestic stock market. Net non-residents' transaction on the Stock Exchange of Mauritius resulted into net sales of Rs0.6 billion in 2011H2 compared to net purchases of Rs0.8 billion in 2010H2. The other investment account yielded net inflows of Rs15.9 billion in 2011H2, up from Rs12.5 billion in 2010H2. The inflows were due to a disbursement of external loan to a public non-financial corporation and increase in non-residents' balances held with resident banks outweighing the rise in banks' foreign assets.

Chart 5.8: Financing of the Current Account

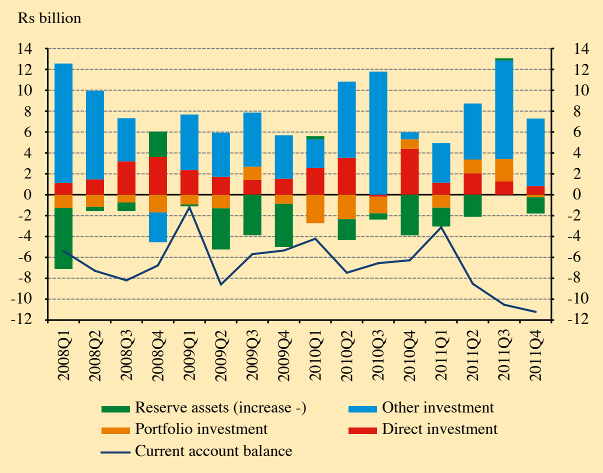


Table 5.2: Balance of Payments Summary

				(Rs million)
	2010H1 [1]	2010H2 [1]	2011H1 [2]	2011H2 [2]
Current Account	**-11,681**	**-12,828**	**-11,640**	**-21,753**
Exports (f.o.b)	31,801	37,749	36,194	39,722
Imports (f.o.b)	-59,105	-68,734	-66,072	-75,332
of which: aircrafts/marine vessels	-	-	-	-
Trade balance	-27,304	-30,985	-29,878	-35,610
Services, net	11,328	10,620	12,469	10,497
of which:travel, net	13,294	13,928	15,725	15,637
Income, net	2,937	3,266	3,303	2,031
Current transfers, net	1,358	4,271	2,466	1,329
Capital and Financial Account	**9,258**	**11,482**	**8,496**	**18,534**
Capital account, net	-115	-33	-25	-28
Direct investment, net	*6,100*	*4,211*	*3,205*	*2,101*
Portfolio investment, net	*-5,060*	*-669*	*72*	*1,916*
Other investment, net	*10,022*	*12,461*	*9,155*	*15,881*
Balance of Payments Surplus (-)/ Deficit (+)	*-1,689*	*-4,488*	*-3,911*	*-1,336*
Net Errors and Omissions	**2,423**	**1,346**	**3,144**	**3,219**

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

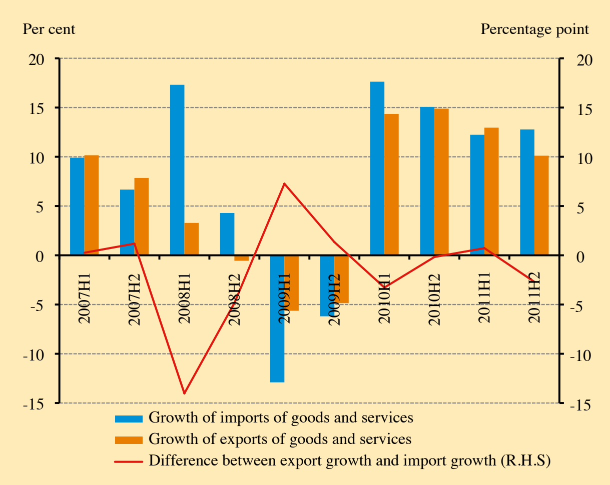
Figures may not add up to totals due to rounding.

The country's overall balance of payments in 2011H2, as measured by the change in reserve assets excluding valuation change, recorded a surplus of Rs1.3 billion. Details on the balance of payments summary are provided in Table 5.2. The financing of the current account deficit is depicted in Chart 5.8.

Net External Demand

Y-o-y growth in imports and exports of goods and services moderated in the 2011H2 to 12.8 per cent and 10.1 per cent, respectively. Consequently the difference between exports growth and imports growth widened from -0.2 percentage point to -2.7 percentage points. Chart 5.9 below depicts the evolution of growth rate of exports and imports of goods and services and the difference between the two growth rates.

Chart 5.9: Growth in External Trade

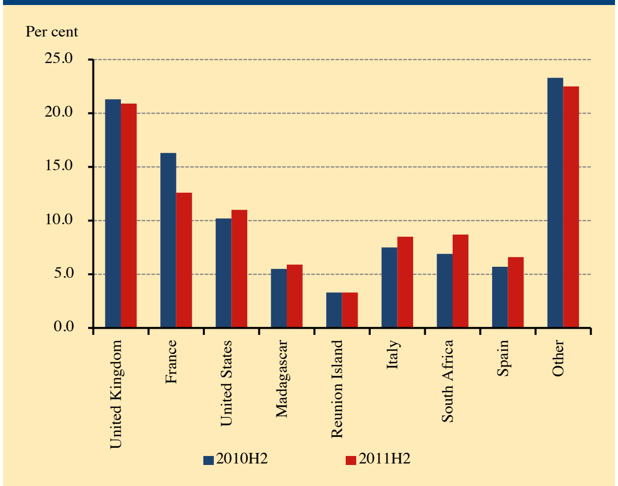


Exports

Total nominal exports of goods rose by 5.2 per cent to Rs39.7 billion in 2011H2. However, excluding ships' stores and bunker, exports of goods decreased by 1.1 per cent to Rs33.2 billion on account of decline in re-exports. In contrast, domestic exports rose by 1.1 per cent, primarily driven by an increase in exports of *Crude materials, inedible, except fuels* (67.1 per cent), *Manufactured goods classified chiefly by material* (5.8 per cent) and *Miscellaneous manufactured articles* (2.7 per cent).

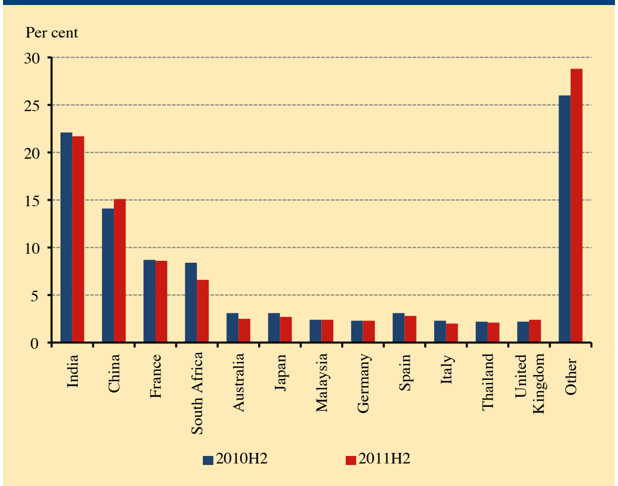
By country of destination, during 2011H2, Europe remained our main market with a share of 60.5 per cent, which was however lower than the share of 62.9 per cent recorded in 2010H2. Within Europe, the share of exports to two major export destinations, United Kingdom and France, declined noticeably to 20.9 per cent and 12.6 per cent from 21.3 per cent and 16.3 per cent, respectively. Major export destinations where exports increased were U.S.A, South Africa, Italy, Spain and Madagascar where export shares climbed to 11.0 per cent, 8.7 per cent, 8.5 per cent, 6.6 per cent and 5.9 per cent, respectively(Chart 5.10).

Chart 5.10: Main Export Destinations



Source: *Statistics Mauritius.*

Chart 5.11: Main Sources of Imports



Source: *Statistics Mauritius.*

Imports

Total nominal imports of goods (c.i.f) registered a growth of 8.9 per cent in the second half of 2011 compared to the corresponding period last year. The higher import bill stemmed mainly from an increase of 13.2 per cent in *Mineral fuels, lubricants and related materials*, 11.4 per cent in *Food and live animals* and 69.1 per cent in *Crude materials, inedible, except fuels*, of which, *textile fibres* accounted for a growth of 123.0 per cent.

The Asian continent accounted for 53.3 per cent of total imports in 2011H2, compared to 53.0 per cent in 2010H2. Imports originated mostly from India (21.7 per cent), China (15.1 per cent), France (8.6 per cent), South Africa (6.6 per cent), Japan (2.7 per cent) and Australia (2.5 per cent). Among major sources of imports, only China recorded a rise in its market share in the 2011H2 (Chart 5.11).

5.4 Labour Market

The unemployment rate declined from 7.9 per cent in 2011Q3 to 7.5 per cent in 2011Q4, partly as a result of an increase in casual jobs being offered mostly in the distributive trade sector. The unemployment rate was, however, higher compared to 7.2 per cent registered in 2010Q4. On a seasonally-adjusted basis, the unemployment rate increased from 8.1 per cent in 2011Q3 to 8.4 per cent in 2011Q4. For the year 2011 as a whole, the unemployment rate is estimated at 7.9 per cent, marginally higher compared to 7.8 per cent in the previous year (Chart 5.12).

On a y-o-y basis, total employment increased by 4,100 in 2011Q4. The *Wholesale and retail trade; repair of motor vehicles, motorcycles and personal household goods* sector registered the highest gain in employment followed by *Transport, storage and communications, Real estate, renting and business activities, Manufacturing* and *Hotels and restaurants*. On the other hand, sectors that shed jobs included *Construction, Agriculture, forestry and fishing, Other community, social* and *personal service and Education*.

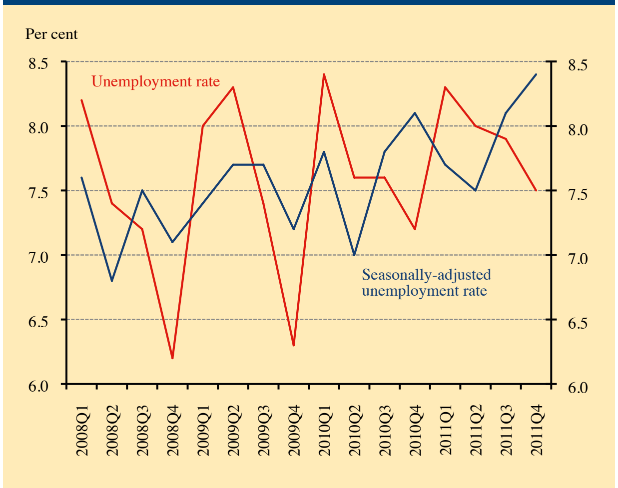
Q-o-q data indicated that in 2011Q4, jobs were created in Transport, storage and communications, *Wholesale and retail trade, repair of motor vehicles, motorcycles and personal household goods, Real estate, renting and business activities, Manufacturing* and *Financial intermediation*. Employment in all the remaining sectors was flat.

Employment in *Export-oriented enterprises* declined by 178 from 55,828 at the end of December 2010 to 55,650 at the end of December 2011, mainly explained by a decline in employment of 454 in the *Wearing apparel* group, partly offset by an increase in employment of 377 in the *Other product* group.

Labour Market Outlook

On current trends, the labour market was assessed as being rather stable. The March 2012 release of the MCCI Business Sentiment Survey indicated that around 18 per cent of respondents expected to recruit in coming months, in line with decisions to diversify or expand their business. Similarly, the MEF Annual Business Trends survey for the year 2012 showed that about 35 per cent of respondents planned to recruit workers in anticipation of an expansion of their business activities and investment. However, about 15 per cent of respondents in the MCCI survey and 13 per cent in the MEF survey stated that they might consider laying off workers in the short to medium term so as to maintain the economic and financial viability of their businesses.

Chart 5.12: Quarterly Unemployment Rate



Source: Statistics Mauritius.

6. Monetary and Financial Developments

Money supply growth moderated while credit expansion picked up in 2011H2. Additional credit was largely channelled to construction, traders and agriculture and fishing. Excess liquidity was brought down to a more reasonable level during 2011H2. Reflecting worsening global conditions, domestic stocks performed poorly in 2011H2. Exchange rate movements were stable, as depicted by MERI1 and MERI2. Monetary and financial developments generally helped contain inflationary pressures in the economy.

6.1 Monetary and Credit Developments

Monetary Base

The monetary base rose by 14.1 per cent between end-June 2011 and end-December 2011 compared to an increase of 25.7 per cent registered in the corresponding period in 2010. The growth rate of reserve deposits held by other depository corporations (ODCs) during 2011H2 slowed to 9.8 per cent, compared to the growth rate of 34.0 per cent in 2010H2. The growth rate of currency in circulation during 2011H2 stood at 19.6 per cent, lower than the growth rate of 21.1 per cent registered in the 2010H2.

On the sources side of the monetary base, net foreign assets of the Bank edged up by 0.3 per cent in 2011H2 in contrast to growth of 13.7 per cent recorded in 2010H2. Domestic claims by the Bank went up mainly on account of a rise in net claims on central government in 2011H2.

Broad Money Liabilities

Broad Money Liabilities (BML) grew at a slower pace of 4.1 per cent in 2011H2 compared to to a rise of 5.3 per cent in 2010H2. Chart 6.1 shows the evolution in the growth rates of the monetary base and BML while Chart 6.2 depicts the evolution in the growth rates of BML and credit to private sector as well as the inflation rate.

Components of Broad Money Liabilities

The moderate growth of BML in 2011H2 was mainly due to a deceleration in the growth of quasi-money liabilities. Quasi-money liabilities rose by 2.5 per cent in 2011H2 compared to a rise of 3.9 per cent in 2010H2, reflecting mainly a moderation in the growth of savings rupee deposits from 13.1 per cent in 2010H2 to 5.6 per cent in 2011H2. Narrow Money Liabilities (NML) rose by 10.9 per cent in the six months ended December 2011, compared to a growth of 7.7 per cent for the six months ended December 2010, reflecting higher growth in transferable rupee deposits.

Time rupee deposits growth went up from 0.1 per cent for the six months ended December 2010 to 4.0 per cent for the six months ended December 2011. Foreign currency deposits continued to contract, from a negative growth of 4.0 per cent in 2010H2 to a negative growth of 5.7 per cent in 2011H2. Securities other than Shares, remained almost unchanged in 2011H2 compared to a rise of

Chart 6.1: Growth in Monetary Base and Broad Money Liabilities
(Percentage change over corresponding month of previous year)

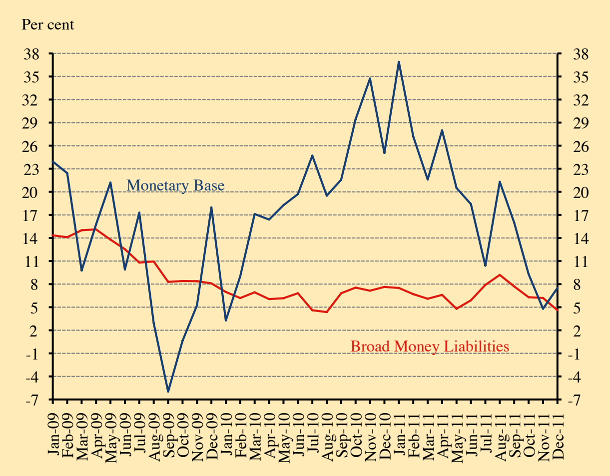
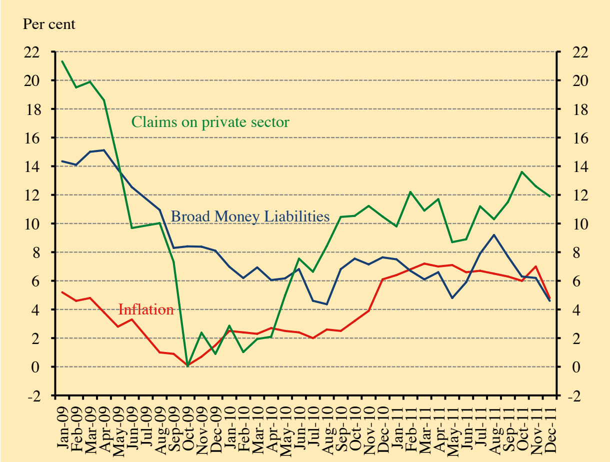


Chart 6.2: Growth in Broad Money Liabilities and Credit to Private Sector and Inflation Rate
(Percentage change over corresponding month of previous year)



Rs2.0 billion in 2010H2. Table 6.1 provides details on growth rates of the components of BML and credit.

Sources of Broad Money Liabilities

The net foreign assets of depository corporations edged up by 1.3 per cent in 2011H2 compared to a rise of 5.1 per cent in the six months ended December 2010, mainly as a result of an increase in net foreign assets held by the ODCs. The net foreign assets of the Bank went up by 0.3 per cent, while those of ODCs went up by 3.8 by per cent in 2011H2.

Growth in domestic credit by depository corporations increased from 3.2 per cent in 2010H2 to 5.7 per cent in 2011H2, reflecting mainly higher credit to the private sector. Net credit to budgetary central government rose slightly by 0.8 per cent in 2011H2 compared to a rise of 0.9 per cent in 2010H2. Credit to the private sector by ODCs grew by 6.6 per cent in 2011H2 compared to 3.7 per cent in 2010H2.

Sector-wise Distribution of Credit by Banks

Bank credit to the private sector rose by 4.8 per cent in 2011H2, lower than the 5.9 per cent rise in the corresponding period of 2010. The *construction traders, agriculture and fishing, transport* and *tourism* sectors drove the increase in bank credit with respective shares of 49.1 per cent, 33.4 per cent, 22.9 per cent, 12.6 per cent and 7.9 per cent to total credit expansion. Credit to the *construction, tourism, traders, agriculture and fishing* and *personal* sectors increased by Rs5.1 billion, Rs0.8 billion, Rs3.5 billion, Rs2.4 billion and Rs0.7 billion, respectively. However, credit to public non-financial corporations and financial and business services fell by Rs3.2 billion and Rs0.4 billion, respectively.

Chart 6.3: Distribution of the Change in Bank Credit to the Private Sector – end-June 2011 to end-December 2011

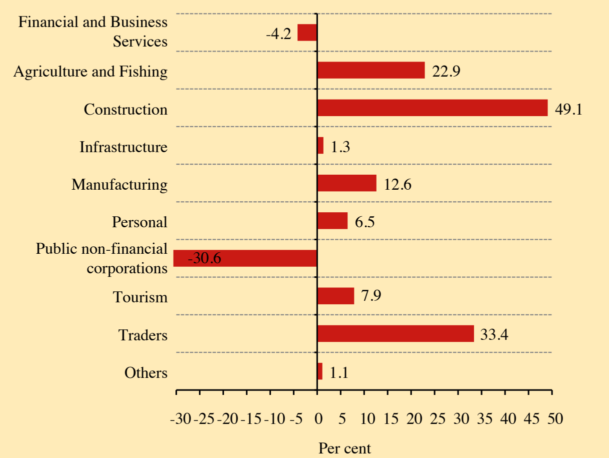


Table 6.1: Broad Money Liabilities, Domestic Credit and Net Foreign Assets

	(Rs million)						% Change between	
	Jun-10	**Dec-10**	**Mar-11**	**Jun-11**	**Sep-11**	**Dec-11**	**Dec-10 & Jun-10**	**Dec-11 & Jun-11**
Broad Money Liabilities[1]	**302,944**	**319,124**	**315,401**	**320,818**	**323,565**	**333,905**	**5.3**	**4.1**
Narrow Money Liabilities	59,262	63,835	60,012	61,402	63,157	68,117	7.7	10.9
Currency with public	15,905	18,975	17,492	17,517	17,958	20,308	19.3	15.9
Transferable deposits	43,357	44,860	42,519	43,886	45,199	47,809	3.5	8.9
Quasi-Money Liabilities	242,841	252,420	251,912	255,371	256,269	261,744	3.9	2.5
Savings deposits	90,513	102,349	106,417	106,470	107,097	112,381	13.1	5.6
Time deposits	94,073	94,150	90,280	92,196	94,644	95,885	0.1	4.0
Foreign currency deposits	58,255	55,921	55,215	56,705	54,528	53,478	-4.0	-5.7
Securities other than shares	842	2,869	3,477	4,045	4,139	4,044	240.8	0.0
Domestic Credit[1]	**294,721**	**304,164**	**301,430**	**311,742**	**321,340**	**329,611**	**3.2**	**5.7**
Credit to private sector[1]	242,449	251,432	254,240	263,933	275,213	281,433	3.7	6.6
Net Foreign Assets[1]	**101,733**	**106,951**	**106,633**	**106,826**	**105,219**	**108,168**	**5.1**	**1.3**

[1] Adjusted for transactions for Global Business Licence Holders

Credit to the household sector went up by 8.8 per cent per cent in the second half of 2011 compared to a rise of 8.2 per cent recorded in 2010H2. Credit to the housing sector grew by 12.3 per cent in 2011H2, higher than the rise of 11.3 per cent recorded in the previous corresponding period. Corporate credit went up by 5.8 per cent compared to a rise of 6.6 per cent in the corresponding period.

The distribution of the change in bank credit to the private sector over the period June 2011 to December 2011 is shown in Chart 6.3.

6.2 Money Market

Liquidity Management

During 2011H2, the overall excess liquidity was brought down to a more reasonable level through the issue of Bank of Mauritius Bills and Notes. Bank of Mauritius Bills for tenors ranging between 91 and 273 days and Bank of Mauritius Notes of 2-Year and 3-Year maturities were issued for a total amount of Rs3.2 billion between July and October 2011. On a daily average basis, banks' excess liquidity stood at Rs2.0 billion during 2011H2 compared to Rs4.1 billion during the first six months of 2011 (Chart 6.4).

Interbank Interest Rates

The interest rates prevailing on the interbank money market hovered in the range of 1.65 per cent to 4.15 per cent during 2011H2 compared to a range of 1.20 per cent to 4.00 per cent during 2011H1. The overnight interbank interest rates ranged between 1.65 per cent to 3.85 per cent during the period under review, while interest rates on short notice and term transactions were within a range of 2.00 per cent and 4.15 per cent. The weighted average interbank interest rate ranged between 1.73 per cent and 3.80 per cent compared to a range of 1.20 per cent to 2.98 per cent during the 2011H1 (Chart 6.5).

Yields on Government Debt Instruments

The Bank introduced a new tenor of Government of Mauritius Treasury Bills (GMTB) of 273 day maturity as from 7 October 2011 in order to increase the spectrum of instruments being offered to bidders. Furthermore, it also started the auction of single maturity instruments as from 18 November 2011 with the objective of allowing government to determine its debt profile.

The weighted yield of 91-Day and 182-Day decreased from 4.19 per cent and 4.46 per cent, respectively, as at end-June 2011 to 4.03 per cent and 4.39 per cent as at end-December 2011. The weighted yield of the 364-day maturity increased by 1 basis point to stand at 4.73 per cent while the weighted yield of the 273-day maturity stood at 4.60 per cent as at end-December 2011 (Chart 6.6).

During the period under review, the Bank continued the monthly issues of 2-Year, 3-Year and 4-Year Treasury Notes. The coupon rates on the Government of Mauritius Treasury Notes, were kept unchanged at 5.25 per cent, 5.50 per cent and 5.75 per cent

Chart 6.4: Banks' Daily Excess Reserves

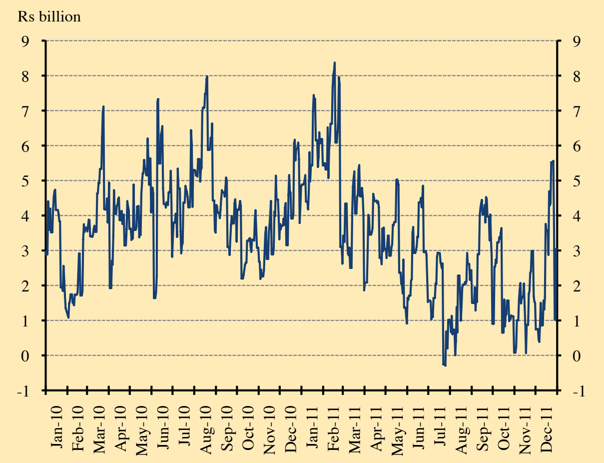
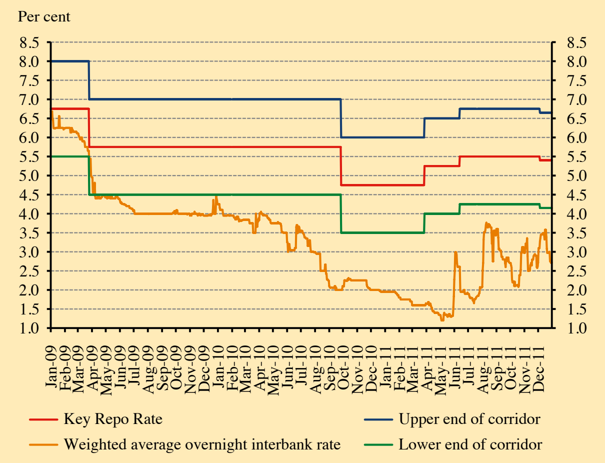


Chart 6.5: Overnight Weighted Average Interbank Interest Rate



per annum for the 2, 3 and 4-Year Treasury Notes, respectively, over the period July to November 2011. However, the coupon rates were revised downwards by 10 basis points to 5.15 per cent, 5.40 per cent and 5.65 per cent per annum for the 2, 3 and 4-Year Treasury Notes, respectively, following the cut in the KRR on 5 December 2011. Bidders continued to show a preference for the 2-Year maturity and, except for the auction held in November 2011, all auctions were oversubscribed.

The weighted yield for the 2-Year tenor went down from 5.34 per cent as at end-June 2011 to 5.10 per cent as at end-December 2011 while weighted yields on the 3-Year and 4-Year tenors increased from 5.62 per cent and 5.85 per cent as at end of June 2011 to 5.70 per cent and 6.07 per cent, respectively, as at end-December 2011 (Chart 6.7).

Regarding longer term instruments, a new issue of the Five-Year Government of Mauritius Bonds with a coupon rate of 6.75 per cent and for an amount of Rs1,800 million was auctioned on 17 August 2011. Bids received and accepted amounted to Rs2,264.1 million and Rs902.4 million, respectively, and the weighted yield stood at 6.95 per cent. A re-opening of the Five-Year Government of Mauritius Bonds for an amount of Rs1,800 million was made on 12 October 2011. Bids received and accepted amounted to Rs3,652.7 million and Rs1,800 million, respectively, and the weighted yield stood at 6.77 per cent.

On 14 September 2011, an auction of the Ten-Year Government of Mauritius Bonds with coupon rate of 8.00 per cent and for an amount of Rs2,000 million was held for issue on 16 September 2011. Bids received and accepted amounted to Rs3,485.1 million and Rs1,287.4 million and the weighted yield stood at 8.86 per cent. A re-opening of the Ten-Year Government of Mauritius Bonds for an amount of Rs1,000 million took place on 16 November 2011. Bids received and accepted amounted to Rs2,256.7 million and Rs1,341.2 million, respectively. The weighted yield stood at 8.75 per cent.

The Fifteen–Year Inflation Indexed Government of Mauritius Bond for an amount of Rs1,000 million was auctioned on 7 December 2011. Bids received and accepted amounted to Rs1,730 million and Rs1,000 million, respectively. The weighted bid margin stood at 2.81 per cent.

Chart 6.6: Yields on Treasury Bills

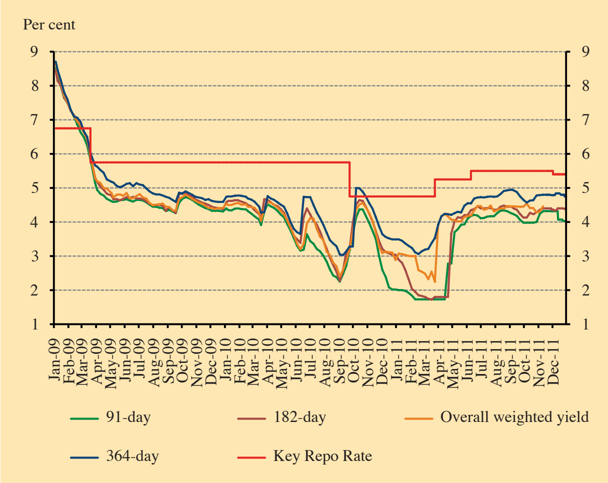


Chart 6.7: Yields on Treasury Notes

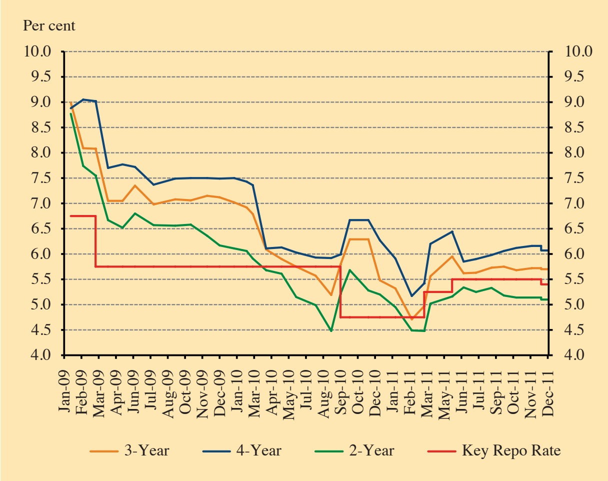
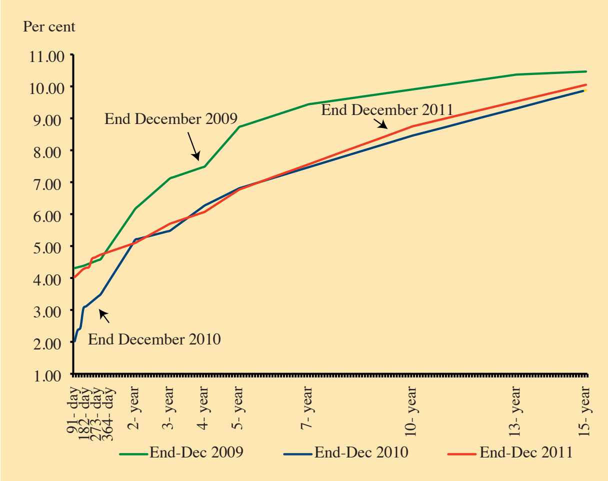


Chart 6.8: Yield Curve



Overall, as at end-December 2011 compared to end-December 2010, the yield curve flattened at the shorter end of the maturity spectrum as yields on Treasury Bills increased but did not change much at the medium to longer end. It is expected that a smooth yield curve will be helpful in allowing financial institutions to price their debt instruments (Chart 6.8).

6.3 Interest Rates

During 2011H2, banks have generally adjusted their deposits and lending rates in line with the changes in the Key Repo Rate. The savings deposits rates (SDR) varied within a range of 3.50-4.25 per cent as at end-December 2011, unchanged from end-June 2011, while prime lending rates (PLR) went up to a range of 7.50-9.00 per cent, from a range of 7.30-9.00 per cent. Banks' modal savings deposit rate (SDR) and modal prime lending rate (PLR) stood at 3.90 per cent and 8.00 per cent as at end-December 2011, respectively, compared to 4.00 per cent and 8.00 per cent as at end-June 2011. The weighted average deposits rate stood within a range of 4.29-4.37 per cent compared to a range of 3.65-4.58 per cent and the weighted average lending rate went down to a range of 9.20-9.66 per cent compared to a range of 9.22-9.98 per cent during 2011H2.

The real interest rate on savings deposits moved into negative territory in 2011H2 and stood at -2.4 per cent in December 2011. Deposits and lending rates as well as the Key Repo Rate are shown in Chart 6.9.

6.4 Stock Market

The SEMDEX, the official index of the Stock Exchange of Mauritius, posted a negative performance in 2011H2, reflecting developments in global stock markets against the backdrop of the euro zone debt crisis and growing signs of a global economic slowdown. SEMDEX fell by 10.0 per cent, hitting its lowest level since October 2010. Over the same period, the SEM-7, comprising blue-chip companies, fell by 11.2 per cent as against gains of 11.8 per cent and 5.8 per cent in the corresponding period of 2010 and in the 2011H1, respectively (Chart 6.10). The performance of companies that are heavily reliant on external demand was slightly worse than companies whose performance is to a greater extent driven by domestic demand. The shares of the two largest banks dropped by 11.2 per cent and 12.5 per cent, respectively, after having both been on an upward trend since end-June 2010.

Reflecting the drop in investor confidence, the stock market recorded net outflows in the 2011H2. Net sales by foreign investors on the domestic stock market amounted to Rs583.4 million, with net disinvestments of Rs341.2 million and Rs176.7 million on account of a conglomerate and hotels, respectively.

Chart 6.9: Key Repo Rate and Deposits and Lending Rates

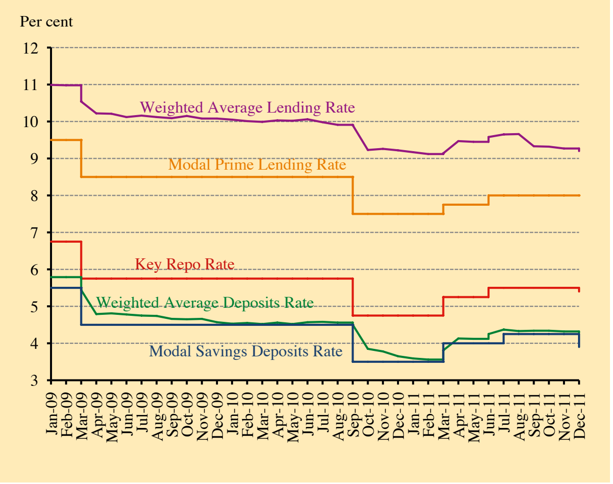
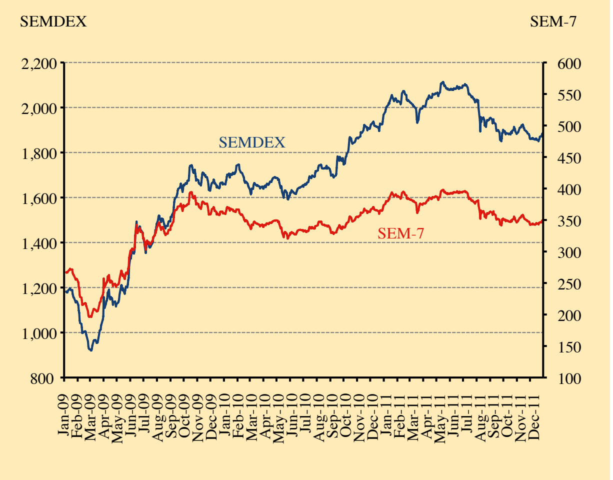


Chart 6.10: SEMDEX and SEM-7



Source: Stock Exchange of Mauritius.

6.5 Domestic Foreign Exchange Market

Activity on the Domestic Foreign Exchange Market

Transactions on the domestic foreign exchange market remained buoyant. Total turnover of spot and forward transactions amounted to US$3,779 million, representing a daily average of US$30.0 million during 2011H2 compared to a daily average of US$30.5 million in 2011H1. Monthly average transactions on the interbank foreign exchange market was US$52.1 million during the period under review compared to US$39.2 million in 2010H1.

The foreign exchange position of banks fell in 2011H2. Banks maintained a daily average overbought position of US$5.7 million compared to US$29.9 million over the period January to June 2011. Over the period July to December 2011, the Bank intervened on the domestic foreign exchange market to buy US$45.2 million and €4.2 million from banks and foreign exchange dealers.

Domestic Currency

In 2011H2, the exchange rate of the rupee vis-à-vis the three major currencies reflected both international currency markets developments and demand and supply conditions on the domestic market. From July till August 2011, the rupee strengthened against the US dollar to reach a high of Rs28.55. It thereafter, depreciated against the greenback, closing the year at around Rs30.04 per US dollar.

The Rs/euro exchange rate witnessed a general appreciating trend during the period under review. From Rs41.90 at the beginning of July 2011, the rupee appreciated to a high of Rs38.89 at the end of December 2011. The movements of the rupee against the euro reflected to a large extent international movements of the euro.

The exchange rate of the rupee against the Pound sterling was relatively volatile within a narrow range. The rupee closed the year 2011 trading at around Rs46.29 per Pound, almost unchanged from Rs46.36 at the beginning of July 2011.

On a point-to-point basis, between end-June and end-December 2011, the rupee depreciated against the US dollar by 3.8 per cent but appreciated vis-à-vis the euro and Pound sterling by 7.8 per cent and 0.6 per cent, respectively.

The evolution of the rupee exchange rate against the US dollar, Pound sterling and euro is shown in Chart 6.11.

Movements in MERIs and REER

The MERI1, which is a nominal effective exchange rate measure based on the currency distribution of trade as weights, posted a depreciation of 0.39 per cent, while MERI2, which includes currency distribution of trade combined with that of tourism receipts as weights, showed a marginal appreciation of 0.06 per cent. The Real Effective Exchange Rate

Chart 6.11: Rupee Exchange Rate Movements

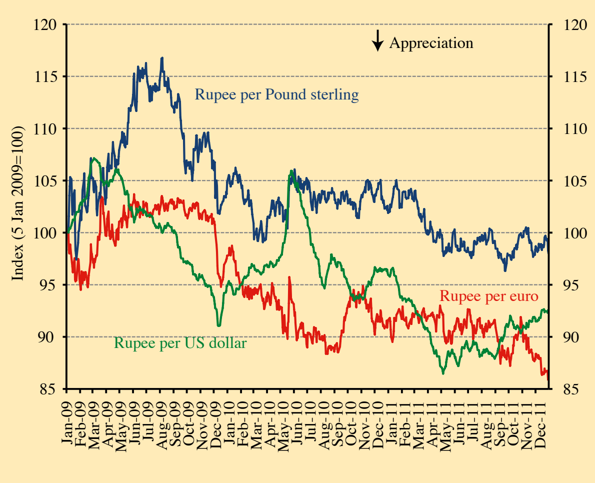
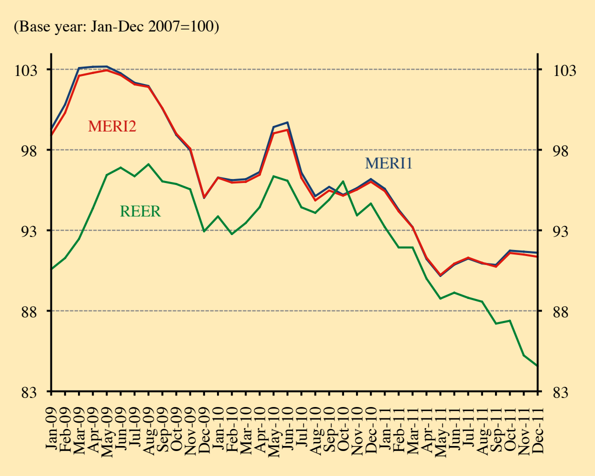


Chart 6.12: MERI1, MERI2 and REER



(REER), with weights based on trade distribution with countries that make up at least 80 per cent of total trade and adjusted for price differentials between the Mauritian economy and its trading partners, appreciated by 4.4 per cent. Chart 6.12 shows the evolution of MERI1, MERI2 and movements of the REER.

7. Growth And Inflation Outlook

7.1 Growth Outlook

In view of strong trade and financial linkages, the outlook for the domestic economy depends to a large extent on economic conditions and prospects in our key export markets. Latest data indicated that the US economy had grown at an annual rate of 3.0 per cent in 2011Q4, up from 1.8 per cent in the preceding quarter. The euro zone economy had contracted by 0.3 per cent q-o-q in 2011Q4, following a marginal growth of 0.1 per cent in the preceding quarter, with subdued output growth in France and a contraction in Germany. The British economy had contracted by 0.3 per cent q-on-q in 2011Q4 as manufacturing and construction real activity was scaled back.

Recent measures implemented by the ECB and euro area governments have alleviated financial markets stresses and improved global funding conditions, contributing to a turnaround in market confidence. According to the IMF, the global economy has stepped back from the brink of danger and signs of stabilisation are emerging from the euro zone and the United States, but high debt levels in developed markets and rising oil prices are key risks ahead.

Recent forecasts by Reuters and JP Morgan point to a mild recession of 0.3 to 0.4 per cent in the euro zone in 2012. The growth forecast for the US has been upgraded reflecting some positive data in the labour and housing markets. The March 2012 Reuters poll predicted a 0.5 per cent growth in the UK for 2012 while JP Morgan estimated a higher growth of 0.8 per cent. The US economy is projected to expand by 2.2 per cent by both agencies.

Looking ahead, in view of subdued growth prospects in key markets, the domestic economy would continue to operate below its capacity in the near term. Muted consumer sentiment in main export markets is expected to weigh on external demand-led sectors such as the tourism and textiles. The uncertain global economic environment has impacted negatively on domestic business confidence levels, especially in the manufacturing and distributive trade sectors. Recent anecdotal evidence pointed to subdued consumer sentiment as well, weighing on domestic demand-led sectors. Against this backdrop, the Bank's central growth forecast for 2012 was estimated down to 3.8 per cent in March 2012, from a previous estimate of around 4.0 per cent.

Notwithstanding emerging signs of stabilisation in US and the euro area, renewed tensions in the euro zone sovereign debt crisis and further increases in oil prices on account of geopolitical problems in the Middle East constitute the main downside risks to the domestic growth outlook. The relatively brighter outlook for the US and emerging economies, such as in South East Asia, is a supportive factor going forward given the attempts to diversify export markets.

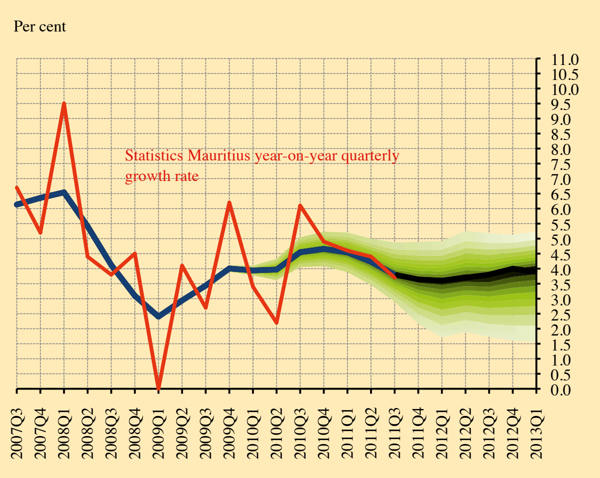
Chart 7.1 presents a fan chart illustrating the probability distributions for the forecasts of output growth, based on the central projection and the risks surrounding them. The red line is the Statistics Mauritius year-on-year estimated growth rates and the dark blue line represents deseasonalised quarterly data. Using these data, the central projection is depicted by the black line while the balance of risks is represented by the green bands around the central scenario.

7.2 Inflation Outlook

While underlying inflationary pressures have eased slightly, increasing global food and oil prices could represent an upside risk to the inflation outlook.

On the external front, the biggest risk for inflation is a potential oil price shock driven by growing concerns over geopolitical oil supply risks. The oil market impact of an Iran-related oil supply shock would be large, given limited inventory and spare capacity buffers, as well as the still-tight physical market

Chart 7.1: Growth Projections



conditions expected throughout 2012. According to the U.S Energy Information Administration (EIA) report released in March 2012, WTI spot prices, which averaged US$95 per barrel in 2011, would average US$106 per barrel in 2012. Global food prices have moderated somewhat during recent months as global supply prospects have improved in key agricultural commodities. However, according to FAO's biannual Food Outlook report issued in November 2011, agricultural commodity market conditions remain fairly tight in spite of improved supply prospects and weakening demand. Moreover, fluctuations in exchange rates and uncertainties in energy markets and the global economy might contribute to sharp price swings in agricultural markets.

From the domestic macroeconomic perspective, the output gap is assessed to be slightly negative, indicating that while some economic slack remained, the domestic economy was still growing close to its trend rate. Wage pressures remained subdued while the pace of monetary and credit expansion does not pose any major risk to inflation in the medium term. The behaviour of the rupee exchange rate vis-à-vis major trading partners' currencies and the pass-through to import prices of food and non-food commodities is likely to be a major critical factor in shaping up the inflation path. The stability of the rupee observed since November 2011 is likely to limit the inflationary pressures arising from external sources. On the other hand, rising inflationary pressures in the near term might arise from other sources, such as, a hike in freight rates and administered prices and potential increases in domestic oil prices which will in all likelihood have a non-negligible impact on the CPI basket.

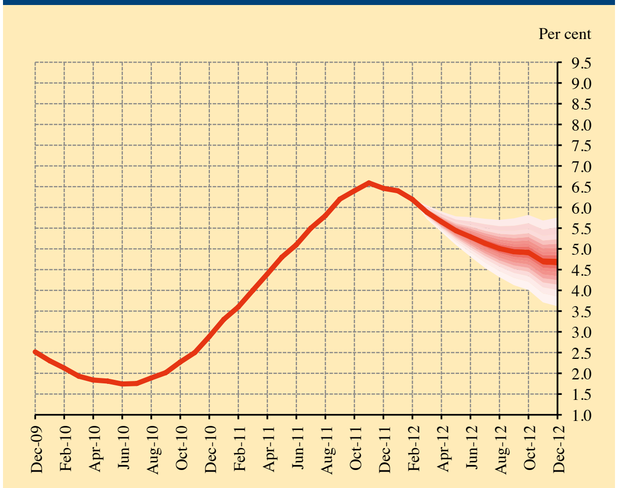
Overall, while the slowdown in domestic economic activity has alleviated price pressures and external inflation pressures have declined slightly, there are substantial uncertainties surrounding the evolution of inflation over the medium term. Inflation will continue to be sensitive to the paths of import prices and global commodity prices and their pass-through to domestic prices.

The risks to the inflation outlook over the forecast time horizon are presented graphically in the inflation fan chart as depicted in Chart 7.2.

The fan chart shows that the central projection for headline inflation will remain moderate for the year 2012 based on the assumptions of the baseline scenario with regard to the external economic environment, domestic economic conditions, administered prices and the fiscal stance. It is assumed that movements in commodity prices will continue to condition the price pressures dynamics, albeit at an uncertain pace. The fiscal stance is assumed unchanged and the negative domestic output gap, which is close to trend, indicates that inflationary pressures might be building up from the demand side. However, there are significant uncertainties around the outlook for inflation in the near-term horizon, as reflected in the widening bands on both sides of the central projection in 2012H2.

Base effect from last year is expected to bring inflation down in 2012, albeit moderately. Headline inflation is expected to show a modest deceleration throughout the forecast period and is projected at around 4.7 per cent by December 2012, on a no-policy change basis. At this stage, upside risks to the inflation outlook stem mainly from rising global food and oil prices.

Chart 7.2: Inflation Fan Chart



Inflation Expectations

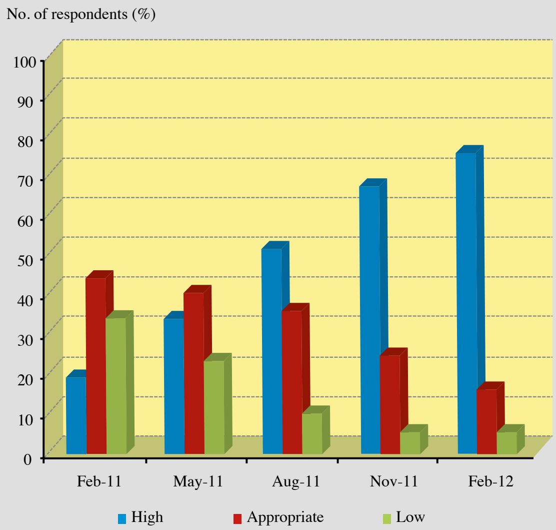
Inflation expectations surveys carried out by the Bank in 2011H2 showed that the proportion of respondents that expect inflation to go up over the next twelve months still remained high. The 14th Inflation Expectations Survey, which the Bank carried out in February 2012, revealed that 68 per cent of respondents expected prices to go up over the next twelve months. The mean inflation rates expected by respondents were 6.3 per cent and 6.4 per cent respectively, for the twelve months ending June 2012 and December 2012. Moreover, external factors were viewed by 79 per cent of respondents as the primary source of inflation in Mauritius.

BOX 3: EVOLUTION OF INFLATION EXPECTATIONS

This Box describes the evolution of the results of the inflation expectations surveys carried out by the Bank in February, May, August 2011 and February 2012.

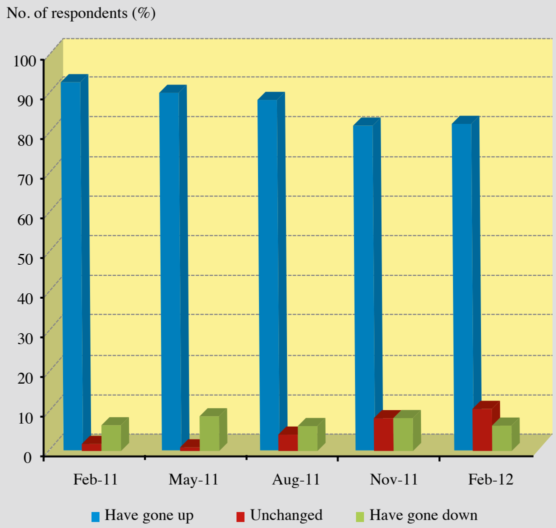
Q.1. How do you perceive the inflation rate in the twelve-month period ending in the month preceding the survey [Note: at 3.3 per cent in January 2011, 4.4 per cent in April 2011, 5.5 per cent in July 2011 and 6.4 per cent in January 2012?

Since inflation continuously increased between January 2011 and January 2012, the proportion of respondents perceiving inflation to be high increased consistently from 20 per cent in February 2011 to 77 per cent in February 2012. Concurrently, those who perceived inflation to be appropriate or low decreased noticeably between February 2011 and February 2012 survey.



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

Between February 2011 and February 2012 the percentage of respondents who described prices as having gone up during the past 12 months declined steadily from 93.5 per cent to 83.0 per cent while the proportion of respondents finding prices unchanged grew consistently from nil to 10.6 per cent. There was not much change in the share of respondents thinking that inflation had gone down.



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

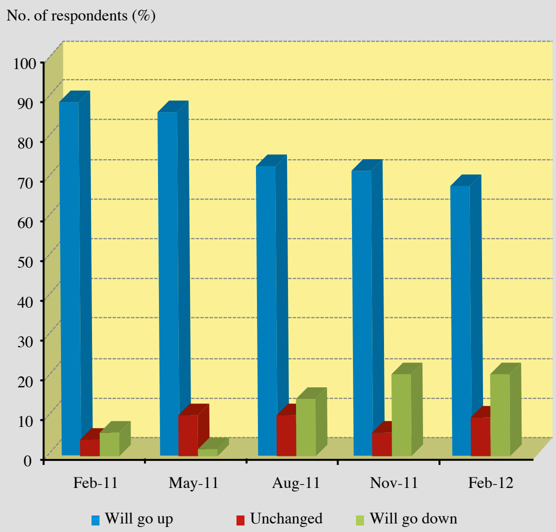
External factors were still perceived by the overwhelming majority as the most important cause of inflation in the five surveys carried out since February 2011, but the share has gone down markedly in February 2012. While in February and May 2011, fiscal policy (FP) was viewed as the second most important factor explaining inflation, in August 2011, it was monetary policy (MP) and in November and February 2011, change in aggregate demand (AD) was seen as the most important factor. With regard to the third most important cause of inflation, monetary policy in both February 2011 and February 2012, change in aggregate demand in both May and August 2011, and fiscal policy in November 2011 were chosen.

Ranking of Factors by Order of Importance	Feb-11		May-11		Aug-11		Nov-11		Feb-12	
	Factor	% of Respondents	Factor	% of Respondents	Factor	% of Respondents	Factor	% of Respondents	Factor	% of Respondents
First	External	89%	External	89%	External	87%	External	83%	External	79%
Second	FP	35%	FP	30%	MP	33%	Change in AD	30%	Change in AD	30%
Third	MP	33%	Change in AD	37%	Change in AD	30%	FP	28%	MP	32%

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

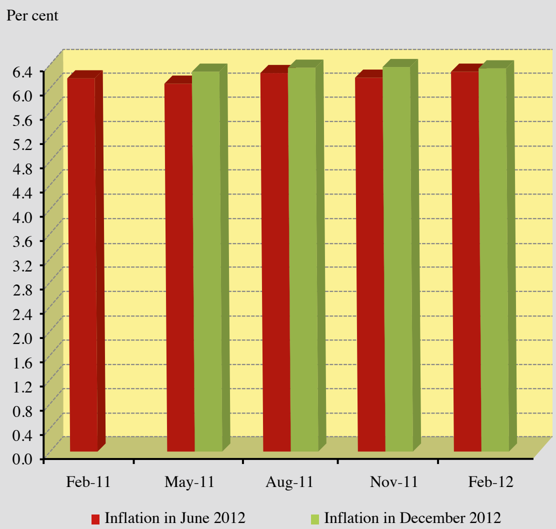
Q.4. Which of the following would best describe the movement of prices over the next 12 months?

The proportion of respondents, who believed prices would go up, declined consistently from 89 per cent in February 2011 to 68 per cent in February 2012. In contrast, the share of respondents expecting prices to remain unchanged increased from 4 per cent in February 2011 to 11 per cent in May and August 2011 before dropping to 6 per cent in November and rising again at 11 per cent in February 2012. The proportion of respondents who anticipated a decrease in prices fell from 7 per cent in February 2011 to 2 per cent in May 2011 before increasing to 15 per cent in August 2011 and then reach 21 per cent in November 2011 and February 2012.



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

Between February 2011 and February 2012, the mean inflation rate for June 2012 expected by respondents did not change much fluctuating between 6.1 per cent and 6.3 per cent. The mean inflation rates expected by respondents for December 2012 increased slightly from 6.3 per cent in May 2011, when the question was first asked, to 6.4 per cent in August 2011 and stayed same until February 2012.



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