

# OVERVIEW

## International Developments

During August 2007, the US dollar, on average, appreciated vis-à-vis the euro and Pound sterling but depreciated against the Japanese yen. The US dollar started the month on a soft note, hampered by expectations that interest rates in both the UK and the euro zone would keep on rising while US interest rate would remain unchanged. The release of weak US jobs data, which showed that 92,000 jobs were created in July 2007 against expectations of an increase of 130,000 also weighed on the US dollar. The US currency, however, managed to shed some of its losses as a rise in US stocks somewhat eased investors' worries about a credit squeeze. As widely expected, the Federal Reserve at its meeting on 7 August, held its benchmark interest rates steady at 5.25 per cent. While acknowledging higher market volatility and tighter lending conditions that had increased downside risks facing the economy, the Fed expressed confidence in ongoing moderate growth and reaffirmed that inflation was still its main concern. The US dollar was, however, marked by greater volatility thereafter as fallout from the US subprime mortgage crisis seemed to gradually spill over into other markets leading major central banks to inject extra funds into the banking system to ease credit squeeze. In a rare move on 17 August, the US Federal Reserve slashed its discount rate, the interest rate it charges on loans to banks, by 50 basis points while maintaining its federal funds rate at 5.25 per cent. Following a meeting with US Treasury Secretary Henry Paulson and US Senate Banking Committee Chairman Chris Dodd, the Fed Chairman assured that he would use all available tools to remedy the situation. The US dollar recouped some of its losses against the major European currencies, but was not able to make any significant breakthrough as uncertainties lingered in the market amid speculation that the Federal Reserve could eventually cut interest rates in September 2007 and hence, reduce the US dollar yield advantage.

The euro moved lower against the US dollar, trading at an average of US\$1.3619 during August 2007 compared to an average of US\$1.3714 during July 2007. The European Central Bank (ECB) left its key-refinancing rate on hold at 4.00 per cent at its Governing Council meeting on 2 August. In his post-meeting press conference, ECB President Jean-Claude Trichet said that "strong vigilance" was needed to stem inflation risks, signalling a possible interest rate hike in September 2007. The euro came under pressure against the US currency in the second week of August amid concerns over European banks' exposure to the US subprime mortgage sector after France's largest listed bank, BNP Paribas, temporarily suspended redemptions of three funds worth 1.6 billion euros. The news, which sent euro zone overnight borrowing rates up sharply as banks scrambled for cash prompted the ECB to pump hefty extra amount of funds into the banking system to ward off the credit crisis. Those injections, in turn, even cooled expectations for a September 2007 interest rate rise in the euro zone and added further downward strain on the euro.

The Pound sterling eased against the US dollar, trading at an average of US\$2.0101 during August 2007 compared to an average of US\$2.0335 during July 2007. At the end of its two-day MPC meeting on

2 August, the Bank of England (BoE) left its key repo rate unchanged at 5.75 per cent, in line with market expectations. Although the release thereafter of the BOE's quarterly inflation report, suggesting that UK interest rates might have to rise more to combat inflation, supported the Pound sterling, the latter's gains were short-lived. The high-yielding British currency, in fact, suffered losses from unwinding of carry trade positions on heightened risk aversion as a result of the credit crunch uncertainty that prevailed in financial markets. The British currency weakened sharply against the US currency, dipping below US\$2.00, after surprisingly weak UK inflation prompted investors to slash bets on whether the Bank of England would raise interest rates again. UK July 2007's consumer price inflation stood at an annual 1.9 per cent, below the Bank of England's 2.0 per cent target for the first time since March 2006, and well below expectations of an easing to 2.3 per cent from June's 2.4 per cent. Nonetheless, the Pound sterling managed to trim down some of its losses drawing support from the release of relatively good economic data.

The Japanese yen gained ground against the US dollar, trading at an average of ¥116.69 per USD during August 2007 compared to an average of ¥121.60 per USD during July 2007. The yen appreciated against the US dollar during the month mostly on investors' fears that a worsening global credit crunch could force a huge reversal of carry trades. Signs of spreading financial distress from the US subprime mortgage crisis fuelled heavy selling of risky assets such as stocks, corporate bonds and high-yielding currencies against the yen. The Japanese currency even reached a 14-month peak of ¥112.26 against the US dollar on 17 August 2007. However, by the close of August 2007, the yen was trading around ¥116.19 vis-à-vis the US dollar as somewhat recovering global stock markets signalled a tentative return to risk appetite and a move back into the carry trade. The Bank of Japan (BOJ), as expected, left its key policy rate unchanged at 0.5 per cent for the sixth straight month at the end of its two-day policy board meeting on 21-22 August 2007.

Oil prices moved lower during August 2007 mainly on concerns that US economic prospects might be weakening after the release of disappointing US labour and services sector reports. Moreover, the persistence of the subprime market crisis that led to a credit squeeze in the United States pointed to further deterioration of the outlook of the US economy. The subprime market crisis also prompted some fund selling, as market players became more risk averse. Some weekly reports from the US Energy Information Administration that showed increases in weekly stock level of crude oil also drove oil prices lower. Nonetheless, as the uncertainty prevailing in financial markets eased, oil futures timidly resumed their ascent. At its 11 September meeting, OPEC decided to increase its output quota by 500,000 barrels effective 1 November 2007. The market viewed the decision as being insufficient and oil futures moved to record levels above US\$80 a barrel thereafter. In the weeks ahead, oil prices would most likely trade above US\$79 a barrel ahead of the Northern Hemisphere winter season that would involve higher heating oil demand.

NYMEX WTI (West Texas Intermediate benchmark crude oil) averaged US\$72.4 a barrel for August 2007, down from US\$74.1 a barrel in July 2007 and US\$73.1 a barrel in August 2006. IPE Brent futures averaged US\$71.2 a barrel during the period under review, down from US\$75.8 a barrel in July 2007 and US\$73.9 a barrel in August 2006.

COMEX gold futures, on average, moved higher during August 2007, trading in an intra-month closing range of US\$658.0/Oz-US\$686.3/Oz compared to a range of US\$650.6/Oz-US\$684.8/Oz in July 2007. Gold prices moved higher during the period under review, supported by increasing physical demand as the high-demand season approaches. COMEX averaged US\$675.5/Oz during August 2007, compared to an average of US\$668.2/Oz in July 2007.

### **Domestic Developments**

Tourist arrivals went up by 17.8 per cent, from 65,540 in July 2006 to 77,225 in July 2007, while gross tourism receipts grew by 54.5 per cent, from Rs1,929 million in July 2006 to Rs2,980 million in July 2007. On a cumulative basis, over the period January to July 2007, tourist arrivals reached 509,338, representing an increase of 19.7 per cent over the 425,677 arrivals recorded over the corresponding period of the previous year. Tourism receipts for the period January to July 2007 rose by 30.8 per cent to reach Rs22,732 million compared to Rs17,380 million recorded over the corresponding period of the previous year.

The Central Statistics Office conducted a new Household Budget Survey from July 2006 to June 2007 to update the basket of goods and services used for the computation of the Consumer Price Index (CPI). The results of the survey will be available on 26 October 2007. The official CPI as from July 2007 will be based on the survey and will be released by mid-November 2007.

An estimate of the CPI for August 2007 has been made on the basis of the consumption pattern of the 2001-02 Household Budget Survey and prices collected in August 2007. The CPI is estimated to have increased from 140.5 in July 2007 to 141.3 in August 2007. The rate of inflation for the twelve-month period ended August 2007 is estimated at 10.3 per cent, down from the estimate of 10.5 per cent in July 2007.

With an estimate of 10.3 per cent for headline inflation for August 2007, CORE1, CORE2 and TRIM10 inflation rates are estimated at 7.0 per cent, 7.2 per cent and 7.4 per cent, respectively. Consequently, for August 2007, core inflation was between 2.9 and 3.3 percentage points lower than the headline inflation.

On 22 August 2007, the Bank maintained the key Repo Rate unchanged at 9.25 per cent per annum after considering the findings and recommendation of the Monetary Policy Committee which met on the previous day.

Net foreign assets of depository corporations expanded by Rs3,258 million or 3.9 per cent, from Rs83,162 million at the end of June 2007 to Rs86,420 million at the end of July 2007, on account of the increase in net foreign assets of other depository corporations offsetting the fall in those of the Bank of Mauritius. Net foreign assets of other depository corporations grew by Rs3,496 million or 11.3 per cent to Rs34,435 million while those of the Bank of Mauritius fell by Rs238 million or 0.5 per cent to Rs51,985 million. Claims on non-residents went up by Rs11,818 million or 3.7 per cent, from Rs319,995 million at the end of June 2007 to Rs331,813 million at the end of July 2007. Liabilities to non-residents increased by Rs8,560 million or 3.6 per cent, from Rs236,833 million at the end of June 2007 to Rs245,393 million at the end of July 2007.

Domestic claims of depository corporations, exclusive of claims on GBL holders, contracted by Rs4,087 million or 1.9 per cent, from Rs210,443 million at the end of June 2007 to Rs206,356 million at the end of July 2007. Net claims on budgetary central Government dropped by Rs2,567 million or 6.1 per cent, from Rs42,235 million at the end of June 2007 to Rs39,668 million at the end of July 2007. Claims on Other Sectors, that is, credit to the private sector fell by Rs1,520 million or 0.9 per cent to Rs166,688 million in July 2007.

Net claims on budgetary central Government from the Bank of Mauritius contracted by Rs451 million or 31.8 per cent, from negative Rs1,417 million at the end of June 2007 to negative Rs1,868 million at the end of July 2007. Net claims on budgetary central Government from other depository corporations fell by Rs2,117 million or 4.8 per cent, from Rs43,653 million to Rs41,536 million.

Claims on Other Sectors from the Bank of Mauritius declined by Rs66 million or 27.8 per cent, from Rs238 million at the end of June 2007 to Rs172 million at the July 2007 while claims on Other Sectors from other depository corporations fell by Rs1,453 million or 0.9 per cent, from Rs167,969 million to Rs166,516 million.

Broad Money Liabilities (BML) grew by Rs1,553 million or 0.7 per cent, from Rs215,408 million at the end of June 2007 to Rs216,961 million at the end of July 2007. Of the components of BML, currency with public increased by Rs209 million or 1.8 per cent to Rs11,807 million while transferable deposits fell by Rs1,431 million or 3.4 per cent to Rs40,717 million. Savings deposits declined by Rs349 million or 0.5 per cent to Rs64,995 million while time deposits went up by Rs3,151 million or 3.3 per cent to Rs97,629 million. Securities other than shares included in broad money declined by Rs27 million or 1.4 per cent to Rs1,813 million.

The monetary base, excluding Bank of Mauritius Bills, fell by Rs190 million or 0.8 per cent, from Rs23,841 million at the end of June 2007 to Rs23,651 million at the end of July 2007. Currency in circulation grew by Rs310 million, or 2.3 per cent, from Rs13,512 million to Rs13,822 million while liabilities to other depository corporations decreased by Rs461 million or 4.9 per cent, from Rs9,480 million to Rs9,019 million.

Broad Money Liabilities multiplier rose from 9.0 at the end of June 2007 to 9.2 at the end of July 2007, reflecting the increase in Broad Money Liabilities and the fall in the monetary base.

The Bank issued Government of Mauritius Treasury /Bank of Mauritius Bills for a total nominal amount of Rs3,060 million through the Primary Market in August 2007. Between end-July and end-August 2007, the weighted average yields on the 91-day, 182-day and 364-day Bills decreased from 10.95 per cent to 9.10 per cent, from 11.04 per cent to 9.76 per cent and from 11.00 per cent to 9.86 per cent, respectively. No repurchase transactions were carried out by the Bank during August 2007. Overnight interbank transactions during the month amounted to Rs14,748 million with a high of Rs1,355 million and a trough of Rs102 million. The weighted average overnight interbank rate for August 2007 was 8.76 per cent compared to 8.72 per cent for the previous month.

During August 2007, total transactions in Government of Mauritius Treasury/Bank of Mauritius Bills effected through primary dealers amounted to Rs1,370.5 million, while trading of Treasury Bills on the Stock Exchange of Mauritius amounted to Rs1.6 million. A total amount of Rs112.3 million of Treasury Bills/Treasury Notes was sold over the counter in August 2007 to 250 individual members of the public for individual amounts ranging from the minimum of Rs100,000 to the maximum of Rs2 million.

At the monthly auction of Treasury Notes held in August 2007, a total nominal amount of Rs1,200 million of Treasury Notes with maturities of 2, 3, and 4 years, and with interest payable semi-annually at the rates of 10.50, 10.90, and 11.10 per cent per annum, respectively, were put on tender. Bids received for the three maturities totalled Rs3,316.8 million, of which Rs1,200 million was accepted. The weighted average yields on bids accepted for the 2, 3, and 4-year maturities were 10.62, 10.88 and 11.11 per cent per annum, respectively.

The first issue of Five-Year Government of Mauritius Bonds for 2007-08 was undertaken on 24 August 2007, through an auction held on 22 August 2007. Bonds for a total nominal amount of Rs750 million were put on tender. Bids for an amount of Rs1,387.7 million were received, of which an amount of Rs750 million was accepted. The weighted average yield on bids accepted was 10.64 per cent per annum. The coupon rate, set at a rate equal to or higher than the lowest accepted yield, was 10.50 per cent per annum.

Between July and August 2007, the rupee, on average, appreciated vis-à-vis the US dollar, euro and Pound sterling but depreciated against the Japanese yen. The weighted average dealt selling rates of the rupee, which are calculated on the basis of transactions of US\$30,000 and above, or the equivalent in other foreign currencies effected by banks showed that the rupee, on average, appreciated against the US dollar, the Euro and the Pound Sterling between July and August 2007.

At the end of July 2007, the net international reserves of the country amounted to Rs85,180 million. Following the release of external trade data for second quarter of 2007, the end-July 2007 level of net international reserves of the country, based on the value of the import bill for fiscal year 2006-07, exclusive of the purchase of aircrafts, represented 39.9 weeks of imports, unchanged from end-June 2007. The gross foreign exchange reserves of the Bank of Mauritius rose from Rs52,678 million at the end of July 2007 to Rs52,754 million at the end of August 2007.

Provisional estimates for 2006-07 showed that the current account of the balance of payments surged to a higher deficit of Rs15,745 million compared with Rs10,356 million in 2005-06. Excluding the purchase of aircrafts, the current account of the balance of payments posted a narrower deficit of Rs9,045 million. The deficit in the merchandise account of the balance of payments, on account of the purchase of two aircrafts, increased to Rs37,878 million, from Rs25,690 million a year earlier. The deficit on the merchandise account was however partly offset by surpluses on the services, income and current transfers accounts. The capital and financial account, inclusive of reserve assets, recorded higher net inflows of Rs5,345 million in 2006-07 compared to Rs4,159 million in 2005-06. The overall balance of payments for 2006-07, measured as the change in reserve assets excluding valuation changes, registered a surplus of Rs6,603 million.