BANK OF MAURITIUS

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## MONETARY POLICY STATEMENT

The Monetary Policy Committee (MPC) of the Bank of Mauritius decided to maintain the key Repo Rate at 5.75 per cent per annum at its regular meeting held on 10 December 2009. The interest rate chargeable on the Special Deposits Facility, set at 100 basis points below the key Repo Rate, remains at 4.75 per cent per annum while that on the Overnight Facility, set at 150 basis points above the key Repo Rate, is held at 7.25 per cent per annum. The interest rate payable on the Standing Facility, set at 400 basis points above the key Repo Rate, is 9.75 per cent per annum.

The MPC reviewed current international and domestic economic as well as financial developments and assessed the outlook for the global and domestic economy before reaching its decision.

***International developments and outlook***

Global economic activity is picking up, supported by unprecedented fiscal and monetary stimulus implemented worldwide, even if the recovery is still fragile and is foreseen to be slow and uneven. All major advanced economies, with the exception of the United Kingdom which is expected to follow suit soon, have recorded positive growth rates as from the second or third quarter of 2009. Also, many large emerging economies – most of which were affected to a lesser degree by the global economic crisis – are already rebounding. The pickup is mainly being led by a revival in global manufacturing activity, according to JPMorgan Global Manufacturing Purchasing Managers' Index. Both consumption and investment are firming up, amid strengthening consumer and business confidence, and stabilising housing markets. World trade has been picking up since September 2009: the International Monetary Fund (IMF), in its October 2009 World Economic Outlook (WEO), forecasts a growth of 2.5 per cent in the volume of world trade in 2010. Financial markets are gradually improving and risk appetite is returning.

The MPC recognised concerns about the sustainability of the global economic recovery, underscored by weak labour market conditions, still fragile financial markets and poor credit growth. Overall, while there is still uncertainty around global growth prospects, the risks appear broadly balanced.

In its October 2009 WEO, the IMF forecasts positive albeit below potential growth rates for all major advanced as well as emerging economies in 2010. World output is projected to contract by 1.1 per cent in 2009 before rising by 3.1 per cent in 2010. Advanced economies are estimated to grow by 1.3 per cent in 2010, well above the previous forecast of 0.6 per cent. Growth in emerging and developing economies is forecast at 5.1 per cent in 2010.

Interest rates are expected to stay low for some time in most economies as central banks maintain the accommodative stance given prospects of slow recovery. Some countries are adopting additional stimulus measures to support demand and still fragile financial systems. A few central banks have begun tightening monetary policy to contain inflation. The general stance, however, is to leave interest rates on hold for the time being. The MPC noted that more attention was being focused on cautious unwinding of the stimulus measures as recovery strengthened and became self-sustaining.

Inflation is anticipated to remain low worldwide in the short term, given prevailing economic slack and the expected slow process of recovery. Further down the road, however, the inflation outlook could worsen as global economic activity gathers momentum and if exit strategies are delayed. Heightened upward pressures on international commodity prices are likely to be felt.

***Domestic developments and outlook***

Domestic economic activity has remained constrained by soft demand from main export markets. The first semester of 2009 was particularly weak as output of the key export sectors contracted but, as anticipated, a rebound has taken place in the second semester.

The MPC noted that in the second quarter of 2009 real output contracted by 4.0 per cent in the textile sector and by 6.2 per cent in the hotels and restaurants sector. The recession in main markets thus led to a sharp retreat in the key export sectors, with the textile sector contracting for the fifth quarter in a row and the hotel and restaurants sector for the third consecutive quarter. While output also declined in the construction as well as in the wholesale and retail trade sectors reflecting the slowdown in economic activity, it grew moderately in other sectors. Seasonally-adjusted quarter-on-quarter official data show that the economy reached a trough in the first quarter of 2009 contracting by 0.8 per cent before growing by 0.6 per cent in the second quarter.

The growth momentum in the second quarter of 2009 is expected to have persisted in the third and fourth quarters. A number of indicators suggest that the export sector has recorded a better performance, benefiting from the pick-up in demand in main markets as well as improving international travel sentiment. The MPC is of the view that the domestic economic stimulus measures have also supported overall performance in the second half of 2009. Economic growth is estimated at 2.8 per cent for 2009, higher than the initial forecast.

The MPC noted that the current official growth forecast for 2010 had been revised upward to 4.3 per cent. Several underlying factors are likely to stimulate overall economic activity during coming quarters, namely improved economic prospects in main exports markets, higher public spending on infrastructural projects and stronger business as well as consumer confidence. Should the external environment continue to improve, the growth outlook could consolidate further.

Fears that the global slowdown would have led to a worsening of the domestic employment situation have dissipated. Job losses have been fewer than initially projected, mitigated to some extent by the fiscal stimulus package. Labour market conditions are anticipated to have improved in the last part of 2009, which should be enhanced with revival of economic activity closer to potential in 2010.

Recent data confirm further moderation in money and credit growth, reflecting the low level of economic activity to a large extent. Money supply grew by 8.4 per cent while credit growth to the private sector by depository corporations remained flat at zero per cent in October 2009 compared to same month in 2008. Nonetheless, banks’ credit to the private sector grew by 7.0 per cent. Demand for credit by the private sector remains weak despite the low interest rate environment. The domestic banking sector remains resilient and the availability of credit is not a cause for concern. Overall, monetary developments are consistent with the maintenance of low and stable inflation over the short to medium term.

The current account deficit is estimated to have fallen to Rs5,505 million in the third quarter of 2009, after rising to Rs8,742 million in the second quarter of 2009, representing a drop to 7.5 per cent from 13.2 per cent as a percentage of GDP at market prices. The improvement in the current account deficit results from a contraction in the merchandise trade deficit, a larger surplus on the services account although the travel account registered lower tourism receipts and a lower deficit in the income account. The surplus on the financial account in the third quarter of 2009 was Rs1,756 million, higher than that of Rs223 million in the previous quarter. Foreign direct investment registered lower net inflows of Rs1,284 million in the third quarter of 2009, from Rs1,689 million in the second quarter of 2009. Net outflows on portfolio investment narrowed significantly in the third quarter of 2009. This development is indicative of continued confidence of foreigners in the domestic economy. The overall balance of payments for the third quarter of 2009, measured as the change in reserve assets excluding valuation changes, registered a marginally lower surplus of Rs3,875 million compared to Rs3,945 million in the previous quarter.

The negative resource balance – measured as saving minus investment – continues to be reflected in the deficit on the current account of the balance of payments. The national saving rate, which is estimated to drop further to 12.8 per cent of GDP in 2009, remains a source of concern.

The MPC examined the strengthening of the domestic currency in effective terms since September 2009 and its implications for the wider economy. The exchange rate appreciation has mostly reflected international currency trends but lately an excess supply of foreign currencies on the domestic market has been noted. The MPC considered that the rupee appreciation could become a cause for concern and called for close monitoring. The MPC also took note that the foreign exchange reserves was at an unprecedented high level. Continued vigilance in preventing excessive exchange rate movements and containing balance of payments pressures is therefore warranted.

Inflation remains subdued. The combined effects of low food and energy prices on international markets compared to a year earlier as well as dampened demand have contributed to subsiding inflationary pressures. The twelve-month average inflation continued to fall reaching 2.9 per cent in November 2009. The year-on-year inflation rate rose to 0.7 per cent in November 2009, from 0.1 per cent in the previous month.[1]

The MPC's assessment of the inflation outlook remains much the same as in September 2009. Over the short-term, inflation, as measured by both the year-on-year and twelve-month average methodologies, could stay below recent trend at around 4 per cent over the next few quarters. Looking further ahead, however, potential risks to the inflation outlook arise mostly from external sources – in particular, from the future course of international oil and food prices – as the pace of global recovery consolidates further and from delayed implementation of exit strategies. Inflation risks emanating from exchange rate developments remain fairly moderate at this juncture.

The MPC weighed the risks to the growth and inflation outlook over the policy-relevant horizon. In the light of its assessment, the MPC judged that inflation would remain benign in the short term but there are potential upside risks over the medium to long term. Also, provided global growth prospects remain favourable, domestic economic activity should gather additional momentum. The MPC determined that the current stance of monetary policy was appropriate and reiterated that monetary policy remained focused on promoting sustainable growth and low inflation.

The MPC will continue to monitor economic and financial developments and remains committed, as per its mandate, to formulate and determine monetary policy, taking into account the orderly and balanced economic development of Mauritius.

**Voting Pattern**

The MPC voted unanimously to maintain the key Repo Rate at 5.75 per cent per annum.

**Date for Regular Meeting**

The MPC will convene its next quarterly meeting on 23 March 2010. It stands ready to meet outside regular meetings as and when required to assess the evolution of the economic situation and, if needed, take appropriate policy measures.

**Bank of Mauritius**
**17 December 2009**

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[1] *Year-on-year inflation is computed as the change in the Consumer Price Index (CPI) for a given month compared with the same month of the preceding year in percentage terms. The Central Statistics Office computes the inflation rate by comparing the average level of prices, as measured by the CPI, during a twelve-month period with the average level during the corresponding previous twelve-month period.*