OVERVIEW

International Developments

During December 2006, the US dollar, on average, depreciated against all major currencies. Sentiment towards the US dollar was bearish at the start of the month with the release of weak US factory data, which reinforced expectations that the US Federal Reserve would have to trim rates in 2007 as the US economy slowed. Market concerns that the sell-off might have been overdone somewhat limited the US currency's decline. The US dollar also managed to derive a brief respite from the release of solid November 2006 jobs data. Comments by former US Federal Reserve Chairman, Alan Greenspan, warning investors to expect a few more years of US dollar weakness, subsequently came in as an excuse for traders to resume selling the US currency. On 12 December 2006, as widely expected, the US Federal Open Market Committee (FOMC) kept its federal funds rate unchanged at 5.25 per cent for the fourth consecutive time. With the Federal Reserve, in its accompanying statement, toning down its tightening bias on monetary policy, stating that expectations of lower inflation reflected the drop in energy costs and the US economy has slowed down over the course of the year, the US dollar came under renewed pressure. However, the US dollar managed thereafter to recoup its losses amid the release of relatively strong data on retail sales, inflation and current account deficit suggesting that the US economy might not need an interest rate cut in early 2007. Position squaring and thin trading ahead of end of year holidays mostly determined the US dollar movement against major currencies towards the close of December 2006.

The euro strengthened against the US dollar during December 2006, trading at an average of US$1.3209 from an average of US$1.2883 in November 2006. Starting the month trading around US$1.3251, the euro hit its intra-month high of US$1.3326 on 5 December 2006 amid expectations of an imminent interest rate hike at the forthcoming ECB interest rate setting meeting. As widely expected the ECB, at its governing council meeting on 7 December 2006, raised its key refinancing rate by 25 basis points to 3.50 per cent. The euro drew only short-lived gains from the rate decision, falling lower against the US dollar, as ECB President Jean-Claude Trichet, in his post-meeting conference, mentioned that euro zone inflation, mostly as a result of lower oil prices, was likely to ease in 2007. The single currency, however, managed to shrug off its losses vis-à-vis the US dollar, after ECB officials signalled more interest rate hikes in the euro zone, saying that rates in the region still remained low in historical terms. The release of a better German ZEW survey of investor sentiment in December 2006, which improved for the first time since January 2006, further supported the euro. The euro, however, lost some ground against the US dollar on profit taking and in the wake of the release of the European Commission's quarterly report which indicated that a weaker US dollar, the hike in value added tax in Germany and easing global demand would weigh on euro zone growth in 2007. The euro hit its intra-month low of US$1.3085 on 19 December 2006, but somewhat managed to regain ground, drawing support from ECB President's testimony before European Parliament wherein he stated that rising price pressures in early 2007 would require a quick and resolute response from the ECB, which was interpreted as setting the groundwork for euro zone interest rates to rise again next year. However, amid thin end of year trading, the euro traded within tight ranges before closing December 2006 at around US$1.3160.

The Pound sterling moved higher against the US dollar during December 2006, trading at an average of US$1.9639 from an average of US$1.9108 in November 2006. From its intra-month high of US$1.9776 attained on 4 December 2006, the Pound sterling retreated against the US dollar on profit taking. As widely expected, on 7 December 2006, the Bank of England (BoE) left its repo rate unchanged at 5.00 per cent. With the market not fully convinced that the BoE would raise rates in February 2007, the Pound sterling remained under pressure. However, the release of above-forecast November 2006 inflation data, with the CPI rising to 2.7 per cent year-on-year and boosting the case for another interest rate hike in early 2007, provided a boost to the Pound. The release of additional data relating to the unemployment rate and house prices further cemented expectations of higher rates in early 2007. Nonetheless, amid position adjustment and thin trading ahead of Christmas and year-end, the Pound somewhat eased against the US dollar to close December trading at around US$1.9636.

The Japanese yen appreciated against the US dollar during December 2006, trading at an average of ¥117.19 per US dollar from an average of ¥117.24 per US dollar in November 2006. Starting the month trading around ¥115.71 per US dollar, the Japanese yen strengthened against the US dollar to hit its intra-month high of ¥114.94 per US dollar on 7 December 2006 after Bank of Japan policy board member Atsushi Mizuno said that it would be wrong to assume that the central bank needed to wait until all economic indicators were strong to raise interest rates again. Thereafter, the Japanese yen embarked on a general downward movement against the US dollar amid resurfacing doubts about whether the Bank of Japan (BOJ) would accommodate a near-term interest rate hike. As widely expected, the BOJ left interest rate unchanged at 0.25 per cent at the end of a two-day policy meeting on 19 December 2006. The Japanese currency remained under pressure as Bank of Japan Governor Toshihiko Fukui tempered expectations for a rate increase in January 2007, warning that domestic consumption and consumer price gains had softened. On 26 December 2006, the Japanese yen hit its intra-month low of ¥118.94 per US dollar before recouping some losses to close the month trading at around ¥118.90 per US dollar.

Oil prices moved higher during December 2006. Repeated calls from OPEC members to cut output quota further at the cartel's meeting on 14 December 2006 pushed oil prices up. At the scheduled meeting, the cartel agreed to cut output by 500,000 barrels, effective 1 February 2007. Oil prices were being driven by speculative motives amid nervousness in the market although mild weather conditions in the US Northeast regions limited the gains made by crude oil futures. Oil prices are expected to trade below US$55 a barrel in the weeks ahead as supply fears in the market seem to be easing amid unusually mild weather conditions in the United States.

NYMEX WTI (West Texas Intermediate benchmark crude oil) averaged US$62.1 a barrel in December 2006, up from US$59.4 a barrel in November 2006 and US$59.5 a barrel in December 2005. IPE Brent futures averaged US$62.3 a barrel during the period under review, up from US$59.8 in November 2006 and US$57.6 a barrel in December 2005. For the year 2006 as a whole, NYMEX WTI and IPE Brent futures averaged US$66.2 a barrel and US$66.1 a barrel, respectively, up from US$56.6 a barrel and US$55.1 a barrel in 2005. On the domestic front, the prices of mogas and diesel were reduced by 20.0 per cent and 12.3 per cent to Rs32.50 per litre and Rs26.50 per litre, respectively, effective 4 January 2007, while the price of domestic cooking gas was left unchanged.

COMEX gold futures, on average, moved slightly higher during December 2006, trading in an intra-month closing range of US$617.9/Oz-US$650.9/Oz compared to a range of US$618.3/Oz-US$652.9/Oz in November 2006. Gold prices continued to be influenced more by speculative moves than fundamental demand and supply factors, with US dollar weakness pushing prices up. COMEX averaged US$632.3/Oz during December 2006, compared to an average of US$629.1/Oz in November 2006.

Domestic Developments

The Central Statistics Office has, in its latest National Accounts Estimates released in January 2007, revised the real growth rate of the economy for 2005 to 2.3 per cent, down from the 2.5 per cent estimated in September 2006, mainly on account of a lower growth in ‘Financial Intermediation’ and in ‘Health and Social Work’. Exclusive of sugar, the growth rate for 2005 is estimated at 2.8 per cent compared to the previous estimate of 3.0 per cent.

The growth rate of the economy for 2006 is estimated at 4.7 per cent. Exclusive of sugar, the growth is estimated at 5.1 per cent. The main contributors to the growth were the ‘Transport, storage and communications’, ‘Financial intermediation’, ‘Wholesale and retail trade’ and ‘Real estate, renting and business services’ industry groups, which grew by 7.1 per cent, 7.4 per cent, 5.1 per cent and 6.2 per cent, respectively. The tourism industry grew by 3.7 per cent, with tourist arrivals reaching 790,000 in 2006. The EPZ sector grew by an estimated 3.0 per cent after four years of contraction. After a contraction of 5.2 per cent in 2005, the construction industry rebounded in 2006, growing by 5.0 per cent due to the construction of new hotels and implementation of projects under the Integrated Resort Scheme (IRS). The sugar industry contracted by 3.8 per cent with a sugar production of around 500,000 tonnes, down from 519,816 tonnes in 2005.

Investment in the economy recovered, in real terms, by 17.7 per cent, after a contraction of 2.4 per cent in 2005. The investment rate, as measured by the ratio of GDFCF to GDP at market prices, increased from 21.3 per cent in 2005 to 23.9 per cent in 2006. Private sector investment grew by 10.8 per cent in 2006 after a decline of 1.0 per cent in 2005. Public sector investment expanded by 34.1 per cent in 2005, mainly as a result of investment in aircraft, following a contraction of 5.4 per cent in 2005. The savings rate declined to 15.7 per cent in 2006 from 16.5 per cent in 2005.

The economy is forecast to grow by around 5.5 per cent in 2007. Exclusive of sugar, the growth rate is estimated at around 5.3 per cent. Sugar production is estimated at around 550,000 tonnes. The tourism sector is forecast to grow by 7.3 per cent, with tourist arrivals estimated at 850,000. The financial intermediation and construction industries are expected to post growth of 7.0 per cent and 6.0 per cent, respectively, while the EPZ sector is expected to expand by 2.5 per cent.

Data released by the CSO in December 2006 show that the total labour force stood at 549,900 (349,300 males and 200,600 females) in the third quarter of 2006 compared to 546,200 (350,800 males and 195,400 females) in the second quarter of 2006. Total employment increased by 4,900 from 492,200 to 497,100 over the same period. The number of unemployed decreased by 1,200 from 54,000 (20,900 males and 33,100 females) in the second quarter of 2006 to 52,800 (20,100 males and 32,700 females) in the third quarter of 2006.

The unemployment rate declined from 9.9 per cent in the second quarter of 2006 to 9.6 per cent in the third quarter of 2006, with male and female unemployment rates at 5.8 per cent and 16.3 per cent, respectively, compared to 6.0 per cent and 16.9 per cent, respectively, in the previous quarter. For 2006, the unemployment rate is expected to decline to 9.4 per cent from 9.6 per cent in 2005.

Tourist arrivals fell by 0.6 per cent, from 70,793 in November 2005 to 70,394 in November 2006, while gross tourism receipts increased by 35.5 per cent, from Rs2,472 million in November 2005 to Rs3,349 million in November 2006. Cumulatively, over the period January to November 2006, tourist arrivals reached 691,967, representing a rise of 3.2 per cent over the 670,544 arrivals recorded in the corresponding period of the previous year. Tourism receipts for the period January to November 2006 increased by 24.2 per cent to reach Rs28,007 million compared to Rs22,550 million recorded over the corresponding period in 2005.

The Consumer Price Index (CPI) increased from 133.3 in November 2006 to 133.7 in December 2006. “Housing, water, electricity, gas and other fuels”, “Communication”, “Recreation and culture” and “Education” recorded no change in their sub-indices while an increase of 0.9 per cent was noted in the “Clothing and footwear” followed by “Restaurants and hotels” (0.8 per cent), “Food and non-alcoholic beverages” (0.7 per cent), “Transport” (0.3 per cent) and “Furnishings, household equipment and routine household maintenance” (0.2 per cent). “Alcoholic beverages and tobacco”, “Miscellaneous goods and services” and “Health” registered declines of 1.2 per cent, 0.2 per cent and 0.1 per cent, respectively. The main contributors to the change in the index between November and December 2006 were other goods and services, which rose by 0.2 index point and trader’s rice, beef, frozen fish, pulses and ready made clothing, each registering an increase of 0.1 index point. This was partially offset by decreases of 0.1 index point in frozen mutton, whisky and rum and other cane spirits. The rate of inflation for the year 2006 stood at 8.9 per cent, up from 4.9 per cent for 2005.

While headline inflation for December 2006 stood at 8.9 per cent, CORE1, CORE2 and TRIM10 inflation rates stood at 7.4 per cent, 7.2 per cent and 6.6 per cent, respectively. Consequently, for December 2006, core inflation was between 1.5 and 2.3 percentage points lower than the headline inflation.

Money supply M2 grew by Rs4,281 million or 2.4 per cent, from Rs177,527 million at the end of June 2006 to Rs181,808 million at the end of November 2006 reflecting the increase in both quasi money and narrow money supply. Narrow money supply M1 increased by Rs674 million or 2.7 per cent to Rs25,743 million while quasi-money went up by Rs3,607 million or 2.4 per cent to Rs156,065 million.

Net foreign assets of the banking system expanded by Rs11,816 million or 19.2 per cent, from Rs61,435 million at the end of June 2006 to Rs73,251 million at the end of November 2006. Net foreign assets of Bank of Mauritius rose by Rs1,231 million or 2.9 per cent to Rs43,685 million, reflecting valuation changes and Bank of Mauritius intervention in the foreign exchange market, while net foreign assets of banks went up by Rs10,586 million or 55.8 per cent to Rs29,567 million over the same period.

Domestic credit grew by Rs5,457 million or 3.3 per cent, from Rs164,961 million at the end of June 2006 to Rs170,418 million at the end of November 2006. Net credit to Government from the banking system contracted by Rs4,085 million or 9.0 per cent, from Rs45,490 million at the end of June 2006 to Rs41,405 million at the end of November 2006. Net credit to Government from Bank of Mauritius increased by Rs579 million or 35.3 per cent to Rs2,220 million while net credit to Government from banks fell by Rs4,664 million or 10.6 per cent to Rs39,185 million. Credit to the private sector expanded by

Rs9,542 million or 8.0 per cent, from Rs119,471 million at the end of June 2006 to Rs129,013 million at the end of November 2006. Between end June 2006 and end November 2006, additional credit was extended to "Traders" (Rs2,442 million), "Financial and Business Services" (Rs2,325 million), "Tourism" (Rs1,562 million), "Construction" (Rs1,149 million), "Public Nonfinancial Corporations" (Rs977 million), "Personal" (Rs887 million), "Infrastructure" (Rs390 million), "Transport" (Rs271 million), "Education" (Rs72 million) and "Manufacturing" (Rs66 million). Over the same period a decline of Rs597 million was recorded at the "Agriculture and Fishing" sector.

Reserve money contracted by Rs2,603 million or 10.6 per cent, from Rs24,543 million at the end of June 2006 to Rs21,940 million at the end of November 2006.

The Bank issued Government of Mauritius Treasury Bills/Bank of Mauritius Bills for a total nominal amount of Rs6,381 million through the Primary Market in December 2006. Following the introduction of the new monetary policy framework on 18 December 2006, the Bank carried out two overnight reverse repurchase transactions in December 2006 at the repo rate less 50 basis points, that is, 8.00 per cent.

During December 2006, total transactions in Government of Mauritius Treasury/Bank of Mauritius Bills effected through primary dealers amounted to Rs1,513.7 million. There was no trading of Treasury Bills on the Stock Exchange of Mauritius.

At the monthly auction of Treasury Notes held in December 2006, a total nominal amount of Rs800 million of Treasury Notes with maturities of 2, 3, and 4 years, and with interest payable semi-annually at the rates of 10.00, 10.40 and 10.65 per cent per annum, respectively, was put on tender. Bids received for the three maturities totalled Rs1,172.3 million, of which Rs800 million were accepted. The weighted average yields on bids accepted were 12.38, 12.68 and 12.93 per cent per annum, respectively.

The third issue of Five-Year Government of Mauritius Bonds for 2006-07 was undertaken on 22 December 2006, through an auction held on 20 December 2006. Bonds for a total nominal amount of Rs500 million were put on tender at a coupon rate equal to or higher than the lowest accepted yield at the auction. Bids for an amount of Rs1,255.4 million were received, of which an amount of Rs500 million was accepted. The weighted average yield on bids accepted was 13.21 per cent per annum, and the coupon rate was 12.90 per cent per annum.

In December 2006, the Bank intervened and sold US dollars for a total amount of US$22.4 million on the interbank foreign exchange market.

Between November 2006 and December 2006, the rupee, on average, depreciated against all major currencies. 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 commercial banks, showed that the rupee, on average, depreciated against the US dollar, Euro, and the Pound sterling between November and December 2006.

At the end of November 2006, the net international reserves of the country amounted to Rs73,801 million. The end-November 2006 level of net international reserves of the country, based on the value of the import bill for fiscal year 2005-06, exclusive of the purchase of aircraft, represented 38.0 weeks of imports, up from 35.8 weeks of imports at the end of October 2006. The gross foreign exchange reserves of the Bank of Mauritius increased from Rs43,685 million at the end of November 2006 to Rs44,127 million at the end of December 2006, reflecting essentially the net appreciation of Bank of Mauritius foreign exchange holdings that more than offset its intervention on the interbank foreign exchange market.