OVERVIEW

International Developments

During February 2006, the US dollar, on average, appreciated against all major currencies. Starting February 2006, the US dollar came under pressure following a report from US intelligence chief that Al-Qaeda was still plotting and preparing attacks on the United States. The US dollar, however, managed to stage higher, drawing support from market expectations that the US Federal Reserve was not yet over with its monetary policy tightening cycle. In his first address as Federal Reserve Chairman, on 6 February 2006, Ben Bernanke vowed to stick to the US central bank's dual mission of keeping prices stable and promoting growth and jobs in cooperation with Congress. The release of data showing that the December 2005 trade deficit swelled by more than expected to US$65.7 billion did not have a lasting impact on the US dollar given that a reassessment of the trade data showed an improvement in the trade deficit with China, from US$18.5 billion in November 2005 to US$16.3 billion in December 2005. The release of stronger-than-expected January 2006 retail sales data, which added to ongoing expectations that interest rates would keep on rising, further benefited the US dollar.

On 15 February 2006, Ben Bernanke, in his first congressional testimony, suggested that the central bank would keep raising interest rates to combat inflation, thereby further strengthening the US currency's interest rate advantage. In the face of these comments, the release of much lower-than-expected December 2005 net capital inflows of US$56.6 billion, which were not enough to cover the trade deficit for that month, did not have a long-lasting impact on the US dollar. In his second consecutive day of congressional testimony, Ben Bernanke maintained his hawkish monetary policy stance while reiterating his upbeat assessment of the US economy and an earlier warning about inflation risks. Other data released thereafter, including strong February 2006 factory activity and January 2006 housing starts, further benefited the dollar. Minutes of the January 2006 US Federal Reserve meeting released on 21 February 2006 showed that upward risks to core inflation remained, which reinforced market expectations that more rate increases would be necessary. The minutes, however, also suggested that after the FOMC's 14th consecutive rate hike on 31 January 2006, monetary policy "seemed close to where it needed to be given the current outlook." The release of core consumer prices, which rose by 2.1 per cent in January 2006, slightly above the upper end of the Fed's 2.0 per cent comfort zone, did little to alter market expectations for more interest rate hikes. In fact, the US dollar managed to close the month on a strong note, weathering the release, towards the end of February, of relatively weak data relating to durable goods orders and new homes sales.

The euro, which traded at an average of US$1.2119 in January 2006, depreciated against the US dollar, trading at an average of US$1.1943 in February 2006. As widely expected, the ECB left its key refinancing rate unchanged at 2.25 per cent at its governing council meeting on 2 February 2006. Despite that decision, the euro reached its intra-month high of US$1.2092 on 3 February 2006, benefiting from comments made by ECB President Jean Claude Trichet that although the ECB had not embarked on a series of interest rate increases, expectations for future rate moves were reasonable. The single currency, amid position adjustment with the US currency's yield potential seen as a supportive factor, subsequently followed a general downward trend against the US dollar. Comments from several ECB officials throughout the month that the ECB would remain proactive in raising rates to prevent inflationary pressure had limited impact on the euro. The release of German's Ifo business climate index towards the end of the month, which hit a 14-year high of 103.3 in February 2006, underscored the euro zone's recovery and reinforced expectations that the ECB would have to raise rates at its next meeting. The euro closed February 2006, trading around US$1.1856.

From an average of US$1.7658 in January 2006, the Pound sterling moved lower against the US dollar in February 2006, trading at an average of US$1.7477. Starting February 2006 at its intra-month high of US$1.7793, the Pound sterling came under pressure following the release of data relating to a survey which showed that service sector activity eased by more than expected in January 2006. As widely expected, the Bank of England (BoE) left its key repo rate unchanged at 4.5 per cent at the end of its two-day Monetary Policy Committee meeting on 8-9 February 2006. The release of lower-than-expected January 2006 inflation figures, with consumer price inflation hitting 1.9 per cent year-on-year, fuelled talk of an interest rate cut and added further pressure on the Pound. The Bank of England quarterly inflation report released on 15 February 2006, which rather than hinting at a rate cut as some had expected, suggested that UK interest rates were likely to remain on hold for some time to come, provided some brief respite to the Pound. By the end of the third week of February, the Pound had, however, reached its intra-month low of US$1.7353, undermined by the release of weaker-than-expected retail sales data, which prompted renewed talk of future interest rate cuts. Minutes of the Bank of England February 2006 MPC meeting released on 22 February 2006, showing that eight of the nine members voted to keep interest rates on hold, managed to help the Pound. The British currency closed February 2006, trading around US$1.7403.

The Japanese yen, on average, depreciated vis-à-vis the US currency, trading around ¥117.88 per US dollar in February 2006 as against ¥115.44 per US dollar in the previous month. From ¥118.22 per US dollar at the start of February 2006, the Japanese yen weakened against the US dollar to reach its intra-month low of ¥118.92 per US dollar on 7 February 2006. The start of a two-day Bank of Japan (BOJ) policy board meeting on 8-9 February 2006 revived speculation that the central bank could be nearing the end of its hyper-loose monetary policy. However, the Bank of Japan kept its monetary policy unchanged by a 7-2 vote, vowing to keep its "quantitative easing" framework of flooding the banking system with excess funds until year-on-year changes in the nationwide core consumer price index stabilised above zero. Subsequent remarks from Bank of Japan Governor Toshikiko Fuiki that the bank needed to end its ultra-easy policy once economic conditions were favourable and then move to a regular monetary policy targeting interest rates provided support to the yen. The yen, however, shrugged off its gains vis-à-vis the US dollar after Japan's Vice Finance Minister Koichi Hosokawa said that the Japanese economy was still in mild deflation despite recent signs of improvement. Towards the end of February, the yen managed to rebound, indirectly benefiting from growing concerns about an economic slowdown in some high-yielding countries such as New Zealand. Additional comments from BOJ Governor again reiterating that the bank had entered a critical phase of deciding when to end its ultra-loose policy, thereby heightening expectations of the possibility that Japan would dismantle its easing policy as early as March, further helped the yen. On 27 February 2006, the Japanese yen reached its intra-month high of ¥116.05 per US dollar before closing the month trading around ¥116.34 per US dollar.

Oil prices moved lower during February 2006, with prices temporarily below US$60 a barrel, on growing oil stock levels in the United States. The US Energy Information Administration reported that in the first three weeks of February 2006 US gasoline stock level increased, suggesting that US demand for gasoline might have eased to some extent, moderating supply fears in the market. Nonetheless, in the last week of February 2006, violence in Nigeria and a failed attack on Saudi Arabia's oil production facilities added nervousness to the oil market and pushed prices above US$60 a barrel again. In its February 2006 market report, OPEC trimmed its forecast for 2006 oil demand growth, projecting global demand to increase by 1.57 million barrels per day (bpd), compared with an estimate of 1.62 million bpd in its January 2006 report. Nonetheless, in the weeks ahead, oil prices will most likely trade above US$60 a barrel, as the market remains sensitive to supply disruption fears.

In February 2006, NYMEX WTI (West Texas Intermediate benchmark crude oil) averaged US$61.9 a barrel, compared to US$65.5 a barrel in January 2006 and US$48.1 a barrel in February 2005. IPE Brent futures averaged US$61.1 a barrel in February 2006, down from US$63.8 a barrel in January 2006 and up from US$45.9 a barrel in February 2005.

COMEX gold futures, on average, moved higher during February 2006, trading in an intra-month closing range of US$542.1/Oz-US$576.8/Oz compared to a range of US$527.8/Oz-US$575.5/Oz in January

2006. Gold prices continued to be influenced more by speculative moves than fundamental demand and supply factors. COMEX gold futures reached a new 25-year high of US$576.8/Oz on 2 February. During February 2006, gold prices fluctuated widely with the difference in prices on two consecutive trading days even exceeding US$10. COMEX averaged US$558.4/Oz during February 2006, compared to an average of US$552.0/Oz in January 2006.

Domestic Developments

Tourist arrivals increased by 18.0 per cent, from 73,053 in January 2005 to 86,218 in January 2006, while gross tourism receipts rose by 40.4 per cent, from Rs2,429 million in January 2005 to an all-time high of Rs3,411 million in January 2006. On a cumulative basis, over the period July 2005 to January 2006, tourist arrivals reached 497,970, representing an increase of 8.4 per cent on the 459,237 arrivals recorded over the corresponding period of the previous fiscal year. Tourism receipts for the period July 2005 to January 2006 grew by 18.6 per cent to reach Rs16,531 million compared to Rs13,942 million recorded over the corresponding period of the previous fiscal year.

The Consumer Price Index (CPI) rose from 123.1 in January 2006 to 123.5 in February 2006. The main contributors to the increase were bread, other food products, cooking gas and other goods and services, each registering an increase of 0.1 index point. The rate of inflation for the 12-month period ended February 2006 stood at 4.9 per cent, down from 5.0 per cent in January 2006.

Money supply M2 expanded by Rs11,288 million or 7.1 per cent, from Rs159,625 million at the end of June 2005 to Rs170,913 million at the end of January 2006, reflecting increases in both of its components. Narrow money supply M1 went up by Rs2,817 million or 12.7 per cent to Rs25,057 million while quasi-money increased by Rs8,471 million or 6.2 per cent to Rs145,856 million.

Net foreign assets of the banking system expanded by Rs6,880 million or 13.0 per cent from Rs52,951 million at the end of June 2005 to Rs59,831 million at the end of January 2006. Net foreign assets of Bank of Mauritius fell by Rs748 million or 1.8 per cent to Rs41,948 million while net foreign assets of banks went up by Rs7,627 million or 74.4 per cent to Rs17,883 million.

Domestic credit went up by Rs9,569 million or 6.6 per cent, from Rs145,973 million at the end of June 2005 to Rs155,542 million at the end of January 2006. Net credit to Government from the banking system fell by Rs730 million or 1.8 per cent, from Rs40,907 million at the end of June 2005 to Rs40,177 million at the end of January 2006. Net credit to Government from Bank of Mauritius decreased by Rs1,602 million or 199.5 per cent to a negative figure of Rs799 million while net credit to Government from banks went up by Rs872 million or 2.2 per cent to Rs40,976 million. Credit to the private sector from banks rose by Rs10,299 million from Rs105,066 million at the end of June 2005 to Rs115,365 million at the end of

January 2006, or 9.8 per cent. Over that period, additional credit was directed to “Public Nonfinancial Corporations” (Rs3,061 million), “Traders” (Rs1,878 million), “Construction” (Rs1,729 million), “Personal” (Rs1,075 million), “Financial and Business Services” (Rs834 million), “Agriculture & Fishing” (Rs654 million), “Infrastructure” (Rs650 million), “Tourism” (Rs582 million), “Manufacturing” (Rs368 million), “Transport” (Rs261 million) “Freeport Enterprise Certificate Holders” (Rs147 million), “Education” (Rs79 million) and “State and Local Government” (Rs17 million). Over the same period, declines were registered at “Information, Communication and Technology” (Rs892 million) and “Professional” (Rs369 million).

Reserve money rose by Rs232 million or 1.0 per cent, from Rs22,941 million at the end of June 2005 to Rs23,173 million at the end of January 2006.

The Bank issued Government of Mauritius Treasury Bills/Bank of Mauritius Bills for a total amount of Rs2,175 million through the Primary Market in February 2006. No repurchase transactions were undertaken by the Bank during the month.

During February 2006, total transactions in Government of Mauritius Treasury/Bank of Mauritius Bills effected through primary dealers amounted to Rs658.4 million while trading of Treasury Bills on the Stock Exchange of Mauritius amounted to Rs4.6 million.

On 28 February 2006 the Bank undertook the fourth issue of Five-Year Government of Mauritius Bonds. Bonds for a total nominal amount of Rs500 million were put on tender at a coupon rate of 8.75 per cent per annum. Bids were received for a total amount of Rs1,521.5 million, of which Rs500 million was accepted. The weighted average yield on bids accepted was 8.94 per cent per annum.

Between January 2006 and February 2006, the rupee, on average, appreciated vis-à-vis the euro, Pound sterling and Japanese yen but depreciated against the US dollar.

The Bank intervened and sold US$8.0 million to banks during the month. The weighted average dealt selling rates of the rupee, which are calculated on the basis of transactions of US$30,000 and above effected by commercial banks, or the equivalent in other foreign currencies, showed that the rupee, on average, depreciated against the US dollar but appreciated against the Euro and Pound sterling between January and February 2006

At the end of January 2006, the net international reserves of the country amounted to Rs60,397 million. Following the release of external trade data for the fourth quarter of 2005, the end-January 2006 level of net international reserves of the country, based on the value of the import bill for calendar year 2005, exclusive of the purchase of aircraft, represented 33.7 weeks of imports, up from 31.4 weeks at the end of December 2005. The foreign exchange reserves of the Bank of Mauritius fell to Rs41,384 million at the end of February 2006, from Rs41,948 million at the end of January 2006.