OVERVIEW

International Developments

During July 2006, the US dollar, on average, appreciated against the Japanese yen and Pound sterling but depreciated vis-à-vis the euro. US data released during the month were mixed, leaving the market uncertain about the future path of interest rates. Jobs growth data for June 2006 released in the first week of July 2006 fell short of expectations and highlighted concerns about a slowdown in the US economy. However, the US Commerce Department later reported that the trade deficit expanded by less than expected to US$63.84 billion in May 2006 from a downwardly revised US$63.34 billion in April 2006. This was followed by the release of capital flows data from the US Treasury, which showed that the United States attracted net capital inflows amounting to US$69.6 billion in May 2006, which were more than enough to cover the trade deficit for that month, as well as stronger-than-expected producer price data, boosting expectations of another interest rate hike in August 2006. However, the US dollar's rally in the wake of the upbeat US data was short-lived as US Federal Reserve Chairman Ben Bernanke, in his semi-annual testimony before Congressional Committee, stated that inflation would likely ease in the coming quarters, cooling expectations that the central bank would bump up interest rates again the following month. In his remarks, Fed Chairman Bernanke stated that the Fed faced both the risk of pushing rates too high and damaging the economy and the danger of not doing enough to curb inflation. He also mentioned that the full economic impact of the last seventeen interest rate increases had yet to be felt and that the Fed must be forward-looking in all its decisions. Moreover, minutes of the US Federal Reserve's 28-29 June 2006 meeting released the following day, revealed "significant uncertainty" surrounding the path of interest rates, supporting expectations that the US central bank might be near the end of its rate-hiking campaign that began in June 2004. The US dollar thereafter recouped some of its losses, as investors covered short positions, thinking that the recent sell-off on waning expectations for a US interest rate pause had gone too far. The release of second quarter GDP data, towards the close of the month, showing a below-than-expected annual 2.5 per cent growth pace and confirming the view that the US economy was slowing down, weighed on the US dollar.

The euro appreciated against the US dollar during July 2006, trading at an average of US$1.2691, from an average of US$1.2667 in June 2006. The euro hit its intra-month high of US$1.2806 on 4 July 2006 following the release of strong manufacturing data, which supported expectations that the European Central Bank (ECB) could accelerate the pace of interest rate hikes. The euro, which thereafter, shrugged off some of its gains, found renewed support against the US dollar after the ECB, following the governing council meeting, signalled that it was prepared to step up the pace of interest rate rises. On 6 July 2006, while the ECB, as expected, left its key refinancing rate unchanged at 2.75 per cent, ECB President Jean-

Claude Trichet said that the central bank would exercise strong vigilance over price risks. The euro, however, amid position adjustment could not sustain its gains and on 19 July 2006, it reached its intra-month low of US$1.2497 following the release of Germany ZEW economic expectations index which fell to its lowest level since May 2005. With investors growing more confident that the ECB would raise interest rates at its next governing council meeting on 3 August 2006 following comments by ECB officials that inflation risks were worsening in the euro area, the single currency rebounded vis-à-vis the US dollar. This view was further reinforced by the release of annual inflation data towards the end of the month, thereby supporting the euro, which closed July 2006 trading around US$1.2763.

The Pound sterling, on average, weakened against the US dollar during July 2006, trading at an average of US$1.8436 as against US$1.8447 in the preceding month. Starting the month trading at around US$1.8456, the Pound sterling lost ground against the US dollar as markets were convinced that the Bank of England (BoE) was unlikely to raise interest rates anytime soon. As widely expected, the Bank of England left interest rate unchanged at 4.50 per cent at the end of its two-day Monetary Policy Committee meeting on 6 July 2006. Retail sales data released towards mid-July 2006 raised concerns that consumer spending could slow and the Pound sterling hit its intra-month low of US$1.8203 on 18 July 2006. But the trend was reversed with the British currency benefiting from the release of stronger-than-expected inflation data, which rekindled expectations that the Bank of England might raise interest rates this year. Minutes from the 5-6 July 2006 Bank of England meeting, however, showed that all seven members of the BoE's Monetary Policy Committee backed the decision to keep the key repo rate on hold at 4.50 per cent. The Pound sterling closed July 2006 trading at its intra-month high of US$1.8649.

The Japanese yen moved lower against the US dollar during July 2006 trading on average at ¥115.65 per US dollar compared to ¥114.52 per US dollar in June 2006. From ¥114.47 per US dollar on 3 July 2006, the Japanese yen strengthened against the US currency to hit its intra-month high of ¥113.61 per US dollar on 10 July 2006. The yen, however, could not hold on to its gains, losing ground against the US dollar after the Bank of Japan, as expected on 14 July 2006, raised rates for the first time in six years, stating however, that rates could be kept at very low levels for some time. The BOJ lifted the overnight call rate target to 0.25 per cent from zero per cent and its discount rate to 0.4 per cent from 0.15 per cent. Traders, however, said that such an outcome would not likely prompt big buying of the yen because the gap between Japanese rates and those in the United States and the euro zone remained huge, favouring the dollar and the euro. The Japanese yen hit its intra-month low of ¥117.35 per US dollar on 19 July 2006. The minutes of the BOJ policy board meeting released on 21 July 2006 showed that the nine members unanimously voted for the rate increase. The Japanese yen recouped some of its losses towards the end of the month, supported by a rise in the Chinese yuan, which closed at its highest level against the US dollar since its revaluation last year, amid renewed pressure for the yuan to appreciate more quickly. The Japanese yen closed July 2006, trading at ¥115.65 per US dollar.

Oil prices moved higher during July 2006, mainly on geopolitical concerns stemming from the problems in the Middle East and supply disruption fears in Nigeria. Moreover, US stock reports from the US Energy Information Administration showed large drops in US crude and gasoline levels, adding further upward pressure on oil prices. The stock data highlighted the strong US gasoline demand in the United States. NYMEX and IPE Brent reached new record highs of US$77.0 a barrel and US$77.3 a barrel, respectively, on 14 July 2006. In the weeks ahead, oil prices will most likely trade above US$70 a barrel, as the market remains sensitive to supply disruption fears amid ongoing geopolitical tensions in the Middle East.

NYMEX WTI (West Texas Intermediate benchmark crude oil) averaged US$74.4 a barrel in July 2006, up from US$71.0 a barrel in June 2006 and US$59.0 a barrel in July 2005. IPE Brent futures averaged US$74.3 a barrel during the period under review, up from US$69.8 a barrel in June 2006 and US$58.0 a barrel in July 2005.

COMEX gold futures, on average, moved higher during July 2006, trading in an intra-month closing range of US$613.2/Oz-US$668.0/Oz compared to a range of US$566.5/Oz-US$648.7/Oz in June 2006. Gold prices continued to be influenced more by speculative moves than fundamental demand and supply factors, with geopolitical issues and the value of the US dollar acting as stimulating factors. COMEX averaged US$635.5/Oz during July 2006, compared to an average of US$599.8/Oz in June 2006.

Domestic Developments

Tourist arrivals fell by 0.6 per cent, from 42,994 in June 2005 to 42,755 in June 2006, while gross tourism receipts went up by 9.8 per cent, from Rs1,537 million in June 2005 to Rs1,688 million in June 2006. Cumulatively, for the year 2005-06, tourist arrivals reached 771,889, representing an increase of 4.9 per cent on the 735,495 arrivals recorded in the year 2004-05. Tourism receipts for the year 2005-06 grew by 18.6 per cent to reach Rs28,571 million compared to Rs24,097 million recorded in the previous fiscal year.

The Consumer Price Index (CPI) increased from 126.2 in June 2006 to 129.9 in July 2006. Except for “Clothing and Footwear”, “Communication” and “Education”, which registered no change in their sub-indices, all the remaining nine Divisions recorded increases in their sub-indices. The largest rise of 6.4 per cent was noted in “Transport”, followed by “Restaurants and Hotels” (+4.7 per cent), “Food and Non-Alcoholic Beverages” (+3.9 per cent), “Alcoholic Beverages and Tobacco” (+2.6 per cent) and “Housing, Water, Electricity, Gas and Other Fuels” (+2.6 per cent). The main contributors to the change in the index between June and July 2006 were gasoline (+0.9 index point), bread (+0.6 index point), Government imported rice (+0.4 index point), cigarettes (+0.3 index point), catering services (+0.3 index point), cooking gas (+0.2 index point) and Government imported flour, meat, pastry products, cooking oil, soft drinks, kerosene, domestic services, diesel oil, airfare and other goods and services, each registering an increase of 0.1 index point. The rate of inflation for the twelve-month period ended July 2006 stood at 5.6 per cent compared to 5.1 per cent for fiscal year 2005-06.

Money supply M2 grew by Rs17,904 million or 11.2 per cent, from Rs159,625 million at the end of June 2005 to Rs177,529 million at the end of June 2006 on account of increases in both of its components. Narrow money supply M1 increased by Rs2,829 million or 12.7 per cent to Rs25,069 million while quasi-money went up by Rs15,075 million or 11.0 per cent to Rs152,460 million.

Net foreign assets of the banking system expanded by Rs8,484 million or 16.0 per cent, from Rs52,951 million at the end of June 2005 to Rs61,435 million at the end of June 2006. Net foreign assets of Bank of Mauritius fell by Rs242 million or 0.6 per cent to Rs42,454 million while net foreign assets of banks went up by Rs8,725 million or 85.1 per cent to Rs18,981 million over the same period.

Domestic credit grew by Rs18,985 million or 13.0 per cent, from Rs145,973 million at the end of June 2005 to Rs164,958 million at the end of June 2006. Net credit to Government from the banking system increased by Rs4,580 million or 11.2 per cent, from Rs40,907 million at the end of June 2005 to Rs45,487 million at the end of June 2006. Net credit to Government from Bank of Mauritius rose by Rs838 million or 104.4 per cent to Rs1,641 million while net credit to Government from banks increased by Rs3,742 million or 9.3 per cent to Rs43,846 million. Credit to the private sector expanded by Rs14,405 million from Rs105,066 million at the end of June 2005 to Rs119,471 million at the end of June 2006 or 13.7 per cent. Over fiscal year 2005-06, additional credit was channelled to “Public Nonfinancial Corporations” (Rs2,851 million), “Financial and Business Services” (Rs3,104 million), “Traders” (Rs2,178 million), “Construction” (Rs2,484 million), “Personal” (Rs1,552 million), “Infrastructure” (Rs1,323 million), “Manufacturing” (Rs578 million), “Tourism” (Rs224 million), “Transport” (Rs174 million), “Freeport Enterprise Certificate Holders” (Rs164 million), “Agriculture & Fishing” (Rs499 million), “Education” (Rs89 million) and “State and Local Government” (Rs37 million). Over the same period, declines were registered at “Information, Communications and Technology” (Rs796 million) and “Professional” (Rs312 million).

Reserve money registered an increase of Rs1,602 million or 7.0 per cent, from Rs22,941 million at the end of June 2005 to Rs24,543 million at the end of June 2006.

The issuance plan for Government securities in 2006-07 was released on 27 July 2006. In addition to the weekly issue of Treasury Bills, Treasury Notes with maturities of 2, 3, and 4 years and interest payable on a semi-annual basis, will be issued on a monthly basis. Five-Year Government of Mauritius Bonds will be issued once every two months for a nominal amount of Rs500 million on each issue. Long-term bonds with maturities ranging from 7 to 20 years will be issued on three occasions for a total aggregate nominal amount of Rs3.0 billion.

The Bank issued Government of Mauritius Treasury Bills/Bank of Mauritius Bills for a total nominal amount of Rs5,400 million through the Primary Market in July 2006. A 3-day reverse repurchase transaction was conducted by the bank at a weighted yield of 3.77 per cent.

During July 2006, total transactions in Government of Mauritius Treasury/Bank of Mauritius Bills effected through primary dealers amounted to Rs575.8 million. There was no trading of Treasury Bills on the Stock Exchange of Mauritius.

On 5 July 2006, the Bank undertook the first issue of Treasury Notes for 2006-07. Treasury Notes with maturities of 2, 3, and 4 years and interest of 7.60 per cent, 7.90 per cent and 8.25 per cent, respectively, payable semi-annually, were put on tender for a total nominal amount of Rs800 million. Bids were received for a total amount of Rs84.7 million, of which an amount of Rs59.2 million was accepted. The weighted average yields on bids accepted were 8.05 per cent, 8.32 per cent, and 8.71 per cent per annum, respectively.

In July 2006, the Bank intervened and sold US dollars for a total amount of US$10 million on the interbank foreign exchange market.

Between June and July 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 banks, also showed that the rupee, on average, depreciated against the US dollar, Euro and Pound sterling between June and July 2006.

At the end of June 2006, the net international reserves of the country amounted to Rs61,974 million. The end-June 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 34.6 weeks of imports, down from 35.1 weeks of imports at the end of May 2006. The gross foreign exchange reserves of the Bank of Mauritius increased from Rs42,459 million at the end of June 2006 to Rs43,306 million at the end of July 2006.

Provisional estimates for the first six months of 2006 indicated that foreign direct investment (FDI) in Mauritius stood at Rs2,076 million. Investment was mainly directed to the tourism sector (Rs1,156 million), mostly under the Integrated Resorts Scheme (IRS). The main sources of FDI inflows to Mauritius were the United Kingdom (Rs606 million) and Switzerland (Rs512 million). Outward FDI was estimated at Rs526 million for the first six months of 2006 with significant investment directed to the agricultural sector in Mozambique (Rs254 million) and the tourism sector (Rs153 million) in the Maldives and the Seychelles. Direct investment to Madagascar in the manufacturing sector amounted to Rs58 million.