

# O V E R V I E W

## **International Developments**

During July 2007, the US dollar, on average, depreciated against all major currencies, undermined by the deteriorating subprime mortgage market that could eventually slow the economy and keep US interest rates steady while borrowing costs might rise overseas. Sentiment towards the US dollar remained weak after a relatively neutral statement by the FOMC early in the month. The minutes from the Fed's June 2007 policy meeting were largely in line with market expectations insofar as the housing sector was perceived as the biggest risk to growth and core inflation was "relatively subdued". In addition, Federal Reserve Chairman Ben Bernanke reiterated that inflation was the central bank's biggest concern and his testimony to the Senate Banking Committee supported the market's view that the Fed was unlikely to lower interest rates from 5.25 per cent this year. Weaker-than-expected retail sales as well as new home sales data pointing to continuing weakness in the housing sector released during the month further undermined the US dollar. Towards the end of the month, the US dollar regained some footing on the back of the release of strong gross domestic product data.

The euro moved higher against the US dollar during July 2007, trading at an average of US\$1.3714 from an average of US\$1.3418 in June 2007. From its intra-month low of US\$1.3534 at the beginning of the month, the euro rose against the US dollar in the wake of the release of a stronger-than-expected survey on manufacturing that backed expectations of more euro zone tightening later in the year. As expected, the European Central Bank (ECB) on 5 July 2007, kept its key refinancing rate steady at 4.00 per cent. In his post-meeting press conference, ECB President Jean-Claude Trichet said that he did not want to shake market probabilities on ECB rates, reinforcing market expectations for a September 2007 hike. Euro zone finance ministers played down criticisms from French President Nicolas Sarkozy about the strong euro, saying that they would not impinge upon the independence of the ECB. The euro broke several record highs against the US currency during the month to hit an all-time high of US\$1.3833 in Tokyo trading on 18 July 2007, benefiting from the broad-based weakness of the US dollar. Thereafter, the euro shed some of its gains, but still remained well supported against the US dollar before closing July 2007 trading around US\$1.3707.

The Pound sterling strengthened against the US dollar during July 2007, trading at an average of US\$2.0335, up from US\$1.9859 in June 2007. Starting the month trading at its intra-month low of US\$2.0087, the Pound sterling benefited from the market view of a near-term UK interest rate hike. On 5 July 2007, the Bank of England Monetary Policy Committee (MPC), in line with market expectations, hiked its key repo rate, for the fifth time since August 2006, to a 6-year high of 5.75 per cent. Despite the release of softer-than-expected UK producer price data, the British currency continued to benefit from its high interest rate outlook. Economic data releases, including those on inflation and gross domestic product, and comments from one Bank of England MPC member supported expectations of higher rates in the UK.

The release of the minutes of the July 2007 meeting, showing a 6-3 vote in favour of raising rates to 5.75 per cent, did not materially alter expectations for rates to rise again this year. On 24 July 2007, the Pound sterling reached a new 26-year high of US\$2.0655 in London trade. Thereafter, the British currency shed some of its gains after the release of soft data suggesting that the housing sector was beginning to feel the pinch from recent Bank of England's interest rate hikes. The Pound sterling closed July 2007 trading around US\$2.0306.

The Japanese yen appreciated against the US dollar during July 2007, trading at an average of ¥121.60 per US dollar from an average of ¥122.62 per US dollar in June 2007. Starting July 2007 around ¥122.96 per US dollar, the Japanese yen came under broad pressure, undermined by the level of the Bank of Japan's policy interest rate, which at 0.5 per cent, was the lowest among major countries, and the central bank's repeated pledge to raise interest rates only gradually. On 9 July 2007, the Japanese yen hit its intra-month low of ¥123.61 per US dollar, as investors continued to sell the low-yielding yen for assets in higher-yielding currencies. Thereafter, the Japanese currency recouped some of its losses on expectations that the BOJ would drop hints about the timing of the next rate hike or would warn about the yen's general weakness at its forthcoming interest rate-setting meeting. The Bank of Japan held its key interest rate unchanged at 0.5 per cent as expected at the end of its two-day meeting on 12 July 2007, but did so on a split vote. From then on, the Japanese yen started on a general upward trend against the US dollar after a fall in US equities dampened investors' appetite for risk and prompted them to unwind some bets against the low-yielding currency. The Japanese currency hit its intra-month high of ¥118.50 per US dollar on 30 July 2007 before closing the month trading around ¥118.92 per US dollar.

Oil prices moved higher during July 2007, reaching record highs as US oil stock data indicated that gasoline demand remained elevated in the United States. On average, the US Energy Information Administration reported more declines in the weekly gasoline stock levels. News that two North Sea platforms would undergo scheduled maintenance in August 2007 also supported prices. The International Energy Agency projected in its monthly report that demand would rise by an average of 2.2 million barrels per day (bpd) in 2008, up from this year's expansion of 1.53 million bpd. The report prompted some fund buying in the oil futures market. As oil prices approached near-record high levels, some OPEC members, including Iran, said that they would supply more crude oil if needed. Those comments eased oil prices to some extent. But the release of data showing the US economy growing at 3.4 per cent in the second quarter of 2007 pushed oil prices higher. NYMEX settled at a new all-time high of US\$78.2 a barrel on 31 July 2007. In the weeks ahead, oil prices would most likely trade around US\$75 a barrel.

NYMEX WTI (West Texas Intermediate benchmark crude oil) averaged US\$74.1 a barrel in July 2007, up from US\$67.6 a barrel in June 2007 but down from US\$74.4 a barrel in July 2006. IPE Brent futures averaged US\$75.8 a barrel during the period under review, up from US\$70.5 a barrel in June 2007 and US\$74.3 a barrel in July 2006.

COMEX gold futures, on average, moved higher during July 2007, trading in an intra-month closing range of US\$650.60/Oz-US\$684.8/Oz compared to a range of US\$644.80/Oz-US\$676.9/Oz in June 2007. Gold prices moved higher during the period under review on higher oil prices and inflation worries. COMEX averaged US\$668.2/Oz during July 2007, compared to an average of US\$659.0/Oz in June 2007.

### **Domestic Developments**

Tourist arrivals went up by 23.0 per cent, from 42,755 in June 2006 to 52,584 in June 2007, while gross tourism receipts grew by 49.5 per cent, from Rs1,688 million in June 2006 to Rs2,523 million in June 2007. For fiscal year 2006-07, tourist arrivals reached 860,252, representing an increase of 11.4 per cent over the 771,889 arrivals recorded in the previous fiscal year. Tourism receipts for 2006-07 rose by 26.9 per cent to reach Rs36,243 million compared to Rs28,571 million recorded in 2005-06.

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 July 2007 has been made on the basis of the consumption pattern of the 2001-02 Household Budget Survey and prices collected in July 2007. The CPI is estimated to have increased from 138.8 in June 2007 to 140.5 in July 2007. The rate of inflation for the twelve-month period ended July 2007 is estimated at 10.5 per cent, down from 10.7 per cent for fiscal year 2006-07.

With an estimate of 10.5 per cent for headline inflation for July 2007, CORE1, CORE2 and TRIM10 inflation rates are estimated at 7.3 per cent, 7.5 per cent and 7.5 per cent, respectively. Consequently, for July 2007, core inflation was between 3.0 and 3.2 percentage points lower than the headline inflation.

Net foreign assets of depository corporations expanded by Rs18,960 million or 29.5 per cent, from Rs64,202 million at the end of June 2006 to Rs83,162 million at the end of June 2007, reflecting increases in net foreign assets of both other depository corporations and the Bank of Mauritius. Net foreign assets of other depository corporations rose by Rs9,051 million or 41.4 per cent to Rs30,939 million while those of the Bank of Mauritius increased by Rs9,908 million or 23.4 per cent to Rs52,223 million. Claims on non-residents went up by Rs74,868 million or 30.5 per cent, from Rs245,127 million at the end of June 2006 to Rs319,995 million at the end of June 2007. Liabilities to non-residents rose by Rs55,908 million or 30.9 per cent, from Rs180,925 million at the end of June 2006 to Rs236,833 million at the end of June 2007.

Domestic claims of depository corporations, exclusive of claims on GBL holders, increased by Rs11,837 million or 6.0 per cent, from Rs198,606 million at the end of June 2006 to Rs210,443 million at the end of June 2007. Net claims on budgetary central Government dropped by Rs6,309 million or 13.0 per cent,

from Rs48,544 million at the end of June 2006 to Rs42,235 million at the end of June 2007. Claims on other sectors, that is, credit to the private sector grew by Rs18,146 million or 12.1 per cent to Rs168,207 million in 2006-07.

Net claims on budgetary central Government from the Bank of Mauritius contracted by Rs2,428 million or 240.2 per cent, from Rs1,011 million at the end of June 2006 to negative Rs1,417 million at the end of June 2007. Net claims on budgetary central Government from other depository corporations fell by Rs3,880 million or 8.2 per cent, from Rs47,533 million to Rs43,653 million.

Claims on other sectors from the Bank of Mauritius declined by Rs6 million or 2.5 per cent, from Rs244 million at the end of June 2006 to Rs238 million at the June 2007 while claims on other sectors from other depository corporations went up by Rs18,152 million or 12.1 per cent, from Rs149,817 million to Rs167,969 million.

Broad Money Liabilities (BML) expanded by Rs16,993 million or 8.6 per cent, from Rs198,415 million at the end of June 2006 to Rs215,408 million at the end of June 2007. Of the components of BML, currency with public increased by Rs1,165 million or 11.2 per cent to Rs11,597 million while transferable deposits went up by Rs6,214 million or 17.3 per cent to Rs42,149 million. Savings deposits rose by Rs4,413 million or 7.2 per cent to Rs65,344 million while time deposits went up by Rs5,807 million or 6.5 per cent to Rs94,478 million. Securities other than shares included in broad money fell by Rs606 million or 24.8 per cent to Rs1,840 million.

The monetary base, excluding Bank of Mauritius Bills, increased by Rs1,826 million, or 8.3 per cent, from Rs22,015 million at the end of June 2006 to Rs23,841 million at the end of June 2007. Currency in circulation grew by Rs1,264 million, or 10.3 per cent, from Rs12,248 million to Rs13,512 million while liabilities to other depository corporations rose by Rs432 million or 4.8 per cent, from Rs9,048 million to Rs9,480 million.

At the end of June 2007, Broad Money Liabilities multiplier stood at 9.0, unchanged from the end-June 2006 level.

The Bank issued Government of Mauritius Treasury Bills/Bank of Mauritius Bills for a total nominal amount of Rs10,450 million through the Primary Market in July 2007. Between end-June and end-July 2007, the weighted average yields on the 91-day and 364-day Bills edged down slightly from 10.96 per cent to 10.95 per cent and from 11.04 per cent to 11.00 per cent respectively whereas the weighted average yield on the 182-day Bill increased from 10.94 per cent to 11.04 per cent.

No repurchase transactions were carried out by the Bank during the month. Overnight interbank transactions in July 2007 amounted to Rs8,364 million with a high of Rs710 million and a trough of Rs35 million. The weighted average overnight interbank rate for July 2007 was 8.72 per cent compared to 8.11 per cent for the previous month.

During July 2007, total transactions in Government of Mauritius Treasury Bills/Bank of Mauritius Bills effected through primary dealers amounted to Rs3,606.2 million, while trading of Treasury Bills on the Stock Exchange of Mauritius amounted to Rs1.2 million.

At the monthly auction of Treasury Notes held in July 2007, a total nominal amount of Rs1,200 million, 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, was put on tender. Bids received for the three maturities totalled Rs5,182.1 million, of which Rs1,200 million was accepted. The weighted average yields on bids accepted for the 2, 3, and 4-year maturities were 11.58, 11.85 and 11.95 per cent per annum, respectively.

The Bank has since 24 July 2007 started the sale, over the counter, of Government of Mauritius Treasury Bills and Treasury Notes to individuals. As at end July 2007, a total amount of Rs122.7 million Treasury Bills/Treasury Notes has been sold to 324 individual members of the public for amounts ranging from the minimum of Rs100,000 to the maximum of Rs2 million at the counters of the Bank and the Rodrigues Office.

Between June and July 2007, the rupee, on average, appreciated vis-à-vis the US dollar but depreciated against the euro, Pound sterling and 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 but depreciated against the Euro and Pound Sterling between June and July 2007.

Provisional data show that gross foreign direct investment flows to Mauritius amounted to Rs5,676 million in the first half of 2007. The tourism sector was the largest recipient of foreign direct investment to the tune of Rs3,521 million, mainly on account of investments under the Integrated Resorts Scheme (IRS). Direct investment abroad stood at Rs346 million in the first half of 2007 and was essentially directed towards the agricultural sector in Mozambique (Rs106 million), the manufacturing sector in Madagascar (Rs65 million) and the tourism sector in Seychelles (Rs58 million) and Maldives (Rs31 million).

At the end of June 2007, the net international reserves of the country amounted to Rs85,250 million. The end-June 2007 level of net international reserves of the country, based on the value of the import bill for calendar year 2006, exclusive of the purchase of aircraft and ship, represented 40.8 weeks of imports, up from 40.7 weeks of imports at the end of May 2007. The gross foreign exchange reserves of the Bank of Mauritius fell from Rs52,784 million at the end of June 2007 to Rs52,678 million at the end of July 2007.