# OVERVIEW

## International Developments

During June 2006, the US dollar, on average, appreciated against all major currencies amid renewed expectations of higher US interest rates. On 5 June 2006, US Federal Reserve Chairman, Ben Bernanke, speaking at an international monetary conference in Washington expressed his concern about US core inflation. His remarks were echoed by other US Federal Reserve officials, who also warned against the risk of inflation, thereby boosting chances that US interest rates would rise again later that month. The release of better-than-expected US economic data, namely April 2006 trade figures and May 2006 import and producer prices, further supported expectations of another US interest rate tightening. Moreover, while the market had already factored in a quarter percentage point interest rate increase at the June 2006 FOMC meeting, there was a growing sentiment that US interest rates would probably rise again in August 2006. On 29 June 2006, at the end of its two-day meeting, the US Federal Open Market Committee (FOMC), as expected, unanimously raised its federal funds rate for the 17th straight time by 25 basis points to 5.25 per cent. In its accompanying statement, however, the Fed, left open the possibility that its two-year rate rising campaign could end in August 2006.

The euro depreciated against the US dollar during June 2006, trading at an average of US$1.2667, from an average of US$1.2765 in May 2006. The euro, which started June 2006 trading at US$1.2771, moved higher against the US dollar, hitting its intra-month high of US$1.2948 on 5 June 2006 amid expectations that the European Central Bank (ECB) could boost rate at its governing meeting by half-percentage point to 3 per cent. The single currency, however, shed off its gains after euro zone finance ministers made it clear that they did not want the single currency to extend its export-denting rally much beyond US$1.30. On 8 June 2006, the ECB, against expectations of a much higher hike, raised its key refinancing rate by 25 basis points to 2.75 per cent, appearing to be moderating the pace of future rate increases. Moreover, ECB President Jean-Claude Trichet, in his news conference, stated that euro zone rates remained low and the central bank would continue to monitor economic developments, but stopped short of using the word "vigilance" to refer to the ECB's stance on inflation risks. With the market interpreting the comments as the ECB having no immediate plans to step up its tightening campaign, the euro moved down further against the US dollar. Comments by several other euro zone officials further dampened expectations of near-term interest rate hikes in the euro zone and the single currency on 26 June 2006 fell to its intra-month low of US$1.2514. The euro, thereafter managed to gain ground, closing the month trading at US$1.2714.

The Pound sterling, on average, weakened against the US dollar during June 2006, trading at an average of US$1.8447 as against US$1.8685 in the preceding month. From its intra-month high of US$1.8843 attained on 5 June 2006, the Pound sterling, undermined by the release of weaker-than-expected data relating to British manufacturing output, embarked on a general downward trend against the US currency. As widely expected, the Bank of England, after its two-day meeting on 8 June 2006, left its key repo rate at 4.5 per cent for the 10th month running. With market sentiment remaining bullish towards the US dollar, the Pound sterling remained under pressure. The release of less-hawkish-than-expected June 2006 Bank of England's (BoE) Monetary Policy Committee (MPC) meeting minutes showing only one member voting for a quarter point hike, further hampered the Pound. Amid receding expectations of a near-term UK rate hike prevailing on the market, particularly after the sudden demise of David Walton, the only hawk in the Bank of England Monetary Policy Committee, the British currency declined to its intra-month low of US$1.8175 on 29 June 2006. The Pound sterling closed June 2006 trading at US$1.8342.

The Japanese yen moved lower against the US dollar during June 2006 trading on average at ¥114.52 per US dollar compared to ¥111.71 per US dollar in May 2006. With Japanese growth data confirming the market's view that the Bank of Japan would not raise rates from near zero until July 2006 at the earliest, thereby maintaining the US dollar's rate advantage, the Japanese yen remained under pressure against the US dollar. As expected, the Bank of Japan, at the end of its two-day meeting on 15 June 2006, kept monetary policy unchanged. Persistent speculation that the Bank of Japan Governor Toshihiko Fukui might resign over an investment scandal also undermined the yen.

Oil prices moved lower during June 2006, mainly on easing tensions between Iran and the West. Iran's President viewed a proposal by world powers to defuse the dispute over his country's nuclear programme as a positive step. US stock reports from the US Energy Information Administration were satisfactory during the first three weeks of June 2006, but disappointed the market in the last week. The stock data highlighted the strong US gasoline demand in the United States. Oil prices fluctuated as moves in the market were also driven by technical trading with the price of US$70 a barrel acting as a reference level. In the weeks ahead, oil prices will most likely trade around US$70 a barrel, as the market remains sensitive to supply disruption fears and Iran has yet to respond to the proposals made by the world powers.

NYMEX WTI (West Texas Intermediate benchmark crude oil) averaged US$71.0 a barrel in June 2006, the same level as in May 2006 and up from US$56.4 a barrel in June 2005. IPE Brent futures averaged US$69.8 a barrel during the period under review, down from US$71.0 a barrel in May 2006 and up from US$55.4 a barrel in June 2005. On the domestic front, effective 3 July 2006, the Certification Committee of the Automatic Price Mechanism increased the prices of Diesel and Mogas by 14.9 per cent and 20 per cent to Rs32.75 per litre and Rs37.55 per litre, respectively.

COMEX gold futures, on average, moved lower during June 2006, trading in an intra-month closing range of US$566.5/Oz-US$648.7/Oz compared to a range of US$637.5/Oz-US$721.5/Oz in May 2006. An easing of the tension between Iran and the West over Iran's nuclear ambitions drove gold prices down. Gold prices continued to be influenced more by speculative moves than fundamental demand and supply factors. Expectations that in an effort to contain US inflation the Fed would keep on raising interest rate lured investors away from the bullion. On 13 June 2006, gold prices fell by a record US$44.5 during the trading session. COMEX averaged US$599.8/Oz in June 2006, compared to an average of US$675.6/Oz in May 2006.

**Domestic Developments**

Tourist arrivals fell by 9.3 per cent, from 55,995 in May 2005 to 50,773 in May 2006, while gross tourism receipts rose by 11.2 per cent, from Rs2,080 million in May 2005 to Rs2,314 million in May 2006. Cumulatively, over the period July 2005 to May 2006, tourist arrivals reached 729,134, representing an increase of 5.3 per cent on the 692,501 arrivals recorded over the corresponding period of the previous fiscal year. Tourism receipts for the period July 2005 to May 2006 grew by 19.2 per cent to reach Rs26,883 million compared to Rs22,560 million recorded over the corresponding period of the previous fiscal year.

The Consumer Price Index (CPI) increased from 124.3 in May 2006 to 126.2 in June 2006. Except for “Transport”, which registered a decline of 1.8 per cent in its sub-index due to a fall of 0.3 index point in the motor vehicles component and “Recreation and culture” and “Education”, whose sub-indices remained unchanged, all the remaining nine Divisions registered increases in their sub-indices. The largest rise of 12.3 per cent was recorded in “Alcoholic beverages and tobacco”, reflecting increases of 0.6 index point in alcoholic beverages and 0.8 index point in cigarettes in the wake of the 2006-07 Budget. Although fresh vegetables and ginger recorded declines of 0.1 index point and 0.2 index point, respectively, the “Food and non-alcoholic beverages” Division, which accounts for nearly one-third of the CPI basket of goods and services, registered an increase of 0.6 per cent, reflecting increases of 0.1 index point in bread and 0.2 index point in soft drinks and other food products. Kerosene, catering services and other goods and services also went up by 0.1 index point, 0.3 index point and 0.2 index point, respectively. The rate of inflation for fiscal year 2005-06 stood at 5.1 per cent compared to 5.6 per cent for fiscal year 2004-05.

With effect from 10 July 2006, the Bank of Mauritius increased the Lombard Rate by 50 basis points, from 11.50 per cent to 12.00 per cent per annum. The hike in the Lombard Rate was effected against the background of an intensification of the upside risks to inflation stemming from the recent increases in the administered prices of a number of goods in the consumption basket, the worsening external sector outlook and monetary expansion, in particular the growth of money supply and credit. These coupled with the need to improve the relative attractiveness of rupee-denominated financial assets justify the pursuit of tighter demand management policies.

Money supply M2 went up by Rs14,118 million or 8.8 per cent, from Rs159,625 million at the end of June 2005 to Rs173,743 million at the end of May 2006 reflecting increases in both of its components. Narrow money supply M1 rose by Rs752 million or 3.4 per cent to Rs22,992 million while quasi-money increased by Rs13,366 million or 9.7 per cent to Rs150,751 million.

Net foreign assets of the banking system grew by Rs9,218 million or 17.4 per cent, from Rs52,951 million at the end of June 2005 to Rs62,169 million at the end of May 2006. Net foreign assets of Bank of Mauritius rose by Rs496 million or 1.2 per cent to Rs43,192 million while net foreign assets of banks expanded by Rs8,721 million or 85.0 per cent to Rs18,977 million.

Domestic credit went up by Rs14,136 million or 9.7 per cent, from Rs145,973 million at the end of June 2005 to Rs160,109 million at the end of May 2006. Net credit to Government from the banking system went up by Rs813 million or 2.0 per cent, from Rs40,907 million at the end of June 2005 to Rs41,720 million at the end of May 2006. Net credit to Government from Bank of Mauritius fell by Rs695 million or 86.6 per cent to Rs108 million while net credit to Government from banks rose by Rs1,508 million or 3.8 per cent to Rs41,612 million. Credit to the private sector expanded by Rs13,324 million from Rs105,066 million at the end of June 2005 to Rs118,390 million at the end of May 2006 or 12.7 per cent. Over that period, additional credit was directed to "Public Nonfinancial Corporations" (Rs3,059 million), "Financial and Business Services" (Rs2,385 million), "Traders" (Rs2,339 million), "Construction" (Rs2,240 million), "Personal" (Rs1,380 million), "Infrastructure" (Rs1,022 million), "Manufacturing" (Rs653 million), "Tourism" (Rs567 million), "Transport" (Rs278 million), "Freeport Enterprise Certificate Holders" (Rs125 million), "Agriculture & Fishing" (Rs93 million), "Education" (Rs78 million) and "State and Local Government" (Rs37 million). Over the same period, declines were registered at "Information, Communications and Technology" (Rs824 million) and "Professional" (Rs315 million).

Reserve money grew by Rs244 million or 1.1 per cent, from Rs22,941 million at the end of June 2005 to Rs23,185 million at the end of May 2006.

The Bank issued Government of Mauritius Treasury Bills/Bank of Mauritius Bills for a total amount of Rs8,272 million through the Primary Market in June 2006. No repurchase transactions were undertaken by the bank.

During June 2006, total transactions in Government of Mauritius Treasury Bills/Bank of Mauritius Bills effected through primary dealers amounted to Rs510.8 million while trading of Treasury Bills on the Stock Exchange of Mauritius amounted to Rs0.1 million.

On 9 June 2006, holders of 3-Year Treasury Notes issued in 2004-05 with interest payable at maturity were allowed to convert part or the full amount of their holdings into Treasury Notes with maturities of 2, 3 and 4 years with interest payable semi annually at the rates of 8.00, 8.15 and 8.35 per cent per annum respectively. Out of the Rs13,928.4 million of 3-Year Treasury Notes issued in 2004-05, a total amount of Rs12,898.2 million was converted: Rs4,250.3 million into 2 Year Treasury Notes, Rs4,988.6 million into 3 Year Treasury Notes and Rs3,659.3 million into 4 Year Treasury Notes.

On 30 June 2006, the Bank undertook the sixth and last issue of Five-Year Government of Mauritius Bonds for 2005-06. 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 Rs1,227.2 million, of which an amount of Rs500 million was accepted. The weighted average yield on bids accepted was 8.90 per cent per annum.

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 and appreciated against the Euro and the Pound sterling between May and June 2006.

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

At the end of May 2006, the net international reserves of the country amounted to Rs62,710 million. The end-May 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 35.0 weeks of imports, up from 34.9 weeks of imports at the end of April 2006. The gross foreign exchange reserves of the Bank of Mauritius decreased from Rs43,197 million at the end of May 2006 to Rs42,459 million at the end of June 2006.

Provisional estimates for the first quarter of 2006 suggest that the current account of the balance of payments recorded a deficit of Rs624 million as against a surplus of Rs593 million in the corresponding quarter of 2005, reflecting mainly a deterioration in the merchandise account.  The deficit in the merchandise account of the balance of payments increased to Rs6,143 million, from Rs4,084 million a year earlier.  The deficit on the merchandise account was partially offset by surpluses on the services, income and current transfers accounts.  The income account registered a surplus of Rs866 million as against a deficit of Rs141 million in the corresponding quarter of last year.  The capital and financial account, inclusive of reserve assets, recorded net outflows of Rs3,314 million in the first quarter of 2006 compared to net outflows of Rs436 million in the first quarter of 2005. The overall balance of payments for the same quarter, measured as the change in reserve assets excluding valuation changes, registered a surplus of Rs95 million.