

OVERVIEW

International Developments

During May 2006, the US dollar, on average, depreciated against all major currencies amid renewed concerns over the widening US trade and budget deficits and nervousness over an expected near-term end to the current interest rate tightening cycle. Dollar sentiment also soured on resurfacing talk of central banks diversifying their reserves away from the US currency. On 10 May 2006, the US Federal Reserve, as widely expected, lifted, at its FOMC meeting, its federal funds rate for the 16th straight time by another quarter-percentage point to 5.0 per cent. In its accompanying statement, the Federal Reserve, while stating that further rate tightening would increasingly depend on the US economic outlook, supported the market's view that US interest rate would soon peak. Sentiment for the US dollar further weakened after US Treasury Secretary John Snow, in his testimony before the US Senate Banking Committee on 18 May 2006, reiterated his dissatisfaction about the pace of China's efforts to increase the flexibility of the yuan. The market took these comments as a sign that US officials would accept the US dollar's weakness to help adjust global imbalances. Although, the US dollar managed to regain some footing amid position adjustment, the gains were short-lived. The release of first quarter 2006 GDP data, showing a revised expansion of 5.3 per cent, below market expectations for a 5.7 per cent growth, failed to bolster expectations for an increase in interest rate in June 2006. The nomination at the end of the month of Goldman Sachs Chairman Henry Paulson to succeed John Snow as Treasury Secretary further undermined the US dollar as it did little to dispel suspicions that Washington wanted a weaker dollar.

The euro, on average, appreciated against the US dollar during May 2006, trading on average at US\$1.2765 from an average of US\$1.2257 in April 2006. Starting May 2006 at its intra-month low of US\$1.2582, the euro got a lift from the release of the April 2006 factory activity index for the euro zone, which showed a rise to its highest level since September 2000, thereby confirming the market view that the ECB would raise rates in June 2006. As widely expected, the European Central Bank (ECB), on 4 May 2006, kept its key refinancing rate on hold at 2.5 per cent. At the post-meeting conference, ECB President Jean-Claude Trichet, however, emphasized the central bank's vigilance on inflation and signalled that investors were right to expect another euro zone rate hike in June 2006. The single currency drew further support from upbeat comments made by several key ECB policymakers, who also underscored the prevailing market view that the ECB would deliver a euro-supportive interest rate hike in June 2006. By mid-May 2006, the euro had hit its intra-month high of US\$1.2923, a level it could not sustain after some European officials, including French finance minister Thierry Breton, expressed concern about the currency's strength hurting euro zone economic growth. Amid position adjustment, the euro eased against the US dollar. At the close of the month, renewed comments that strong vigilance on inflationary risks was needed in the euro zone, as well as the release of upbeat German consumer confidence data and euro zone current account figures, supported the euro which closed the month on a relatively firm note, trading at US\$1.2865.

The Pound sterling, on average, strengthened against the US dollar during May 2006, trading at an average of US\$1.8685 as against US\$1.7649 in the preceding month. Starting May 2006 at its intra-month low of US\$1.8237, the Pound sterling moved higher against the US dollar, benefiting from a string of upbeat UK economic data and the general decline of the US currency. British retail sales, according to the British Retail Consortium, surged by 6.8 per cent in April 2006, its fastest pace in four years. Residential house prices in both England and Wales surged in the first quarter of 2006. These data helped to suppress expectations of UK's near-term rate cut and prompt speculation that the next move might be a hike. Moreover, minutes of the May 2006 Bank of England MPC meeting released thereafter also revealed that despite UK interest rate remaining unchanged at 4.5 per cent, there was a three-way split vote, with one member voting for a rate hike, six members voting for rate to remain unchanged and one member supporting a rate cut. The Pound sterling, which had hit its intra-month high of US\$1.8957 towards mid-May 2006, eased against the US dollar thereafter, weighed down by profit-taking and merger and acquisition related selling of the UK currency. The Pound sterling closed May 2006 trading at US\$1.8822.

The Japanese yen remained well supported against the US dollar during May 2006 trading on average at ¥111.71 per US dollar compared to ¥117.10 per US dollar in April 2006. As expected, on 19 May 2006, the Bank of Japan's monetary policy board left rates unchanged after its two-day meeting. The Japanese yen also drew support from rating agency Standard & Poor's affirmation that it had revised its rating outlook for Japan from stable to positive. By the close of the month, the yen was trading at ¥112.11 per US dollar.

Oil prices moved higher during May 2006, mainly on supply fears emanating from ongoing tensions between Iran and the West regarding the former's nuclear ambitions. Unrest in Nigeria and a series of US refinery problems, namely in New Jersey, Texas and Louisiana, during the period under review added further nervousness in the market. US stock reports from the US Energy Information Administration were satisfactory during the first three weeks of May 2006. Meanwhile, a report from the International Energy Agency (IEA) showed that soaring energy costs were affecting oil demand growth while results from the University of Michigan survey signalled that high oil prices were hurting US consumer confidence. Oil prices fluctuated as moves in the market were also driven by speculative motives 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 despite a recent easing of the tension between Iran and the West.

NYMEX WTI (West Texas Intermediate benchmark crude oil) averaged US\$71.0 a barrel in May 2006, compared to US\$70.2 a barrel in April 2006 and US\$49.9 a barrel in May 2005. IPE Brent futures averaged US\$71.0 a barrel during the period under review, up from US\$70.5 a barrel in April 2006 and US\$49.7 a barrel in May 2005.

COMEX gold futures, on average, moved higher during May 2006, trading in an intra-month closing range of US\$637.5/Oz-US\$721.5/Oz compared to a range of US\$590.6/Oz-US\$654.5/Oz in April 2006. Gold prices continued to be influenced more by speculative moves than fundamental demand and supply factors, with fears associated with Iran's nuclear ambitions stimulating fund buying. Gold prices even settled at a new record high of US\$721.5/Oz on 11 May 2006, crossing the key psychological level of US\$700/Oz. COMEX averaged US\$675.6/Oz during May 2006, compared to an average of US\$615.6/Oz in April 2006.

Domestic Developments

Tourist arrivals increased by 8.3 per cent, from 52,971 in April 2005 to 57,361 in April 2006, while gross tourism receipts rose by 25.9 per cent, from Rs1,891 million in April 2005 to Rs2,381 million in April 2006. Cumulatively, over the period July 2005 to April 2006, tourist arrivals reached 678,361, representing an increase of 6.6 per cent compared to 636,506 arrivals recorded over the corresponding period of the previous fiscal year. Tourism receipts for the period July 2005 to April 2006 grew by 20.0 per cent to reach Rs24,569 million compared to Rs20,480 million recorded over the corresponding period of the previous fiscal year.

The Consumer Price Index (CPI) rose from 124.0 in April 2006 to 124.3 in May 2006. The largest increase of 2.2 per cent was noted in the "Recreation and Culture," followed by "Furnishings, Household Equipment and Routine Household Maintenance" (1.2 per cent), "Clothing and Footwear" (1.1 per cent) and "Miscellaneous Goods and Services" (1.1 per cent). The highest decline of 3.2 per cent was recorded in "Communication". The main contributors to the increase were other goods and services, which rose by 0.2 index point, and other food products, alcoholic beverages, ready made clothing, washing materials and softeners, airfare, newspapers and magazines, each registering an increase of 0.1 index point. This was offset by decreases of 0.2 index point in fresh vegetables and 0.1 index point in fresh beef, fresh fruits and telephone services. The rate of inflation for the 12-month period ended May 2006 stood at 4.9 per cent, unchanged from the previous month.

Money supply M2 went up by Rs14,180 million or 8.9 per cent, from Rs159,625 million at the end of June 2005 to Rs173,805 million at the end of April 2006 on account of increases in both of its components. Narrow money supply M1 expanded by Rs720 million or 3.2 per cent to Rs22,960 million while quasi-money grew by Rs13,461 million or 9.8 per cent to Rs150,846 million.

Net foreign assets of the banking system rose by Rs9,052 million or 17.1 per cent, from Rs52,951 million at the end of June 2005 to Rs62,003 million at the end of April 2006. Net foreign assets of Bank of Mauritius fell by Rs390 million or 0.9 per cent to Rs42,306 million while net foreign assets of banks expanded by Rs9,440 million or 92.1 per cent to Rs19,697 million.

Domestic credit grew by Rs12,908 million or 8.8 per cent, from Rs145,973 million at the end of June 2005 to Rs158,881 million at the end of April 2006. Net credit to Government from the banking system went up by Rs164 million or 0.4 per cent, from Rs40,907 million at the end of June 2005 to Rs41,071 million at the end of April 2006. Net credit to Government from Bank of Mauritius fell by Rs376 million or 46.8 per cent to Rs428 million while net credit to Government from banks increased by Rs540 million or 1.3 per cent to Rs40,644 million. Credit to the private sector grew by Rs12,743 million, from Rs105,066 million at the end of June 2005 to Rs117,809 million at the end of April 2006, or 12.1 per cent. Over that period, additional credit was directed to "Public Nonfinancial Corporations" (Rs3,817 million), "Financial and Business Services" (Rs2,468 million), "Construction" (Rs2,095 million), "Traders" (Rs2,011 million), "Personal" (Rs1,272 million), "Infrastructure" (Rs849 million), "Manufacturing" (Rs484 million), "Tourism" (Rs197 million), "Transport" (Rs154 million), "Agriculture & Fishing" (Rs107 million), "Education" (Rs81 million) "Freeport Enterprise Certificate Holders" (Rs62 million), and, "State and Local Government" (Rs37 million). Over the same period, declines were registered at "Information, Communications and Technology" (Rs853 million) and "Professional" (Rs281 million).

Reserve money went up by Rs761 million or 3.3 per cent, from Rs22,941 million at the end of June 2005 to Rs23,702 million at the end of April 2006.

The Bank issued Government of Mauritius Treasury/Bank of Mauritius Bills for a total amount of Rs3,675 million on the Primary Market in May 2006. No repurchase transactions were undertaken by the Bank.

During May 2006, total transactions in Government of Mauritius Treasury/Bank of Mauritius Bills effected through primary dealers amounted to Rs558.2 million while trading of Treasury Bills on the Stock Exchange of Mauritius amounted to Rs0.4 million.

Two auctions of Treasury Notes with maturities of 2, 3 and 4 years and bearing interest at the rates of 7.60, 7.90, and 8.25 per cent per annum respectively were held in May 2006. At the first auction held on 03 May for settlement on 05 May 2006, Treasury Notes for a total nominal value of Rs1,400 million, were put on tender. Bids received for the three maturities totalled Rs1,100.5 million, of which an amount of Rs700.5 million was accepted. The weighted average yields on bids accepted were 7.99, 8.28 and 8.67 per cent per annum, respectively. At the second auction held on 31 May 2006 for settlement on 02 June 2006 Treasury Notes for a total nominal amount of Rs800 million were put on tender. Bids received for the three maturities totalled Rs1,168.9 million, of which Rs800 million was accepted. The weighted average yields on bids accepted were 8.04, 8.30 and 8.69 per cent per annum, respectively.

On 19 May 2006, the Bank undertook the third and last issue of Mauritius Development Loan Stocks (MDLS) for fiscal year 2005-06 with maturities of 8 and 12 years. Two Stocks, namely 9.00% MDLS 2014 (19 May 2014) and 9.25% MDLS 2018 (19 May 2018) were put on tender for a nominal amount of Rs600 million. Bids received for the two stocks totalled Rs1,438.4 million, of which an amount of Rs600 million was accepted. The weighted average yields on bids accepted were 9.75 per cent and 10.33 per cent per annum respectively.

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 April 2006 and May 2006.

Between April 2006 and May 2006, the rupee, on average, depreciated against all major currencies.

At the end of April 2006, the net international reserves of the country amounted to Rs62,537 million. The end-April 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 34.9 weeks of imports, up from 34.6 weeks of imports at the end of March 2006. The gross foreign exchange reserves of the Bank of Mauritius increased from Rs42,315 million at the end of April 2006 to Rs43,197 million at the end of May 2006.