OVERVIEW

International Developments

During September 2004, the US dollar, on average, appreciated against the Pound sterling but depreciated vis-à-vis the euro and Japanese yen. The US dollar was generally under pressure throughout the month, as investors remained uncertain about the near term outlook for the US economy. In the wake of Alan Greenspan's testimony on 8 September 2004, where the US Federal Reserve Chairman sounded more cautious on the economic recovery, the US dollar traded on a softer tone as market players revised their expectations of how aggressively the US Federal Reserve would raise rates after its September FOMC meeting. Aggressive US interest rate hikes expectations were further dented after the release of US August 2004 producer prices, which fell for the first time since February 2004. As widely expected on 21 September 2004 at its scheduled meeting, the US Federal Reserve raised its key federal funds rate by 0.25 percentage point to 1.75 per cent. However, the US dollar suffered from the rate move, as in its accompanying statement, the US Federal Reserve added that inflation and inflation expectations had eased in recent months. Thereafter, although the market reassessed the FOMC's statement more positively for another round of rate policy tightening this year, the US dollar remained under pressure as surging oil prices to new record highs took the center stage in currency trading.

On 3 September 2004, the ECB at its governing council meeting held its key interest rates steady at 2.0 per cent. The euro gained ground against the US dollar, benefiting mostly from position adjustments amid receding expectations of aggressive interest rate hikes in the United States. Hawkish comments from ECB officials emphasizing inflation risk in the euro zone also provided some support to the single currency. By the close of the month, the euro had reached its intra-month high of US$1.2322.

The Pound sterling weakened vis-à-vis the US dollar in the wake of investors' expectations that UK interest rates were unlikely to go much higher. More evidence emerged throughout the month that the UK once-booming housing market was cooling down and the economy was slowing in response to the five interest rate hikes since November 2003. Moreover, the release of weaker-than-expected UK August 2004 inflation data, which brought the annual rate of inflation down to 1.3 per cent, the lowest since April this year, cast additional doubts on prospects for higher UK interest rates. Minutes of the Bank of England's Monetary Policy Committee meeting released also reinforced expectations that UK rates were close to their peak. While the MPC members voted 9-0 to keep interest rates unchanged on 9 September 2004, they also noted that signs of house price cooling might increase the risk of a more abrupt correction in the market. By the close of September 2004, amid surging oil prices, the Pound, however, managed to regain some footing, drawing support from its relatively high yield advantage.

The Japanese yen, which started at its intra-month high of ¥109.24, came under downward pressure against the US dollar following the protracted rise in oil prices. Japan's high dependence on oil imports made the yen a victim of sudden run-ups in oil prices. By the close of September, the Japanese yen managed to move higher vis-à-vis the US dollar.

International oil prices have remained persistently high in September 2004, despite an initial retreat from record highs registered in August 2004. In the first week of September 2004, speculative selling by hedge funds drove international oil prices down. However, US weekly oil stock reports that revealed unanticipated drops kept the market nervous such that oil prices resumed their ascent. Furthermore, the threat that Hurricane Ivan represented for oil and gas production in the Gulf of Mexico also weighed on the market. News that the biggest Russian oil company, Yukos, had reduced its exports to China also added to supply concerns of the market. At its 15 September 2004 meeting, OPEC ministers decided to raise OPEC's crude oil output by 1 million bpd to 27 million bpd effective 1 November 2004. But, the market was little moved by OPEC's decision and international oil prices remained buoyant. In the last week of September 2004, increased instability in the Middle East and a resumption of violence in Nigeria added further worries to the international oil market, sending oil prices to record highs. With the US Northern Hemisphere heading into the winter season, heating oil demand is expected to grow and as supply concerns are not appeasing, oil prices might stay at high levels for some time.

During September 2004, NYMEX WTI (West Texas Intermediate benchmark crude oil) averaged US$46.1 a barrel, compared to US$28.3 a barrel in September 2003. NYMEX peaked at US$50.47 a barrel in overnight trade on 28 September 2004. IPE Brent futures averaged US$42.9 a barrel for the same month, compared to US$26.9 a barrel in September 2003.

On the domestic front, the operation of the Automatic Price Mechanism led to prices of petroleum products being adjusted upward with effect from 2 October 2004. The price of motor gasoline and diesel went up by 6.3 per cent, from Rs24.55 per litre to Rs26.10 per litre, and by 15 per cent, from Rs15.00 per litre to Rs17.25 per litre, respectively, reflecting trends in prices of petroleum products in the international market as well as exchange rate fluctuations.

COMEX gold futures continued their ascent during September 2004, trading in an intra-month closing range between US$399.4/Oz and US$420.4/Oz compared to a range between

US$394.4/Oz and US$415.5/Oz in August 2004. Much of COMEX gold's direction reflected the performance of the US dollar on the foreign exchange market. Moreover the surge in oil prices in the last week of September 2004 led investors to buy the precious metal for its safe haven status. COMEX averaged US$407.9/Oz in September 2004, compared to an average of US$404.2/Oz in August 2004.

Domestic Developments

Tourist arrivals fell by 3.3 per cent, from 56,844 in August 2003 to 54,975 in August 2004, while gross tourism receipts increased by 17.6 per cent, from Rs1,401 million in August 2003 to Rs1,648 million in August 2004. For the period January to August 2004, tourist arrivals went down to 449,825 from 450,553 in the corresponding period of 2003, representing a decrease of 0.2 per cent. Tourism receipts for the period January to August 2004 grew by 29.6 per cent to reach Rs15,255 million compared to Rs11,772 million in the corresponding period of 2003.

The Consumer Price Index (CPI) increased from 112.7 in August 2004 to 113.1 in September 2004. The rate of inflation for the twelve-month period ended September 2004 stood at 4.1 per cent, compared to 4.0 per cent in August 2004.

Money supply M2 increased by Rs1,137 million or 0.8 per cent, from Rs141,132 million at the end of June 2004 to Rs142,269 million at the end of August 2004. Narrow money supply M1, one of the components of M2, edged up by Rs70 million or 0.3 per cent to Rs21,392 million while quasi-money, the other component of M2, went up by Rs1,067 million or 0.9 per cent to Rs120,877 million.

Net foreign assets of the banking system edged down slightly by Rs5 million, from Rs49,120 million at the end of June 2004 to Rs49,115 million at the end of August 2004. Net foreign assets of Bank of Mauritius went up by Rs275 million or 0.6 per cent to Rs43,537 million whereas the net foreign assets of Category 1 banks declined by Rs280 million or 4.8 per cent to Rs5,578 million.

Domestic credit expanded by Rs1,980 million or 1.5 per cent, from Rs128,799 million at the end of June 2004 to Rs130,779 million at the end of August 2004. Net credit to Government rose by Rs691 million or 2.0 per cent, from Rs35,346 million at the end of June 2004 to Rs36,037 million at the end of August 2004. Net credit to Government from Category 1 banks rose by Rs715 million or 2.0 per cent to Rs36,756 million and offset the drop of Rs24 million in net credit to Government from Bank of Mauritius, which fell by 3.5 per cent to a negative figure of Rs719 million. Credit to the private sector from Category 1 banks rose by

Rs1,285 million or 1.4 per cent, from Rs93,120 million at the end of June 2004 to Rs94,405 million at the end of August 2004. Over that period, additional credit was directed to the following sectors: “Tourism” (Rs531 million), “Personal” (Rs335 million), “Construction” (Rs313 million), “Financial and Business Services” (Rs198 million) and “Statutory and Parastatal Bodies” (Rs103 million). Declines were noted in the following sectors “Agriculture & Fishing” (Rs303 million) and “Traders” (Rs86 million).

Reserve money fell by Rs598 million or 2.4 per cent, from Rs24,905 million at the end of June 2004 to Rs24,307 million at the end of August 2004.

Taking into account liquidity conditions in the market in September 2004, the Bank carried out two reverse repurchase transactions. The two transactions were conducted for a period of 7 days at a fixed yield of 1.15 per cent.

During September 2004, total transactions in Treasury/Bank of Mauritius Bills effected through primary dealers amounted to Rs906 million while trading of Treasury Bills on the Stock Exchange amounted to Rs4.2 million.

Spot sales of foreign currencies by the Mauritius Sugar Syndicate to the banking sector during September 2004 amounted to an equivalent of US$4.6 million. The Bank intervened and sold US$16.1 million to banks during the month. The weighted average dealt selling rates of the rupee, which are calculated on transactions of US$30,000 and above, or the equivalent in other foreign currencies, effected by Category 1 banks, showed that the rupee, on average, depreciated against the US dollar and the euro but appreciated against the Pound sterling between August and September 2004.

On 8 September 2004, the Bank announced that during financial year 2004-05 it would issue, on behalf of Government, Five-Year Government of Mauritius Bonds for a total nominal amount of Rs2.0 billion, Mauritius Development Loan Stocks for a total nominal amount of Rs3.0 billion and Treasury Notes.

Effective 17 September 2004, the Bank, acting as agent of Government, started weekly issues of Treasury Notes. Treasury Notes are issued at par and in multiples of Rs100,000, with a maturity period of 3 years. Initially, Treasury Notes are being offered to existing holders of Treasury Bills who wish to convert at maturity part or the full amount of their redemption proceeds. The conversion of Treasury Bills into Treasury Notes will close on 30 June 2005 or earlier, as may be decided by Government. Interest on Treasury Notes, which will be payable at the end of the 3-year period, has been set at 7.30 per cent per annum and may be reviewed depending on market conditions. A total amount of Rs946.6 million of maturing Treasury Bills has been converted into Treasury Notes between 17 and 30 September 2004.

On 30 September 2004, the Bank undertook the first of a series of four quarterly auctions of Five-Year Government of Mauritius Bonds for fiscal year 2004-05. Bonds for a total nominal amount of Rs500 million were put on tender at a coupon rate of 8.00 per cent per annum. Bids were received for a total nominal amount of Rs1,209 million, of which Rs500 million were accepted. The weighted yield on bids accepted was 7.65 per cent.

Between August and September 2004, the rupee, on average, appreciated against the Pound sterling but depreciated against the euro, Japanese yen and US dollar.

At the end of August 2004, the net international reserves of the country amounted to Rs50,028 million. Following the release of external trade data for the second quarter of 2004, the end-August 2004 level of net international reserves of the country, based on the value of the import bill for fiscal year 2003-04, exclusive of the purchase of aircraft, represented 37.5 weeks of imports, up from 37.0 weeks of imports at the end of July 2004. At the end of September 2004, the foreign exchange reserves of the Bank of Mauritius amounted to Rs44,150 million, up from Rs43,627 million at the end of August 2004.