OVERVIEW

International Developments

During September 2006, the US dollar, on average, appreciated against all major currencies. Starting the month on a soft tone on the back of a relatively weak jobs report, the US dollar, somehow, managed to regain ground amid profit taking. The release, thereafter, of data showing a 5 per cent jump in the second quarter 2006 unit labour costs, the largest gain since third quarter of 2000, boosted the US dollar. In addition, the US currency also benefited from concerns expressed by US Federal Reserve officials that until inflationary pressures eased, the US central bank would remain biased toward further rate hikes. With relative interest rate differentials still favouring US dollar denominated assets, the release of data showing a weak US$32.9 billion of capital inflows to the United States in July 2006 - the lowest in 14 months and much less than the US$68.0 billion trade deficit for the same month, and a surprisingly large US$218.4 billion US current account deficit in the second quarter of 2006, had little impact on the US dollar. As expected, on 20 September 2006, the US Federal Reserve at its FOMC meeting left its federal funds rate on hold at 5.25 per cent for the second straight time. In its accompanying statement, the Fed said that there were a number of reasons to expect inflationary pressures to "moderate over time" but it made clear that this was a forecast and not yet reality, holding out the possibility of higher interest rates if needed. However, as the market seemed to focus on the fact that the US Federal Reserve might be through with its tightening campaign, the US dollar moved lower. Data released thereafter pointing towards a slowing economy reinforced expectations that the US Federal Reserve would not raise interest rates again in 2006 and might even start cutting them next year, if not earlier and added further downward pressure on the US dollar. By the close of September 2006, the US dollar managed to regain ground as market players reassessed the outlook for the US economy, which somewhat dampened expectations of an interest rate cut.

The euro weakened against the US dollar during September 2006, trading at an average of US$1.2743 from an average of US$1.2810 in August 2006. From its intra-month high of US$1.2859 at the start of September 2006, the euro lost ground against the US dollar following the release of data indicating a cooling in euro zone service sector growth in August 2006 to its weakest pace since January 2006. Although comments from ECB officials over the possibility of higher euro zone interest rates did provide a brief respite to the euro, the single currency, undermined by the broad-based strength of the US dollar, hit its intra-month low of US$1.2662 on 18 September 2006. Amid market expectations that euro rates might rise as high as 4.0 per cent next year and as the outlook for further hikes in US interest rates eased, the euro regained ground vis-à-vis the US dollar. From then on, the euro traded within tight ranges against the US currency and closed September 2006 trading around US$1.2704.

The Pound sterling moved lower against the US dollar during September 2006, trading at an average of US$1.8876 from an average of US$1.8919 in August 2006. Starting September 2006 at US$1.9031, the Pound sterling reached its intra-month high of US$1.9071, supported by upbeat housing data that fuelled expectations of another interest rate hike soon. The Pound, however, amid position adjustment and in the wake of the release of slower service sector growth in August 2006, could not hold onto its gains. Political uncertainty prevailing in Britain as to when Tony Blair would step down as Prime Minister also weighed on the Pound, which hit its intra-month low of US$1.8663 on 11 September 2006. The Pound, however, recouped its losses, moving higher against the US dollar, benefiting from expectations that interest rate might rise in November 2006 and from the release of strong British retail sales and housing data. The release of minutes of the Bank of England's 6-7 September 2006 Monetary Policy Committee meeting, revealing an 8-0 vote to keep rates steady at 4.75 per cent, as well as strong mortgage data, which further fuelled expectations for a rate rise in November 2006, added support to the Pound. By the close of September 2006, with the release of a downwardly revised second quarter 2006 GDP growth, the Pound came under pressure to close the month trading around US$1.8765.

The Japanese yen depreciated against the US dollar during September 2006, trading at an average of ¥117.03 per US dollar from an average of ¥115.75 per US dollar in August 2006. In the first week of the month, the Japanese yen, drawing support from the release of solid capital spending data, hit its intra-month high of ¥115.85 per US dollar on 5 September 2006. At its policy board meeting on 8 September 2006, the Bank of Japan, as widely expected, kept monetary policy steady with rates at 0.25 per cent. The yen thereafter gave up its gains, reaching its intra-month low of ¥117.96 per US dollar on 13 September 2006, undermined by a run of weak economic data indicating that the Bank of Japan would be slow in raising rates from 0.25 per cent in the months ahead, keeping it the lowest yielding currency among majors for a while longer. The Japanese currency continued to trade in tight ranges for the rest of September 2006 with the market showing limited reaction to the military coup in Thailand while a surprisingly strong tankan survey of business sentiment did little to change the outlook for Japanese interest rates. The Japanese yen closed September 2006, trading at ¥117.79 per US dollar.

Oil prices eased significantly during September 2006 as many factors that were pushing them upwards mitigated. US stock reports from the US Energy Information Administration were satisfactory, in particular, on distillate stocks. OPEC left its output quota unchanged at 28 million barrels per day on 11 September 2006. Iran offered a temporary suspension to its nuclear enrichment program while the United States, China, Britain, France, Russia and Germany agreed to give European negotiator Javier Solana more time to reach a diplomatic solution with Tehran before resuming a push for UN Security Council sanctions. Fund selling pressured oil prices downward as traders noted a fading hurricane season amid ample supplies for the US winter season. The noteworthy fall in oil prices from above US$70 a barrel to around US$60 a barrel is an indication that market conditions in the world oil market might be improving. Nonetheless, in the weeks ahead, oil prices will most likely trade around US$60 a barrel owing to the volatility of geopolitical factors that may raise supply fears.

NYMEX WTI (West Texas Intermediate benchmark crude oil) averaged US$63.9 a barrel in September 2006, down from US$73.1 a barrel in August 2006 and from US$65.6 a barrel in September 2005. IPE Brent futures averaged US$63.6 a barrel during the period under review, down from US$73.9 a barrel in August 2006 and from US$63.8 a barrel in September 2005. On the domestic front, effective 3 October

2006, the Certification Committee of the Automatic Price Mechanism increased the price of Mogas by 8.1 per cent to Rs40.60 per litre while the price of Gas Oil decreased by 7.8 per cent to Rs30.20 per litre. The STC transfer price of Fuel Oil increased by 6.2 per cent to Rs12.3168 per litre. Moreover, the price of Liquefied Petroleum Gas (LPG) for the quarter October-December 2006 has been increased by the maximum of 5.0 per cent allowable under the regulations, from Rs25 per kg to Rs26.25 per kg. Cylinders of 5, 6 and 12 kgs now cost Rs131.25, Rs157.50 and Rs315.00, respectively.

COMEX gold futures, on average, moved lower during September 2006, trading in an intra-month closing range of US$583.0/Oz-US$646.9/Oz compared to a range of US$619.1/Oz-US$664.1/Oz in August 2006. Gold prices continued to be influenced more by speculative moves than fundamental demand and supply factors. Fund selling amid lower oil prices and a stronger US dollar drove prices down. Moreover, the fact that the bullion broke the US$600/Oz-level but was unable to cross the level for some time, kept the gold contract under pressure. COMEX averaged US$603.9/Oz in September 2006, compared to an average of US$640.4/Oz in August 2006.

Domestic Developments

Tourist arrivals grew by 5.9 per cent, from 60,746 in August 2005 to 64,307 in August 2006, while gross tourism receipts increased by 20.9 per cent, from Rs2,053 million in August 2005 to Rs2,483 million in August 2006. Cumulatively, over the period January to August 2006, tourist arrivals reached 489,984, representing a rise of 3.0 per cent over the 475,519 arrivals recorded in the corresponding period of the previous year. Tourism receipts for the period January to August 2006 went up by 22.4 per cent to reach Rs19,863 million compared to Rs16,233 million recorded over the corresponding period in 2005.

The Consumer Price Index (CPI) increased from 130.9 in August 2006 to 131.7 in September 2006. Except for “Transport” and “Recreation and Culture” whose sub-indices declined by 0.2 and 0.1 per cent, respectively, and “Communication” and “Education” with no change in their sub-indices, the remaining nine Divisions recorded increases in their sub-indices. The largest rise of 1.3 per cent was registered in “Furnishings, Household Equipment and Routine Household Maintenance” followed by “Food and Non-Alcoholic Beverages” and “Alcoholic Beverages and Tobacco” with their sub-indices rising by 1.1 per cent. The remaining six Divisions recorded increases in the range of 0.1 to 1.0 per cent. The main contributors to the change in the index between August and September 2006 were other goods and services, which rose by 0.2 index point and trader’s rice, meat, fresh fruits, other food products, alcoholic beverages, household appliances and household utensils, each registering an increase of 0.1 index point. The rate of inflation for the twelve-month period ended September 2006 stood at 6.8 per cent, up from 6.1 per cent for the twelve-month period ended August 2006.

While headline inflation for September 2006 stood at 6.8 per cent, CORE1, CORE2 and TRIM10 inflation rates are estimated at 5.4 per cent, 6.1 per cent and 5.4 per cent, respectively. Consequently, for September 2006, core inflation was between 0.7 and 1.4 percentage points lower than the headline inflation.

Money supply M2 grew by Rs3,722 million or 2.1 per cent, from Rs177,527 million at the end of June 2006 to Rs181,249 million at the end of August 2006 on account of increases in both quasi money and narrow money supply. Narrow money supply M1 rose by Rs294 million or 1.2 per cent to Rs25,363 million while quasi-money increased by Rs3,428 million or 2.2 per cent to Rs155,886 million.

Net foreign assets of the banking system expanded by Rs3,522 million or 5.7 per cent, from Rs61,435 million at the end of June 2006 to Rs64,957 million at the end of August 2006. Net foreign assets of Bank of Mauritius rose by Rs1,737 million or 4.1 per cent to Rs44,191 million while net foreign assets of banks increased by Rs1,785 million or 9.4 per cent to Rs20,766 million over the same period.

Domestic credit grew by Rs4,547 million or 2.8 per cent, from Rs164,958 million at the end of June 2006 to Rs169,505 million at the end of August 2006. Net credit to Government from the banking system fell by Rs615 million or 1.4 per cent, from Rs45,487 million at the end of June 2006 to Rs44,872 million at the end of August 2006. Net credit to Government from Bank of Mauritius declined by Rs224 million or 13.6 per cent to Rs1,417 million while net credit to Government from banks contracted by Rs392 million or 0.9 per cent to Rs43,455 million. Credit to the private sector expanded by Rs5,162 million or 4.3 per cent, from Rs119,471 million at the end of June 2006 to Rs124,633 million at the end of August 2006. Between end June 2006 and end August 2006, additional credit was channelled to “Financial and Business Services” (Rs1,286 million), “Public Nonfinancial Corporations” (Rs702 million), “Agriculture & Fishing” (Rs696 million), “Traders” (Rs657 million), “Construction” (Rs539 million), “Tourism” (Rs491 million), “Personal” (Rs432 million), “Manufacturing” (Rs146 million), “Transport” (Rs131 million) and “Infrastructure” (Rs118 million). Over the same period declines of Rs56 million and Rs46 million were recorded at “Freeport Enterprise Certificate Holders” and “Professional” sectors.

Reserve money contracted by Rs1,040 million or 4.2 per cent, from Rs24,543 million at the end of June 2006 to Rs23,503 million at the end of August 2006.

The Bank issued Government of Mauritius Treasury Bills/Bank of Mauritius Bills for a total amount of Rs3,398 million through the Primary Market in September 2006. No repurchase transaction was undertaken by the Bank.

During September 2006, total transactions in Government of Mauritius Treasury/Bank of Mauritius Bills effected through primary dealers amounted to Rs853.5 million. Trading of Treasury Bills on the Stock Exchange of Mauritius amounted to Rs1.6 million.

At the monthly auction of Treasury Notes held in September 2006, a total nominal amount of Rs1,500 million of Treasury Notes with maturities of 2, 3 and 4 years and with interest payable semi-annually at the rates of 8.10, 8.40 and 8.65 per cent per annum, respectively, were put on tender. Bids were received for a total amount of Rs283.6 million, of which an amount of Rs253.0 million was accepted. The weighted average yields on bids accepted were 8.52, 8.50 and 8.83 per cent per annum, respectively.

The first issue of long-term Government of Mauritius Bonds for 2006-07 was undertaken on 22 September 2006, through an auction on 20 September 2006. 7-Year, 13-Year and 20-Year Bonds bearing interest at 9.10, 9.50 and 9.75 per cent per annum respectively, were put on tender for a total nominal amount of Rs1,000.0 million. Bids were received for a total amount of Rs674.3 million, of which Rs604.8 million were accepted. The weighted average yields on bids accepted for the 7-Year, 13-Year and 20-Year Bonds were 11.31, 11.98 and 12.17 per cent per annum, respectively.

In September 2006, the Bank intervened and sold US dollars for a total amount of US$31.8 million on the interbank foreign exchange market.

Between August 2006 and September 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, showed that the rupee, on average, depreciated against the US dollar, Euro and Pound sterling between August and September 2006.

At the end of August 2006, the net international reserves of the country amounted to Rs65,527 million. Following the release of external trade data for the second quarter of 2006, the end-August 2006 level of net international reserves of the country, based on the value of the import bill for fiscal year 2005-06, exclusive of the purchase of aircraft, represented 33.7 weeks of imports, up from 32.9 weeks at the end of July 2006. Reflecting mainly intervention by the Bank on the foreign exchange market, the foreign exchange reserves of the Bank of Mauritius fell to Rs43,015 million at the end of September 2006, from Rs44,191 million at the end of August 2006.

The current account of the balance of payments deteriorated significantly to record a higher deficit of Rs10,452 million in 2005-06 from Rs6,245 million in 2004-05. In relation to GDP, the deficit on the current account represented 5.3 per cent in 2005-06 compared to 3.4 per cent in 2004-05. The deterioration largely reflected the worsening in the merchandise account, which has been to a certain extent offset by the combined surpluses on the services, income and current transfers accounts. The deficit on the merchandise account widened to Rs25,939 million in 2005-06, from Rs20,262 million a year earlier, largely on account of a rise in the import bill of petroleum products by nearly Rs5,253 million in 2005-06. The surplus on the services account declined slightly by 0.5 per cent, from Rs12,478 million in 2004-05 to Rs12,410 million in 2005-06, reflecting higher deficits on both the 'other services' and transportation accounts. The income account posted a net inflow of Rs1,438 million in 2005-06 while the surplus on the current transfers account fell from Rs1,673 million in 2004-05 to Rs1,639 million in 2005-06. The capital and financial account recorded higher net inflows of Rs4,204 million in 2005-06 compared to net inflows of Rs3,380 million in 2004-05. The overall balance of payments, measured as the change in reserve assets excluding valuation changes, registered a deficit of Rs3,019 million in 2005-06, slightly lower than the deficit of Rs3,133 recorded in the previous fiscal year.