BANK OF MAURITIUS

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MONETARY POLICY STATEMENT

The Monetary Policy Committee (MPC) of the Bank of Mauritius convened a special meeting on 2 May 2008 to reassess the balance of risks to price stability and economic growth against the backdrop of the recent downward revision of global economic outlook and the current difficulties affecting sectors of the domestic economy more exposed to world market conditions. The MPC voted to cut the key Repo Rate by 50 basis points to 8.00 per cent per annum, effective 2 May 2008.

The interest rate chargeable on the Special Deposits Facility, set at 100 basis points below the key Repo Rate, was reduced by 50 basis points to 7.00 per cent per annum while that on the Overnight Facility introduced at 150 basis points above the key Repo Rate was accordingly lowered to 9.50 per cent per annum. The interest rate payable on the Standing Facility, at 400 basis points above the key Repo Rate, was reduced to 12.00 per cent per annum.

The MPC reviewed the latest international economic developments and noted that the IMF had, in April 2008[1] , downgraded global economic growth for the year 2008 to 3.7 per cent. The global economy was losing momentum amid heightened uncertainty about the extent and severity of the slowdown in the advanced economies and its spillover effects on emerging economies. The Euro zone was expected to withstand the global financial crisis with a forecast drop of 0.2 percentage point in economic growth to 1.4 per cent. However, the economic performance of its constituent countries was mixed. Germany and France would both register a 1.4 per cent growth rate in 2008, but the slowdown would be more pronounced in Italy and Spain. In the United Kingdom, growth would slow to 1.6 per cent in 2008.

The MPC also noted that, in the light of dampening consumer spending and retail sales data, business sentiment in the main trading partner countries had significantly weakened and, thus, the risks of the slowdown in retail sales spilling over to Mauritian manufacturers and exporters had indeed increased.

Headline inflation had globally increased reflecting soaring food and energy prices mainly – a trend which, despite the slowdown in advanced economies, was expected to persist in the short- to medium-term. In recent months, inflation had been overshooting targeted levels in many advanced countries as well as in emerging economies where food carries a greater weight in consumption baskets.

[1] IMF April 2008 World Economic Outlook.

Since the beginning of the year, prices of nearly all food commodities have risen on the international markets as a result of growing demand in China and India, bio-fuels programmes, rising protectionism in the form of export quotas and taxes, panic-buying by grain importers, and hedge funds' investment in commodity markets. Reflecting these upward pressures, the United Nation's Food and Agriculture Organisation's world food price index has increased by 69 per cent in the first quarter of 2008 compared to the corresponding quarter of 2007. The IMF had also observed that tight market balances should continue to support prices of many commodities well above recent averages, especially for grains and edible oils. The MPC agreed that higher prices and price volatility were likely to persist for some time and it expressed concerns over the globally-discussed issue of food price inflation, food availability on world markets, food security and the potential implications on the domestic economy.

In Mauritius, food price inflation, which has increased from 14.7 per cent in June 2007 to 17.0 per cent in March 2008, has visibly contributed to the increase in headline inflation. The MPC noted that Core 2 inflation rate[2] had been stable over the last four months with some signs of easing since the last MPC meeting held in March 2008. The MPC also noted that the pass-through effects of the appreciation of the rupee have started to be reflected in a range of consumer product prices.

The MPC assessed the potential effects of the global economic slowdown on the major industries in the domestic real sector, export-oriented as well as those producing for the domestic economy. Macroeconomic conditions, though currently broadly supportive of economic activity, could weaken during the course of the year. The adverse effects of external developments on the export manufacturing sector have become noticeable and concerns were raised that Mauritius, as a highly-open small economy, might not be as resilient as larger emerging economies in withstanding such external shocks. The view was also expressed, however, that in a fast changing world, it was imperative that the export industry adapts to global demand conditions, increases resiliency by tailoring its exports to customer needs, and enhances flexibility to be able to hold on its own in the global marketplace.

The MPC took note of the fact that the Rupee was presently more or less stable. The MPC also noted that the financial account of the balance of payments would continue to register strong Foreign Direct Investment (FDI) inflows and to a lesser extent short-term capital inflows. In an economy with a fully liberalised capital account and monetary policy geared towards its core functions of maintaining price stability and promoting orderly and balanced economic development, the exchange rate is better left to be determined by market forces and exchange rate volatility hedged by appropriate financial instruments.

In setting its policy interest rate, the MPC, at this juncture, viewed the downside risks to economic growth exceeding the upside risks to inflation. In its assessment of risks to the growth and inflation outlook, the MPC noted that while overall economic growth appeared reasonable, the downside risks to growth becoming significantly imbalanced had risen with jobs at risk as export-oriented sectors turned out to be

[2] Core 2 inflation excludes Food, Beverages, Tobacco, mortgage interest, energy and administered prices from headline inflation.

increasingly vulnerable to external market conditions. Inflationary pressures, which were to a large extent imported and driven by internationally rising food and energy prices, were likely to subside, the more so with the emergence of slack in the economy and lower resource utilisation.

The MPC, however, recognised that, even though headline inflation was currently driven by forces on which domestic monetary policy had limited impact, it was important that the first-round effects did not lead to broader price and wage pressures. Further, in the light of recent monetary developments and the forthcoming Pay Research Bureau (PRB) award, the view that inflationary expectations should be contained was emphasised as a necessary condition for sustaining macroeconomic stability over the medium-term. The MPC therefore reiterated its call to economic operators in the import and distributive trade sectors to exercise restraint and reflect purely economic factors in pricing their products. Likewise, the MPC urged moderation in wage-bargaining to prevent second-round effects of a wage-price spiral.

The MPC expressed the view that its policy action could only have short- to medium-term beneficial effect on the growth outlook by reducing the cost of funds. In the medium- to long-term, sustainable growth would require higher levels of productivity and efficiency. Nevertheless, the interest rate decision of 2 May 2008 combined with those taken earlier should help in mitigating the downside risks to economic activity and maintaining employment in key sectors of the economy.

The MPC will continue to meet outside regular quarterly meetings as and when required to assess the evolution of the economic situation and if needed take appropriate policy measures. The MPC will monitor domestic as well as international economic and financial developments and remains committed to price stability and to promote orderly and balanced economic development.

Voting Pattern

The MPC voted with a majority of **six to one** to reduce the key Repo Rate by 50 basis points to 8.00 per cent per annum. One member voted to keep the policy interest rate unchanged.

Bank of Mauritius

2 May 2008