# OVERVIEW

## International Developments

During September 2008, the US dollar, on average, appreciated against the Pound sterling and the euro but lost ground vis-à-vis the Japanese yen.  The US dollar started the month on a good note, drawing support from a sharp drop in oil prices and weakness in other major economies.  The release of US August 2008 unemployment data showing that the US economy lost jobs for the eighth consecutive month and the unemployment rate rose to a near five-year high of 6.1 per cent brought the US dollar under downward pressure.  However, the US government's takeover of Freddie Mac and Fannie Mae to shore up its US housing market and protect against more global financial turbulence benefited the US dollar as it boosted confidence in the US financial sector and even prompted investors to buy the dollar.  However, market's optimism over the bail-out of the two largest mortgage finance firms eroded and the US dollar fell as shares of Lehman Brothers Holdings Inc, the fourth largest US investment bank, plunged on worries over the bank's ability to raise capital, shifting the spotlight back on the US fragile financial sector. Risk aversion heightened as Lehman Brothers ultimately filed for bankruptcy protection.  Meanwhile US Treasury Secretary Henry Paulson tried to soothe market fears stating that the US financial system remained sound despite current stresses and he was prepared to take further actions if necessary to maintain stability.  At the same time, the market digested news that Bank of America had agreed to buy Merrill Lynch and the Federal Reserve would accept equities in exchange for cash loans for the first time in its history.  The US dollar, on its part, recovered after the Federal Reserve held interest rates steady at 2 per cent at its regular FOMC meeting on 16 September 2008, opting for the time being to relieve rattled financial markets with central bank lending facilities rather than interest rate cuts.  According to analysts, despite much of the bad news originating in the United States, the US dollar also benefited from the widespread financial jitters as investors became increasingly keen to send money back home for safety. Nonetheless, the US currency could not sustain its gains as the US government's rescue of insurer American International Group (AIG) failed to calm investor concerns about the stability of the US financial sector.  Market scepticism about how effective the rescue package of US$700 billion proposed by Bush administration would be in resolving the worst credit crisis since the Great Depression also added to negative market sentiment towards the US dollar.  Although lower oil and gold prices provided momentarily some respite to the US currency, the US Congress's rejection of the US$700 billion bank bailout package towards the close of the month brought the US dollar under strong selling pressure.  In fact, the US lawmakers' vote against the bailout package caused panic among investors, with Dow Jones industrial average suffering its biggest one-day point drop ever as well as affecting stock markets in Asia and Europe.

The euro depreciated against the US dollar trading at an average of US$1.4381 in September 2008 compared to an average of US$1.5001 in August 2008. The euro started the month on a weak tone, undermined by political tensions between EU and Russia. At its governing council meeting held on 4th September, the European Central Bank (ECB) left its benchmark lending rates unchanged at 4.25 per cent. However, although the ECB President maintained his unambiguously hawkish language on inflation in his post-meeting news conference, markets largely focused on growth downgrades for the euro zone. The single currency witnessed further losses after the ECB cut its growth outlook for the 15-nation region, boosting the likelihood of future interest rate cuts. With the market focusing on souring economic outlook prevailing outside the United States as well, the euro breached below the US$1.40 level, reaching its intra-month low of US$1.3961 on 11 September 2008. The euro's woes were also worsened by comments from Jean-Claude Juncker, chairman of euro zone finance ministers, saying the currency was still overvalued in real terms. The euro, thereafter managed to rebound from its lows against the US dollar, supported by comments from ECB President that inflation remained the key focus. With growing worries weighing on the US dollar, the euro maintained its momentum attaining its intra-month high of US$1.4777 on 23 September 2008. The positive note, however, retreated with losses in the euro kicking off, after factory data showed euro-zone manufacturing activity contracted at its fastest rate in nearly seven years. The euro suffered further as banks in Europe also succumbed to the widening crisis fallout, prompting investors to rush for currencies seen as a safe-haven during the turmoil, such as the Japanese yen and Swiss franc. At the close of the month, the euro was trading at US$1.4376 as the credit crunch claimed several new victims in Europe - amongst which Wachovia Corp - confirming that the financial crisis was spreading from the United States to Europe.

The Pound sterling depreciated against the US dollar during the month of September 2008, trading at an average of US$1.8004 from an average of US$1.8942 in August 2008. Market sentiment towards the Pound sterling was rather weak at the start of September 2008 after UK finance minister said that the economic outlook was its most challenging in 60 years. Adding to the sterling's woes was the release of a forecast by the Organisation of Economic Co-operation and Development (OECD) that the UK economy would fall into a recession in the second half of the year. Against the background of broad weakness in the UK economy, the Bank of England Monetary Policy Committee, at the end of its two-day meeting on 4 September 2008, left UK interest rates unchanged at 5 per cent. The growing UK economic malaise was further highlighted by the Halifax's latest house price survey, which showed prices fell by 12.7 per cent on the year in August 2008, the biggest drop since records began in 1983. The Pound, however, managed to pull back from its lows, boosted by broad US dollar losses although sentiment remained downbeat on the view that the UK economy was deteriorating fast and raising the chances of monetary easing later this year. Moreover, the Pound also benefited from traders taking advantage of the currency's slide to recent multi-year lows to buy it back at cheaper levels. But the Pound came under renewed pressure after forecasts from the UK National Institute of Economic and Social Research, highlighted recession risks facing the UK by stating that the economy contracted by 0.2 per cent in the three months to August after a 0.1 per cent fall in GDP in the three months to July. These concerns were further exacerbated by fears that neither the Bank of England nor the UK government would be in a position to help prop up the sharply slowing economy via interest rate cuts or fiscal measures. The Pound hit its intra-month low of US$1.7503 on 11 September 2008, hurt by comments from Bank of England policymaker David Blanchflower pointing to a deeper than forecast decline in the UK economy and rises in unemployment soon. The Pound, thereafter, bounced off its low against the US dollar as weak US economic data stalled a broad rally of the US currency, while investors trimmed bets on an imminent UK interest rate cut. Bank of England policymaker Paul Tucker said that inflation expectations were flashing an "amber light", adding to the view that the central bank was in no hurry to cut rates yet to help the ailing economy. The Pound sterling held on its gains, as investors put poor jobs data to one side and clung to news of merger talks between Lloyds TSB and domestic rival HBOS. The British currency further consolidated its gains reaching an intra-month high of US$1.8568 on 25 September 2008, largely driven by US dollar losses as UK market fundamentals paled in comparison to US turmoil. A survey showing British retail sales fell less sharply than expected in September also helped to underpin the Pound. The Confederation of British Industry's distributive trades survey balance picked up to -27 from -46 in August. The Pound, however, closed the month on a softer note against the dollar after UK lender Bradford & Bingley was nationalised, snapping attention away from US financial sector worries. The deepening banking sector and money market crisis which have spread in Europe against a backdrop of slowing growth also dimmed the Pound's yield appeal as speculation grew that the Bank of England would need to cut rates soon.

International oil prices, on average, moved lower during September 2008 supported by stronger dollar and weaker global demand for oil. IPE Brent settled its intra-month high of US$108.3 a barrel on 02 September 2008 while NYMEX reached a peak of US$120.9 a barrel on 22 September 2008, posting its biggest one-day gain on record due to the weak US dollar and with the rescue plan seen as inflationary, thereby making commodities a hedge against the dollar. At its meeting on 09 September 2008 in Vienna, Austria, OPEC made the unexpected decision to cut output by around 500,000 barrels per day due to softening global demand. The next OPEC meeting will be held in Oran, Algeria, on 17th December 2008. The International Energy Agency lowered its 2008 world oil demand growth forecast by 100,000 barrels per day to 690,000 bpd and also trimmed its forecast for 2009 global demand growth by 40,000 bpd to 890,000 bpd. It further noted that prices have dropped significantly in recent weeks, driven by a weakening world economy, in particular in major OECD countries, as a result its concomitant lower oil demand growth, higher crude supply, a strengthening of the US dollar and an easing of geopolitical tensions.

NYMEX WTI (West Texas Intermediate crude oil) averaged US$103.8 a barrel in September 2008, down from US$116.7 a barrel in August 2008 but up from US$79.6 a barrel in September 2007. IPE Brent figures averaged US$100.4 a barrel during the month under review, down from US$115.2 a barrel in August 2008 but up from US$77.0 a barrel in September 2007.

COMEX gold futures, on average, moved down during September 2008, trading in an intra-month closing range of US$745.0/Oz-US$909.0/Oz compared to US$792.1/Oz-US$913.5/Oz in August 2008. Gold prices reached a peak of US$909.0/Oz on 22 September 2008, supported by a weak US dollar and rise in oil prices. The bullion averaged US$833.9/Oz during September 2008, compared to an average of US$842.5/Oz in August 2008.

**Domestic Developments**

In the September 2008 issue of its National Accounts Estimates, the Central Statistics Office maintained the real growth rate of the economy for 2007 at 5.4 per cent. Exclusive of sugar, the growth of the economy is estimated at 6.1 per cent. The main contributors to growth in 2007 were the “Construction”, “Hotels and restaurants”, “Transport, storage and communications”, “Real estate, renting and business activities” and “Financial intermediation” industry groups, which grew by 15.2 per cent, 14.0 per cent, 7.7 per cent, 7.6 per cent and 7.5 per cent, respectively. The “Wholesale and retail trade” industry group grew by 4.4 per cent. The textile sector grew by 8.5 per cent in 2007 compared to 2.9 per cent in 2006. The sugar sector, affected by tropical cyclone Gamede which hit the country in February 2007, contracted by 13.6 per cent in 2007.

After registering a high growth of 19.0 per cent in 2006, gross domestic fixed capital formation (GDFCF) grew further in real terms by 8.6 per cent in 2007. The investment rate, as measured by the ratio of GDFCF to GDP at market prices, increased from 24.3 per cent in 2006 to 25.1 per cent in 2007. Private sector investment grew further by 24.0 per cent after a growth of 15.1 per cent in 2006. On the other hand, public sector investment contracted by 24.7 per cent in 2007 after a high growth of 28.3 per cent in 2006. The savings rate increased to 21.3 per cent in 2007 from 17.1 per cent in 2006.

The economy is now expected to grow by 5.6 per cent in 2008, slightly lower than the forecast of 5.7 per cent made in June 2008, mainly due to lower projected growths in the textile sector and “Hotels and restaurants” industry group. Exclusive of sugar, the growth rate would be the same at 5.6 per cent. The manufacturing sector is forecast to grow by 3.1 per cent in 2008, mainly on account of growths of 3.5 per cent, 2.8 per cent and 2.6 per cent in “other manufacturing”, “textile” and “food” industries, respectively. The construction sector is expected to post a strong performance in 2008 with a growth of 11.0 per cent, mainly due to the construction of commercial and office buildings, hotels and projects under the Integrated Resort Scheme. The “Hotels and restaurants” industry group is expected to grow by 5.6 per cent, based on a projection of 960,000 tourist arrivals. The financial sector would grow by an estimated 7.8 per cent. The sugar sector is expected to grow by 5.5 per cent, based on a sugar production of 460,000 tonnes.

Tourist arrivals rose by 2.4 per cent, from 69,941 in August 2007 to 71,605 in August 2008, while gross tourism receipts went down by 12.7 per cent, from Rs3,177 million in August 2007 to Rs2,774 million in August 2008. On a cumulative basis, over the period January 2008 to August 2008, tourist arrivals reached 608,532 representing an increase of 5.0 per cent over 579,279 arrivals recorded over the corresponding period of the previous year. Tourism receipts for the period January 2008 to August 2008 grew by 8.1 per cent to reach Rs28,003 million compared to Rs25,909 million recorded over the corresponding period of the previous year.

The Consumer Price Index (CPI) increased from 116.3 in August 2008 to 116.7 in September 2008. The largest rise of 3.7 per cent was noted in the Division “Alcoholic beverages and tobacco” “followed by “Miscellaneous goods and services” (+0.7 per cent), “Housing, water, electricity, gas and other fuels” (+0.3 per cent), “Restaurants and hotels” (+0.3 per cent), “Transport” (+0.2 per cent), “Food and non alcoholic beverages” (+0.1 per cent) and “Communication” (+0.1 per cent). The divisions “Clothing and footwear”, “Furnishings, household equipment and routine household maintenance”, “Health” and “Recreation and culture” registered declines of 0.2 per cent, 0.1 per cent, 0.4 per cent and 0.3 per cent, respectively while “Education” recorded no change in its index. The main contributors to the rise in the index between August 2008 and September 2008 were cigarettes, which registered an increase of 0.3 index point and air tickets and other goods and services, each registering an increase of 0.1 index point. A drop of 0.1

index point for motor vehicles was noted. The rate of inflation for the twelve-month period ended September 2008 stood at 9.8 per cent, up from 9.5 per cent for the twelve month period ended August 2008.

While headline inflation for September 2008 stood at 9.8 per cent, CORE1, CORE2 and TRIM10 inflation rates stood at 8.3 per cent, 6.0 per cent and 5.5 per cent, respectively. Consequently, for September 2008, core inflation was between 1.5 and 4.3 percentage points lower than the headline inflation.

Net foreign assets of depository corporations fell by Rs530 million, or 0.6 per cent, from Rs83,628 million at the end of June 2008 to Rs83,098 million at the end of August 2008, on account of the decrease in both the net foreign assets of Bank of Mauritius and those of the other depository corporations. Net foreign assets of other depository corporations fell by Rs76 million, or 0.3 per cent, to Rs26,525 million while those of the Bank of Mauritius fell by Rs453 million, or 0.8 per cent, to Rs56,573 million.

Domestic claims of depository corporations, excluding claims on GBL holders, went up by Rs1,115 million, or 0.4 per cent, from Rs258,704 million at the end of June 2008 to Rs259,819 million at the end of August 2008. Net claims on budgetary central Government rose by Rs775 million, or 1.5 per cent, from Rs53,171 million at the end of June 2008 to Rs53,946 million at the end of August 2008. Claims on other sectors, that is, credit to the private sector grew by Rs341 million, or 0.2 per cent, to Rs205,873 million in August 2008.

Net claims on budgetary central Government from the Bank of Mauritius fell by Rs659 million, or 15.1 per cent, from negative Rs4,362 million at the end of June 2008 to negative Rs3,703 million at the end of August 2008. Net claims on budgetary central Government from other depository corporations rose by Rs116 million, or 0.2 per cent, from Rs57,533 million to Rs57,649 million.

Claims on Other Sectors from the Bank of Mauritius rose by Rs3 million, or 2.4 per cent to Rs138 million at the end of August 2008 while claims on Other Sectors from other depository corporations expanded by Rs337 million, or 0.2 per cent, from Rs205,398 million to Rs205,735 million.

Broad Money Liabilities (BML) grew by Rs4,102 million, or 1.6 per cent, from Rs252,175 million at the end of June 2008 to Rs256,277 million at the end of August 2008. Of the components of BML, currency with public rose by Rs414 million, or 3.2 per cent, to Rs13,329 million while transferable deposits fell by Rs2,095 million, or 3.9 per cent, to Rs51,302 million. Savings deposits rose by Rs110 million, or 0.1 per cent, to Rs74,007 million while time deposits went up by Rs5,678 million, or 5.1 per cent, to Rs116,105 million. Securities other than shares included in broad money fell by Rs6 million, or 0.4 per cent, to Rs1,534 million.

The monetary base fell by Rs2,537 million, or 9.3 per cent, from Rs27,328 million at the end of June 2008 to Rs29,865 million at the end of August 2008. Currency in circulation grew by Rs652 million, or 4.3 per cent, from Rs15,008 million to Rs15,660 million while liabilities to other depository corporations increased by Rs1,938 million, or 16.2 per cent, from Rs11,933 million to Rs13,871 million.

Broad Money Liabilities multiplier fell from 9.2 at the end of June 2008 to 8.6 at the end of August 2008, reflecting a greater expansion of Monetary Base as compared to Broad Money Liabilities.

In September 2008, the Bank issued Government of Mauritius Treasury Bills for a total nominal amount of Rs4,937 million through the weekly Primary Auctions. Between end-August and end-September 2008, the weighted average yields of the 91-day, 182-day and 364-day Bills increased from 7.77 per cent to 9.09 per cent, from 8.32 per cent to 9.29 per cent and from 8.70 per cent to 9.74 per cent respectively. During September 2008, the market preference remained skewed towards the 91-day Bills.

During the month, the Bank carried out four repurchase transactions for a total amount of Rs3,500 million on an auction basis for period ranging between 7 to 14 days at the quoted rate of 9.50 per cent. Transactions on the interbank money market in September 2008 amounted to Rs39,405 million with a daily average of Rs1,314 million, a high of Rs2,070 million and a trough of Rs650 million. The weighted average overnight interbank rate for September 2008 increased to 8.79 per cent from 6.71 per cent for the previous month.

Total transactions in Government of Mauritius Treasury Bills/Bank of Mauritius Bills effected through primary dealers amounted to Rs674.3 million. There were no transactions of Bills on the Stock Exchange of Mauritius. A total amount of Rs15.60 million Treasury Bills/Treasury Notes was sold over the counter at the Bank to members of the public for individual amounts ranging from the minimum of Rs50,000 to the maximum amount of Rs2 million.

At the monthly auction of Treasury Notes held in September 2008, a total nominal amount of Rs1,200 million of Treasury Notes with maturities of 2, 3 and 4 years, and with interest payable semi-annually at the rates of 8.25, 8.50 and 8.90 per cent per annum, respectively, were put on tender. Bids received for the three maturities totalled Rs941.5 million only. The weighted average yields on bids accepted for the 2, 3 and 4-year maturities were 8.86, 9.20 and 10.72 per cent per annum, respectively.

In September 2008, the Bank intervened on the domestic foreign exchange market and sold US$22.0 million.

Between August 2008 and September 2008, the rupee, on average appreciated vis-à-vis the euro and Pound sterling, while it depreciated against the US dollar and Japanese yen. 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 reported by banks, showed that between August and September 2008 the rupee, on average, depreciated against the US dollar and the Euro but appreciated against the Pound sterling.

At the end of August 2008, the net international reserves of the country stood at Rs83,410 million. The end-August 2008 level of net international reserves of the country, based on the value of the import bill for fiscal year 2007-08, exclusive of the purchase of aircraft, represented 33.9 weeks of imports, up from 33.1 weeks of imports at the end of July 2008. The gross foreign exchange reserves of the Bank of Mauritius, on account of intervention by way of sales of foreign exchange on the domestic interbank foreign exchange market, decreased from Rs56,976 million at the end of August 2008 to Rs55,784 million at the end of September 2008.