BANK OF MAURITIUS

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MONETARY POLICY STATEMENT

The Monetary Policy Committee (MPC) of the Bank of Mauritius decided to maintain the key Repo Rate at 5.75 per cent per annum at its regular meeting held on 22 September 2009. The interest rate chargeable on the Special Deposits Facility, set at 100 basis points below the key Repo Rate, remains at 4.75 per cent per annum while that on the Overnight Facility, set at 150 basis points above the key Repo Rate, is held at 7.25 per cent per annum. The interest rate payable on the Standing Facility, set at 400 basis points above the key Repo Rate, is 9.75 per cent per annum.

The MPC reviewed current international and domestic economic as well as financial developments and assessed the outlook for the global and domestic economy before reaching its decision.

International developments and outlook

Hopes of recovery in the global economy have been sustained since the last MPC meeting. Global economic as well as financial market conditions have continued to improve, largely facilitated by the unprecedented monetary and fiscal stimulus measures implemented across the world. The latest economic data suggest that the major economies are stabilising while some have already moved out of recession and that world trade has also been stabilising. Overall, global economic performance is expected to continue improving in the second half of 2009 and positive growth is foreseen as from 2010.

In its July 2009 World Economic Outlook (WEO) Update, the International Monetary Fund (IMF) projected the world economy to contract by 1.4 per cent in 2009 but to grow by 2.5 per cent in 2010, with marked differences in economic performances across regions. Recovery was expected to be stronger in emerging and developing economies which were projected to record positive growth rates of 1.5 per cent in 2009 and 4.7 per cent in 2010. In contrast, advanced economies were projected to contract by 3.8 per cent in 2009 before recovering to post a positive growth of 0.6 per cent in 2010. China and India would lead the way globally. As the economic recovery has been gathering strength, most of these forecasts are likely to be revised upward in the October 2009 WEO update of the IMF.

While growth is foreseen as from 2010, the pace and extent of recovery remain uncertain. Consumer spending, a key driver of economic growth in major economies, is expected to stay weak for some time on account of job insecurity, high indebtedness and massive loss of wealth. Moreover, although credit spreads have narrowed further and equity markets have risen as confidence has improved, credit markets are yet to reflect normal conditions. Also, capacity utilisation remains low and employment levels are still adjusting to the falls in output. The MPC recognised that the combination of vulnerable financial markets and weak labour market conditions compounded by the expected pickup in commodity prices might exert strains on global economic recovery. Nonetheless, the MPC noted a clear improvement in growth prospects worldwide.

Interest rates in most economies remain at historically low levels and there seems to be little scope for increases in policy interest rates in the near term, as uncertainty prevails over how long it would take before economic activity picks up sustainably. The MPC noted that monetary policy in most economies remained geared towards supporting economic recovery. The MPC, however, recognised that the cycle of monetary easing by major economies appeared to have bottomed out and increasing attention was now being focused on 'exit strategies' without, however, jeopardising the nascent recovery.

The disinflationary momentum has stabilised, with inflation at low levels in most economies, and global inflation is expected to remain subdued throughout 2010, held down by significant excess capacity and weakness in demand. However, the medium- to long-term inflation outlook reflects expectations that the expansionary economic policies pursued worldwide may result in higher inflation when the global economy recovers. Already, expectations of recovery have started raising commodity prices, particularly for food and oil.

Domestic developments and outlook

The domestic economy continues to be constrained by weak demand in main export markets. Key export sectors are estimated to have contracted in the first semester of 2009 while other economic sectors have slowed down significantly. In the first quarter of 2009, seasonally-adjusted data indicate that the economy may have contracted by a full percentage point relative to fourth quarter of 2008. The MPC is of the view that the economy may have reached a trough in the first quarter of 2009 and may have begun to recover progressively thereafter. Aggregate demand appears to have stayed weak, as reflected in the general decline in the growth rate of credit to the business and household sectors.

There are indications that activities in the export sectors are contracting at a slower pace. The data on external trade for the second quarter of 2009 show a pickup in nominal exports, which also reflect exchange rate developments favourable to the export-oriented sectors, compared with the corresponding quarter of 2008. The expected rebound in retail sales in main export markets should provide a boost to the textile sector in particular. Compared with the corresponding quarter of the preceding year, the contraction of tourist arrivals is less severe in the second quarter than in the first quarter of 2009. Tourist arrivals are expected to pick up gradually from lower levels reached in the first semester of 2009 as international travel sentiment keeps on improving. Overall, as our main export markets begin to recover, external demand-led sectors are foreseen to record a higher pace of economic activity in the second semester of 2009 relative to the first semester. This likely development would generate positive spill-over effects on other sectors of the economy. There are indications that business sentiment may be improving further.

The MPC anticipates a better performance of the economy in the second half of 2009, with the likelihood that overall Gross Domestic Product (GDP) growth rate would be around 2.7 per cent in 2009. The MPC is also of the view that the downside risks to the growth outlook have further diminished.

The MPC noted that fewer job losses than initially anticipated had been recorded. Although the labour market may reflect trends in the broader economy with a lag, it is not expected to weaken much further.

The latest monetary data confirm the decline in the growth rate of both money supply and credit. Consequently, monetary developments do not jeopardise the maintenance of low inflation over the short to medium term. The growth rate of money supply has fallen to 10.8 per cent in the year to July 2009. The low interest rate environment has not spurred strong demand for credit by the private sector. The expansion of credit to the private sector has continued to decline, attaining 9.6 per cent in the year to July 2009, but still remains at a relatively comfortable level. The domestic banking sector has demonstrated strong resilience and the availability of credit is not a cause for concern.

Inflationary pressures have continued to subside. Lower global commodity prices compared to a year earlier and moderating cost pressures have contributed to ease inflation further. On a year-on-year basis, inflation in August 2009 fell to 1.0 per cent, the lowest level in nearly two decades. As measured by the twelve-month moving average, it has also continued to decline to 5.2 per cent in August 2009, a level last seen around mid-2006. The MPC anticipates inflation, measured by both the average and year-on-year methodologies, to converge to around 3 per cent by the end of 2009, lower than the previous estimate of 4 per cent.[1]

Further, a majority of stakeholders expect inflation to fall in the short term. Domestic economic slack and low price pressures from external sources are anticipated to mitigate inflationary pressures in the short term. Over the medium term, however, the inflation outlook remains uncertain. Potential risks stem from the future course of oil and food prices on international markets.

Concern was also expressed about the low national saving rate forecast at 14.3 per cent of GDP for 2009 and which is expected to be revised further down.

The current account deficit is estimated to have widened to Rs8,757 million in the second quarter of 2009, after shrinking to Rs1,743 million in the first quarter. This deterioration is attributed mainly to the sharp turnaround in the income account, a widening of the merchandise trade deficit and to the drop in the surplus in the services account. Reflecting the pickup in imports, the deficit on the merchandise account increased to Rs11,786 million in the second quarter of 2009 from Rs9,471 million in the first quarter of 2009. The surplus on the services account fell to Rs3,574 million in the second quarter of 2009 from Rs5,174 million in the first quarter, largely due to shrinking tourism receipts. Foreign direct investment (FDI) recorded higher net inflows of Rs1,984 million in the second quarter of 2009 compared to Rs1,210 in the first quarter of 2009, thereby demonstrating some resilience of the Mauritian economy in attracting FDI despite the global slowdown. The overall balance of payments for the second quarter of 2009, measured as the change in reserve assets excluding valuation changes, registered a surplus of Rs3,945 million.

The MPC took note that the foreign exchange reserves of the country had reached an unprecedented high level. Further, the domestic foreign exchange market has been well-balanced, with the exchange rate of the rupee reflecting mostly international currency trends. Nevertheless, continued vigilance in preventing excessive exchange rate movements and containing balance of payments pressures is warranted.

The effects of the domestic fiscal stimulus and the substantial easing of monetary policy since October 2008 are still unfolding. Overall, the MPC judged that improved prospects in main export markets, the domestic stimulative economic policy measures and supportive business as well as consumer sentiment would enhance economic performance over the medium term.

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[1] *Year-on-year inflation is computed as the change in the Consumer Price Index (CPI) for a given month compared with the same month of the preceding year in percentage terms. The Central Statistics Office computes the inflation rate by comparing the average level of prices, as measured by the CPI, during a twelve-month period with the average level during the corresponding previous twelve-month period.*

The MPC weighed the risks to the growth and inflation outlook over the policy-relevant horizon. The MPC judged, in the light of its assessment, that the inflation outlook would continue improving in the short term with, however, potential upside risks over the medium to long term. Further, the declining trend in quarterly economic growth rate appears to have been reversed: provided global growth prospects remain favourable, domestic growth should continue to gather additional momentum. To consolidate the recent positive developments, the MPC decided to maintain the current stance of monetary policy.

The MPC will continue to monitor economic and financial developments and remains committed, as per its mandate, to formulate and determine monetary policy, taking into account the orderly and balanced economic development of Mauritius.

Voting Pattern

The MPC voted unanimously to maintain the key Repo Rate at 5.75 per cent per annum.

Date for Regular Meeting

The MPC will convene its next quarterly meeting on 10 December 2009. It stands ready to meet outside regular meetings as and when required to assess the evolution of the economic situation and, if needed, take appropriate policy measures.

Bank of Mauritius
29 September 2009