Quarterly Economic Report

September 2019

BANK OF MAURITIUS

QUARTERLY ECONOMIC REPORT

September 2019

In accordance with section 4(1) of the Bank of Mauritius Act 2004, the primary object of the Bank of Mauritius is to maintain price stability and to promote orderly and balanced economic development. The formulation and determination of monetary policy is entrusted to the Monetary Policy Committee (MPC) as set out in sections 54 and 55 of the Bank of Mauritius Act 2004. The MPC determines the appropriate monetary policy stance through changes in the Key Repo Rate. The MPC usually meets four times during a year, but stands ready to meet in between its regular meetings. In their decision-making process, MPC members assess the balance of risks between economic growth and inflation by considering a wide range of domestic and international economic and financial data and information. Given the time lags before monetary policy takes effect, the MPC is pre-emptive and forward-looking, and relies on a number of indicators, namely forecasts of relevant economic variables and assumptions.

This third issue of the Quarterly Economic Report presents macroeconomic developments during the third quarter of 2019. Consideration is also given to general economic policies that support price stability and sustainable economic growth. This Report aims to enhance the public's understanding of the policies applied to achieve the mandates of the Bank of Mauritius. The analysis in this Report is based on macroeconomic data available at the date of its preparation. Unless otherwise stated, this edition relies on information and data available as at end-September 2019.

This Report is available on the Bank of Mauritius' website at https://www.bom.mu under the URL item *Publications and Statistics*. The Bank of Mauritius welcomes feedback from readers. Please forward comments and suggestions to *communications@bom.mu*.

Quarterly Economic Report September 2019

ISSN 1694-3740

TABLE OF CONTENTS

1. SUMMARY

At its meeting on 09 August 2019, the Monetary Policy Committee (MPC) of the Bank of Mauritius, by majority vote, reduced the Key Repo Rate (KRR) by 15 basis points to 3.35 per cent per annum. The MPC noted that the prospects for global economic outlook further weakened due to increasing trade tensions between the two largest economies, rising uncertainties associated with Brexit and geopolitical tensions. MPC members viewed that the domestic economy has to further enhance its resilience to withstand the worsening external environment. The MPC assessed that price pressures continued to ease since its May 2019 meeting. Based on an assessment of the risks to the growth and inflation outlook, a majority of members viewed that the inflation outlook provided room for a reduction in the policy rate as a pre-emptive move against risks associated with faltering global growth.

Global economic growth weakened further. According to the latest publications of the IMF and OECD, real GDP growth projections for the global economy reached their lowest annual growth rates since the financial crisis. Economic activity has been adversely affected by mounting trade tensions, leading to a slowdown in global trade, new exports orders and declining output in the manufacturing sector. Advanced economies displayed a stronger-than-expected growth reflecting solid US growth while the downgrades were largely a result of softer emerging market performance. Inflationary pressures have been contained globally on the back of the broad-based softening in growth across all regions.

In Mauritius, inflation remains contained and low. Headline inflation remained stable over the last five months to September 2019, hovering within a range of 0.9-1.0 per cent, reflecting mainly the absence of major supply shocks. Over the same period, year-on-year inflation depicted its inherent volatility associated with base effects and dropped to 1.3 per cent in September 2019. The underlying inflationary pressures, as reflected in the Bank's CORE1 and CORE2 measures, remained low since January 2019. On a 12-month average basis, CORE1 inflation waned from 1.5 per cent in June 2019 to 1.0 per cent in September 2019 while CORE2 inflation remained contained at 1.9 per cent. On a year-on-year basis, CORE1 inflation increased from -0.2 per cent in June 2019 to 0.2 per cent in September 2019 while CORE2 inflation rose from 1.4 per cent to 1.9 per cent. The Bank has revised further down its inflation projection from 1.5 per cent to around 0.5 per cent for calendar year 2019 and to about 1.5 per cent for 2020 in the absence of major supply shocks.

The domestic economy has remained resilient and posted a commendable performance in 2019Q2. Real GDP at basic prices grew by 3.6 per cent y-o-y in 2019Q2, higher compared to 3.4 per cent in 2019Q1 and 3.3 per cent in 2018Q2. For the year 2019, Statistics Mauritius downgraded its projection for real GDP at market prices to 3.8 per cent, slightly lower from 3.9 per cent projected in June 2019. Growth remains driven by domestic demand though exports and imports of goods and services have been estimated to grow higher at 2.7 per cent and 4.3 per cent, respectively. The cut in the Key Repo Rate in August 2019, is expected to support domestic economic activity. At the sectoral level, domestic economic activity remained supported by the services sector.

The unemployment rate dropped in 2019Q2, reflecting higher employment creation relative to the expansion in the labour force. Total employment increased by 12,300 y-o-y in 2019Q2, while the labour force rose by 10,900. As a result, the unemployment rate dropped to 6.6 per cent in 2019Q2, lower than 7.0 per cent in 2018Q2 and 6.9 per cent in 2019Q1. The unemployment rate is projected to decline slightly to 6.8 per cent in 2019, from 6.9 per cent in 2018.

The annual growth rate in broad money supply decelerated in August 2019, but remained adequate. Broad Money Liabilities (BML) increased by 7.1 per cent y-o-y in August 2019, lower than the increase of 7.7 per cent in July 2019. Bank loans to Other Nonfinancial Corporations, Households and Other Sectors (excluding GBCs) went up by Rs4.7 billion or 1.3 per cent, from Rs301.4 billion in October 2018 to Rs306.1 billion in August 2019. Reflecting the increase in loan facilities availed, bank loans as a percentage of GDP stood at 60.6 per cent in August 2019.

The current account deficit narrowed in 2019Q2 reflecting a higher surplus on the primary income account. The deficit was estimated at Rs4.9 billion in 2019Q2, compared to Rs5.0 billion in 2019Q1 and Rs7.9 billion in 2018Q2. As a ratio to GDP, the deficit improved from 6.6 per cent in 2018Q2 to 3.8 per cent in 2019Q2. The gross official international reserves (GOIR) of the country GOIR increased to Rs263.1 billion (equivalent to USD7,217 million) as at end-September 2019. GOIR, based on the value of imports of goods (f.o.b.) and services for calendar year 2018, represented 12.3 months of imports as at end-September 2019.

The Bank pursued its open market operations to contain excess rupee liquidity and stepped up its intervention on the domestic foreign exchange market. Nonetheless, banks' average rupee excess liquidity rose to Rs12.8 billion in 2019Q3, from Rs11.2 billion in 2019Q2. The Bank issued its own securities for a total amount of Rs34.0 billion while a total of Rs32.8 billion of BoM securities matured over the period. The Bank intervened on the domestic foreign exchange market to purchase a total amount of US$80 million[1], injecting an amount of Rs2.9 billion, of which, an amount of Rs1.1 billion was sterilised for the period under review. Special Deposits for an amount of Rs13.8 billion was outstanding as at end-September 2019.

[1] *Data up to 27 September 2019.*

Table 1: Mauritius - Selected Economic Indicators

	2013	2014	2015	2016	2017	2018*	2019**
Real GDP at market prices (Y-o-y, per cent)@	3.4	3.7	3.6	3.8	3.8	3.8	3.9
Nominal GDP (Y-o-y, per cent)@	6.2	5.3	4.5	6.1	5.2	5.3	5.3
Per capita GDP (Rs)	295,591	310,862	324,570	344,029	361,456	380,266	399,274
Consumer price index (end of period)	92.9	93.1	94.3	96.5	100.6	102.4	n.a.
Consumer price index (average)@	91.4	94.3	95.5	96.5	100.0	103.2	103.9 [1]
Average annual inflation (per cent)@	3.5	3.2	1.3	1.0	3.7	3.2	0.5
Exchange rate (end of period, Rs/US$)	30.63	32.09	36.54	36.82	34.35	34.81	36.92 [2]
Exchange rate (average, Rs/US$)	31.15	31.07	35.64	36.33	35.30	34.62	35.74 [1]
Nominal depreciation (-) (average, per cent)	1.58	0.25	-12.83	-1.91	2.92	1.96	-3.45 [3]
REER (end of period)	117.7	117.8	126.7	124.4	120.3	118.9	n.a.
REER (depreciation (-), end of period, per cent)	3.81	-0.08	-7.02	1.85	3.41	1.18	n.a.
91-Day Treasury/BoM Bill yield (end of period, per cent)	3.26	2.21	3.39	2.76	2.41	3.40	2.40 [4]
91-Day Treasury/BoM Bill yield (average, per cent)	2.59	2.21	1.83	2.54	2.13	3.38	2.95 [5]
Unemployment rate (per cent)	8.0	7.8	7.9	7.3	7.1	6.9	6.8
Per cent of GDP	**2012/13**	**2013/14**	**2014/15**	**2015/16**	**2016/17**	**2017/18**	**2018/19***
Budgetary revenue	21.2	21.0	20.5	20.9	21.1	22.5	22.3
of which: Tax revenue	*18.2*	*18.8*	*18.4*	*18.5*	*18.8*	*19.5*	*19.9*
Budgetary expenditure	23.2	24.5	24.2	24.4	24.6	25.4	25.5
of which: Wages and salaries	*5.6*	*6.2*	*6.1*	*6.2*	*6.4*	*6.2*	6.1
Interest payments	*2.7*	*2.6*	*2.5*	*2.4*	*2.5*	*2.4*	2.6
Budget balance	-2.0	-3.5	-3.7	-3.5	-3.5	-2.9	-3.2
of which: Central Government primary balance	*0.7*	*-0.9*	*-1.2*	*-1.1*	*-1.0*	*-0.5*	*-0.6*
	Dec-17	**Mar-18**	**Jun-18**	**Sep-18**	**Dec-18**	**Mar-19**	**Jun-19**
Total Budgetary Central Government debt	56.9	56.6	57.0	57.7	57.2	57.9	57.4
of which: Domestic	47.1	47.0	47.6	48.9	48.6	49.6	49.3
External	9.9	9.6	9.5	8.8	8.6	8.3	8.1
Total public sector debt	63.4	63.0	63.4	64.1	64.9	65.2	64.6
of which: Domestic	50.9	50.8	51.2	52.5	53.6	54.4	53.9
External	12.5	12.2	12.2	11.6	11.3	10.8	10.7
Per cent of GDP	**2013**	**2014**	**2015**	**2016**	**2017**	**2018***	**2019****
Trade balance	-18.7	-17.7	-16.0	-16.6	-19.9	-21.3	-22.3
Current account balance	-6.2	-5.4	-3.6	-4.0	-4.6	-5.8	-6.5
of which: Exports of goods, f.o.b	*23.6*	*24.2*	*22.8*	*19.4*	*17.6*	*16.7*	*16.4*
Exports of services	*22.9*	*22.7*	*23.4*	*23.1*	*23.0*	*22.4*	*22.1*
Imports of goods, f.o.b	*-42.3*	*-41.9*	*-38.7*	*-36.0*	*-37.6*	*-38.0*	*-38.8*
Imports of services	*-18.2*	*-16.6*	*-17.5*	*-16.8*	*-16.4*	*-15.4*	*-15.1*
Overall balance of payments (Rs billion)	+16.6	+23.0	+20.0	+26.2	+28.3	+16.6	n.a.
Gross Official International Reserves (Rs million)	105.0	124.3	152.9	178.9	200.4	217.6	n.a.
Y-o-y, per cent	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019****
Net foreign assets	-1.3	15.5	15.6	3.8	3.2	0.7	4.1
Net domestic assets	14.6	-0.3	6.7	3.5	16.5	-6.8	6.4
*of which: Claims on other sectors^*	*13.5*	*-2.8*	*8.1*	*1.0*	*15.0*	*-8.8*	*5.5*
Net Claims on Central Government	*29.9*	*28.8*	*-6.2*	*29.1*	*28.5*	*8.1*	*12.3*
Broad money	5.8	8.7	10.2	9.1	9.3	6.3	7.0
Private sector credit growth	5.9	1.3	4.2	-0.2	8.0	7.5	7.4
Income velocity of money	1.0	1.0	0.9	0.9	0.9	0.9	0.9
Money multiplier	5.9	5.9	6.0	5.8	5.1	5.5	5.4

*Note: *: Estimate. **: Forecast. Y-o-y: Year-on-year. @Bank of Mauritius staff estimate for 2019. n.a. not available.*

[1] *Average up to September 2019.* [2] *Data for 30 September 2019.*

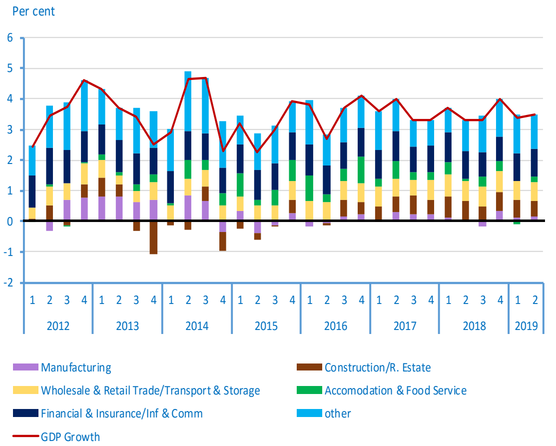
[3] *Change January to September 2019 compared to the corresponding period of 2018.* [4] *Data for auction held on 27 September 2019.*

[5] *Average up to 27 September 2019.*

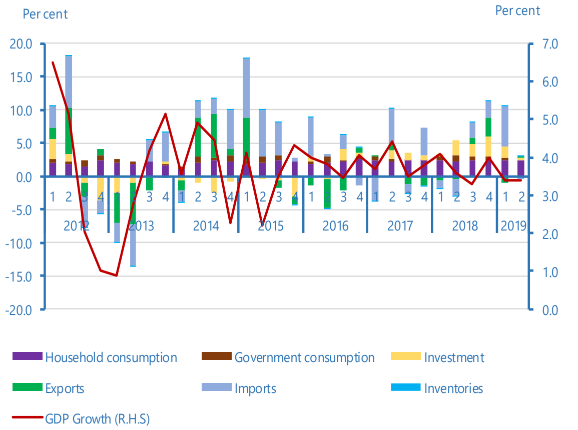
^Effective May 2018, Financial Derivatives are recorded at market or fair values and are not strictly comparable with prior months' data.

Chart 1: Macroeconomic Developments

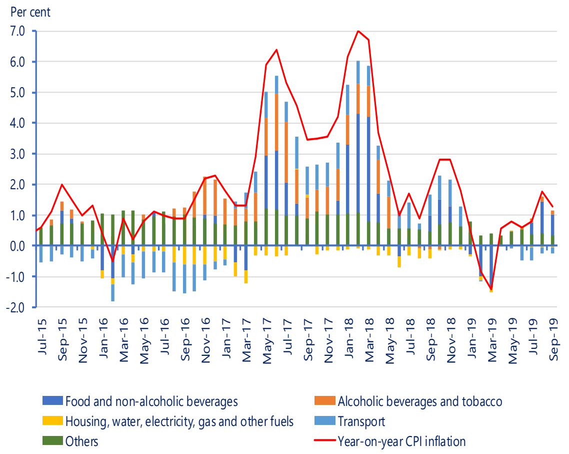
All sectors had positive contributions to growth in 2019Q2.



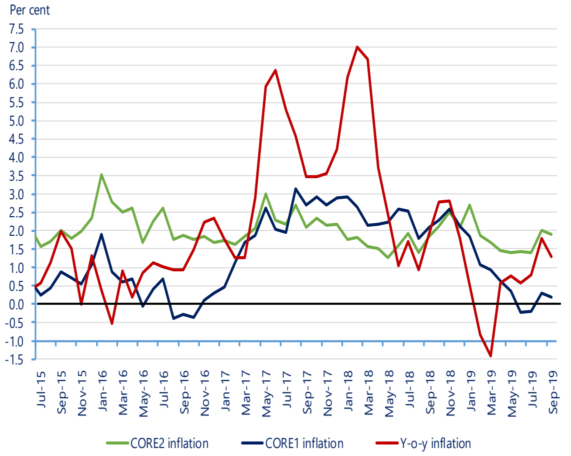
In 2019Q2, growth was driven by domestic demand, except for government consumption expenditure which was flat.



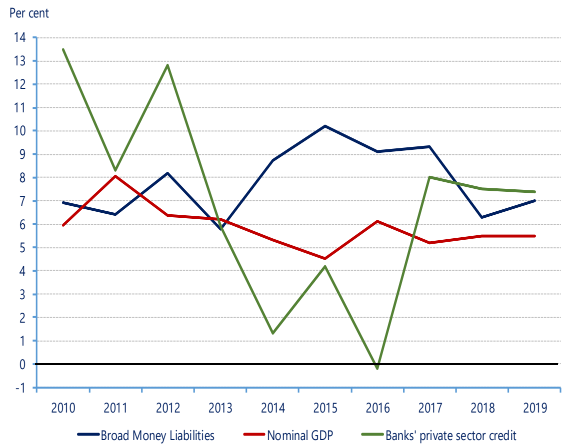
Reflecting base effects, y-o-y inflation rose until August 2019, before falling in September and remained contained.



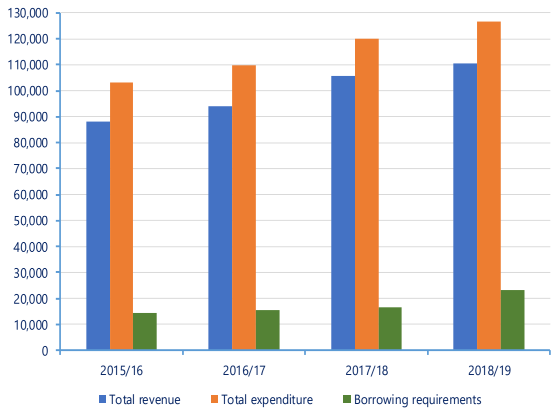
CORE1 inflation moved out of the negative zone in August 2019 while CORE2 inflation was contained below 2 per cent in September 2019.



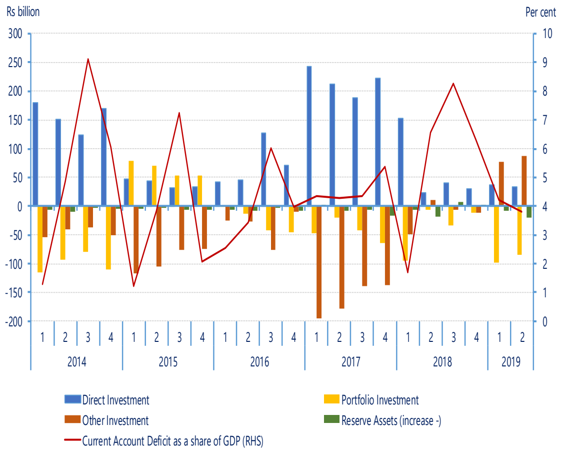
Both broad money and private sector credit maintained their growth momentum in line with economic activity.



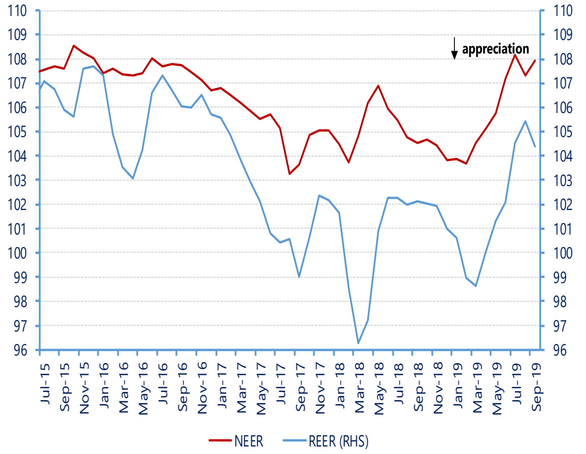
Government borrowing requirements were projected to increase in absolute terms, but would be met through domestic financing.



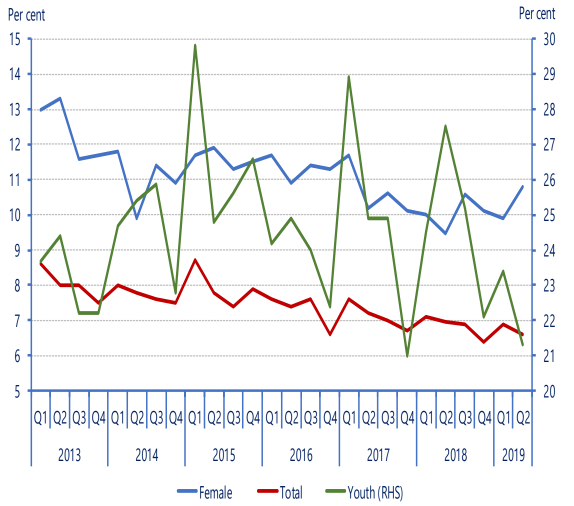
The current account deficit is estimated to have narrowed in 2019Q2, thanks to a higher surplus on the primary income account.



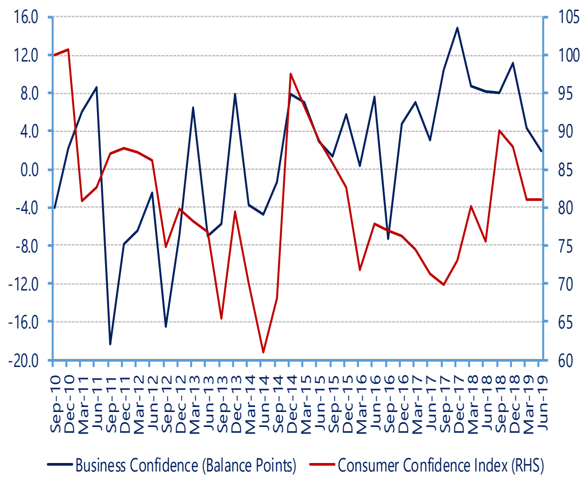
Reflecting broadly international currency movements, the rupee depreciated on both nominal and real effective terms in 2019Q3.



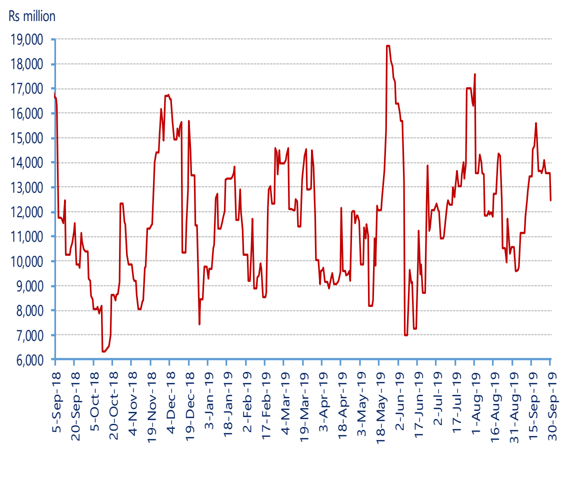
The unemployment rate declined further in 2019Q2.



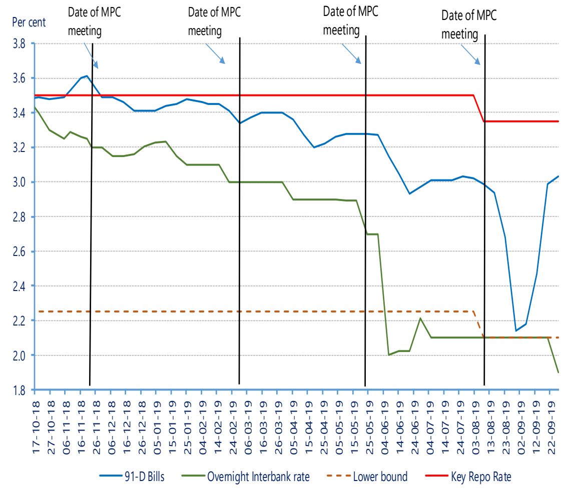
Business confidence rose at a slower pace in 2019Q2, while consumer sentiment was flat.



Rupee excess reserves rose in September 2019 despite the Bank's conduct of open market operations.



The yield on 91-Day Bills continued to hover within the interest rate corridor.



2. Recent Global Economic and Financial Developments

Global economic growth has been losing momentum since 2018H2 and the global economic landscape continued to be subject to greater uncertainty. The risks for an economic slowdown have increased amid continuing trade conflicts between the US and China, geopolitical tensions and heightened economic uncertainty which are dampening confidence and investment. Inflation continued to remain subdued across countries while most commodity prices have decreased. Globally, central banks have become more accommodative amid lingering uncertainty surrounding the global economy.

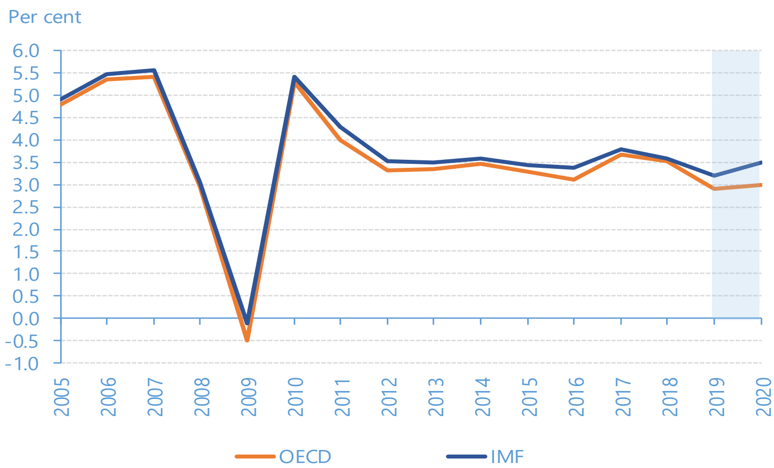
2.1 Economic Activity

The global economy lost further momentum in 2019H1 and the slowdown was broad-based across major advanced and emerging economies. Trade tensions and heightened policy uncertainty remained the headwinds to global economic activity, which resulted in declines in investment and output growth. Latest projections from the IMF and OECD put global GDP growth at their lowest level since the global financial crisis. Economic activity has been adversely affected by mounting trade tensions, leading to a slowdown in global trade, new exports orders and declining output in the manufacturing sector. Rising uncertainty negatively impacted on investment, which would weigh on firms' hiring intentions in the medium term and productivity in the longer term. The IMF revised downward its forecast for global growth for 2019 in its October 2019 World Economic Outlook (WEO). Global growth is being projected to soften to 3.0 per cent in 2019 (0.2 percentage point lower than projected in the July 2019 WEO Update), from 3.6 per cent in 2018 (Chart 2.1). The IMF forecast global growth to recover to 3.4 per cent in 2020, mostly to be attributed to recovery in growth performance of stressed economies in Europe and Latin America.

The OECD also reviewed global GDP growth downwards in both 2019 and 2020 citing downside risks to the economic outlook and rising uncertainty. In its September 2019 Interim Economic Outlook, the moderation in growth was mainly attributed to escalating US-China trade conflict, Brexit-related uncertainties, mounting geopolitical tensions and financial markets vulnerabilities. The OECD projected global GDP growth to slow from 3.6 per cent in 2018 to 2.9 per cent in 2019, down by 0.3 percentage point from its May 2019 projections. In line with the IMF forecast, projected global GDP growth by the OECD was the weakest since the global financial crisis. In 2020, global growth was forecast to increase marginally to 3.0 per cent, a downward revision of 0.4 percentage point from its previous forecast, as growth prospects would continue to be held back by the observed trade trends, weak business and consumer confidence as well as depressed investment.

GDP growth in the US decelerated in 2019Q2. The US economy grew by 2.3 per cent in 2019Q2, slowing by 0.4 percentage point compared to 2019Q1 (Chart 2.2). Positive contributions of consumer and government expenditure backed the increase in real GDP. However, the slower pace in 2019Q2 reflected weakness in the manufacturing sector that weighed on inventory investment, exports and non-residential fixed investment. The manufacturing sector continued to face headwinds from the ongoing trade war. The IHS Markit US Manufacturing Purchasing Managers Index (PMI) averaged 49.5 in 2019Q3 compared to 49.9 in 2019Q2, indicating lower production and weak client demand. Business confidence remained relatively gloomy due to muted demand conditions and ongoing trade war, worsening already difficult external demand conditions. The US Services PMI also declined, from an average of 51.8 in 2019Q2 to an average of 51.5 in 2019Q3, mainly due to lower new export orders.

Chart 2.1: Global GDP Growth



Sources: OECD and IMF.

Growth in the euro area also lost steam during 2019Q2. Real GDP growth slowed to 1.2 per cent in 2019Q2, from 1.3 per cent in the previous quarter. Though economic activity was supported by solid household consumption and a strong labour market performance, which stimulated wage growth, the slowdown in global trade and falling exports hurt growth performance. Political uncertainties over the outcome of Brexit took a toll on consumer confidence and business investment, acting as a drag on euro area's economic activity. Among the major euro area economies, Spain posted the highest quarterly growth rate, followed by France and Germany, while growth in Italy stagnated. The euro area Manufacturing PMI worsened from 47.7 in 2019Q2 to 46.4 in 2019Q3, with the difficulties of Germany's industrial sector continuing to dent euro area manufacturing sector's performance. The euro area Services PMI went down from 53.1 in 2019Q2 to 52.8 in 2019Q3.

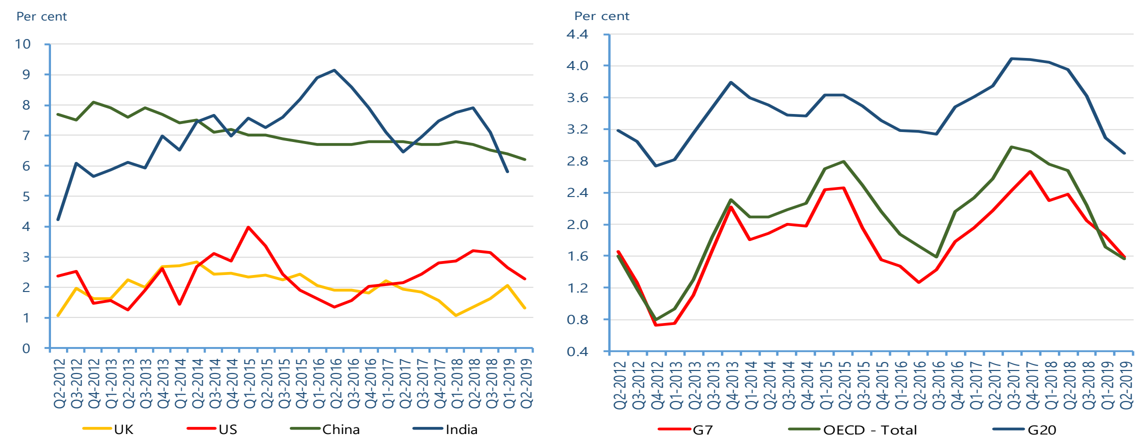
UK's growth performance was marred by uncertainties surrounding Brexit. Real GDP grew by 1.2 per cent in 2019Q2, compared to 1.8 per cent in 2019Q1. Fears of a 'no-deal' Brexit induced firms to increase stock-building in 2019Q1 that had repercussions on 2019Q2 performance. Brexit-related issues continued to weigh on economic activity as business confidence and investment weakened while some manufacturing firms went into earlier annual closure. The IHS Markit's Manufacturing PMI dropped to its lowest level since July 2012 and UK's manufacturing sector has been contracting since May 2019. The index averaged 47.9 in 2019Q3, compared to 50.2 in 2019Q2. Even the Services PMI for UK declined due to slowdown in new orders, reflecting the impact of Brexit on client decision-making and poor confidence in the business outlook.

Economic activity in China softened during 2019Q2 impacted by the ongoing trade conflict with US. China's real GDP growth fell from 6.4 per cent in 2019Q1 to 6.2 per cent in 2019Q2, the slowest since 1992. Growth remained supported by domestic demand, benefiting from government's various stimulus packages to support the economy. Economic activity was weighed by the drop in exports and ongoing trade dispute with US has raised scepticism of firms, thereby influencing investment sentiments. Alongside, the US-China technology disputes took a toll on the technology sector of China. China's Manufacturing PMI went up marginally from 49.7 in 2019Q1 and 49.9 in 2019Q2 to 50.6 in 2019Q3. The improvement in in the manufacturing PMI was driven by a quick expansion in production and new export orders. Nevertheless, inventories and finished goods of firms decreased, and the number of employees in the manufacturing sector went down in 2019Q3. China' services PMI slowed to 51.7 in 2019Q3, from 53.1 in 2019Q2.

The Indian economy grew at its weakest pace over the past six years in 2019Q2. Real GDP growth stood at 5.1 per cent in 2019Q2, down from 5.8 per cent in 2019Q1 and 7.9 per cent in 2018Q2. Consumer demand weakened, indicating fragile sentiments while investment was flat in the aftermath of uncertainty following the general elections of April-May 2019. The manufacturing sector in India slowed owing to trade tensions impacting on external demand. The Indian Government announced a series of measures, including liberalisation of Foreign Direct Investment in some selected sectors to boost economic activity. India's Manufacturing PMI dropped from 52.2 in 2019Q2 to 51.8 in 2019Q3, reflecting slowdown in production and sales and matched by a fall in factory input. The services sector PMI mirrored the trend of the manufacturing sector's PMI and the decline was driven by a fall in the number of new business inflows.

On an aggregated basis, real GDP growth of the major trading partner countries for Mauritius slowed to 1.8 per cent in 2019Q2 from 2.0 per cent in 2019Q1 and 2.5 per cent in 2018Q2. The Trading Partner Countries' Growth (TPG) rate for Mauritius, derived on the basis of the country's exports destination, rose at its slowest pace since 2013Q3. Among Mauritius' trading partners, France was the only country whose GDP increased in 2019Q2 relative to the previous quarter, while the remaining trading partners' GDP growth slowed in 2019Q2.

Chart 2.2: GDP Growth in major economies



Source: OECD.

The Purchasing Managers Index (PMI), a leading indicator for global economic activity, hinted towards a slowdown in global economic growth in September 2019. The J.P.Morgan's Global Composite PMI fell to 51.2 in September 2019 from 51.6 in July 2019 (Chart 2.3). The decline was attributed to a slowdown in the services sector at the expense of a marginal improvement in the manufacturing sector. Following 8 consecutive months of decrease, J.P. Morgan's Global Manufacturing PMI edged up marginally from 49.3 in July 2019 to 49.7 in September 2019 but still recorded a deceleration in new orders. The manufacturing sector continued to remain below the benchmark of 50.0 due to drop in business optimism and international trade flows. J.P. Morgan's Global Manufacturing PMI averaged 49.5 in 2019Q3 compared to 49.9 in 2019Q2.

World trade growth remained in negative territory while the Baltic Dry Index (BDI) reached new highs in September 2019 on account of factors not associated to trade. World trade contracted by 1.4 per cent and 1.2 per cent in July 2019 and August 2019, respectively, resulting from the impact of the trade feud between US and China and heightened uncertainty. Both countries announced that they would impose additional tariffs, raising downside risks to the global economic outlook. World imports shrank by 1.1 per cent in August 2019 and world exports contracted by 1.4 per cent. The Baltic Dry Index increased by 20.6 per cent in September 2019 compared to July 2019.

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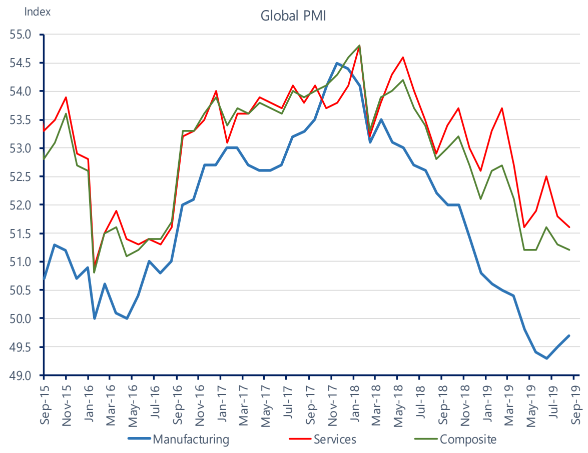
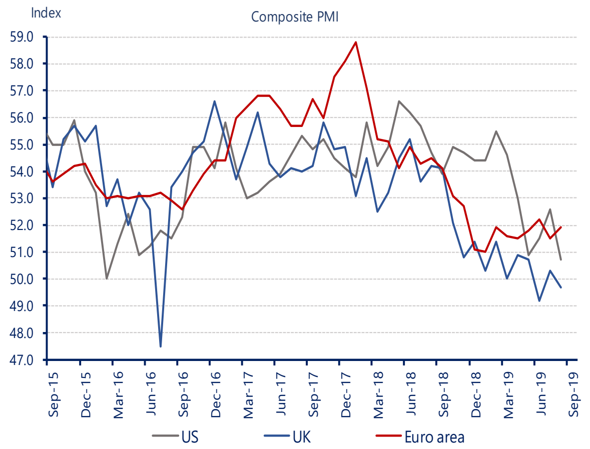
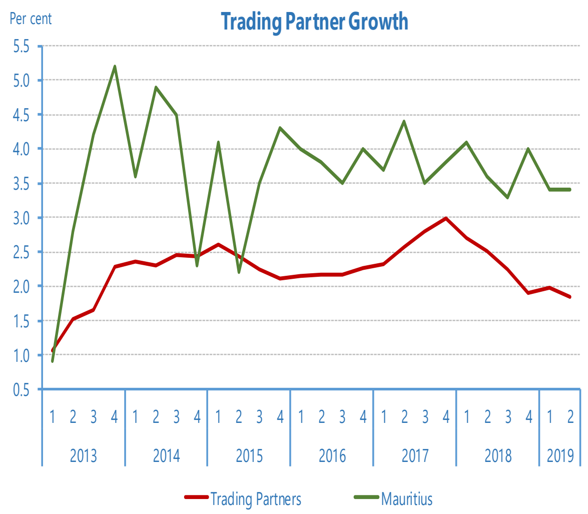
Chart 2.3: PMI, Real GDP Growth and World Trade



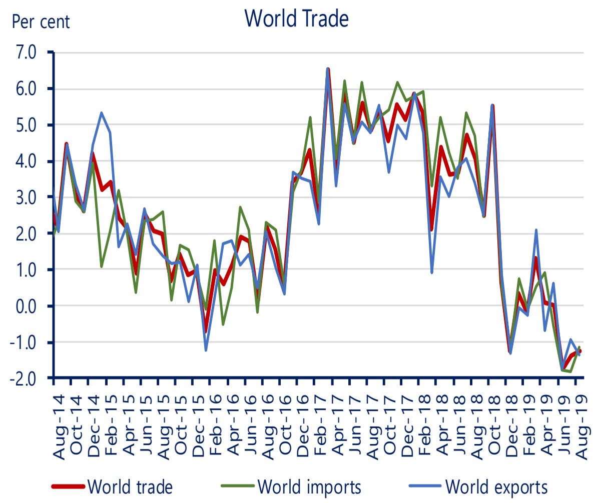
Source: Markit.



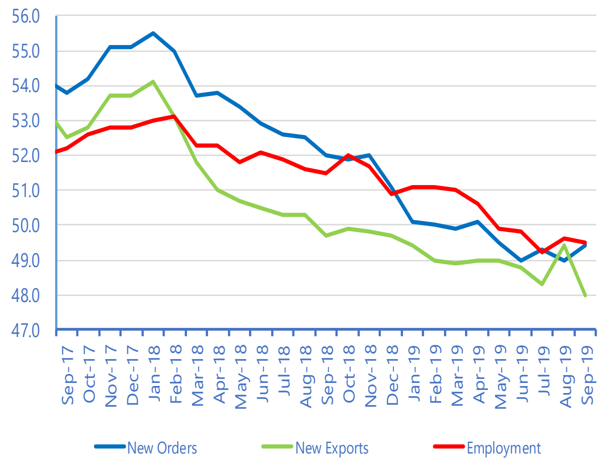
Source: Markit.



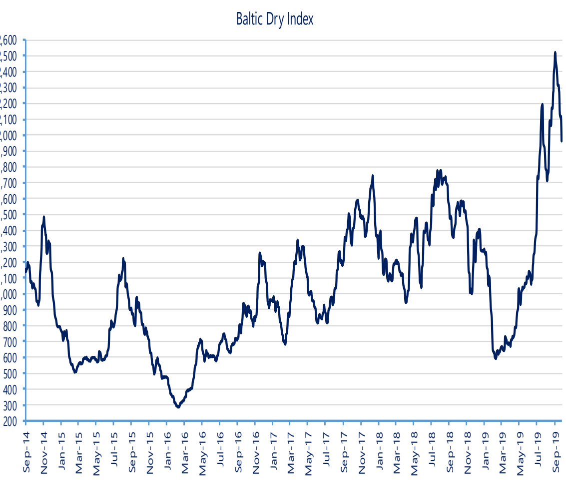
Source: Bank staff calculations.



Source: CPB Netherlands Bureau of Economic Research.



Source: Markit.



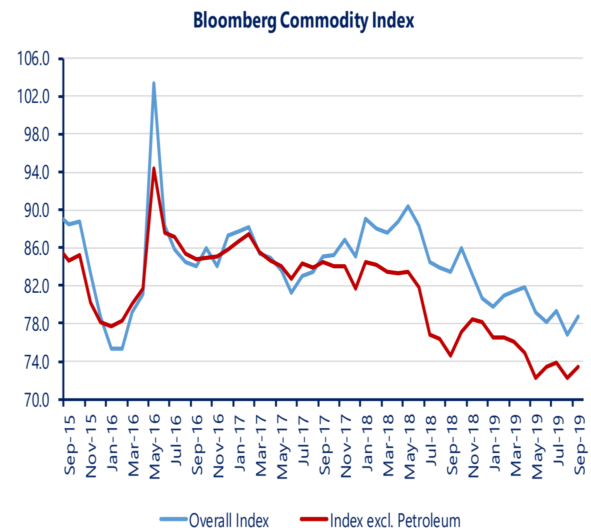
Source: Reuters.

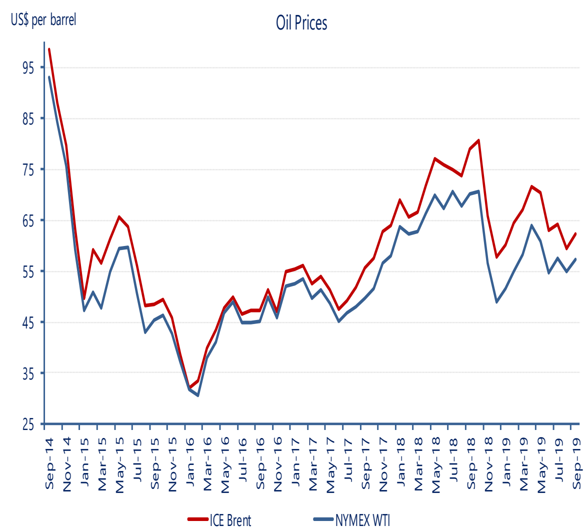
2.2 Global Commodity Prices

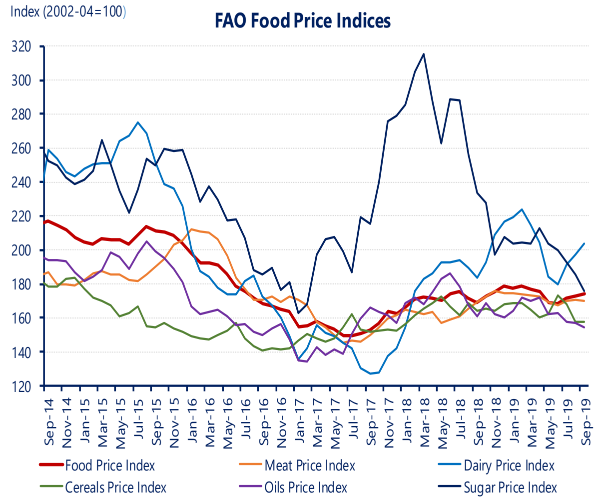
Crude oil prices recovered in 2019H1, supported by production cuts among OPEC and non-OPEC partners, as well as the United States' decision to terminate waivers on its sanctions on Iran. On 2 July 2019, OPEC and several non-OPEC producers extended production cuts announced in December 2018 through the end of 2020Q1. Saudi Arabia contributed the most to the fall in supply, reducing output by 1 million barrels per day (mb/d), while the Russian Federation cut production by 0.2 mb/d. Nevertheless, concerns over slowing global demand and trade tensions between the United States and China resulted in lower estimates for oil demand for the rest of 2019, weighing on prices. EIA reduced its Brent crude oil price forecast to US$59/b in 2019Q4 and US$57/b in 2020Q2, reflecting the rise in global oil inventories in 2020H1 (Chart 2.4).

International food prices, gauged by FAO Food Price Index, dropped for the fourth consecutive month in September 2019. The drop in September 2019 reflected sharp falls in the prices of sugar, dairy and leading cereals, which outweighed increases in all other sub-indices. The International Grains Council's (IGC) Grains and Oilseed Index, which increased from 189 points in March 2019 to a peak of 193 points in June, declined to a low of 183 points in September 2019. The index lost 5.2 per cent in September 2019 compared to June 2019, while all the other sub-indices fell over the same period, with the exception of rice. The highest decline of 17.3 per cent pertained to maize, followed by barley (7.4 per cent) and wheat (7.2 per cent). According to the FAO, the FY2019-20 season is likely to be characterised by stiff competition among exporters, given prospects of high exports relative to anticipated demand for the major crops.

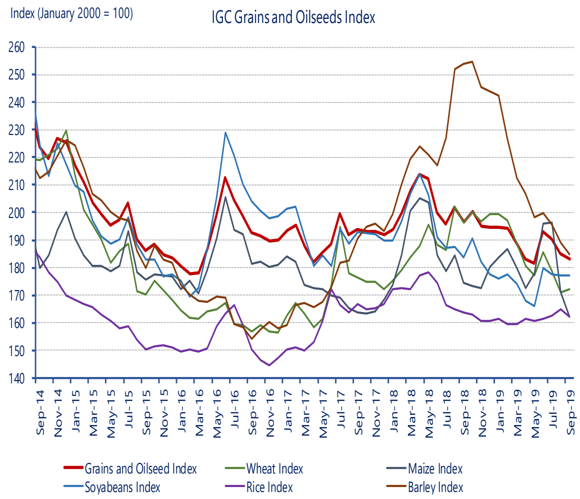
Chart 2.4: Global Commodity Prices







Source: Reuters.



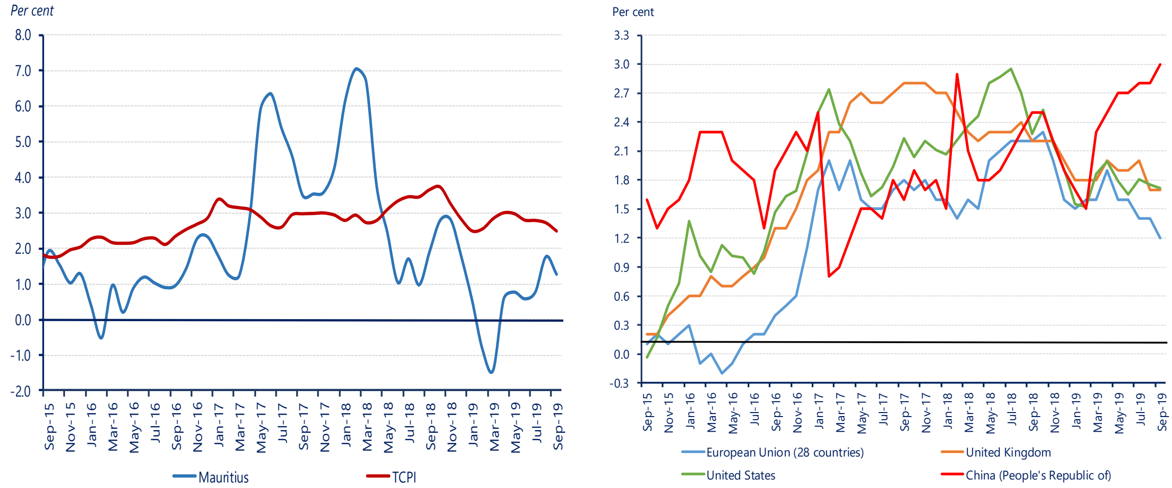
Source: Reuters.

2.3 Global Inflation Developments

Global inflationary pressures remained subdued during 2019Q3 on the back of broad-based softening in GDP growth across all regions that resulted in dissipating demand influences. Core inflation continued to remain below central bank targets in advanced economies and below the historical averages in several EMEs. The IMF has, in its World Economic Outlook October 2019, projected inflation in advanced economies to decline from 2.0 per cent in 2018 to 1.5 per cent in 2019, and for EMDEs, to tick down from 4.8 per cent to 4.7 per cent. Inflation in the US remained stable at 1.7 per cent in September 2019, still below US Fed's inflation target. Likewise, inflation in the euro area stood below the ECB's medium term target, at 1.2 per cent in September 2019, decreasing marginally from 1.4 per cent in August 2019. In the UK, after having hit the inflation target of 2 per cent in July 2019, inflation dropped to 1.7 per cent in September 2019. Inflation in China stood at 3.0 per cent in September 2019, ticking up from 2.8 per cent in August 2019, while inflation in India picked up slightly from 6.0 per cent in August 2019 to 6.3 per cent in September 2019. Inflation in South Africa fell in September 2019, decreasing from 4.3 per cent to 4.1 per cent.

Inflation in the main trading partners of Mauritius has been quite sustained in 2019, mainly reflecting rising prices in China and India. In recent months, however, Trading Partner Countries' Consumer Price Inflation (TCPI) based on the source import countries has declined from 2.8 per cent in July 2019 to 2.5 per cent in September 2019 (Chart 2.5).

Chart 2.5: Trading Partner Inflation



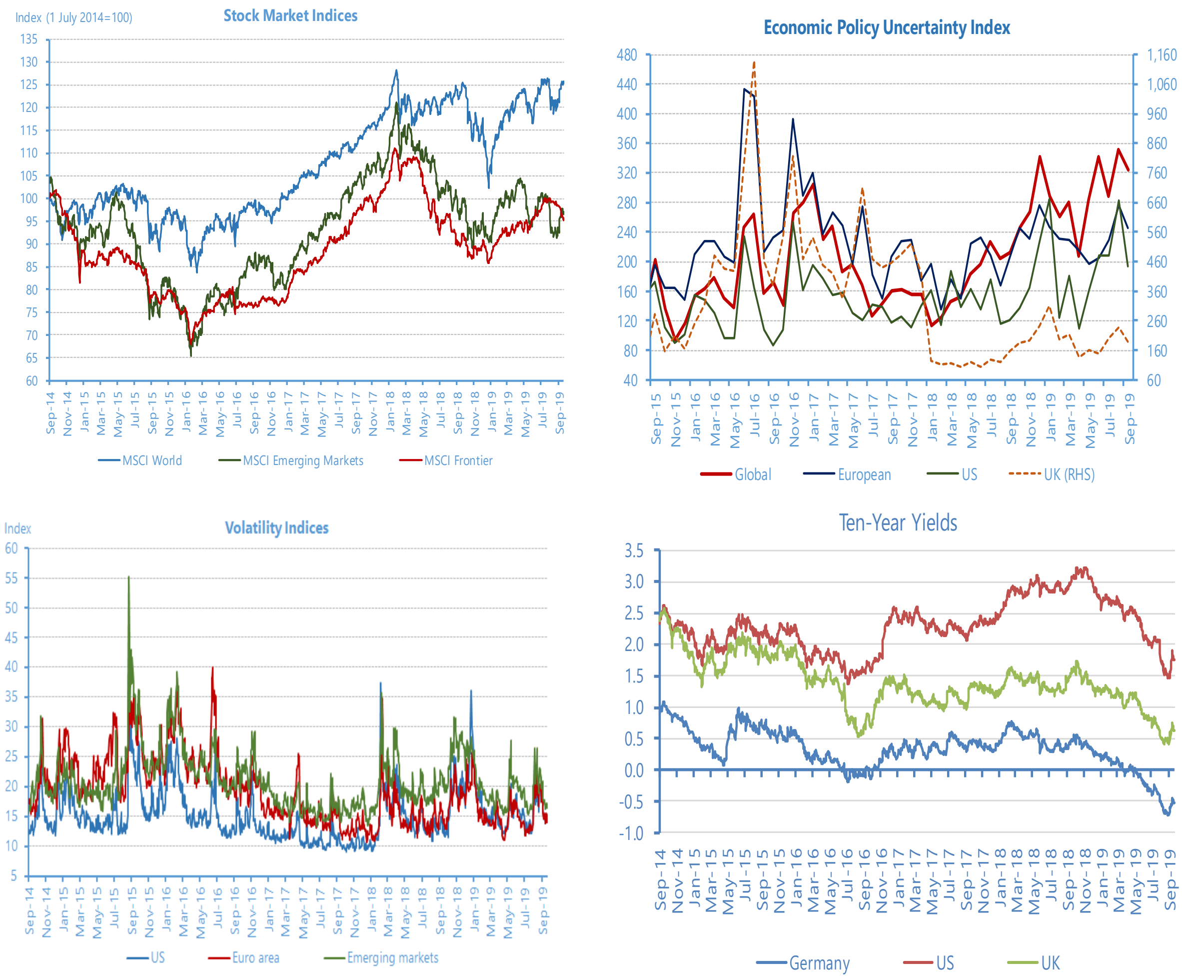
Source: Bank staff calculations. *Source: OECD.*

2.4 Global Equity Markets

Equity markets around the globe yielded positive returns in 2019Q3. The MSCI World Index rose by 1.6 per cent in 2019Q3 compared to 2019Q2 (Chart 2.6). However, the gains were capped because of on-going economic worries, including global growth slowdown, which would raise concerns on corporate profitability. The world's major central banks, acknowledging the weak global backdrop, eased their policy stance. These factors raised investors' concerns in global equity markets, while government bond yields dropped further encouraging improved risk appetite. Emerging market equities lagged as global growth indicators stayed soft. The US Fed lowered interest rates by 25 basis points in September 2019, its second cut since late July, and suggested it was prepared to move aggressively if the US economy showed additional signs of weakening.

The Global Economic Policy Uncertainty Index dropped towards the end of September 2019, following a re-schedule of tariffs and UK's Parliament passing a bill to avoid a no-deal Brexit from the European Union. These developments contributed to dampen global uncertainty level despite ongoing decline in global oil prices and higher capital outflows from some emerging economies. The index decreased by 5.7 per cent, from 342.6 in June 2019 to 323.2 in September 2019. The indices for the US, Europe and UK decreased by 31.3 per cent, 11.1 per cent and 21.4 per cent, respectively, compared to a month earlier. On the other hand, uncertainty in financial markets, as gauged by VIX and VIX-Emerging Markets also fell amid concerns over the US-China trade dispute, and fell from 19.0 and 19.2 to 15.7 and 15.6, respectively, in September 2019.

Chart 2.6: Stock Market and Volatility



Sources: Reuters and Economic Policy Uncertainty.

2.5 Exchange Rates

Global foreign exchange markets were also under the spell of global growth uncertainties which were driven by trade frictions, geopolitical tensions, the Brexit saga and more accommodative monetary policy stance by central banks. The US dollar remained the preferred currency among investors despite ongoing global economic concerns and was also supported by US Fed's injection of liquidity into the money market to curb sudden increases in the short-term borrowing costs. The Dollar Index averaged 98.0 in 2019Q3, up by 0.7 per cent q-o-q and 2.5 per cent y-o-y. The Dow Jones Dollar Index increased by 0.8 per cent q-o-q (Chart 2.7). Brexit-related issues, domestic political uncertainties and weak economic data led to a depreciation of the Pound sterling. The British currency depreciated by 14.1 per cent q-o-q to settle at 0.81 against the US dollar in 2019Q3. The euro weakened amid mixed economic data reflecting a lacklustre Eurozone economy. Investors' confidence also took a toll following the release of business surveys, portraying an economy that was slowing down.

2.6 Monetary Policy Stances

Global economic slowdown coupled with benign inflationary pressures has triggered a shift towards easier monetary policy stances by central banks across both advanced economies as well as emerging market economies, with the exception of the Bank of England. Against a backdrop of weakening global economic activity, subdued inflationary pressures and negative impact of the ongoing US-China trade dispute, the US Fed opted to cut the Federal funds rate by 25 basis points in July 2019, which was followed by another cut of 25 basis points in September 2019, bringing the benchmark rate to 1.75-2.00 per cent (Chart 2.8). The interest rate cuts by US Fed provided a breathing space to EMEs which, in turn, lowered their own policy rates in view of supporting their economies to a higher growth path. In parallel, the European Central Bank (ECB), at its September 2019 meeting, lowered its deposit rate by 10 basis point further into negative territory at -0.5 per cent and proposed to restart its quantitative-easing scheme.

Other central banks also loosened their monetary policy stances over the period under review. Most central banks have been reducing their policy rates, over concerns about the growth performance. The Reserve Bank of India cut its policy rate on 07 August 2019 by 35 basis points, taking into account the deteriorating global economic conditions and slowdown in domestic investment and private consumption. The central banks of Brazil, Australia, New Zealand and South Africa also lowered their respective policy rates in 2019Q3 to bolster economic activity.

Chart 2.7: Exchange Rate

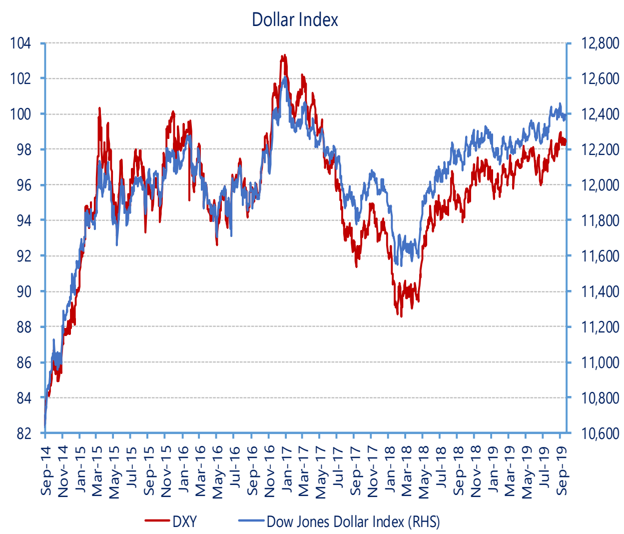
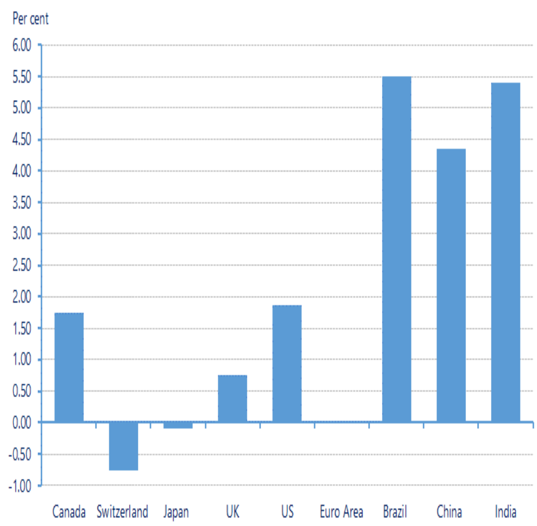


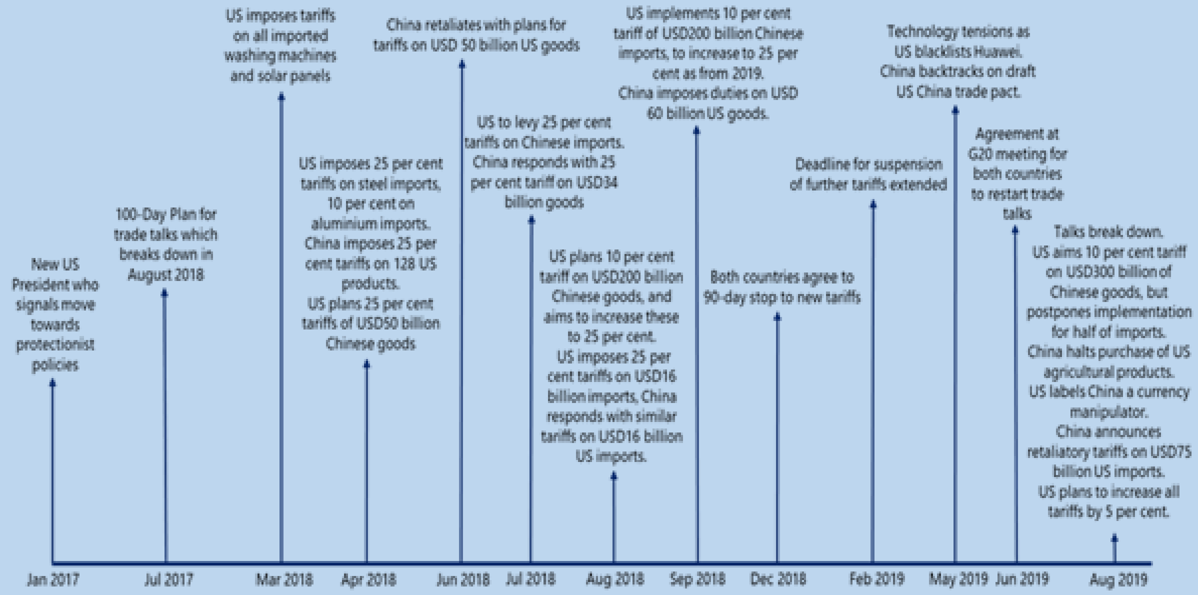
Chart 2.8: Policy Rate



US China Trade War

The new US administration, which came into office in January 2017, signified its intention to curb its current account deficit by resorting to protectionist measures. By March 2017, two executive orders were passed, calling for tighter tariffs in cases of anti-subsidy and anti-dumping, and a review of the US trade deficit and its causes. While the imposition of tariffs in 2018H1 globally targeted imports, the subsequent implementation of tariffs thereon focused mainly on imports from China, the world's largest exporter of goods, although the US also adopted a tighter stance against other trading partners in general, such as Mexico and to a lesser extent the EU.

Timeline of the Trade Conflict



In April 2018, the US applied tariffs on steel and aluminium imports. China, the largest producer of refined aluminium and steel, retaliated by imposing 25 per cent tariffs on some 128 US products. In August 2018, the US announced its plan to impose 10 per cent tariffs on US$200 billion of Chinese goods, aiming to increase these to 25 per cent. It also implemented 25 per cent tariffs on US$16 billion of Chinese goods, to which China retaliated by applying 25 per cent tariffs on US$16 billion of US imports. The tariffs on US$200 billion of Chinese imports were levied as from September 2018. Following a hiatus of about 5 months agreed upon by both countries in December 2018, the US blacklisted Huawei, the largest Chinese telecommunication manufacturer in May 2019. In June 2019, both countries agreed to conduct talks at the G20 meeting in August 2019. However, these were not conclusive, culminating in an escalation in the trade conflict, with further tariffs planned going forward. China suspended the purchase of US agricultural products, while the US labelled China a currency manipulator.

The OECD, in its September 2019 Economic Outlook, estimated the trade war to impact negatively on global growth by 0.3-0.4 percentage point in 2020 and 0.2-0.3 percentage point in 2021. Its effects on global trade trends, industrial production and investment have become increasingly apparent, predominantly because of heightened uncertainty and depressed business confidence. The global policy uncertainty index has risen from an average of 152.6 in 2018H1 to 277.0 in 2019H1. Global trade volumes have been receding since end-2018, from growth of 3-6 per cent in 2017 and for the major part of 2018. Trade tensions have weighed heavily on industrial sectors, especially in advanced in economies, as industrial production growth has slowed markedly from about 3 per cent in 2017 and 2018 to around 1 per cent in 2019, even contracting in advanced economies in recent months. Aggregate investment growth has declined sharply in G20 economies, from an annual rate of 5 per cent at the start of 2018 to only 1 per cent in 2019H1.

While the US and China are directly affected by the rise in trade barriers, the rising uncertainty is detrimental to most of the advanced and emerging economies. These economies would also be vulnerable to second round effects due to weaker growth in the world's two largest economies, coalescing with other major downside risks such as a no-deal Brexit, continued dislocation of supply chains, financial market vulnerabilities, including risk-off episodes related to the uncertainty. The situation is complicated further by limited policy space to counter downturns, more specifically with already low policy rates in advanced economies, as well as constrained fiscal space in general.

Source: Reuters.

3. Recent Domestic Economic Developments

The growth performance has been resilient in 2019Q2, though downside risks have increased on account of the protracted uncertainty surrounding the global economy. Both the headline and core measures of inflation point to tame price pressures in the economy.

3.1 Inflation

Headline inflation remained stable over the last five months, hovering within a range of 0.9-1.0 per cent, reflecting mainly the absence of major supply shocks. Over the same period, y-o-y inflation trended upwards to 1.8 per cent in August 2019, before declining to 1.3 per cent in September 2019 (Chart 3.1).

Chart 3.1: Headline Inflation and Y-o-y Inflation

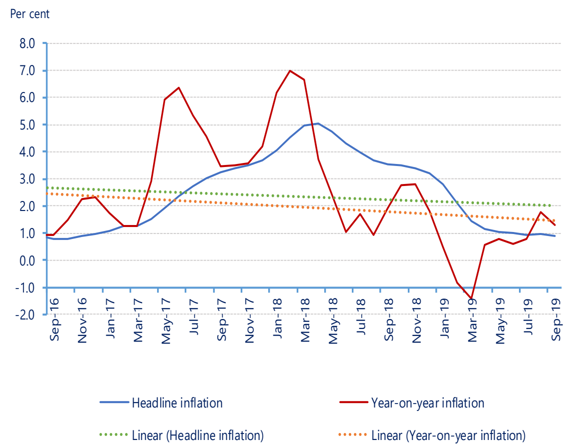
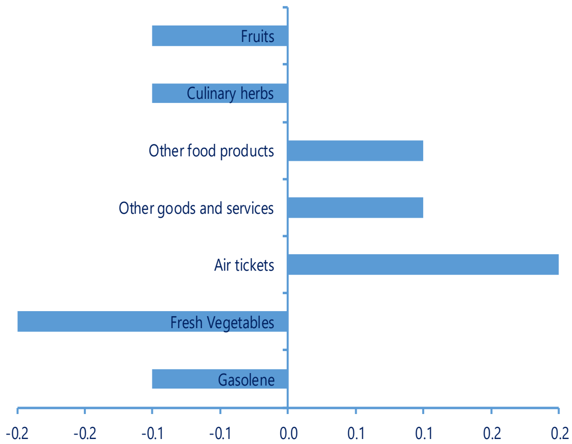


Chart 3.2: Contribution of CPI Items: 2019Q3, Index Point



Overall, the CPI fell by 0.1 index point, from 103.4 in June 2019 to 103.3 in September 2019. The main contributors to the CPI decline were 'fresh vegetables' (-0.2 index point), followed by 'gasolene' (-0.1 index point), 'culinary herbs' (-0.1 index point) and 'fruits' (-0.1 index point), partly offsetting the increase of 0.2 index point in 'air tickets' and 0.1 index point in both 'other goods and services' and 'other food products' (Chart 3.2). The momentum of price changes, as indicated by the 3-month moving average (seasonally-adjusted) inflation increased in September 2019 while a drop was noted in sequential inflation reflecting ebbing price pressures (Charts 3.3 and 3.4).

Chart 3.3: 3-Month Moving Average Inflation (Seasonally Adjusted)

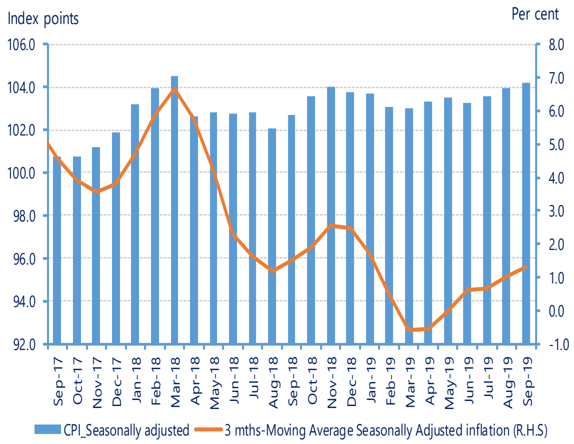
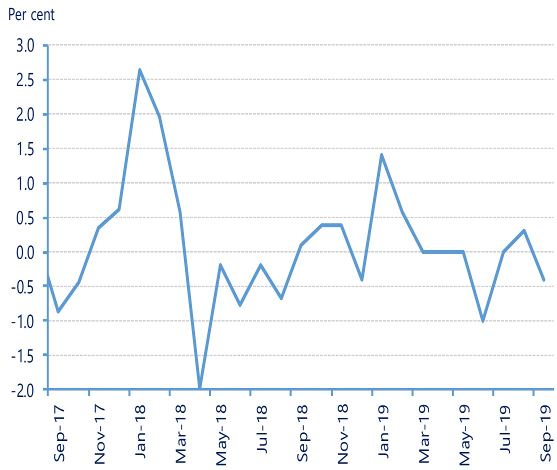


Chart 3.4: Sequential Inflation



An analysis of the CPI basket across its main divisions showed that the 'Food and non-alcoholic beverages' accounted for nearly 40 per cent of headline inflation and for about 80 per cent of y-o-y inflation in September 2019. The 'Food and non-alcoholic beverages' division contributed 0.4 percentage point to headline inflation and 1.0 percentage point to y-o-y inflation (Table 3.1). With the exception of 'Housing, water, electricity, gas and other fuels', 'Transport' and 'Education', all the remaining divisions contributed to y-o-y inflation in September 2019.

Table 3.1: Weighted Contribution to Y-o-y and Headline Inflation: September 2019

DIVISION	Weights	Consumer Price Index		CPI-Average		Contribution to inflation	
		Sep-18	Sep-19	12-Mths Av. to Sep-18	12-Mths Av. To Sep-19	Year-on-Year Inflation *(per cent)*	Headline Inflation *(per cent)*
Food and non-alcoholic beverages	248	100.9	105.1	104.7	106.2	1.0	0.4
Alcoholic beverages and tobacco	110	104.2	105.3	104.3	104.9	0.1	0.1
Clothing and footwear	46	101.7	104.9	101.1	104.1	0.1	0.1
Housing, water, electricity, gas and other fuels	112	98.1	97.5	98.4	97.8	-0.1	-0.1
Furnishings, household equipment and routine household maintenance	59	101.6	104.5	101.8	103.2	0.2	0.1
Health	38	103.3	105.2	102.3	104.7	0.1	0.1
Transport	147	105.1	103.7	103.5	104.6	-0.2	0.1
Communication	44	99.1	98.7	99.8	99.2	0.0	0.0
Recreation and culture	42	101.0	102.4	100.8	101.6	0.1	0.0
Education	50	104.2	100.0	102.7	101.6	-0.2	-0.1
Restaurants and hotels	54	103.5	104.9	101.4	104.6	0.1	0.1
Miscellaneous goods and services	50	102.1	103.1	101.2	102.8	0.0	0.1
Consumer Inflation	**1,000**	**102.0**	**103.3**	**102.6**	**103.6**	**1.3**	**0.9**

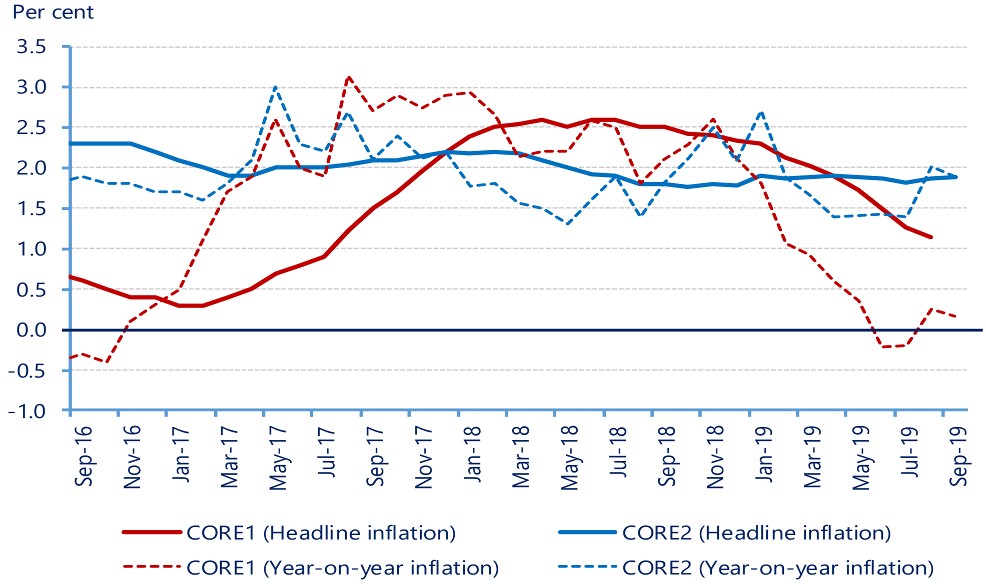
Note: av.: average

Figures may not add up to totals due to rounding.

Source: Statistics Mauritius and Bank of Mauritius.

The underlying inflationary pressures, as reflected in the Bank's CORE1 and CORE2 measures, remained low since January 2019. On a 12-month average basis, CORE1 inflation waned from 1.5 per cent in June 2019 to 1.0 per cent in September 2019 while CORE2 inflation remained contained at 1.9 per cent. On a y-o-y basis, CORE1 inflation increased from a negative rate of 0.2 in June 2019 to 0.2 per cent in September 2019 while CORE2 inflation rose from 1.4 per cent to 1.9 per cent (Chart 3.5).

Chart 3.5: CORE1 and CORE2 Inflation



The majority of other inflation measures depicted mixed performances. Y-o-y food price inflation rose from 2.1 per cent in June 2019 to 4.5 per cent in September 2019. On a 12-month average period, food price inflation picked up from 0.8 per cent to 1.5 per cent over the same period. Y-o-y goods and services inflation rose from 0.4 per cent and 0.9 per cent in June 2019 to 1.3 per cent and 1.1 per cent, respectively, in September 2019. On a 12-month average period, goods inflation fell marginally from 0.9 per cent to 0.8 per cent, while services inflation remained unchanged at 1.4 per cent (Tables 3.2 and 3.3). Y-o-y CPI excluding mortgage interest from the CPI basket increased from 0.5 per cent in June 2019 to 1.3 per cent in September 2019 while the 12-month average period, CPI excluding mortgage interest inflation stood at 1.0 per cent, down from 1.1 per cent. Y-o-y imported inflation remained in the negative territory and stood at -0.3 per cent in September 2019 while the 12-month average period, imported inflation fell from 0.9 per cent to 0.4 per cent over the same period.

Inflation expectations (headline) assessed in the August 2019 BOM survey continued to drift down, in line with the prevailing low headline inflation (Table 3.4). Inflation expectations for the mean inflation rates outturn expected by respondents in the survey month of August 2019 were 1.6 per cent for December 2019 and 2.2 per cent a year ahead (i.e. July 2020). Inflation expectations from the August 2019 round of the BOM's Survey vis-à-vis the last round (May 2019) moderated by 80 basis points for December 2019 expectations and 60 basis points for one-year ahead expectations. For the horizon period ended December 2019, 97.6 per cent of them were anticipating the headline inflation rate to be below 3.0 per cent (Chart 3.6).

Table 3.2: Y-o-y Inflation Indicators

Per cent

	CPI Inflation	Food price inflation	CPI excl. mortgage payments inflation	Imported inflation	Goods inflation	Services inflation	CORE1 inflation	CORE2 inflation	CPI Inflation excl. Vegetables
Sep-18	1.9	4.0	2.2	1.2	2.3	1.2	2.1	1.8	1.3
Oct-18	2.8	6.4	2.9	1.2	3.1	2.3	2.3	2.1	1.7
Nov-18	2.8	5.4	3.0	1.5	3.0	2.5	2.6	2.5	2.0
Dec-18	1.8	2.4	1.9	1.0	1.6	2.2	2.1	2.1	1.7
Jan-19	0.5	-1.3	0.7	0.8	0.0	2.1	1.8	2.7	1.7
Feb-19	-0.8	-4.4	-0.8	0.9	-1.4	0.8	1.1	1.9	1.4
Mar-19	-1.4	-5.8	-1.4	0.8	-2.1	0.6	0.9	1.7	1.3
Apr-19	0.6	0.1	0.5	0.6	0.5	0.6	0.6	1.4	1.3
May-19	0.8	1.5	0.7	-0.1	0.7	0.9	0.4	1.4	0.9
Jun-19	0.6	2.1	0.5	-0.8	0.4	0.9	-0.2	1.4	0.5
Jul-19	0.8	3.4	0.8	-0.9	0.7	0.8	-0.2	1.4	0.3
Aug-19	1.8	6.2	1.8	-0.2	2.0	1.3	0.3	2.0	0.8
Sep-19	1.3	4.5	1.3	-0.3	1.3	1.1	0.2	1.9	0.6

Note: excl.: excluding

Table 3.3: Twelve-month Average Inflation Indicators

Per cent

	Headline Inflation	Food price inflation	CPI excl. mortgage payments inflation	Imported inflation	Goods inflation	Services inflation	CORE1 inflation	CORE2 inflation	CPI Inflation excl. Vegetable
Sep-18	3.5	5.7	3.9	3.6	4.7	1.3	2.5	1.8	2.6
Oct-18	3.5	6.0	3.8	3.3	4.6	1.4	2.4	1.8	2.5
Nov-18	3.4	6.2	3.7	3.0	4.5	1.4	2.4	1.8	2.4
Dec-18	3.2	6.0	3.5	2.6	4.1	1.5	2.3	1.8	2.2
Jan-19	2.8	4.8	3.1	2.3	3.4	1.5	2.3	1.9	2.1
Feb-19	2.1	3.0	2.4	2.0	2.5	1.5	2.1	1.9	1.9
Mar-19	1.4	1.1	1.7	1.8	1.6	1.4	2.0	1.9	1.8
Apr-19	1.2	0.5	1.4	1.6	1.2	1.3	1.9	1.9	1.7
May-19	1.0	0.5	1.2	1.2	1.0	1.3	1.7	1.9	1.6
Jun-19	1.0	0.8	1.1	0.9	0.9	1.4	1.5	1.9	1.4
Jul-19	0.9	1.0	1.0	0.6	0.8	1.3	1.3	1.8	1.3
Aug-19	1.0	1.4	1.1	0.5	0.9	1.4	1.1	1.9	1.2
Sep-19	0.9	1.5	1.0	0.4	0.8	1.4	1.0	1.9	1.2

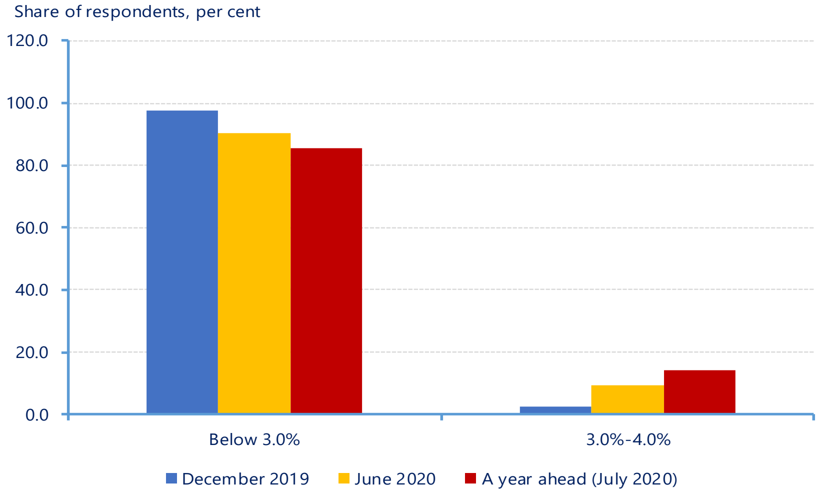
Note: excl.: excluding

Table 3.4: Inflation Expectations

Per cent

Expectations		1-year ahead	Dec-19
Survey Period	**May-19**	2.8	2.4
	Aug-19	2.2	1.6

Chart 3.6: Sample Respondents' Expectations of Headline Inflation – August 2019 Survey



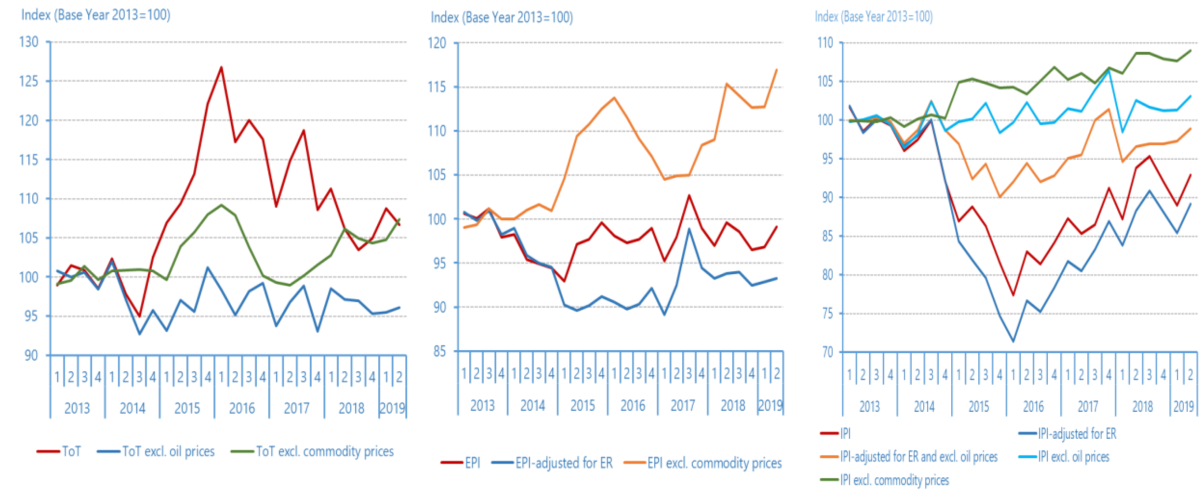
The absence of major supply shocks and low domestic input cost pressures in 2019Q2 reflected the subdued performance in both the Producer Price Inflation-Agriculture (PPI-A) and Producer Price Inflation-Manufacturing (PPI-M). Though in negative territory, y-o-y PPI-A inflation rate improved from -13.0 per cent in March 2019 to -5.8 per cent in June 2019, reflecting increases across the prices of its main components except for 'fresh vegetables'. Over the 12-month period, PPI-A inflation rate inched up from -5.6 per cent in March 2019 to -4.5 per cent in June 2019. Y-o-y Producer Price Inflation-Manufacturing (PPI-M) inflation rate remained unchanged at 1.7 per cent in June 2019, reflecting mixed performance across its components. Over the 12-month period, PPI-M inflation rate fell from 2.9 per cent to 2.5 per cent.

International Terms of Trade

The Terms of Trade (ToT) deteriorated in 2019Q2 compared to the previous quarter but improved slightly y-o-y. The ToT declined by 1.9 per cent compared to 2019Q1 but rose by 0.5 per cent compared to 2018Q2. ToT, excluding oil prices, however, worsened by nearly 1.0 per cent, y-o-y. Export prices went up by 2.4 per cent q-o-q in 2019Q2 on account of a higher export prices of 'Food and live animals' (+0.5 per cent) and 'Miscellaneous manufactured articles' (+4.0 per cent), which more than offset the decrease in the prices of 'Manufactured goods classified chiefly by material' (-4.6 per cent).

Import prices increased by 4.4 per cent q-o-q in 2019Q2 due to the notable hike in the price of 'Crude materials, inedible, except fuels' (+4.1 per cent). However, compared to the same quarter last year, import prices recorded a decline of 1.0 per cent in 2019Q2 owing to a decline in the price of 'Animal and vegetable oils, fats and waxes' (-10.7 per cent), followed by "Crude materials, inedible, except fuels" (-3.9 per cent) and 'Beverages and Tobacco' (-1.0 per cent). The decreases in import prices were nevertheless partly offset by increases in the prices of "Miscellaneous manufactured articles" (+8.2 per cent) and "Food and live animals" (+0.7 per cent). In volume terms, both exports and imports rose in 2019Q2 compared to 2019Q1 by 3.9 per cent and 2.0 per cent, respectively (Chart 3.7).

Chart 3.7: Terms of Trade, Export Price Index and Import Price Index

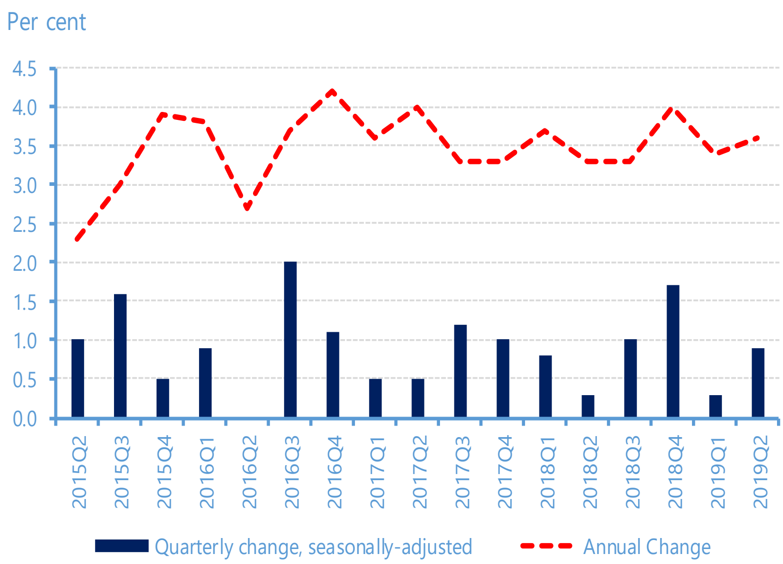


Sources: Statistics Mauritius and Bank staff calculations.

3.2 GDP by Sector

The domestic economy remained resilient in 2019Q2. Real GDP at basic prices grew by 3.6 per cent y-o-y in 2019Q2, higher compared to a growth of 3.4 per cent and 3.3 per cent in 2019Q1 and 2018Q2, respectively. On a quarter-on-quarter seasonally adjusted basis, real GDP rose by 0.9 per cent in 2019Q2, from 0.3 per cent in 2019Q1 (Chart 3.8).

Chart 3.8: GDP Growth



On the supply side, the financial, construction, distributive trade and professional sectors contributed to around 50 per cent of the growth in 2019Q2 (Table 3.5). The key services sectors grew strongly in 2019Q2: 'information and communication' (5.6 per cent), 'financial and insurance activities' (5.4 per cent), 'professional, scientific and technical activities' (4.9 per cent) and 'wholesale and retail trade' (3.5 per cent). Growth in the 'accommodation and food service activities' sector rebounded by 2.5 per cent in 2019Q2 compared to a contraction of 1.1 per cent in 2019Q1, reflecting the increase in tourist arrivals during the quarter. However, the *'real estate activities'* sector posted a moderate growth of 2.4 per cent compared to a growth of 3.2 per cent in the previous quarter. The *'manufacturing'* sector grew by 1.2 per cent in 2019Q2, after a growth of 1.1 per cent in 2019Q1. However, the *'food processing'* subsector contracted by 0.9 per cent following a growth of 2.9 per cent in 2019Q1. In the *'construction'* sector, growth remained commendable at 8.6 per cent in 2019Q2, supported by building and construction works.

Table 3.5: GDP - Sectoral Real Growth Rates (Year-on-year)

Per cent

	2017				2018				2019	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Primary Sector										
Agriculture forestry & fishing	3.4	-0.6	-0.4	-1.6	-7.3	-5.3	1.7	1.7	6.0	6.5
Mining & quarrying	2.7	1.9	0.8	1.2	-0.9	2.9	3.0	2.7	3.2	3.8
Secondary Sector										
Manufacturing	0.3	2.2	1.6	1.5	1.3	0.2	-1.2	2.3	1.1	1.2
Electricity, gas, steam & AC	4.9	3.8	2.4	2	4.2	3.9	1.4	1.2	4.7	4.5
Water supply	1.9	-0.7	2.1	7.5	5.1	4.4	2	6.5	2.8	2.2
Construction	5.7	8.9	8.7	6.6	11.2	11.1	6.6	9.9	8.7	8.6
Tertiary Sector										
Wholesale & retail trade	3.3	2.9	2.6	3.3	3.8	3.4	3.7	3.7	3.6	3.5
Transportation & storage	4.1	3.6	3.3	3.9	3.9	3.5	3.3	3.4	3.2	3.1
Accommodation & food service activities	3.4	9.2	4.3	3.1	4.8	1.1	5.7	4.2	-1.1	2.5
Information and communication	5.6	5.6	5.3	5.6	5.8	5.6	5.3	5.3	5.7	5.6
Financial & insurance	5.3	5.9	5.3	5.6	5.6	5.5	5.1	5.2	5.2	5.4
Real estate	3.3	2.8	3.5	3.4	3.6	3.5	2.6	3.0	3.2	2.4
Professional, scientific & technical activities	5.7	5.4	5.2	5.1	4.8	5.2	5.2	5.3	4.9	4.9
Administrative & support service activities	5.7	5.8	5.6	6	5.6	5.6	5.8	5.7	5.2	5.4
Public administration	1.7	1.8	-1.4	0.4	-2.2	3.6	2.2	3	2.4	0
Education	2.5	1.2	1.6	2	2.2	2.2	2.2	2.8	0.3	0.9
Health	4.1	6.4	5	2.6	4.1	3.7	3.5	5.4	3.4	4.2
Art, entertainment & recreation	5.5	4.7	4	4.9	4.1	4.4	4.3	5.4	4.4	3.8
Other service activities	3.5	2.9	3.4	3	4.0	3.1	3.6	3.3	3.5	3.3
GDP at basic prices	**3.6**	**4.0**	**3.3**	**3.3**	**3.7**	**3.3**	**3.3**	**4**	**3.4**	**3.6**
Taxes on products (net of subsidies)	4.1	6.7	4.4	7.8	7.4	5.3	3.3	4.1	3.2	2.4
GDP at market prices	**3.7**	**4.4**	**3.5**	**3.8**	**4.1**	**3.6**	**3.3**	**4**	**3.4**	**3.4**

Source: Statistics Mauritius and BoM staff estimates.

3.3 GDP by Expenditure

On the expenditure side, growth continued to be supported by strong consumption growth (Table 3.6). Final consumption expenditure expanded by 2.6 per cent in 2019Q2 compared to 3.1 per cent growth in the previous quarter, reflecting more or less unchanged government consumption spending, after growth of 2.3 per cent in 2019Q1. The growth of gross fixed capital formation slowed down sharply from 10.3 per cent in 2019Q1 to 2.8 per cent in 2019Q2, mainly on account of the contraction in *'machinery and equipment'* by 5.8 per cent in 2019Q2. On the external front, exports of goods and services grew by 0.5 per cent, as against a contraction of 2.6 per cent in the previous quarter. The recovery reflected principally a rebound by 0.4 per cent in exports of services, which had contracted sharply by 7.9 per cent in 2019Q1. Exports of goods grew marginally by 0.5 per cent in 2019Q2 following a growth of 5.8 per cent in 2019Q1. Imports of goods and services declined by 0.9

per cent in 2019Q2, as against a robust growth of 11.9 per cent in 2019Q1, reflecting mainly the drop in imports of goods.

Table 3.6: Domestic and External Demand

Per cent

	2016				2017[1]				2018[1]				2019	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q3	Q1[1]	Q2[2]
I. Domestic Demand														
Final consumption	**2.6**	**3.2**	**2.7**	**3.2**	**3.4**	**3.0**	**2.7**	**2.8**	**3.3**	**3.6**	**3.3**	**3.3**	**3.1**	**2.6**
Households	2.6	2.8	2.9	3.4	3.4	3.2	3.1	3.2	3.3	3.2	3.2	3.2	3.2	3.2
General Government	2.4	5.1	1.5	2.3	3.3	2.1	0.5	0.4	3.6	5.6	3.5	4.0	2.3	-0.1
GDFCF	**3.5**	**-2.3**	**9.8**	**3.8**	**0.1**	**8.1**	**6.4**	**3.8**	**2.6**	**12.4**	**9.9**	**18.6**	**10.3**	**2.8**
Building & construction work	-3.8	-6.3	9.3	6.4	5.7	7.9	7.8	5.8	10.3	11.5	8.3	11.4	8.8	8.7
Machinery & equipment	16.1	4.7	10.7	-1.0	-8.1	8.2	4.2	0.5	-9.3	13.5	13.0	33.0	13.0	-5.8
II. Net External Demand														
Exports of G & S	**-2.4**	**-8.7**	**-4.4**	**1.2**	**0.4**	**2.7**	**-3.4**	**-3.6**	**-1.5**	**-1.1**	**2.9**	**8.5**	**-2.6**	**0.5**
Exports (goods)	-11.4	-14.4	-11.0	-4.6	-2.2	-4.9	-7.8	-5.7	-10.0	-2.1	6.3	9.2	5.8	0.5
Export (services)	5.8	-2.8	2.2	6.0	2.4	9.5	0.5	-2.1	4.7	-0.2	0.2	8.0	-7.9	0.4
Imports of G & S	**10.5**	**0.7**	**3.7**	**-2.7**	**-6.7**	**9.7**	**-2.2**	**8.1**	**-1.9**	**-4.5**	**3.9**	**4.3**	**11.9**	**-0.9**
Imports (goods)	13.2	1.5	3.9	-1.5	-7.2	10.8	-3.3	7.9	-4.2	-4.6	9.8	4.4	15.5	-1.6
Imports (services)	3.6	-1.7	3.0	-6.1	-4.3	7.4	0.9	6.8	4.3	-4.3	-11.5	4.0	3.0	1.3
III. GDP at market prices	**4.0**	**3.8**	**3.5**	**4.1**	**3.7**	**4.4**	**3.5**	**3.8**	**4.1**	**3.6**	**3.3**	**4.0**	**3.4**	**3.4**

[1] *Revised Estimates.* [2] *First Estimates.*
Source: Statistics Mauritius and BoM staff estimates.

Outlook

In its September 2019 issue of National Accounts Estimates, Statistics Mauritius downgraded its projection for real GDP at market prices marginally to 3.8 per cent in 2019, from 3.9 per cent in June 2019 (Table 3.7). The growth projection for the *'agriculture'* sector has been revised upward to 3.4 per cent compared to 2.4 per cent in the June 2019 issue, due to higher output of food crops. Growth in the *'manufacturing'* sector has been downgraded by 0.3 percentage point, reflecting lower than expected performances in *'food processing'* and *'other manufacturing'*. Growth in the *'accommodation and food service activities'* sector has been revised downward to 1.8 per cent, based on expected tourist arrivals of 1,425,000.

In terms of main revisions to the expenditure components, growth in investment spending has been revised upwards to 7.9 per cent, compared to 6.6 per cent in the previous issue, following higher expected growth of 2.7 per cent in private sector investment. The growth forecasts for both exports of goods and services and imports of goods and services have been revised upwards to 2.7 per cent and 4.3 per cent, respectively, in 2019 (Table 3.8).

Table 3.7: Sectoral Real Growth Rates

Per cent

	2018	2019		
		Mar 2019 Issue	Jun 2019 Issue	Sep 2019 Issue
GDP Growth Rate	**3.8**	**3.9**	**3.9**	**3.8**
Agriculture, forestry and fishing	-1.3	2.3	2.4	3.4
(sugar production - tonnes)	*(323,406)*	*(324,000)*	*(325,000)*	*(325,000)*
Manufacturing	0.7	1.0	1.1	0.8
- sugar	-19.0	7.0	7.5	7.5
- food processing (excluding sugar)	3.4	2.0	2.0	1.5
- textile	-6.8	-0.5	-1.4	-1.4
- other manufacturing	4.7	2.0	2.0	1.8
Construction	9.5	8.6	8.5	8.5
Wholesale and retail trade	3.6	3.4	3.4	3.4
Accomodation and food service activities	4.1	3.6	2.5	1.8
(tourist arrivals)	*(1,399,408)*	*(1,450,000)*	*(1,435,000)*	*(1,425,000)*
Transportation and storage	3.5	3.0	3.2	3.1
Information and communication	5.5	5.3	5.4	5.4
Financial and insurance activities	5.4	5.2	5.2	5.2

Source: Statistics Mauritius

Table 3.8: Expenditure on GDP - Growth Rates

Per cent

	2018	2019		
		Mar 2019 Issue	Jun 2019 Issue	Sep 2019 Issue
GDP Growth Rate	**3.8**	**3.9**	**3.9**	**3.8**
Final consumption expenditure	3.4	3.2	3.1	3.1
- Households	3.2	3.3	3.3	3.3
- General Government	4.2	2.6	2.4	2.3
Gross Fixed Capital Formation	10.9	12.6	6.6	7.9
- Private Sector	10.4	-0.8	0.1	2.7
- Public Sector	12.7	53.8	26.7	24.0
Exports	2.3	1.0	1.2	2.7
- Goods	0.7	2.3	2.9	2.6
- Services	3.4	0.1	0.0	2.8
Imports	0.4	4.6	3.3	4.3
- Goods	1.4	6.8	4.8	5.7
- Services	-1.9	-0.5	-0.4	0.8

Source: Statistics Mauritius

3.4 Labour Market and Labour Costs

Labour market conditions improved further in 2019Q2, with a decline in the unemployment rate with respect to both 2019Q1 and 2018Q2, driven by higher employment creation relative to the expansion in the labour force (Chart 3.9). Total employment increased by 12,300 y-o-y in 2019Q2, while the labour force recorded an increase of 10,900. As a result, the unemployment rate dropped to 6.6 per cent in 2019Q2, lower than 7.0 per cent in 2018Q2 and 6.9 per cent in 2019Q1.

Female unemployment rate increased from 9.5 per cent in 2018Q2 to 10.8 per cent in 2019Q2 while the male unemployment rate declined to 3.8 per cent, its lowest level since 2010Q4. Youth unemployment declined significantly from 27.5 per cent to 21.3 per cent over the same period, partly reflecting the impact of targeted measures such as the Youth Employment Programme.

Wages continued to support the purchasing power of households in 2019Q2, with nominal wages growing at a higher pace than the inflation rate (Chart 3.10). The Wage Rate Index (WRI) increased y-o-y by 4.1 per cent, driven mainly by higher wages in the private sector (5.1 per cent). Public sector wages, on its part, grew by 2.7 per cent over the same period. On a sectoral basis, the rise in the overall WRI was mainly attributed to an increase in wages in sectors such as manufacturing, wholesale and retail trade, transportation and storage, financial services and education.

Chart 3.9: Contribution to Unemployment

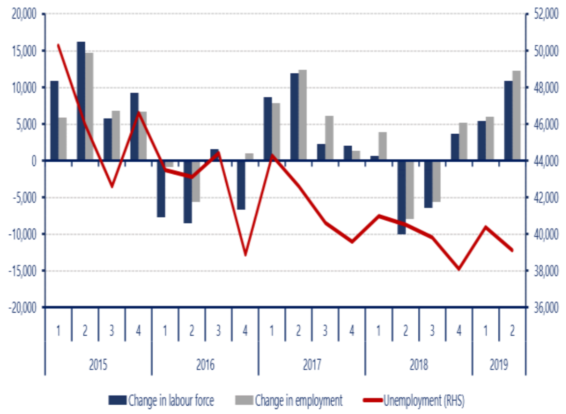
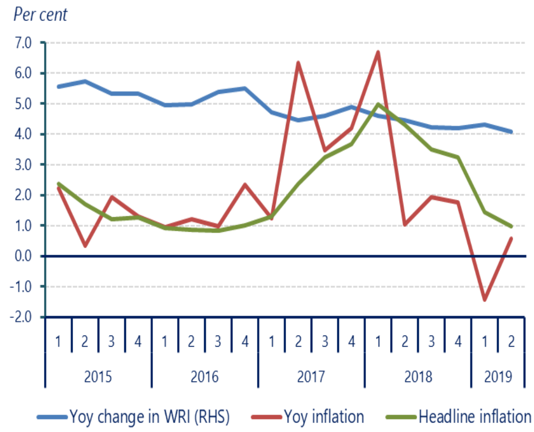


Chart 3.10: Wages and Inflation



Source: Statistics Mauritius.

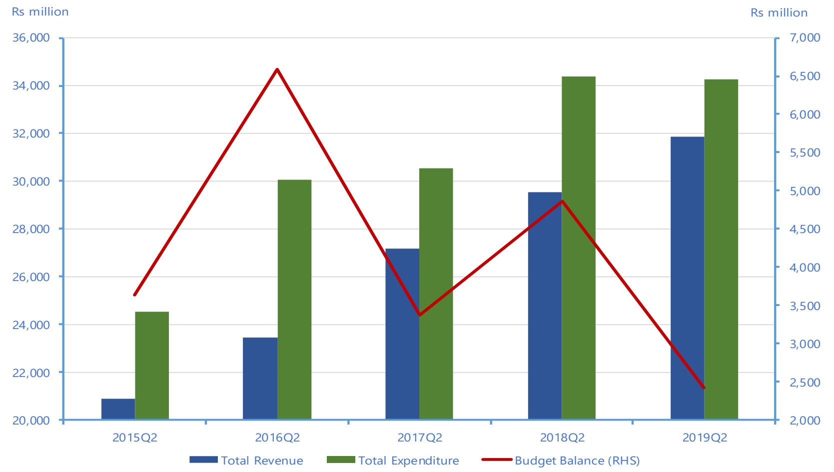
3.5 Fiscal and Debt Developments

During 2019Q2, the budget balance improved y-o-y by almost 50 per cent, reflecting mainly buoyant government revenue and flat total expenditure. Total revenue increased by 7.8 per cent y-o-y to Rs31.8 billion in 2019Q2, mainly due to a significant rise in other revenue and a rise of 3.2 per cent in tax revenue, partly offset by a decline in grants received by Government (Chart 3.11 and Table 3.9).

Total expenditure of Government was more or less stable at Rs34.3 billion in 2019Q2. Among its main components, the increase in social benefits amounting to Rs2.2 billion was more than offset by declines in other expense and capital expenditure. Net acquisition of nonfinancial assets stood at Rs3.1 billion in 2019Q2, compared to Rs3.8 billion in the corresponding quarter last year.

The budget deficit declined markedly from Rs4.8 billion to Rs2.4 billion in 2019Q2 and it was financed by domestic sources. As a ratio to GDP, the budget deficit stood at 1.9 per cent in 2019Q2, compared to 4.0 per cent in 2018Q2. The primary balance as a share to GDP, which is computed by deducting interest payments from the budget deficit, improved from a deficit of 1.6 per cent to a surplus of 0.6 per cent in 2019Q2.

Chart 3.11: Total Revenue, Expenditure and Budget Deficit



Source: Statistics Mauritius.

Table 3.9: Statement of Government Operations

Quarter 2	Rs Million			Annual Percentage Change, Per cent	
	2017Q2	2018Q2	2019Q2	2017-18	2018-19
Total Revenue	27,160	29,535	31,839	8.7	7.8
	(24.1)	(24.6)	(25.6)		
Tax Revenue	23,900	27,019	27,892	13.0	3.2
Of which					
Taxes on income, profits, and capital gains	7,034	7,981	8,957	13.5	12.2
Taxes on property	1,512	1,525	1,548	0.9	1.5
Taxes on goods & services	14,552	16,726	16,555	14.9	-1.0
Taxes on international trade & transactions	282	326	326	15.8	0.1
Other taxes	521	461	506	-11.5	9.9
Social contributions	347	342	336	-1.5	-1.9
Grants	1,860	1,225	609	-34.1	-50.3
Other Revenue	1,053	949	3,002	-9.8	216.2
Total Expenditure	30,539	34,391	34,265	12.6	-0.4
	(27.1)	(28.7)	(27.5)		
Compensation of employees	6,759	7,128	7,296	5.4	2.4
Use of goods & services	2,772	3,142	3,293	13.3	4.8
Interest	2,804	2,995	3,119	6.8	4.1
Subsidies	427	483	402	13.1	-16.7
Grants	5,846	6,501	6,668	11.2	2.6
Social benefits	6,865	5,940	8,099	-13.5	36.4
Other expense	1,617	4,433	2,330	174.2	-47.4
Net acquisition of nonfinancial assets	3,447	3,769	3,057	9.3	-18.9
Budget balance	-3,379	-4,856	-2,426	-43.7	50.0
	(3.0)	(4.0)	(1.9)		

Figures in bracket represent share of GDP.
Source: Statistics Mauritius.

Public Debt

Total public sector debt grew by 0.8 per cent from Rs318 billion as at end-March 2019 to Rs320.7 billion as at end-June 2019, reflecting mainly the increase in budgetary central government domestic debt. As a share to GDP, public sector debt fell by 0.6 percentage point, from 65.2 per cent to 64.6 per cent. Budgetary Central Government (BCG) domestic debt increased by 1.2 per cent to Rs244.7 billion as at end-June 2019 while BCG external debt remained more or less stable, representing 8.1 per cent of GDP. Public enterprise total debt fell by 0.8 per cent to Rs35.6 billion as at end-June 2019. Public sector external debt increased in absolute terms by 0.5 per cent and as a ratio to GDP it represented 10.7 per cent (Table 3.10).

Table 3.10: Public Sector Debt

Rs million

	Mar-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19
1. Budgetary Central Government Domestic Debt	**217,000**	**217,587**	**223,719**	**232,486**	**234,258**	**241,820**	**244,733**
- Short Term	*24,932*	*25,060*	*25,856*	*27,938*	*26,283*	*29,088*	*31,590*
- Medium Term	*51,549*	*54,899*	*54,393*	*55,362*	*56,791*	*57,691*	*56,106*
- Long Term	*125,601*	*138,318*	*144,640*	*150,525*	*153,194*	*158,688*	*160,688*
Government securities issued for mopping up excess liquidity	*15,947*	*1,021*	*894*	*894*	*894*	*893*	*893*
Consolidation adjustment (iro Government Securities held by non-financial public corporations)	*-1,029*	*-1,711*	*-2,064*	*-2,233*	*-2,904*	*-4,540*	*-4,544*
As percentage to GDP	***49.3***	***47.0***	***47.6***	***48.9***	***48.5***	***49.3***	***49.3***
2. Budgetary Central Government External Debt	**46,103**	**44,544**	**44,538**	**42,078**	**41,414**	**40,256**	**40,267**
- Short Term	*39*	*29*	*14*	*12*	*17*	*12*	*10*
- Medium and Long Term	*41,417*	*39,838*	*39,823*	*37,422*	*36,786*	*35,573*	*35,494*
- Long term debt liability - IMF SDR Allocations	*4,647*	*4,677*	*4,701*	*4,644*	*4,611*	*4,671*	*4,762*
As percentage to GDP	***10.5***	***9.6***	***9.5***	***8.8***	***8.6***	***8.2***	***8.1***
3. Budgetary Central Government Total Debt	**263,103**	**262,130**	**268,257**	**274,564**	**275,672**	**282,076**	**285,000**
As percentage to GDP	***59.8***	***56.6***	***57.0***	***57.7***	***57.1***	***57.5***	***57.4***
4. Public Enterprises Total Debt	**24,468**	**29,458**	**29,751**	**30,387**	**37,193**	**35,893**	**35,594**
Public Enterprises Debt as percentage to GDP	***5.6***	***6.4***	***6.3***	***6.4***	***7.7***	***7.3***	***7.2***
Public Sector Domestic Debt	229,622	235,375	240,758	250,022	258,629	265,332	267,673
Public Sector Domestic Debt as percentage to GDP	*52.2*	*50.9*	*51.2*	*52.5*	*53.6*	*54.4*	*53.9*
Public Sector External Debt	58,074	56,317	57,342	55,020	54,327	52,717	52,991
Public Sector External Debt as percentage to GDP	*13.2*	*12.2*	*12.2*	*11.6*	*11.3*	*10.8*	*10.7*
5. Public Sector Debt	**287,696**	**291,691**	**298,100**	**305,042**	**312,956**	**318,048**	**320,664**
As percentage to GDP	**65.4**	**63.0**	**63.4**	**64.1**	**64.9**	**65.2**	**64.6**

Source: Ministry of Finance and Economic Development.

3.6 Monetary Aggregates

The annual growth rate in broad money supply decelerated in August 2019. Broad Money Liabilities (BML) increased by 7.1 per cent y-o-y in August 2019, lower than the increase of 7.7 per cent in July 2019. Rupee deposits and foreign currency deposits contributed 3.7 percentage points and 1.9 percentage points, respectively, to the growth rate of BML in August 2019 (Table 3.11). The annual growth rate of Net Foreign Assets (NFA) of depository corporations slowed down notably from 5.8 per cent in July 2019 to 0.9 per cent in August 2019. This was largely attributed to a decline in the NFA of Other Depository Corporations (ODCs) which was offset by a nearly 15.0 per cent increase in the NFA of the Bank of Mauritius (BoM). Y-o-y, depository corporations' claims on other sectors (excluding financial derivatives) increased by 7.2 per cent in August 2019, compared to 4.9 per cent in July 2019, driven largely by an acceleration in the growth of claims by ODCs from 4.9 per cent to 7.3 per cent. Net claims on central government maintained its momentum and grew by 17.7 per cent in August 2019.

The monetary base fell by 7.3 per cent y-o-y in August 2019, as against an increase of 9.1 per cent in July 2019. The drop in monetary base was attributed to a decline of 13.7 per cent of deposits of ODCs held with the BoM, partly offset by increases in currency with public and currency with ODCs.

Table 3.11: Components and Sources of Broad Money Liabilities[1]

(Rs million)

Components of Broad Money Liabilities [2]	Dec-18	Jan-19	Feb-19	Mar-19	Apr-19	May-19	Jun-19	Jul-19	Aug-19
I. Currency with Public	**31,636**	**29,894**	**29,612**	**29,987**	**29,809**	**29,874**	**30,056**	**30,328**	**30,500**
II. Deposit Liabilities	***501,478***	***503,229***	***506,831***	***508,195***	***510,403***	***509,632***	***515,057***	***517,498***	***516,305***
II.I Rupee Deposits	412,277	413,955	415,348	416,746	416,906	417,016	421,676	421,610	420,306
II.2. Foreign Currency Deposits	89,201	89,275	91,483	91,449	93,497	92,616	93,382	95,889	95,999
III. Debt securities	**21,900**	**21,850**	**23,249**	**24,829**	**25,147**	**24,904**	**26,983**	**27,151**	**27,059**
BROAD MONEY LIABILITIES (I+II+III)	**555,014**	**554,973**	**559,691**	**563,011**	**565,359**	**564,410**	**572,096**	**574,977**	**573,864**
Sources of Broad Money Liabilities									
I. Net Foreign Assets	**570,677**	**555,739**	**612,169**	**580,722**	**601,793**	**587,298**	**592,038**	**631,512**	**604,448**
Bank of Mauritius	217,004	218,847	219,967	226,577	229,226	240,408	252,958	258,965	259,428
Other Depository Corporations	353,672	336,892	392,202	354,146	372,567	346,890	339,080	372,547	345,020
1. Net Claims on Central Government	***75,333***	***77,578***	***79,130***	***81,328***	***81,462***	***83,756***	***81,157***	***80,770***	***83,084***
Bank of Mauritius	-19,273	-20,935	-19,289	-20,773	-18,967	-21,200	-18,446	-18,377	-21,627
Other Depository Corporations	94,606	98,513	98,419	102,101	100,430	104,957	99,603	99,147	104,711
2. Claims on Other Sectors [3]	***460,262***	***459,857***	***465,278***	***465,124***	***469,943***	***472,758***	***478,158***	***479,547***	***483,231***
Bank of Mauritius	3,927	3,916	3,920	3,923	3,927	3,936	4,040	4,022	4,024
Other Depository Corporations	456,335	455,941	461,358	461,201	466,016	468,822	474,118	475,524	479,207
2.1 Claims on other sectors, excluding financial derivatives	*459,351*	*458,939*	*464,528*	*464,145*	*468,965*	*471,682*	*477,204*	*478,401*	*481,904*
II. Domestic Claims (1+2)	**535,595**	**537,435**	**544,408**	**546,452**	**551,405**	**556,514**	**559,315**	**560,317**	**566,315**
III. Net Non-Monetary Liabilities	**551,258**	**538,200**	**596,886**	**564,163**	**587,840**	**579,402**	**579,256**	**616,851**	**596,899**
BROAD MONEY LIABILITES (I+II-III)	**555,014**	**554,973**	**559,691**	**563,011**	**565,359**	**564,410**	**572,096**	**574,977**	**573,864**

Figures may not add up to totals due to rounding.

[1] Based on the methodology of the IMF's Depository Corporations Survey framework.

[2] Effective October 2018, the Bank discontinued the dissemination of narrow money liabilities and quasi-money liabilities. Instead, the

[3] Effective May 2018, Financial Derivatives are recorded at market or fair values and are not strictly comparable with prior months' data.

3.7 Credit Developments

Bank loans[2] to Other Nonfinancial Corporations ('ONFCs'), households and other sectors[3] (excluding GBCs) went up by Rs4.7 billion or 1.3 per cent, from Rs301.4 billion in October 2018 to Rs306.1 billion in August 2019 (Table 3.12). Reflecting the increase in loan facilities availed, bank loans as a percentage of GDP stood at 60.6 per cent in August 2019.

The expansion in loans over the period ended August 2019 was largely supported by an increase in household borrowings, Other Financial Corporations and public nonfinancial corporations. Household borrowings were higher by Rs6.7 billion or 6.6 per cent compared to October 2018, largely due to additional loans availed by households for both housing and consumption purposes. Similarly, loans extended to Other Financial Corporations and Public nonfinancial corporations increased by 17.6 per cent and 33.5 per cent, respectively, during the period under review.

Table 3.12: Bank Loans to ONFCs, Households and Other Sectors as at end of period

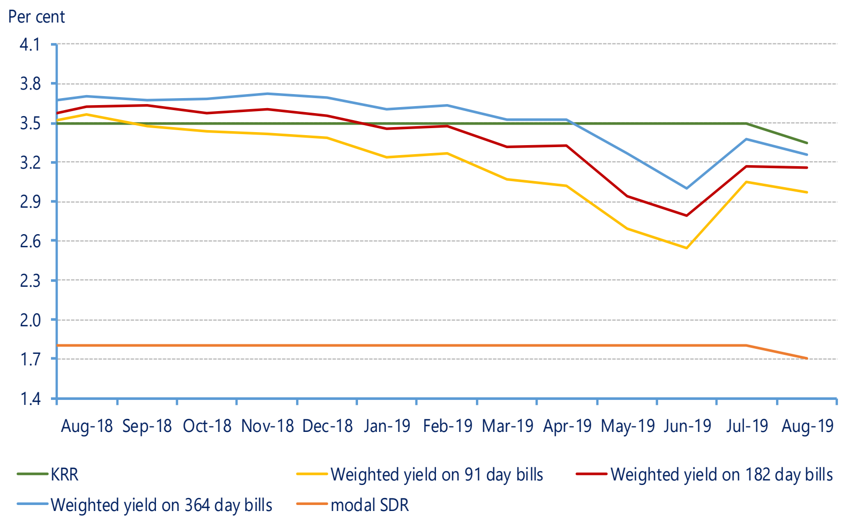
	Oct-18	Aug-19	Change		Bank Loans as a percentage of GDP as at end-Aug 19
	Rs million	*Rs million*	*Rs million*	*Per cent*	*Per cent*
1. OTHER NONFINANCIAL CORPORATIONS	**158,112**	**148,254**	**-9,859**	**-6.2**	**29.3**
A - Agriculture, forestry and fishing	15,577	10,782	-4,795	-30.8	**2.1**
B - Mining and quarrying	47	2	-45	-96.7	**0.0**
C - Manufacturing	22,877	20,801	-2,076	-9.1	**4.1**
D - Electricity, gas, steam and air conditioning supply	4,226	4,547	321	7.6	**0.9**
E - Water supply; sewerage, waste management and remediation activities	263	121	-142	-53.9	**0.0**
F - Construction	20,515	18,150	-2,364	-11.5	**3.6**
G - Wholesale and retail trade; and repair of motor vehicles and motorcycles	23,963	23,803	-160	-0.7	**4.7**
H - Transportation and storage	3,194	2,962	-232	-7.3	**0.6**
I - Accommodation and food service activities	38,790	38,451	-339	-0.9	**7.6**
J - Information and communication	2,769	2,857	88	3.2	**0.6**
L - Real estate activities	14,016	15,641	1,625	11.6	**3.1**
M - Professional, scientific and technical activities	3,622	2,091	-1,531	-42.3	**0.4**
N - Administrative and support service activities	4,751	4,461	-290	-6.1	**0.9**
P - Education	1,199	1,173	-25	-2.1	**0.2**
Q - Human health and social work activities	305	753	448	147.2	**0.1**
R - Arts, entertainment and recreation	835	730	-105	-12.6	**0.1**
S - Other service activities	1,165	929	-236	-20.3	**0.2**
2. Households	**101,828**	**108,527**	**6,700**	**6.6**	**21.5**
of which: Housing	*65,454*	*70,226*	*4,772*	*7.3*	*13.9*
3. Other Financial Corporations (excluding Financial GBC1s)	**37,926**	**44,585**	**6,659**	**17.6**	**8.8**
4. Public nonfinancial corporations	**3,533**	**4,717**	**1,184**	**33.5**	**0.9**
5. Financial GBC1s	**25,452**	**34,186**	**8,734**	**34.3**	**8.4**
6. Non-Financial GBC1s	**24,255**	**28,937**	**4,681**	**19.3**	**8.0**
7. GBC2s	**9,002**	**6,388**	**-2,614**	**-29.0**	**3.0**
TOTAL (excluding GBCs)	**301,399**	**306,083**	**4,684**	**1.3**	**60.6**

[2] *Loans only include facilities extended by banks in the form of loans, overdrafts and finance leases.*
[3] *Other sectors include Other Financial Corporations and Public Nonfinancial Corporations.*

3.8 Interest Rates

Banks' have adjusted their interest rates on rupee savings deposits, rupee term deposits and Prime lending rates following the 15 basis point reduction of the Key Repo Rate (KRR) at the August 2019 MPC meeting. The Prime lending rate varied between 5.50 per cent and 8.50 per cent in August 2019, lower compared to a range of 5.65-8.50 per cent since September 2017. Interest rates on rupee savings deposits with banks declined from a range of 1.35-2.10 per cent in July to a range of 1.35-2.00 per cent in August 2019 while interest rates on rupee term deposits declined from a range of 0.10-5.00 to 0.10-4.65 per cent over the same period. The weighted average interest rate on rupee deposits and weighted average rupee lending rate fell from 1.72 per cent and 6.24 per cent in July 2019 to 1.63 per cent and 6.11 per cent, respectively, in August 2019. As a result, the spread between the rupee weighted lending and weighted deposit rates, a key determinant of profitability in the banking sector, narrowed from 4.52 per cent to 4.48 per cent in August 2019 (Chart 3.12).

Chart 3.12: KRR, SDR and Weighted Average Yields on 91-Day, 182-Day and 364-Day Bills



3.9 Exchange Rate Developments

The exchange rate of the rupee continued to reflect developments on the international markets as well as domestic demand and supply conditions. In 2019Q3, on a q-o-q basis, the weighted average dealt rate of the rupee depreciated by 2.5 per cent and 1.4 per cent against the US dollar and Euro, respectively, but it appreciated by 1.7 per cent vis-à-vis the Pound sterling (Chart 3.13). On a nominal effective exchange rate basis, as measured by MERI1, the rupee depreciated by 1.7 per cent in 2019Q3 compared to 2019Q2, while, on a real effective exchange rate basis, the rupee recorded a depreciation of 3.6 per cent (Chart 3.14). The Bank intervened on four occasions in the domestic foreign exchange market in 2019Q3 with the aim to alleviate volatility in the rupee, purchasing a total of US$30 million in July 2019 and US$50 million in August 2019 and selling a total of US$76.8million in August 2019.

Chart 3.13: Evolution of the Rupee Against Major Currencies

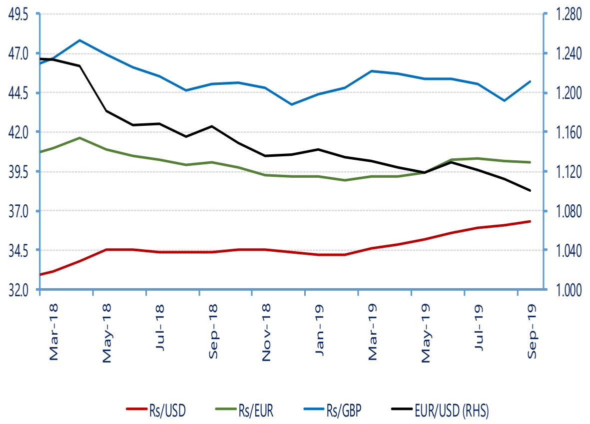
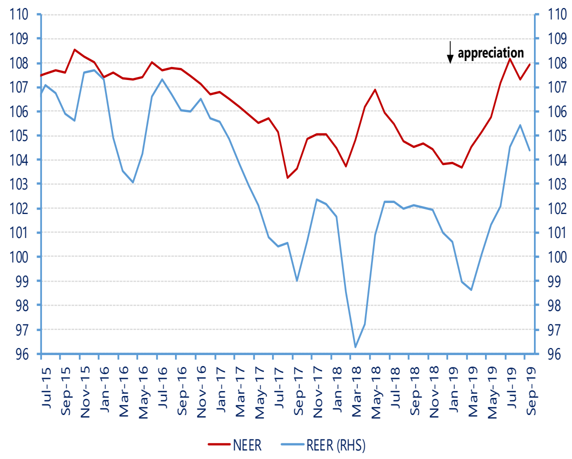


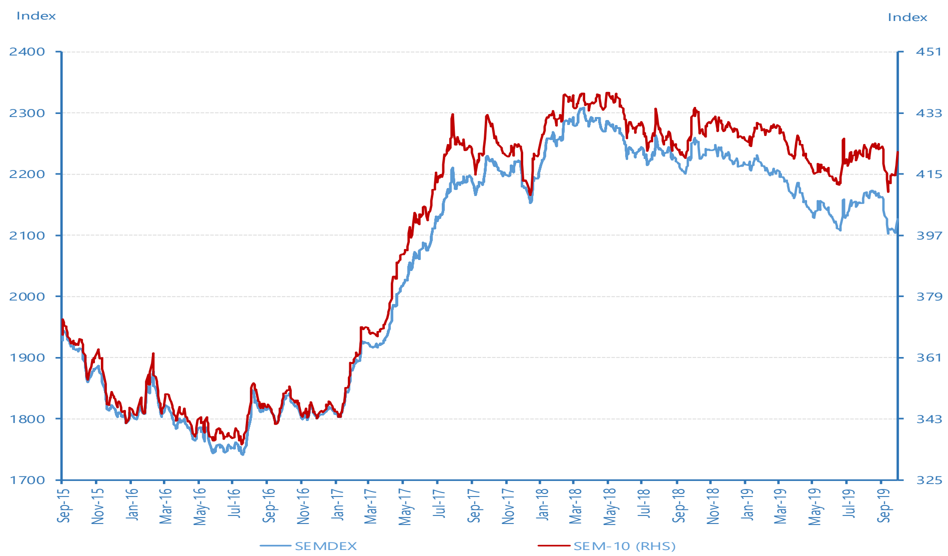
Chart 3.14: Evolution of NEER and REER



3.10 Stock Market Developments

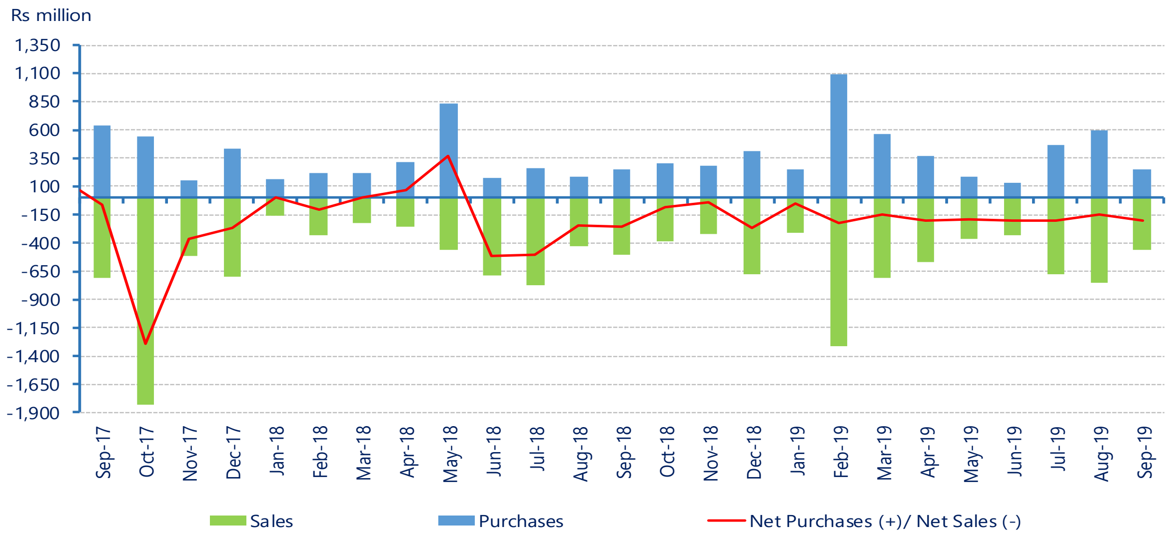
Both the SEMDEX and SEM-10 recouped part of their losses in 2019Q3. The SEMDEX and the SEM-10, which comprises the ten most capitalised stocks on the Official Market increased by 0.1 per cent and 0.5 per cent, respectively, on average in 2019Q3 compared to the previous quarter (Chart 3.15). On a point-to-point basis, between end-June 2019 and end-September 2019, the performance of the two market indices was positive, with both SEMDEX and SEM-10, registering an increase of 0.1 per cent and 0.9 per cent, respectively.

Chart 3.15: SEMDEX and SEM 10



Net investment by foreign investors remained in the negative territory since 2018H2. Net disinvestment amounted to Rs564 million in 2019Q3, slightly lower compared to Rs586 million in 2019Q2 (Chart 3.16).

Chart 3.16 Foreign Transactions on the Domestic Stock Exchange



3.11 Balance of Payments

Preliminary estimates of Mauritius' balance of payments point towards a narrowing current account deficit to Rs4.9 billion in 2019Q2, compared to Rs5.0 billion in 2019Q1 and Rs7.9 billion in 2018Q2, mainly attributed to higher primary income which offset the deterioration in the services balance. As a ratio to GDP, the current account deficit improved from 6.6 per cent in 2018Q2 to 3.8 per cent in 2019Q2. The deficit on the goods accounts, in nominal terms, was relatively unchanged at around Rs25.6 billion compared to the previous year, as both exports and imports remained broadly stable. As a ratio to GDP, the deficit on the goods account dropped from 21.3 per cent to 19.8 per cent over the same period. Exports of goods (f.o.b.) increased by 1.1 per cent y-o-y to Rs20.5 billion in 2019Q2, boosted by a growth of 4.2 per cent in *'Domestic exports'*. As a ratio to GDP, exports of goods eased from 16.8 per cent to 15.9 per cent over the same period. Imports of goods (c.i.f.) ticked up by 0.5 per cent y-o-y to Rs46.0 billion in 2019Q2, but dropped from 38.1 per cent to 35.7 per cent as a share to GDP. The surplus on the services account shrunk to Rs6.7 billion in 2019Q2 from Rs7.3 billion in 2018Q2, mostly attributed to reduced net surplus accruing on the 'travel' sub-account.

Net borrowing on the financial account, inclusive of reserve assets amounted to Rs6.4 billion in 2019Q2, compared to Rs10.2 billion in 2018Q1, and was adequate in financing the estimated current account deficit. The balance of payments surplus expanded to Rs19.2 billion in 2019Q2 from Rs18.9 billion a year ago. The direct investment account recorded net inflows of Rs33 billion in 2019Q2, while the portfolio investment account, inclusive of GBLHs' transactions, registered net outflows of Rs99.7 billion. The other investment account posted net inflows of Rs125.8 billion (Chart 3.17).

The gross official international reserves (GOIR) of the country expanded further in September 2019, improving the country's import cover as well. The GOIR increased by Rs3.3 billion, from Rs259.8 billion (equivalent to USD7,207million) as at end-August 2019 to Rs263.1 billion (equivalent to USD7,217 million) as at end-September 2019. Compared to a year ago, the GOIR rose by Rs43.2 billion. Based on the value of imports of goods (f.o.b.) and services for calendar year 2018, the GOIR represented 12.3 months of imports as at end- September 2019 compared to 12.1 months as at end-August 2019 and 10.3 months as at end-September 2018 (Chart 3.18).

Chart 3.17: Financing of the Current Account Deficit

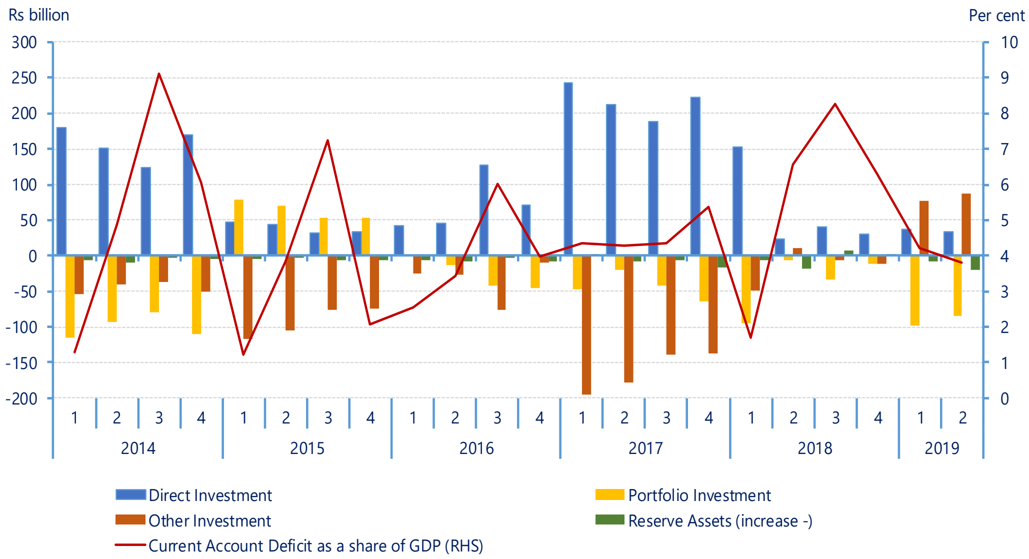
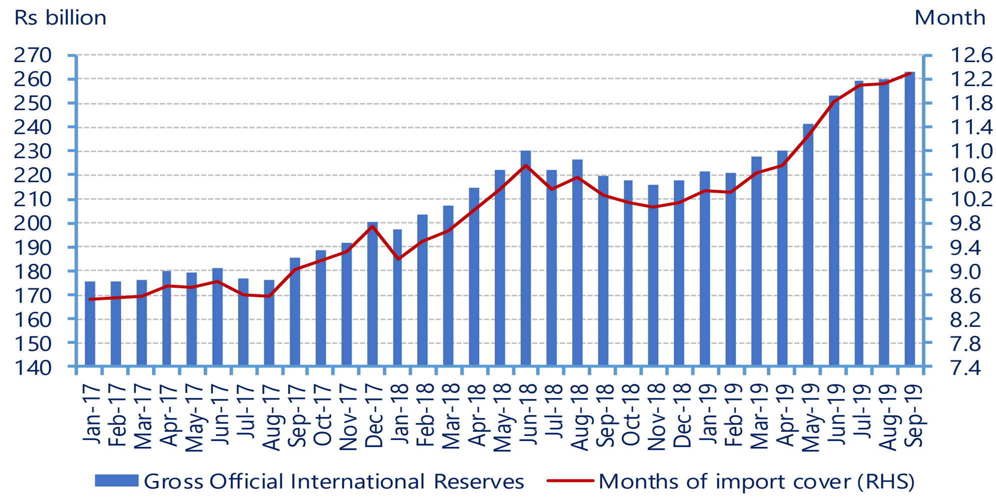


Chart 3.18: Gross Official International Reserves



External Vulnerabilities

The key reserve adequacy and solvency metrics pointed to an enhanced resilience of the country to external shocks. Gross external debt persistently declined from Rs81.1 billion as at end-June 2018 to Rs77.0 billion as at end-June 2019, while gross official reserves increased from Rs230.5 billion to Rs253.3 billion (Table 3.13). The ratio of the gross external debt to exports of goods and services dropped from 43.5 per cent to 41.0 per cent over the same period. As at end-June 2019, GOIR were more than three times higher than the gross external debt.

Table 3.13: External Debt Indicators

		Jun-15	Jun-16	Jun-17	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19
		Rs million							
Gross External Debt [1]	*as at end*	86,919	87,935	79,181	81,127	78,920	78,408	77,096	77,025
External Debt Service [1]	*year ended*	8,127	7,787	15,039	10,976	10,349	8,977	7,931	7,828
Exports of Goods	*year ended*	97,088	88,296	82,250	78,863	79,286	80,569	82,558	81,790
Exports of Goods and Services	*year ended*	194,164	187,418	184,967	186,483	186,029	188,576	189,160	188,027
Imports of Goods and Services	*year ended*	233,859	228,404	239,502	248,088	253,911	257,233	262,123	261,708
Gross Official International Reserves [2]	*as at end*	139,894	168,679	181,339	230,496	219,899	217,585	227,826	253,316
GDP at market prices	*year ended*	400,565	422,083	446,577	470,094	475,670	482,211	490,500	496,300
Broad Money Liabilities	*as at end*	418,402	421,917	491,497	537,638	537,076	555,014	563,011	572,096
I. Solvency *(Per cent)*		**Jun-15**	Jun-16	Jun-17	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19
Gross External Debt/GDP [3]		21.7	20.8	17.7	17.3	16.6	16.3	15.7	15.5
Gross External Debt/Exports of Goods		89.5	99.6	96.3	102.9	99.5	97.3	93.4	94.2
Gross External Debt/Exports of Goods and Services		44.8	46.9	42.8	43.5	42.4	41.6	40.8	41.0
External Debt Service/Exports of Goods		8.4	8.8	18.3	13.9	13.1	11.1	9.6	9.6
External Debt Service/Exports of Goods and Services		4.2	4.2	8.1	5.9	5.6	4.8	4.2	4.2
II. Reserve Adequacy *(Per cent)*		**Jun-15**	Jun-16	Jun-17	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19
Reserves/Imports of Goods and Services		59.8	73.9	75.7	92.9	86.6	84.6	86.9	96.8
Reserves/Broad Money Liabilities		33.4	40.0	36.9	42.9	40.9	39.2	40.5	44.3
Reserves/Gross External Debt		160.9	191.8	229.0	284.1	278.6	277.5	295.5	328.9

[1] *Gross external debt outstanding as at end of period excludes global business entities and other deposit-taking institutions' debt.*

[2] *Gross Official International Reserves as at end of period comprise gross foreign assets of the Bank of Mauritius, reserve position in the IMF and the foreign assets of Government.*

[3] *GDP figures for 2013 onwards are based on SNA 2008.*

Note: Gross External Debt and External Debt Service data for the period March 2017 and onwards has been updated following revision of External Sector statistics

Sources: MoFED; Statistics Mauritius; Bank of Mauritius.

4. Monetary Policy Decisions and Implementation

The Monetary Policy Committee of the Bank of Mauritius reduced, by majority vote, the Key Repo Rate by 15 basis points to 3.35 per cent per annum at its meeting held on 09 August 2019. The Bank pursued its open market operations in order to contain the level of excess liquidity at tolerable levels.

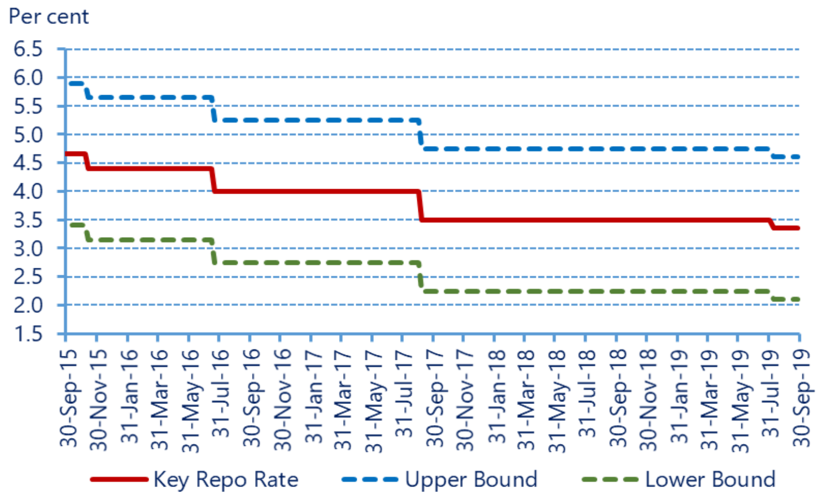
4.1 Monetary Policy Decisions

At its August 2019 meeting, while reviewing global economic developments, the Monetary Policy Committee (MPC) noted that global economic activity had moderated and that the pace of growth of major advanced and emerging economies has slowed somewhat. The major multilateral international agencies had again scaled down their global growth projections for 2019. In its July 2019 World Economic Outlook Update, the IMF revised down global growth further for 2019 from 3.3 per cent to 3.2 per cent. In the June 2019 issue of its Global Economic Prospects, the World Bank downgraded its global growth forecast from 2.9 per cent to 2.6 per cent. In its May 2019 Economic Outlook, the OECD set world growth at a below-trend rate of 3.2 per cent. There was uncertainty about the prospects for a sustained recovery in the world economy, with important downside risks seen in the short to medium-term. Economic conditions in some emerging and developing countries continued to deteriorate.

Global inflation remained subdued and below major central banks' targets. Inflation in the US dropped to 1.7 per cent in September 2019 from 1.8 per cent in July 2019 amid cheaper gasoline and food prices. Moreover, inflation in euro area, UK and China remained relatively low.

Members viewed that domestic economic activity was expected to remain resilient in the short-term, even though, the global economic environment looked highly uncertain. The lower GDP growth in 2019Q1 and the potential impact of slowing global demand on the domestic economy through the trade and confidence channel was discussed by the members. MPC members noted the continued downward trend in inflation and the moderation in inflation expectations. They also remarked that central banks have been easing monetary policy to support their economies. As a result, MPC members favoured reduction in the policy rate as a pre-emptive move against the risks associated with weakening global growth (Chart 4.1).

Chart 4.1: Evolution of the Key Repo Rate



4.2 Monetary Policy Implementation

The Bank pursued its open market operations to contain rupee excess liquidity within a tolerable level and stepped up its intervention on the domestic foreign exchange market. Banks' rupee excess liquidity averaged Rs12.8 billion during 2019Q3, compared to Rs11.2 billion in 2019Q2. The Bank issued its own securities for a total amount of Rs34.0 billion against maturing BoM securities of Rs32.8 billion over the same period. The Bank intervened on the domestic foreign exchange market to purchase a total amount of US$80 million[4] with a resulting amount of Rs1.1 billion sterilised as Special Deposits. During the period under review, Government issued securities totalling Rs19.0 billion and sold foreign exchange amounting to US$76.8 million (equivalent to Rs2.8 billion) from its account maintained with the Bank.

With a view to improving public sector cash management, Government introduced a new instrument, namely the Treasury Certificates (GMTCs) as from June 2019. These Certificates were to be issued on a weekly basis to Non-Financial Public Sector Bodies (NFPSBs) in the 91-Day, 182-Day and 364-Day tenors. Subsequently, the frequency and tenor were revised and the issuance of GMTCs is currently on a tap basis in the 182-Day tenor only. GMTCs for a total amount of Rs2.2 billion have been issued since the beginning of July 2019.

Short term yields remained generally within the interest rate corridor of the Bank's operational framework for monetary policy (Chart 4.2). The 91-Day yield depicted mixed trends during the period under review and declined from 3.09 per cent on 05 July 2019 to a low of 2.40 per cent on 27 September 2019. The average weighted yield for the 182-Day and 364-Day Bills lost 55 and 62 basis points and stood at 2.68 per cent and 2.78 per cent, respectively, between 05 July and 27 September 2019. On a monthly average basis, the overnight interbank interest rate, which stood at 2.41 per cent in July 2019, dropped to 2.05 per cent in September 2019, partly reflecting the drop in the 91-Day Bill yield. The scaling up of open market operations by the Bank led to an

[4] *Data up to 27 September 2019.*

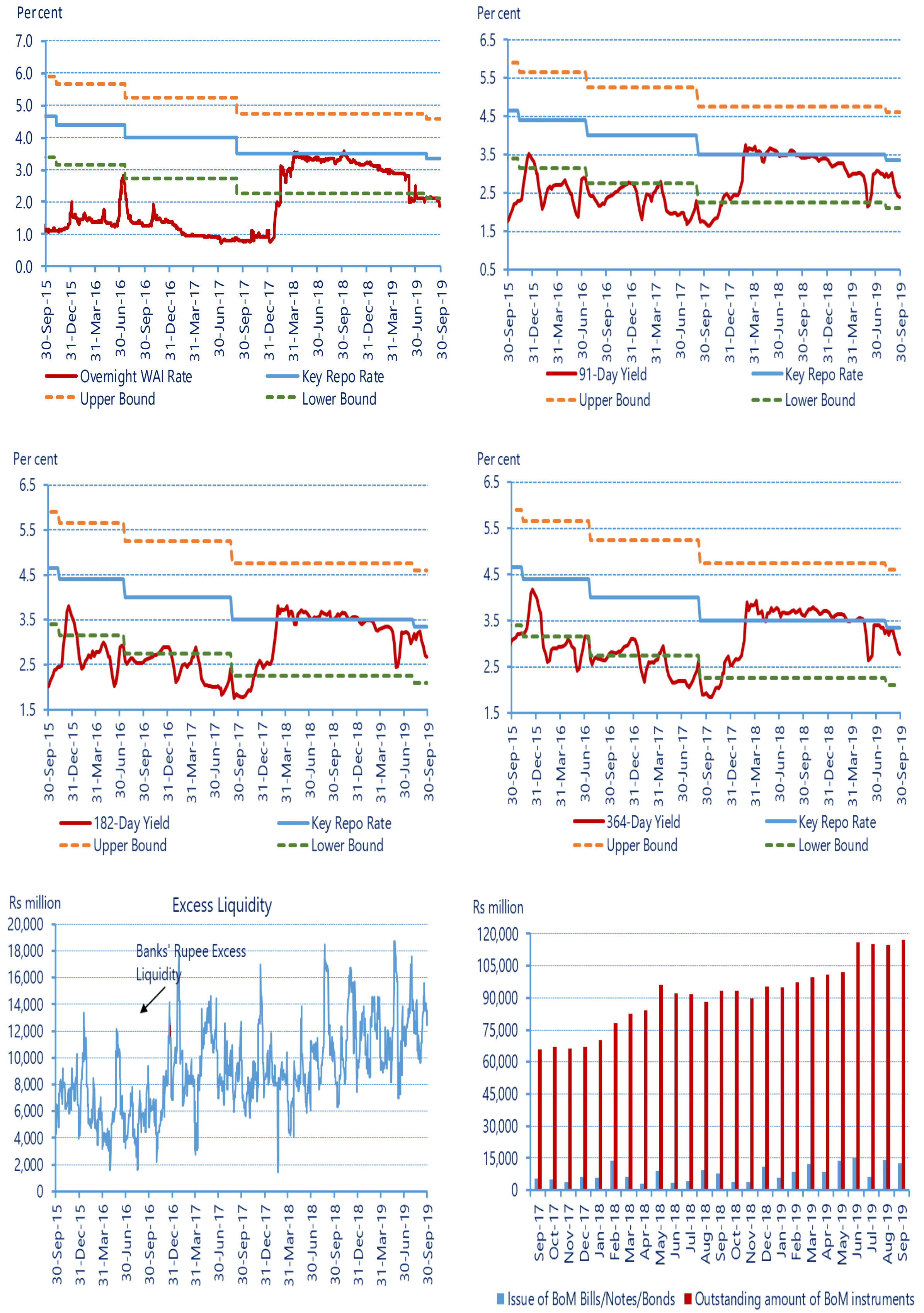
increase in the amount of outstanding BoM securities, which rose from Rs116 billion as at end-June 2019 to Rs117 billion as at end-September 2019 (Table 4.1).

Table 4.1: Outstanding BoM Securities

	Amount outstanding as at 31 May 2019	Amount outstanding as at 26 July 2019	Amount outstanding as at 30 August 2019	Amount outstanding as at 27 September 2019
Bank of Mauritius Bills	48,661.6	58,692.4	60,926.4	63,231.3
Special Deposits	7,031.1	13,834.0	13,834.0	13,834.0
Bank of Mauritius Notes	37,050.0	33,025.0	30,525.0	30,525.0
3-Year Bank of Mauritius Golden Jubilee Bonds	8,974.4	8,974.4	8,974.4	8,974.4
15-Year Bank of Mauritius Bonds	500.0	500.0	500.0	500.0
Total	**102,217.1**	**115,025.8**	**114,759.8**	**117,064.7**

Note: Figures may not add up to total due to rounding.

Chart 4.2: Excess Liquidity and Money Market Rates



5. Domestic Economic Outlook

The Bank's forecasts of key macroeconomic indicators are based on data available as at end-June 2019 and takes into consideration global economic projections made by various international multilateral agencies, like the IMF, World Bank and OECD taking into account latest domestic economic trends and projections. Based on certain assumptions, the Bank lowered its forecast for headline inflation to around 0.5 per cent for 2019, down from the previous estimate of 1.5 per cent and to around 1.5 per cent for 2020 in the absence of major supply shocks. Economic activity will continue to expand in terms of domestic demand and real GDP growth is forecast to remain resilient at about 3.9 per cent in 2019 and at 4 per cent in 2020.

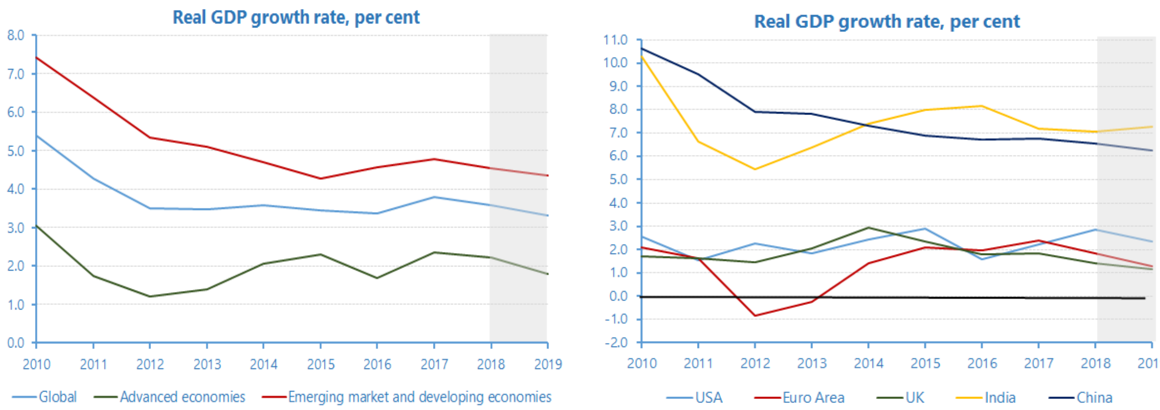
5.1 Background and Assumptions

Global growth is anticipated to soften in the near-term, reflecting an intensification of the trade conflict between the US and China; prolonged uncertainty with regards to the UK's withdrawal from the EU, and other geopolitical factors. Monetary policy is projected to remain accommodative to counter the downturn in activity across major economies. High frequency indicators continue to indicate fragile growth in the near-term, as recent world trade and industrial production indices suggest that economic activity is faltering somewhat. Recent surveys of purchasing managers, a forward-looking index designed to provide a guide about activity in the manufacturing and services sectors, also pointed towards a worsening of operating conditions across manufacturing sectors in almost all regions.

A broad-based deterioration of economic conditions in advanced economies is projected in both 2019 and 2020. Growth is projected to decelerate in advanced economies from 2.2 per cent in 2018 to 1.9 per cent in 2019 (Chart 5.1). This slowdown is expected to persist in 2020, due to a noticeable fall in US growth performance, from 2.6 per cent in 2019 to 1.9 per cent in 2020, partially offset by a stronger economic performance in the euro area and other advanced economies. The waning of fiscal stimulus together with the impact of higher tariffs on economic activity, would be the major factors adversely hitting the US economy in the medium term albeit the recent easing of monetary policy would contribute to partly offset the unfavourable performance. Euro area's growth would pick up from 1.3 per cent in 2019 to 1.6 per cent in 2020, as external demand would recover. The prospects for growth in the UK remain in the balance, with the increased probability of a no-deal Brexit as the 31 October 2019 deadline looms and is likely to weigh heavily on activity. In the event of an extension of the deadline accompanied with trade arrangements with the EU, UK growth is expected to remain more or less unchanged in 2020 at 1.4 per cent.

Weaker external demand and investment is expected to weigh on EMDEs' economic performance in the near-term, although economic activity would rebound in 2020 thanks to policy stimulus. Growth is projected to slow from 4.5 per cent in 2018 to 4.1 per cent in 2019, on account of a broad-based weakening of economic activity across all regions. China's growth is set to decline from 6.4 per cent in 2018 to 6.2 per cent in both 2019 and 2020, largely reflecting the impact of tariffs on exports' performance. Economic activity would, however, continue to be supported by fiscal and monetary stimulus which should continue into 2020. India's growth is set to pick up from 7.0 per cent in 2019 to 7.2 per cent in 2020, amid strong exports growth and investment. Recent measures such as the new income scheme for small farmers and a loosening of monetary policy would provide further support to activity. Economic activity in South Africa continues to be dragged down by structural bottlenecks, like frequent power cuts and underperforming state-owned enterprises amidst policy uncertainty. Growth is set to stagnate at 0.7 per cent in 2019, before increasing to 1.1 per cent in 2020 with improving business confidence and a pick-up in investment activity. Growth in Brazil is projected to slow from 1.1 per cent in 2018 to 0.8 per cent in 2019, given uncertainty over pension reforms which would ameliorate fiscal sustainability. Successful implementation of these measures and resulting improvement in confidence would lead to a recovery in growth to 2.4 per cent in 2020. Conditional on expectations of receding trade tensions; an improvement in external demand conditions in 2020, and an easing of external financing conditions, EMDEs' growth is projected to recover to around 5 per cent in 2020 and drive global output.

Chart 5.1: Global Growth



Source: IMF's April 2019 WEO.

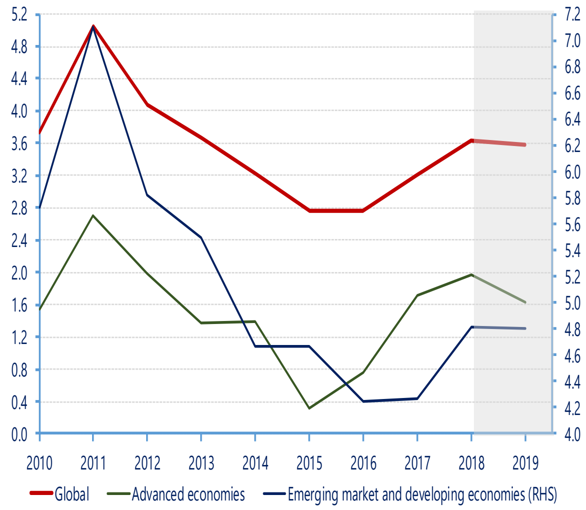
The persisting trade conflict between the two major economies is expected to linger and its impact will weigh on global trade performance. According to the July 2019 IMF WEO Update, world trade is forecast to grow at a slower pace of 2.5 per cent in 2019, lower by 0.9 percentage point compared to the April 2019 WEO forecast, as trade trends remain largely dependent on the continuing trade feud between the US and China. World trade volume is projected to bounce back in 2020, increasing by an estimated 3.7 per cent. Growth in world trade volumes in advanced economies is projected to slow to 2.2 per cent in 2019, but forecast to rise by 3.1 per cent in 2020. For EMDEs, trade volume growth is forecast to decelerate to 2.9 per cent in 2019 but will recover to 4.8 per cent in 2020.

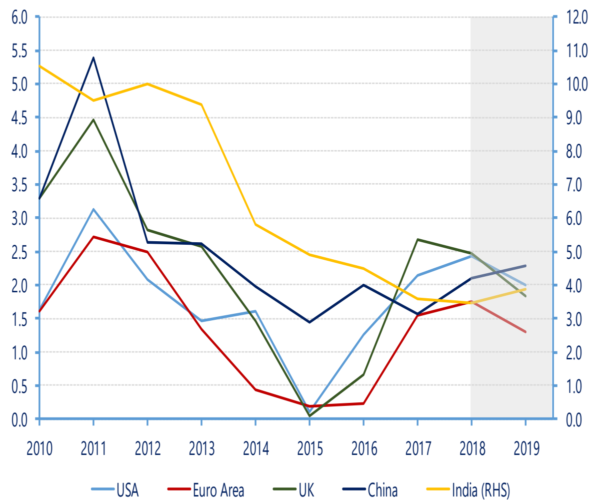
The US Fed has cut its Federal Funds Rate for the second time in 2019 at its September FOMC meeting. Following a first rate cut in July 2019 to 2.00-2.25 per cent, the first since the global financial crisis, the US Fed lowered its policy rate further to 1.75-2.00 per cent in September 2019 in light of global economic developments and outlook, as well as muted inflationary pressures. In spite of the sustained expansion of economic activity, strong labour market conditions, and an inflation rate close to target, uncertainties to the economic outlook prompted FOMC members to cut the policy rate. Almost all central banks have shifted to a more accommodative monetary policy stance in 2019 in order to support growth amidst subdued inflation outcome.

ECB's Governing Council reduced its deposit facility rate at its September 2019 meeting and restarted its asset purchase programme to support the Eurozone. While the ECB kept its other key interest rates unchanged, it cut its deposit facility rate by 10 basis points to -0.50 per cent. With the resumption of quantitative easing, the ECB is targeting that financial conditions remain highly accommodative to support the euro area's economic expansion and build-up of price pressures to meet the medium term target of 2 per cent.

Amid the subdued global economic performance, global inflationary pressures are expected to remain muted. As a result, commodity price movements are more likely to be dependent on supply side factors in the near term. In its July 2019 WEO Update, the IMF projected a decline in the inflation rate for advanced economies to 1.6 per cent in 2019, from 2.0 per cent in 2018, reflecting some degree of economic slack and weak global demand for commodities which have been keeping their prices rather stable (Chart 5.2). Inflation for advanced economies is expected to bounce back to 2.0 per cent in 2020 as most of these economies are expected to be closing their respective negative output gaps. Inflation in EMDEs would be rather stable at 4.8 per cent in 2019 and 4.7 per cent in 2020.

Chart 5.2: Global Inflation, Per cent





Source: IMF's April 2019 WEO.

Table 5.1: Selected Indicators' Projections

Real GDP growth and inflation forecasts, per cent (Reuters poll)

Countries	Quarter on quarter real GDP growth rate (Per cent)					Year-on-year inflation rate (Per cent)				
	2019Q2	2019Q3	2019Q4	2020Q1	2020Q2	2019Q3	2019Q4	2020Q1	2020Q2	2020Q3
United states (Y-o-y)	1.8	1.9	1.8	1.8	1.8	2.1	2.1	2.1	2.2	2.2
United Kingdom	0	0.3	0.3	0.3	0.3	1.8	1.8	2.0	1.9	1.9
Eurozone	0.2	0.3	0.4	0.3	0.3	1.1	1.2	1.4	1.3	1.4
of which: France (Y-o-y)	1.2	1.0	1.2	1.5	1.2	1.0	1.2	1.5	1.2	1.3
China (Y-o-y)	6.2	6.2	6.2	6.1	6.1	2.5	2.4	2.6	2.4	2.3
India (Y-o-y)	6.3	6.7	6.9	7.2	7.2	3.5	3.8	4.1	4.1	4.2
South Africa (Annualised)	1.9	1.5	1.6	0.7	1.4	4.5	4.6	5.3	5	4.9
Australia	0.6	0.7	0.7	0.6	0.6	1.7	1.7	2.0	1.9	2.0

Exchange rate forecast (Reuters poll)

	End-Aug 2019	End-Sep 2019	End-Dec 2019	End-Mar 2020	End-Jun 2020
EUR/USD	1.1300	1.1300	1.1400	1.1550	1.1700
GBP/USD	1.2600	1.2600	1.2800	1.3000	1.3200

Oil price forecasts, US$ per barrel (US Energy Information Administration)

	2019Q3	2019Q4	2020Q1	2020Q2	2020Q3
NYMEX West Texas Intermediate	60.33	63.00	63.00	63.00	63.00
ICE Brent	66.67	67.00	67.00	67.000	67.00

Sources: OECD, Reuters and US EIA.

The global growth outlook remains subject to major downside risks over the forecast horizon. Following a breakdown of trade talks after the G20 meeting, trade tensions further intensified in August 2019, dampening prospects for a quick resolution of the trade dispute. The trade war has also extended to technology supply chains disruptions, increasingly denting investor sentiment. The likelihood of a no-deal Brexit has risen with the advent of the new UK Prime Minister and increased political turmoil prior to the 31 October 2019 deadline. Stress in some of the large emerging economies could increase their vulnerability in a context of moderating global growth and weaker external demand. In addition, the low interest rate environment is raising the possibility of another round of zero or negative interest rates, in an environment where the central banks of many advanced economies do not have adequate monetary policy space to counter a potential downturn in economic activity.

Oil Price Developments

Global oil prices are projected to remain more or less around their current levels in the near term. The '*Declaration of Cooperation*' by OPEC and non-OPEC oil producing countries has mitigated the decline in oil prices and contributed to the reduction in stocks' overhang on the crude oil market. The price hike in September 2019 resulted from supply disruptions from Saudi Arabia after an attack on one of its major pipeline. However, prices have dropped thereafter over slowing global economy and trade concerns, which have depressed demand for oil. OPEC's projection of world oil demand for the rest of 2019 has been revised down due to weaker-than-expected data from various global demand centres and slower economic growth projections for the remainder of the year. Demand is, nonetheless, expected to recover in 2020. World oil supply for 2019 has been revised up on account of increased production by non-OPEC countries such as the US, China, Brazil and Canada.

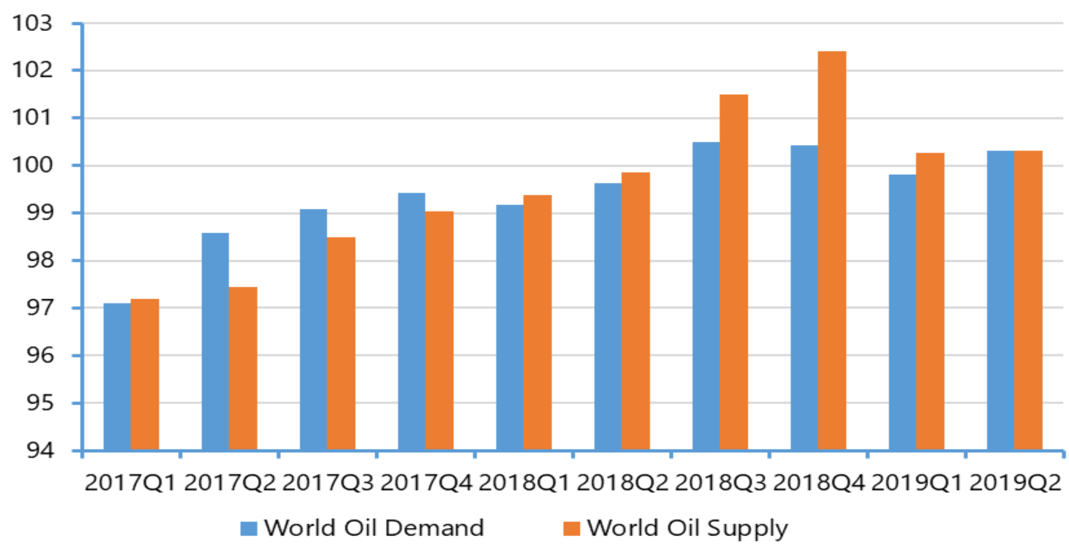
The EIA reduced its crude oil price forecast for 2019 and 2020 in September 2019, reflecting weak oil demand conditions. Brent crude oil prices were projected to average USD63/b in 2019, after a downward revision in world demand for oil of 0.9 billion b/d, reflecting the moderation in economic activity in OECD countries. For 2020, crude oil prices have been estimated to decline further to an average of USD62/b. At this juncture, there are uncertainties in crude oil market over supply developments and future price movements given the combination of oil supply disruption risk and lower economic growth expectations. World demand for oil in 2019 is expected to be 100.8 million b/d, compared to 99.9 million b/d in 2018 (Table 5.2 and Chart 5.3). If realised, 2019 would be the first year when demand growth is less than 1.0 million b/d since 2011. World demand is expected to rise to 102.2 million b/d in 2020.

Table 5.2: Supply and Demand for Oil

	2019Q1	2019Q2	2019Q3	2019Q4	2018	2019*	2020*
	Million barrels per day						
World Oil Demand	99.81	100.32	101.32	101.83	99.93	100.82	102.22
Non-OPEC supply	64.43	64.91	66.17	67.17	63.5	65.68	67.89
OPEC NGLs and non-conventionals	35.83	35.41	35.15	35.15	37.29	35.38	34.68
Total non-OPEC supply and OPEC NGLs	100.26	100.32	101.33	102.31	100.79	101.06	102.57
	Dollars per barrel						
Crude Oil Prices							
West Texas Intermediate Spot Average	54.82	59.94	55.59	54.83	65.06	56.31	56.5
Brent Spot Average	63.14	69.07	61.02	60.33	71.19	63.39	62

**: forecast.*
Sources: OPEC and US EIA.

Chart 5.3: Supply and Demand for Oil



Source: US EIA.

Domestic Assumptions

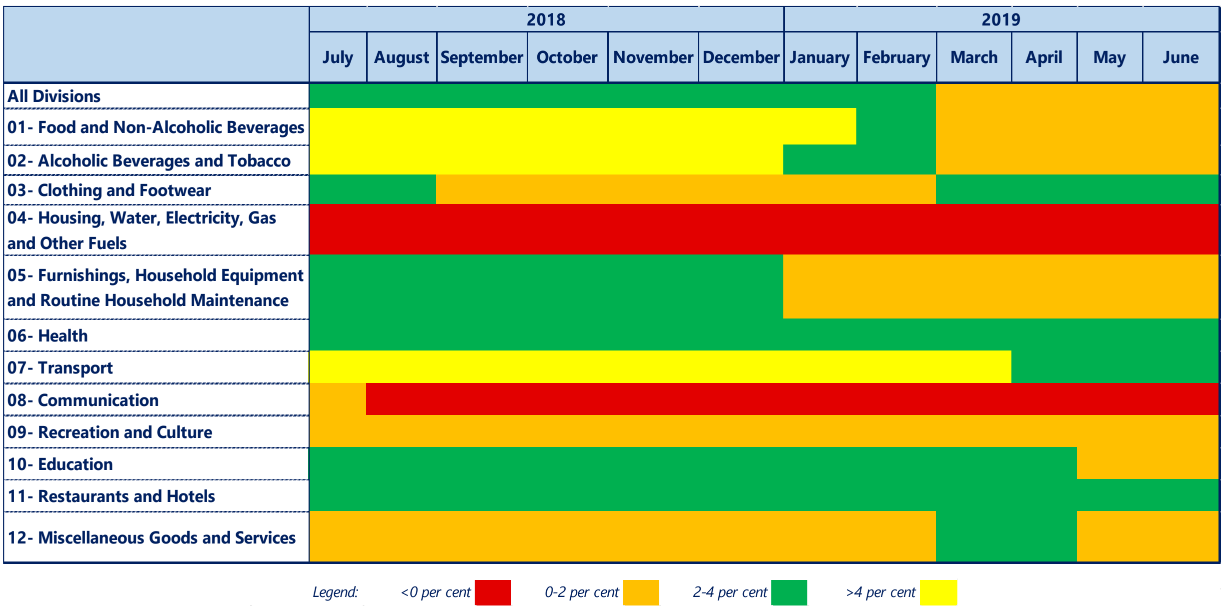
Taking into account the potential factors that can influence the outcome of future inflation and real GDP growth in Mauritius, Bank staff have assumed that:

- prices of domestic petroleum products will remain unchanged over the forecast horizon based on global projections of oil prices for the rest of 2019 and for 2020;
- prices of other administered products are also expected to remain unchanged;
- Government will meet its budget deficit target of 3.2 per cent of GDP for FY2019-20, as laid out in its medium-term macroeconomic projections set out in the 2019/20 Budget;
- the implementation of public sector infrastructure projects as per the Public Sector Investment Programme to remain within the expected deadline;
- inflation expectations will continue to be well-anchored;
- business and consumer confidence indicators will remain at current levels;
- the exchange rate of the rupee will remain around current levels; and
- the absence of significant supply shocks, both locally and globally, that may impact on commodity prices.

5.2 Inflation Heatmap

The momentum of price changes by divisions, as analysed in the inflation heatmap, has softened over the past 12 months. More than 70 per cent of the goods and services in the CPI basket has recorded inflation outcomes of less than 2 per cent in June 2019, hinting at ebbing inflationary pressures. In particular, none of the divisions has signalled any emanating price pressures exceeding 4 per cent in 2019Q2. Consequently, the softening bias in domestic price inflation is likely to persist over the near term (Table 5.3).

Table 5.3: Headline Inflation Heatmap by Division



Near-term Projections

Inflation Forecast

Headline inflation is expected to maintain its downtrend till the end of 2019. Based on the assumption that the prices of fresh vegetables will continue to moderate in the near future, coupled with the downward adjustment in energy prices in 2019Q2, headline inflation is projected to decline to 0.8 per cent in 2019Q3 and further to 0.5 per cent in 2019Q4. However, these forecasts are made on the basis of the hypotheses deemed most probable. The monthly inflation rate in Mauritius was modelled using an Autoregressive Integrated Moving Average (ARIMA) process, over the period July 2002 to June 2019, based on which forecasts over the next six-month periods were generated. This process is a univariate modelling technique which expresses a time series in terms of its past values (autoregressive component) and current and past error terms (moving average component).

Inflation is expected to recover from its trough in December 2019 and settle slightly higher over the next 12-month period, albeit remaining contained. The fall in prices of petroleum products and cooking gas following 2019/20 Budget measures has restricted inflationary pressures somewhat. In addition, the relatively weaker exchange rate pass-through to CPI coupled with subdued imported inflation continued to contain domestic price pressures. On the demand side, the contribution of output gap pressures to CPI inflation remained tame, notwithstanding the decline in economic slack within the domestic economy. The second half of the year is generally associated with rather benign cost-push pressures given more stable weather conditions and less volatility in fresh vegetables prices. On the external front, global inflation continues to remain contained, mainly on account of subdued global commodity prices and weak demand-driven inflationary pressures. Given downward pressure of latest budget measures on the price level in 2019Q2, the previously announced inflation projection of 1.5 per cent for 2019 has been revised downwards. In the absence of exceptional shocks during 2019H2, headline inflation is projected to remain low in 2019. Based on a set of assumptions, headline inflation is now expected at around 0.5 per cent in 2019 and at about 1.5 per cent in 2020.

5.3 Real GDP Growth Forecast

Many business cycle indicators are available at higher frequencies, which can be used to nowcast real GDP growth. In this respect, the Bank uses ARMA, bivariate equations, trivariate equations, Principal Components Analysis (PCA), Dynamic Factor Model, and the Denton benchmarking technique to estimate near-term real GDP growth. A benchmark forecast for 2019Q2 real GDP growth rate was derived using an ARMA (1,1) process. The process involved constructing bridge equations, with real GDP regressed against distinct exogenous variables with a constant term. The PCA is thereafter used to reduce the large set of variables that altogether contribute to explain variations in the target variable into a small set of values called principal factors. The Dynamic Factor Model is a standard econometric tool to measure co-movement in macroeconomic time series and for forecasting. The model uses a coincident indicator, or estimated common factor, to forecast real GDP by means of a transfer function. Four monthly indicators - tourist arrivals, credit to the private sector, number of cheque clearances and broad money liabilities - and one quarterly indicator, euro area GDP, have been used based on their observed correlations with growth. The monthly data series are turned into quarterly averages and seasonally adjusted using the X-12 method. The quarterly series for the domestic GDP are seasonally adjusted using the Tramo-seats method. While GDP is available with a lag, a proxy for the actual quarter may be obtained by benchmarking the quarterly GDP with High Frequency Indicators (HFIs) using the Denton Benchmarking Technique. One necessary condition is that the HFIs should be highly positively correlated with GDP for them to have increased likelihood of sharing similar cycles. A set of 20 HFIs was analysed and only 10 of those with a correlation co-efficient with real GDP estimated close to or above 0.75 were retained for the Denton benchmarking process. The various approaches have yielded real GDP growth in the range of 3.6 to 3.8 per cent, with the most likely outcome of 3.6 per cent for 2019Q2.

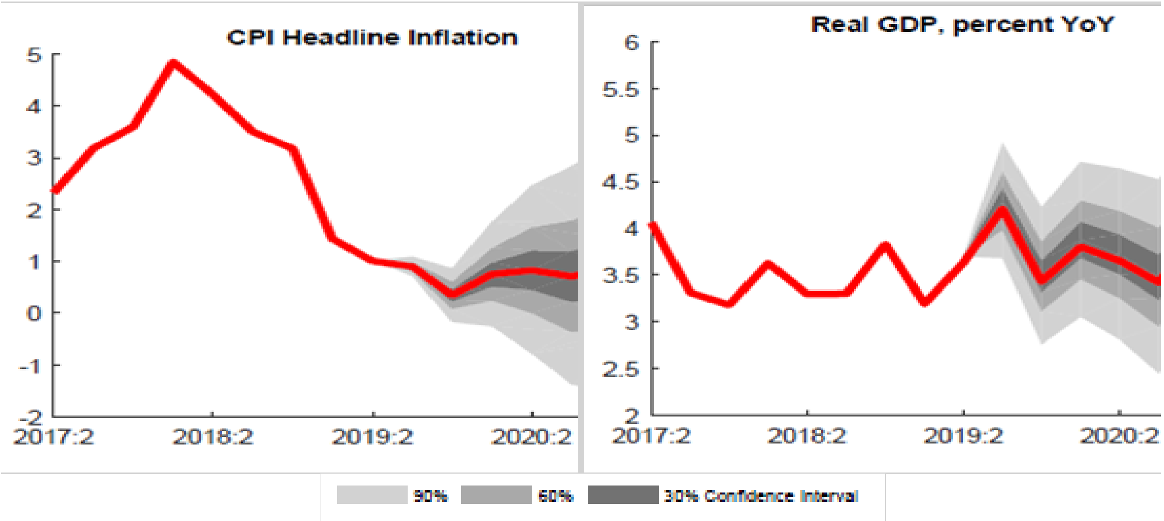
The domestic economic growth momentum is expected to be sustained in 2019. Output growth in 2019H2 will remain supported by household and government consumption expenditure growth. Positive domestic conditions continue to favourably influence domestic economic activity. The buoyant performance of key sectors such as construction, financial and insurance activities, real estate activities and accommodation and food service activities to real GDP growth remains vital to sustaining economic activity. The recently announced pro-growth fiscal policies, together with the accommodative monetary policy stance are expected to maintain favourable macroeconomic conditions, optimum for pro-business and investment facilitation. The economic impetus arising from major infrastructure projects such as metro express, smart cities and works under the Road Decongestion Programme continues to positively influence domestic output growth. At the sectoral level, economic activity remains supported by the services sector. The growth in the ‘financial and insurance activities’ sector is expected to moderate to 5.2 per cent although ‘accommodation and food service activities’ sector will underperform marginally, as a result of subdued growth in tourist arrivals and tourism earnings in 2019H1. The ‘wholesale and retail trade’ sector is expected to grow at a slightly lower pace in 2019 while the ‘manufacturing’ sector is expected to grow by about 1.3 per cent. The dynamism in the ‘construction’ sector would be sustained, growing at around 8.5 per cent in 2019 on the back of major infrastructure projects.

Conditional on a set of assumptions, Bank staff, at its forecasting round in August 2019, have maintained real GDP growth rate of about 3.9 per cent in 2019 and 4 per cent in 2020. However, the external economic conditions, especially in our major trading partners can potentially impact on net external demand, which may dent the domestic growth momentum especially if certain sectoral issues remain unaddressed.

5.4 Risks to the Forecast

Headwinds to growth prospects and meeting the inflation forecast over the projection horizon still remain and the fan chart depicts the probability of various outcomes for CPI inflation and real GDP growth. Over the forecast period, the distribution reflects uncertainty over the evolution of CPI inflation and real GDP growth. The fan chart is constructed so that the projections are expected to lie within each pair of the lighter coloured areas, i.e., the confidence intervals. In any particular quarter of the forecast period, CPI inflation and real GDP growth are therefore expected to lie somewhere within the fan on 90 out of 100 occasions, i.e., at 90 per cent confidence interval (Chart 5.4). The uncertainty associated with the forecasts of CPI inflation and real GDP growth is reflected with the widening dispersion from the central estimate over the projection horizon.

Chart 5.4: Fan Charts - Headline Inflation and Real GDP Growth, Per cent



LIST OF TABLES

LIST OF CHARTS

ACRONYMS

CPI	Consumer Price Index
FAO	Food and Agriculture Organisation
FOMC	Federal Open Market Committee
GBC	Global Business Companies
GDP	Gross Domestic Product
GOIR	Gross Official International Reserves
IMF	International Monetary Fund
KRR	Key Repo Rate
MERI	Mauritius Exchange Rate Index
MSCI	Morgan Stanley Capital International
OECD	Organisation for Economic Co-operation and Development
Q-o-q	Quarter-on-quarter
US Fed	US Federal Reserve System
WEO	World Economic Outlook
Y-o-y	Year-on-year

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ISSN 1694-3740