Minutes of the 67th Monetary Policy Committee Meeting held on 15 June 2023

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The 67th meeting of the Monetary Policy Committee (MPC) was held on Thursday 15 June 2023 at 08:00 hours at the Bank of Mauritius. The following members attended the meeting:

- Mr. Harvesh Kumar Seegolam (Governor and Chairman)
- Mr. Mardayah Kona Yerukunondu (First Deputy Governor)
- Mrs. Hemlata Sadhna Sewraj-Gopal (Second Deputy Governor)

External Members

- Mr. Lim Chan Kwong Lam Thuon Mine
- Mr. Mohammad Mushtaq Namdarkhan
- Mrs. Christine Marie Isabelle Sauzier
- Professor Sanjeev Kumar Sobhee

Summary of Staff Report on Economic and Financial Developments

Bank staff briefed MPC members on global and domestic economic and financial market developments that have taken place since the last MPC meeting held on 15 December 2022. MPC members were also apprised of the latest macroeconomic projections before deliberating on the policy rate.

Global Economic Developments

1. Global economic recovery is well under way in 2023Q1 despite a challenging economic environment characterised by relatively tight financial conditions. The US economy remained resilient as consumption picked up, against a backdrop of favourable weather conditions, rising wages and robust sentiment. The euro area registered moderately positive growth rate, after a slowdown in 2022Q4, supported by reinforced household spending and rising global demand. The UK economy has remained relative buoyant, with economic activity picking up across a spectrum of sectors, including healthcare, transport and education. The recently announced measures by the

government are also helping to give further impetus to the economy and consolidate the robustness of its ongoing recovery. Economic activity accelerated in China, following the decision by the Chinese authorities to re-open the economy in December 2022. Consumption and exports rebounded and are expected to remain robust, albeit the property market downturn could constitute a headwind for economic recovery. Growth in the Indian economy remained solid in 2023Q1 amidst a recovery in domestic consumption and private investment - making it the fastest-growing among the world's top economies.

2. Leading economic indicators, such as the Purchasing Managers Indices (PMIs), which were already pointing towards an improvement in global economic activity in 2023Q1, expanded further in the second quarter. The J.P. Morgan Global Composite Output Index rose to 54.4 in May 2023, remaining above the 50.0 neutral mark for the fourth consecutive month. This was supported by a marked expansion in the services sector amidst higher output growth and rising intakes of new orders, which led to enhanced business optimism and job creation. While activity in the manufacturing sector remained somewhat subdued, the rate of expansion improved to an 11-month high.

3. In its April 2023 World Economic Outlook, the IMF had revised its global growth projection for 2023 to 2.8 per cent. This marked an improvement of 0.1 percentage point compared to its October 2022 projection of 2.7 per cent, albeit it also represented 0.1 percentage point lower than its January 2023 forecast of 2.9 per cent. Relative to its January 2023 projections, the IMF downgraded its 2023 growth prospects for emerging and developing economies by 0.1percentage point to 3.9 per cent. For advanced nations, growth prospects were re-adjusted upwards by 0.1 percentage point to 1.3 per cent.

4. Most central banks have pursued their tightening cycle during 2022 and at the start of the year to prevent a de-anchoring of inflation expectations. The decisions by central banks worldwide to pursue such hawkish policies are now beginning to yield dividends. Inflation has been on a declining trend in many parts of the world but nonetheless remains elevated. However, core measures of inflation are yet to embark on a downward trajectory in many countries and are expected to do so in the latter part of 2023, as the effects of policy tightening undertaken so far begin to firmly grip demand conditions and, by ricochet, put a lid on these measures.

5. The decline in inflation also mirrors falling shipping costs and lower energy and food prices. The Freightos Baltic Index, which measures global container freight rates worldwide and used as a proxy for shipping stocks, maintained its downward trajectory. The Food and Agriculture Organisation Food Price Index, which tracks the most globally traded food commodities, fell to 124.3 in May 2023, from 131.8 in December 2022, driven by falling prices of vegetable oils, dairy products and cereals, which more than offset the increases in sugar and meat prices.

6. Oil prices fell in March 2023, partly due to the impact of mild winter temperatures in Europe which curtailed energy consumption and helped preserve gas inventories and partly due to fears associated with a looming recession in the wake of the US banking sector turmoil. Following an uptick in April due to curtailment of supplies by the OPEC, crude oil prices declined afterwards to an average of US$75.7 a barrel in May 2023.

7. The IMF forecasts global inflation to recede from 8.7 per cent in 2022 to 7.0 per cent in 2023, on the back of lower commodity prices, while underlying inflation is likely to decline more slowly.

8. The interest of central banks in pursuing their tightening cycle has clearly waned during 2023Q2, with an increasing number opting for an unchanged policy stance at their policy meetings. Against a backdrop of receding inflationary pressures but still elevated inflation rates, central banks have also become more cautious about risks to their growth outlook. Since the beginning of the year, 118 decisions of monetary policy committee meetings globally have been to maintain the status quo, as opposed to 100 decisions which have been to hike policy rates. Since March 2023, 77 decisions to leave policy rates unchanged were noted globally as opposed to 62 decisions which were about raising rates. This growing propensity for central banks to leave their policy rates unchanged may increase going forward with the June 2023 decision of the US Federal Reserve to maintain its status quo. Looking ahead, the US Federal Reserve underscored that this pause was concocted out of caution and that it would assess the macroeconomic situation in the US at its future meetings before deliberating on the direction of its policy stance. As for the Bank of England (BoE) and the European Central Bank (ECB), their policy rates are expected to reach a peak in 2023Q3 and will remain so till 2023Q4 for the BoE and till 2024Q1 for the ECB.[1]

Domestic Economic Developments

9. The Mauritian economy remained solidly anchored on its recovery path, with real GDP expanding by 8.7 per cent in 2022. Growth was broad-based and reflected better-than-expected performance of a wide spectrum of sectors, including *'Accommodation and food service activities'*, *'Manufacturing'*, *'Agriculture'*, and *'Financial and insurance activities'*, amongst others. The *'Accommodation and food service activities'* sector recorded an exceptional triple-digit growth rate of 200 per cent in 2022, after two years of contraction, with positive spillover effects onto other sectors of the economy, including retail trade, construction and real estate.

10. Tourist arrivals reached 997,290 in 2022, which represented 72 per cent of the 2019 level. Tourism earnings amounted to Rs64,845 million (USD1,456 million) in 2022 – higher than the 2019 level. The tourist average length of stay rose from 10.6 nights in 2019 to 11.8 nights in 2022. In parallel, the average expenditure by tourist per night had increased over the same period. Tourist arrivals stood at 514,258 during the period January to May 2023, representing 92 per cent of the 2019 level, and nearly 60 per cent higher compared to the corresponding period in 2022. The Mauritian tourism sector remains euro-centric with traditional markets such as France, the United Kingdom and Germany accounting for the lion's share of total arrivals. Tourism earnings aggregated Rs28,876 million (USD635 million) during the period January to April 2023, higher by 72 per cent compared to the same period of 2022.

11. On the expenditure side, growth was driven by both domestic and external demand. Consumption growth remained robust at 3.8 per cent in 2022, supported by both household and government spending. Household spending provided the highest relative contribution to GDP in 2022 in view of its multiplier effect on a wide variety of economic activity fields. Investment, as

[1] *Source: Refinitiv poll.*

measured by Gross Fixed Capital Formation, expanded by 7.8 per cent, led by private sector investment in the construction of smart cities, property development schemes and renovation of hotels. These positive developments on the expenditure side helped improve labour market conditions. Total employment rose by 29,000 from 502,500 in 2022Q1 to 531,500 in 2022Q4. The labour force expanded by 20,200 to 570,300 and unemployment dropped by 8,800 to 38,800 over the same period. The combined effect of these forces led to a lower unemployment rate of 6.8 per cent in 2022Q4, down from 8.7 per cent in 2022Q1. Both the female and youth unemployment rates declined steadily.

12. The relatively high degree of openness of the Mauritian economy, its high propensity to import what it consumes and moderately high pass-through effect from foreign prices to domestic prices mean that domestic price pressures largely follow global price developments, albeit with a lag. Inflation in Mauritius has begun to ease since February 2023 amidst the normalisation of global supply chains and declining global commodity prices. Headline inflation moderated from 10.8 per cent in December 2022 to 10.6 per cent in May 2023, after an uptick in February 2023. Year-on-year (y-o-y) inflation declined steadily to reach 7.9 per cent in May 2023, down from 12.2 per cent in December 2022. A decomposition of CPI across its main components showed that *'Food and non-alcoholic beverages'*, *'Transport'* and *'Housing, water, electricity, gas and other fuel'* which have an overall weight of 24.8 per cent, 14.7 per cent and 11.2 per cent, respectively, in the overall CPI basket, accounted for more than half of headline inflation in May 2023.

13. Core inflation moderated, albeit at a relatively slow pace. On a 12-month average basis, CORE1 and CORE2 inflation remained unchanged at 9.3 per cent and 7.3 per cent, respectively, in May 2023 compared to December 2022. On a y-o-y basis, CORE1 inflation dropped from 9.8 per cent in December 2022 to 5.3 per cent in May 2023 while CORE2 inflation went down from 7.4 per cent to 5.3 per cent.

14. Notable improvements in the external sector were noted in 2022. The current account deficit narrowed to Rs14.7 billion in 2022Q4 (8.9 per cent of GDP), from Rs19.4 billion in 2021Q4 (13.9 per cent of GDP), as a result of the strong performance of the tourism sector which helped consolidate the services account component of the current account. The higher surpluses in the services account outweighed the increase in the trade deficit, which emanated from a more pronounced rise in imports of goods which outstripped the rise in exports of goods during 2022.

15. Intra-yearly indicators of external sector developments so far during 2023 paint an encouraging picture. The current account deficit is projected to improve to 8.3 per cent of GDP in 2023, from 12.2 per cent of GDP in 2022. Sustained growth in the tourism sector as a result of improved connectivity, a more aggressive marketing campaign and encouraging forward bookings for 2023 is expected to result in a higher surplus in the services account. In parallel, high global interest rate outlook and better return prospects on net foreign asset growth of resident entities are expected to contribute positively to the primary income component of the current account.

16. Financial flows are expected to remain robust in 2023 as global economic activities continue to recover and cross-border investment activities remain buoyant. The two main

recipients of financial flows, namely the GBC and banking sectors, are expected to register positive growth in their net acquisition of assets abroad, despite some episodes of global financial market uncertainty. With respect to non-GBC flows, the real estate sector is expected to remain at the receiving end of large influxes of foreign direct investment in Mauritius. Other investment flows are mostly projected to reflect healthy growth of bank deposits from non-residents.

17. An overall balance of payments surplus of Rs9.6 billion (1.6 per cent of GDP) has been projected for 2023, as against a deficit of Rs13.9 billion in 2022 (2.4 per cent of GDP). Stronger macroeconomic fundamentals in the form of robust financial flows in the financial account along with a lower current account deficit are expected to support the domestic currency in the medium-term. Gross Official International Reserves (GOIR) as at end-May 2023 remained broadly adequate as a buffer against external shocks. Based on the imports of goods (f.o.b.) and services for calendar year 2022, GOIR represented 9.9 months of imports as at end-May 2023, which remains higher than the safety threshold prescribed by a number of regional trading blocs. External vulnerability metrics indicate moderate risk profile of the current level of gross external debt.

18. The new Monetary Policy Framework (MPF) of the Bank of Mauritius was launched at the beginning of the year. Open market operations have been conducted to steer the overnight interbank rate, the operating target under the new framework, close to the Key Rate. An amount of Rs62.6 billion of 7-Day BOM Bills was issued on a weekly basis at the Key Rate of 4.50 per cent per annum. Banks have availed of the Overnight Deposit Facility for a daily average of Rs6.8 billion. The open market operations have resulted in a significant decline in rupee excess liquidity in the banking system. The Bank also mopped up an amount of Rs2.3 billion through FX interventions since the beginning of the year. Over the same period, the net issuance of government securities in various maturity denominations helped reduce excess liquidity by Rs15.9 billion. The Bank has also issued various instruments with relatively longer maturity in order to address structural excess liquidity. Since implementation of the new MPF (i.e. 16 January to 15 June 2023), the Bank managed to reduce excess liquidity to a daily average of Rs2.2 billion and to keep the overnight interbank rate between 3.90 per cent and 4.50 per cent, which is well within the interest rate corridor which stands at 200 basis points around the Key Rate through Standing Facilities.

19. The exchange rate of the rupee has been reflecting domestic and international market forces so far during the year and is expected to move in line with domestic macroeconomic fundamentals over the medium-term. Performance of the domestic FX market has been encouraging, pointing towards signs of recovery in 2023. Total turnover stood at USD5.1 billion from January to May 2023, constituting an increase of 41 per cent relative to USD3.6 billion registered in the corresponding period of 2022. The strong performance of the external sector, in particular the tourism sector and financial account flows, is expected to further uplift the domestic FX market and to ensure its operations in an orderly manner.

20. The banking sector continues to be sound, robust and resilient, despite external headwinds in the form of banking turmoil and global financial market disturbances affecting the US and some European countries. Capital and liquidity buffers of banks in Mauritius remain at comfortable levels. The Capital Adequacy Ratio stood at 20.4 per cent as at end-March 2023, well above the minimum regulatory requirements imposed by the Bank, and offers adequate cushion against potential

external disruptions, should these materialise. The strength of the banking sector in Mauritius is also supported by the ample availability of unencumbered high-quality liquid assets that offer adequate protection against the sudden materialisation of severe but plausible liquidity strains. The aggregate Liquidity Coverage Ratio (LCR) stood at 237.5 per cent in March 2023 while the LCR for material foreign currencies stood at 210.3 per cent – largely exceeding the regulatory floor of 100 per cent in both cases. As an International Financial Centre (IFC) through which large amounts of material foreign currencies are intermediated, these results underscore the resilience of the banking sector on the liquidity front.

21. Banks continues to provide support to the economy by ensuring constant flow of credit. Bank credit to the private sector grew, on an annual basis, by 9.3 per cent in April 2023, up from 2.4 per cent in October 2022, reflecting mainly the growth in credit extended to the corporate sector. The hikes in the policy rate to mitigate inflationary pressures in 2022 have raised debt servicing costs for both the household and the corporate sectors. However, no evident signs of financial distress have emerged so far in these sectors. Bank credit to the corporate sector picked up as from November 2022 and registered an annual growth of 6.1 per cent in April 2023. Similarly, bank credit to the household sector continued to grow, reaching an annual rate of 14.1 per cent in April 2023, from 13.6 per cent in October 2022.

22. The credit portfolio of the banking sector remains sound, as evidenced by the improvement in asset quality. Non-Performing Loans (NPLs) as a percentage of gross loans have been on a downward trend since last year and lie below average levels registered prior to the pandemic. NPLs represented 4.1 per cent of gross loans as at end-March 2023, down from 4.4 per cent as at end-September 2022 and 4.9 per cent as at end-March 2022. The coverage ratio of NPLs continues to be adequate. The NPL coverage ratio stood at 56.4 per cent as at end-March 2023.

23. The domestic macro-financial environment is not expected to accentuate risks on the financial stability front in 2023. Stress tests results confirm the banking sector's resilience to plausible macro-financial shocks that may materialise during the year.

Staff Economic Outlook

24. As a small open island economy, the growth trajectory of Mauritius is scenario-based and is linked to the pace of global economic recovery. The broad-based recovery observed during 2022 is expected to continue during 2023. The positive momentum in the tourism sector is expected to be sustained in 2023, with tourist arrivals and earnings picking up steadily and overshooting pre-pandemic levels, with positive spillover effects onto related sectors. Domestic demand will remain supported by sustained private and public sector consumption and investment spending. The 2023-24 budgetary measures are expected to provide further impetus to economic activity. In particular, the overhauling of the personal income tax regime and implementation of various social measures, especially those aimed at lower-income households who have relatively higher marginal propensity to consume, are expected to further catalyse consumption. Measures to facilitate business and enhance competitiveness will provide a fillip to private investment while public investment will be upheld by ongoing large-scale infrastructural projects. Bank staff project real GDP growth at above 6 per cent for 2023.

25. Inflationary dynamics in Mauritius are largely influenced by external factors, given the country's relatively high openness and propensity to import. Receding inflation in key source markets for imported commodities and dissipating global supply bottlenecks will contribute towards easing domestic price pressures. The effects of monetary policy tightening engineered in major trading partner economies in 2022 and in early 2023 are expected to keep a lid on inflation in these economies, whilst retaining anchorage on inflationary expectations. Global energy prices and shipping costs are expected to fall further during 2023. Consequentially, inflation in Mauritius is projected to take a downward trajectory in 2023 and is forecast at 6.8 per cent for the year. Inflationary expectations are expected to remain well-anchored in Mauritius.

MPC Decision

26. The MPC was apprised of the latest international and domestic developments that have taken place since the last MPC meeting held in December 2022.

27. The MPC took note that the ongoing economic recovery process is broad-based and well under way, with positive performances across major key economic sectors. The growth outlook for 2023 is nonetheless subject to downside risks, including a slowdown in partner economies. The ongoing geopolitical conflict, if prolonged, may also dampen the recovery in external demand and, by ricochet, stall the domestic growth impulse.

28. On the inflation front, the MPC observed that inflation in Mauritius is currently on a downward trajectory. The global inflationary environment is becoming more benign, with easing inflationary pressures across many parts of the world. The Bank's decision to hike its policy rate during 2022 has played an important part in anchoring inflation expectations in Mauritius over the medium-term.

29. The MPC considered alternative macro-financial scenarios, before deliberating on the Key Rate. Risks to the growth and inflationary outlooks were carefully balanced out under each scenario. The MPC decided that increasing the Key Rate was not appropriate under the current circumstances.

30. As a result, the MPC unanimously decided to keep the Key Rate unchanged at its current level of 4.50 per cent per annum.

31. The next MPC meeting will be held in August 2023.

32. The MPC will continue to monitor the economic situation closely and stands ready to meet in between its regular meetings, if the need arises.

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