Minutes of the 68th Monetary Policy Committee Meeting held on 15 September 2023

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The 68th meeting of the Monetary Policy Committee (MPC) was held on Friday 15 September 2023 at 08:45 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

1. 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 June 2023. MPC members were also apprised of the latest macroeconomic projections before deliberating on the policy rate.

Global Economic Developments

2. Global economic recovery is underway in 2023Q2, after a first quarter characterized by tight financial conditions and an uncertain global environment. Divergences are however noted across regions. Growth of the US economy is under way, supported by robust consumption and investment figures. Economic activity in the euro area strengthened in 2023Q2 amidst signs of receding inflation, despite a challenging outlook for its manufacturing sector as seen by declining orders. The UK economy remains buoyant with broad-based pick-up in economic activity and encouraging household consumption and services. China which had benefited from a positive

impulse to its economic activity following the decision by the authorities to re-open the economy, has been showing signs of waning momentum in 2023Q2, following the materialization of headwinds in the real estate sector. The Indian economy, on the other hand, continues to remain one of the fastest growing economies with robust demand and resilient services activity.

3. In its July 2023 edition of the World Economic Outlook (WEO) update, the IMF has adopted a more optimistic outlook for global recovery by revising its projection for 2023 upward by 0.2 percentage point to 3.0 per cent, relative to its April 2023 projections. Growth prospects for both advanced and emerging and developing economies were revised upwards to 1.5 per cent (representing 0.2 percentage point revision) and 4.0 per cent (representing 0.1 percentage point revision) respectively. The IMF nonetheless flagged that the balance of risks to global growth was tilted to the downside.

4. The leading economic indicators which have been pointing towards sustained momentum in global economic activity during the first two quarters of 2023, are now pointing at a slower-paced expansion. The J.P. Morgan Global Composite Output Index fell from 52.7 in June 2023 to 51.6 and 50.6 in July and August 2023, respectively, amidst decelerating growth in new orders following the slowdown in global manufacturing.

5. Global inflation has been on a downward trend so far during 2023, due to lower commodity prices, as well as lower freight costs amidst normalization of global supply chains. The Food and Agricultural Organisation (FAO) food price index fell from 123.9 in July 2023 to 121.4 in August 2023 on the back of sufficient inventory levels, despite fears by the IMF that cereal prices could increase by around 15 per cent in 2023 due to the suspension of the Black Sea Grain Initiative by Russia. The Freightos Baltic Index, which measures global container freight rates worldwide and used as a proxy for shipping stocks, has remained on a downward path. Energy prices soared in the first two months of 2023Q3, following the decision by Saudi Arabia to cut crude oil productions. Brent crude oil prices, for instance, rose from US$74.9 per barrel in June 2023 to US$80.4 per barrel in July 2023 and further to US$85.1 per barrel in August 2023. Gold prices have taken a backseat following expectations that the US Fed could raise rates at its September 2023 meeting and therefore undercut its appeal as a safe-haven investment. The decisions by central banks worldwide to pursue policy tightening during 2022 and beginning of 2023 have begun to reap dividends in the form of lower inflation. However, despite receding, inflation in many countries remains above their central banks' targets. Core inflation has been declining more gradually in many economies. In its WEO July 2023 release, the IMF forecast global inflation to fall from 8.7 per cent in 2022 to 6.8 per cent in 2023. Core inflation, on the other hand, will decline more gradually from an annual average of 6.5 per cent in 2022 to 6.0 per cent in 2023.

6. The monetary policy tightening cycle has varied across countries. The US Fed, which paused rate hikes at its June meeting, raised its policy rate by 25 basis points in July 2023 from 5.25 per cent to 5.50 per cent. The European Central Bank (ECB) and the Bank of England (BoE) have continued to raise their policy rates at their respective meetings and stated evidence of persistent price pressures would warrant further tightening in monetary policy. Going forward, policy rates in the US and in the UK are likely to peak in 2023Q3 and for the euro area, it is expected to peak in

2023Q4. Policy rates in UK are expected to stay higher for a longer period till 2024Q2 amidst the still elevated inflation and their delayed policy response relative to the US, while a normalization in the policy rates is expected as from 2024Q1 for the US and the euro area.

7. The pace of monetary policy tightening has clearly faded in other parts of the world as 2023Q3 swept in. Against a backdrop of receding inflation, a growing number of central banks globally have been relatively more cautious about their growth outlooks. Since the beginning of the year, 192 monetary policy decisions globally have been to maintain the status quo out of 367 decisions (representing around 52 percent). Since June 2023, 80 decisions have been to keep rates unchanged out of 143 decisions (representing around 56 per cent). This growing propensity to keep policy rates unchanged may continue in many economies until the end of the year.

Domestic Economic Developments

8. The Mauritian economy grew by 5.5 per cent in 2023Q1, after having recorded a strong performance in 2022. Growth remains broad-based and reflects buoyant economic activity across a wide spectrum of sectors, including *'Accommodation and food service activities'* which grew by around 60 per cent in 2023Q1, as well as positive performances of the *'Financial and insurance activities'*, *'Transportation'* and *'Wholesale and retail trade'* sectors which are now close to their pre-pandemic levels. The sustained growth in the *''Accommodation and food service activities'* sector trickled down positively to other sectors of the economy, including retail trade, real estate and construction.

9. Around 803,300 tourists visited the island from January to August 2023, representing 92 per cent of the 2019 level, and almost 45 per cent higher compared to the corresponding period of 2022. With a share of 63 per cent in total tourist arrivals for the period January to August 2023, the European continent remained the main source market for Mauritius – led by France (38 per cent), United Kingdom (17 per cent) and Germany (14 per cent). During the period January to July 2023, tourism earnings aggregated Rs48,141 million, higher by 58 per cent compared to the same period of 2022. In US dollar terms, tourism earnings totalled nearly US$1.1 billion for the first seven months of 2023, well above 2019 level. Furthermore, the average length of stay of tourist stood at 11.5 nights over the period January to August 2023. Based on forward bookings, prospects for the sector remain strong for 2023. Ongoing marketing initiatives, as well as increased flight connectivity, and the opening of new destinations, mean that the forecast of 1.3 million tourist arrivals established by Statistics Mauritius remains largely feasible for the year.

10. On the aggregate demand side, growth was supported by encouraging domestic and external demand results in 2023Q1. Household spending remained the largest contributor to GDP growth in 2023Q1 with positive spillover effects on various economic activities due to its multiplier effects. Investment, measured by the Gross Fixed Capital Formation, registered solid growth performance at 8.3 per cent, due to the ongoing implementation of large-scale infrastructural projects, namely the construction of smart cities, road de-congestion plans and property development, amongst others. The recovery in global demand provided impetus to exports of goods and services which grew at 15.7 per cent in 2023Q1. The robustness of consumption

generated higher imports of goods and services. The latter grew by 8.9 per cent in 2023Q1. These positive cyclical developments helped improve labor market conditions in 2023Q1. Unemployment dropped to 6.7 per cent in 2023Q1. Female unemployment rate now stands at a new record low at 8.5 per cent in 2023Q1, while youth unemployment rate declined to 20.0 per cent – the lowest reading since 2010.

11. Inflation in Mauritius is, to a large extent, impacted by global price developments in view of the relatively high degree of openness of the economy, its relatively high marginal propensity to import and the pass-through effect from foreign prices to domestic prices. Headline inflation has been on a declining trend for six consecutive months ending August 2023. Over the last three months, headline inflation moderated from 10.6 per cent in May 2023 to reach 9.6 per cent in August 2023. Over the same time frame, year-on-year inflation eased from 7.9 per cent to 5.9 per cent. A decomposition of CPI across its main divisions 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, accounted for more than half of headline inflation in August 2023. This decline in inflation may persist until the end of 2023 on two grounds: Core measures of inflation, which are more realistic representations of demand-based inflationary pressures, have taken a back seat. On a 12-month average basis, CORE1 inflation fell from 9.3 per cent in May 2023 to 7.4 per cent in August 2023, while CORE2 inflation also went down from 7.3 per cent to 6.3 per cent. On a y-o-y basis, CORE1 inflation dropped from 5.3 per cent in May 2023 to 3.3 per cent in August 2023 while CORE2 inflation went down from 5.3 per cent to 4.5 per cent; furthermore, the composition of inflationary and deflationary items in the CPI basket has shifted more in favour of the latter. Items in the CPI basket that were viewed as 'highly inflationary', i.e. generating above 5 per cent, have dropped from nearly 70 per cent in January 2023 to around 45 per cent of the CPI basket in August 2023. In contrast, items that were 'deflationary', i.e. having less than 0 per cent inflation, have increased from 1.2 per cent to 12.2 per cent over the same period. The decline in inflation seen so far may persist until the end of the year, in the absence of any price shocks stemming from abroad.

12. The improvements in the external sector continued in 2023Q2. The current account deficit narrowed to Rs10.7 billion in 2023Q2 (6.5 per cent of GDP) from Rs20.6 billion in 2022Q2 (15.7 per cent of GDP). The robust performance of the tourism sector and elevated global interest rates, respectively, benefited the services and income accounts that, together, mitigated the impact of a widening trade deficit on the current account balance in 2023Q2. This trend looks set to continue until year end. Consequently, the current account deficit is projected to improve to 6.9 per cent of GDP in 2023, from 11.5 per cent of GDP in 2022.

13. The net financial flows segment of the balance of payments benefited from positive influxes into the direct investment and other investment accounts in 2023Q2, with net inflows of Rs18.4 billion and Rs19.3 billion, respectively. Net inflows into the direct investment account emanated mostly from global business sector. Cross-border investment activities are expected to remain buoyant during 2023 and to contribute favourably to financial flows. In the aftermath of the country's exit from the FATF and EU lists amongst others, the favourable decisions by the two international credit rating agencies, namely Standard & Poor's which maintained Mauritius as an investment grade jurisdiction and Moody's which upgraded the scorecard-indicated outcome of

Mauritius, is expected to consolidate the reputation of Mauritius as an International Financial Centre of repute. Mauritius is also expected to keep on attracting significant gross FDI into sectors such as real estate as investor appetite continues to remain in positive territory.

14. An overall balance of payments surplus of Rs11.4 billion (1.8 per cent of GDP) is projected for 2023, as against a deficit of Rs13.9 billion in 2022 (2.4 per cent of GDP). The combination of lower projected current account deficit for the year and robust financial flows should fundamentally support the domestic currency over the medium-term and, to some extent, help counteract the impact of negative interest rate differential vis-a-vis the US dollar. Gross Official International Reserves (GOIR) as at end-August 2023 remained broadly adequate as a buffer against external shocks. Based on the imports of goods and services for calendar year 2022, GOIR represented 10.5 months of imports as at end-August 2023, an improvement compared to 10.0 months of imports as at end-May 2023 that was considered by the MPC when it met in June 2023. The level of safety provided by the country's GOIR, continues to remain higher than the safety threshold prescribed by regional trading blocs. The risk profile of the country's gross external debt is assessed to remain moderate by metrics capturing external vulnerabilities.

15. The Bank continued to monitor the domestic money and foreign exchange (FX) market development in light of the new Monetary Policy Framework (MPF) implemented effective 16 January 2023. The Bank undertakes open market operations to steer the overnight interbank rate, which is the new Operating Target, close to the Key Rate. Since January 2023, the weekly issuance of 7-Day BOM Bills averaged Rs47.2 billion. Banks also availed of Overnight Deposit Facility for a daily average of Rs26.6 billion. Active open market operations by the Bank have contained rupee excess liquidity in the banking system to a daily average of Rs2.3 billion over the period 15 June to 13 September 2023. However, the Bank had to undertake longer term operations as part of the monetary policy toolkit to remove the structural excess liquidity from the banking system. Following these open market operations, the Bank mopped up a total amount of Rs 14 billion up to 13 September 2023. These operations resulted in a significant decline in structural rupee excess liquidity in the banking system which, however, remains high. As part of the monetary policy toolkit, the Bank has issued longer term instruments of maturities up to three years for a total amount of Rs 44 billion, to address the structural excess liquidity in the banking system. The outstanding amount of BOM securities issued to manage excess liquidity stood at Rs 151.1 billion as at 14 September 2023, with around 42 per cent maturing within 7 days.

16. The Bank also mopped up an amount of Rs2.9 billion through FX intervention since the last MPC. Over the same period, the net issuance of government securities has also contributed to reduce excess liquidity by around Rs11.9 billion. FX injections by the Bank amounted to USD114 million since beginning of the year. This represented a reduction compared to injections totaling USD611.8 million during the same period last year. The Bank has intervened on two occasions this month for an aggregate amount of USD 50 million to alleviate pressures in the domestic FX market. Total turnover in the market stood at USD8.4 billion as at 13 September 2023, representing an increase of 38 per cent compared to USD6.0 billion registered in the corresponding period of 2022. This underscores more orderly operations in the FX market which, in parallel, benefited from the ongoing economic reprisals in tourism and financial services. The rupee exchange rate appreciated against the US dollar, euro and Pound Sterling since June 2023. The evolution of the rupee was

congruent to both international exchange rate movements as well as domestic demand and supply conditions. Going forward, it is expected that the exchange rate of the rupee will be reflective of market forces and will evolve in line with domestic macroeconomic fundamentals over the medium-term.

17. The resilience, soundness and robustness of the banking sector have been underpinned by strong solvency and liquidity buffer figures during 2023Q2. At 19.9 per cent as at end-June 2023, the Capital Adequacy Ratio of the banking sector as a whole stood well-above the minimum regulatory requirements imposed by the Bank and provided enough buffer against materialization of shocks. Banks in Mauritius also continue to hold sufficient unencumbered high-quality liquid assets. The Liquidity Coverage Ratio (LCR), both, aggregate and in material foreign currencies, stood at 257.1 and 191.9 per cent respectively in June 2023, largely exceeding the safety floor of 100 per cent. Banks in Mauritius are therefore assessed to be sufficiently resilient to withstand 30-day liquidity stresses, both, domestically and from outside.

18. Macro-financial landscape improved further in 2023Q2. The macro-pertinence of banks continues to be underpinned by their role in buttressing key sectors of the economy by ensuring constant flow of credit. Despite the hikes in the Bank's policy rate to mitigate inflationary pressures in 2022 which have raised debt servicing costs for both the household and the corporate sectors, credit flows to household and corporations have been positive in 2023Q2. Bank credit to the private sector expanded by 7.5 per cent in July 2023, on an annual basis, relative to 9.3 per cent in April 2023. This increase was primarily led by household credit growth of 12.2 per cent in July 2023 compared to 14.1 per cent in April 2023. Corporate credit rose by 4.4 per cent in July 2023, mostly driven by credit extended in Rupees.

19. The credit portfolio of the banking sector continues to remain sound. NPLs represented 4.2 per cent of gross loans as at end-June 2023, marginally up from 4.1 per cent as at end-March 2023. At 56.3 per cent, the coverage ratio of NPLs remains adequate.

20. Based on the findings of the latest stress test exercise, vulnerabilities in the banking system have receded in the first half of 2023 relative to 2022. While risks to financial stability are present including from global developments, the domestic macro-financial environment is not expected to cause further rise in risks over the next few quarters.

Staff Economic Outlook

21. The domestic economy is expected to continue grow at a commendable pace in 2023. Economic activity will be bolstered by broad-based dynamism across key economic sectors. Tourist arrivals will pick up steadily, reverting to pre-pandemic levels, with positive spillover effects onto related sectors. *'Financial and insurance activities'* will maintain a solid performance, as Mauritius consolidates its position as a trusted IFC. *'Construction'* will maintain its growth momentum, driven by various ongoing large-scale infrastructural projects, including the extension of metro express. On the demand front, private and public sector spending will continue to catalyze demand. Household consumption expenditure will remain robust, underpinned by the support measures

extended by the government and healthy growth in wages. Investment spending is expected to gather steam, supported by major development projects in the pipeline. The Bank projects growth for 2023 in the range of 6.5 - 7.5 per cent. However, as a small open economy, the growth outlook in Mauritius is scenario-based and is contingent on global developments. Risk factors stemming from outside may cloud the growth outlook, with the balance of risks tilted to the downside.

22. Inflationary dynamics in Mauritius are largely influenced by external factors, given the country's relatively high openness and propensity to import. The normalisation of global food and energy prices, as well as the easing of global supply and logistics disturbances, are expected to contribute to further easing of price pressures in the domestic economy. Continued downward adjustment in the prices of fresh vegetables in the second half of 2023, as well as improved supply conditions of domestic food production, are expected to contribute favourably to domestic inflationary conditions. The gradual normalisation of monetary policy engineered during 2022 by the Bank of Mauritius is expected to work through the economy and keep core inflation from gaining traction. This policy normalisation is also expected to keep inflation expectations well anchored. The Bank projects inflation for 2023 at 7.0 per cent. Disruptions stemming from global price shocks could nonetheless tilt the balance of risks to inflation to the upside, should they materialize.

MPC Decision

23. The MPC took cognizance of the latest international and domestic developments that have taken place since the last MPC meeting held in June 2023.

24. While the ongoing economic recovery in Mauritius remains broad-based across major key economic sectors. and is solidly entrenched, the growth outlook for 2023 is nonetheless subject to downside risks mainly stemming from external disturbances. Inflation in Mauritius is well saddled on a downward trajectory and this trend looks set to continue. However, shocks tied to global price developments may tilt the balance of risks to the upside.

25. The MPC balanced the risks to the growth and to the inflation outlooks and took note that the Bank's decision to hike policy rates during 2022 has played a crucial role in anchoring inflationary expectations over the medium-term and this is still working through the economy.

26. The MPC decided that changing the Key Rate is not warranted at this stage and unanimously decided to keep the Key Rate unchanged at its current level of 4.50 per cent per annum.

27. The next MPC meeting will be announced in due course.

28. 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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