

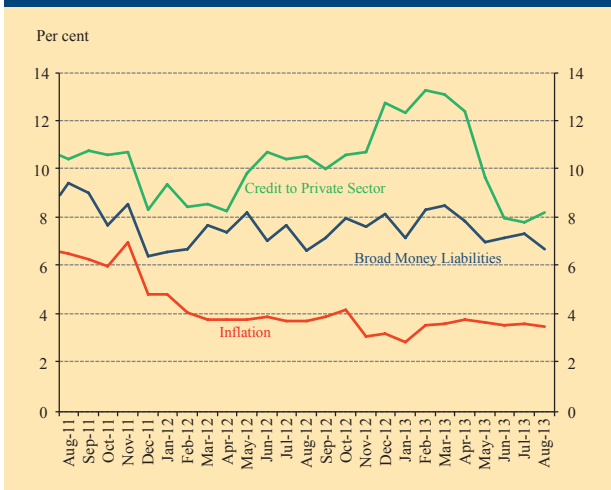
5. MONETARY AND FINANCIAL DEVELOPMENTS

Both monetary and credit developments have remained subdued since the April 2013 Inflation Report, reflecting continuing weak economic activity. Credit was largely channelled to the construction, personal and financial and business services sectors. While overall excess liquidity in the money market was higher, interbank interest rates and yields on Government securities increased. Transactions on the domestic foreign exchange market remained active. On a weighted average dealt basis, the rupee depreciated against the US dollar, euro and Pound sterling.

5.1 Monetary and Credit Developments

Reflecting continuing weak economic activity, monetary and credit developments have remained subdued since the April 2013 Inflation Report and have exerted mild pressures on inflation. Since late 2011, y-o-y growth in Broad Money Liabilities (BML) has moved within a narrow range. It stood at 6.7 per cent in August 2013 and when adjusted for inflation, was at 3.6 per cent (Chart 5.1).

Chart 5.1: Y-o-Y Growth in Broad Money Liabilities and Credit to Private Sector and Inflation Rate



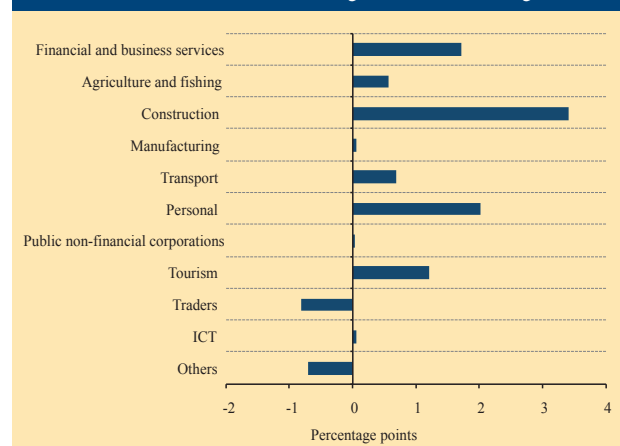
Among the components of BML, quasi-money liabilities grew by 5.5 per cent y-o-y, down from 8.3 per cent in February 2013, as savings and time deposits expanded by 13.1 per cent and 0.2 per cent, respectively, and foreign currency deposits fell by 1.9 per cent. Narrow money liabilities grew by 8.3 per cent, as a result of higher growth in transferable deposits. Securities other than shares increased by 126.6 per cent, up from 17.8 per cent in February 2013.

The net foreign assets of depository corporations increased by 11.2 per cent y-o-y, mainly as a result of an increase of 14.3 per cent in the net foreign assets of the Bank of Mauritius. The latter can be partly explained by the implementation of the Operation Reserves Reconstitution (ORR) programme as from June 2012.

The monetary base increased by 11.4 per cent y-o-y in August 2013, while the reserve deposits held by ODCs at the Bank increased by 10.6 per cent. The positive growth in the monetary base was mainly due to contributions of the Bank's net foreign assets and domestic claims.

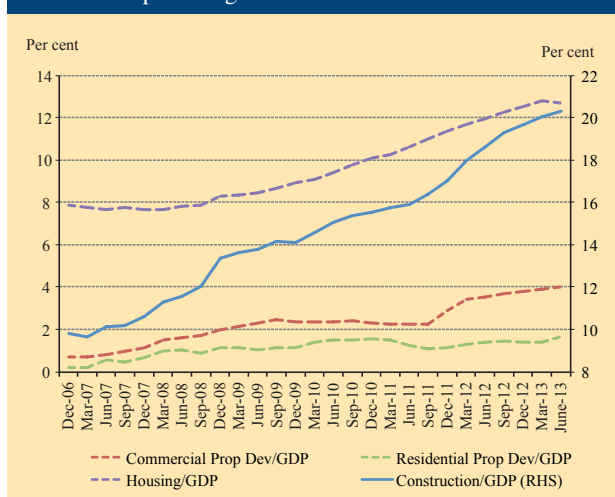
Credit to the private sector increased by 8.2 per cent y-o-y in August 2013 compared with 13.3 per cent in February 2013. The growth in banks' credit to the private sector over the year was mostly channelled to the construction sector (3.4 percentage points), followed by the 'personal' (2.0 percentage points) and 'financial and business services' (1.7 percentage point) sectors. Credit to 'traders' contributed negatively to total credit growth (Chart 5.2).

Chart 5.2: Sectoral Contribution to the Change in Banks' Credit to the Private Sector – end-August 2012 to end-August 2013



The increase in credit to the ‘construction’ sector and to ‘residential housing’ was sustained. As a percentage of GDP, the share of credit extended to ‘construction’ reached 20.3 per cent in June 2013 while the share of credit to ‘housing’ stood at around 12 per cent. There was a notable increase in credit extended to ‘commercial and property development’ as a percentage of GDP over the period under review (Chart 5.3). It is estimated that these increases may have had a significant impact on property prices. They have also increased vulnerabilities in the banking system by raising firms’ indebtedness which, going forward, may constrain investment and growth. The Bank has recently issued guidelines on the implementation of a number of macro-prudential measures to deal with those issues.

Chart 5.3: Credit to the Construction Sector as a percentage of GDP as at June 2013

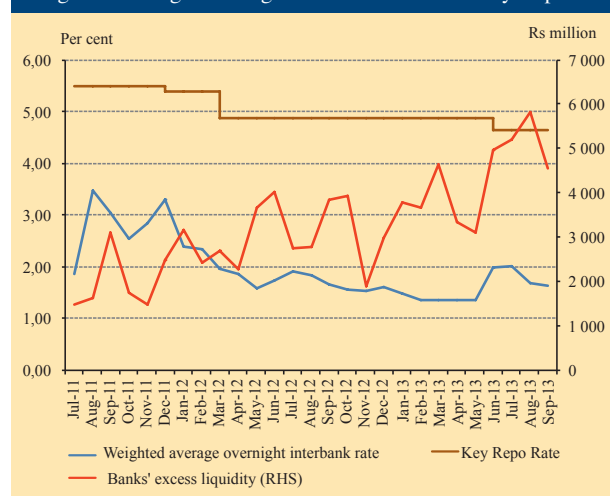


5.2 Money Market

Since the publication of the last Inflation Report to August 2013, the overall excess liquidity in the banking system has increased to an average of Rs4.5 billion. Net redemption of Government securities, higher Government expenditure, the placement of public funds with banks and net intervention by the Bank on the domestic foreign exchange market contributed to the overall excess liquidity in the money market. The Bank issued its own instruments to the value of Rs10.5 billion to mop up some of the excess liquidity during the same period.

With banks allowed to keep part of their cash reserve requirements in foreign currency, a decrease in rupee balances held at the Bank of Mauritius resulted in a rise in overnight interbank interest rates to above 2 per cent in July 2013, notwithstanding the reduction in the KRR in June 2013. Thereafter, the weighted average interbank rates fell to an average of 1.64 per cent in September 2013 (Chart 5.4).

Chart 5.4: Banks’ Monthly Average Excess Reserves, Weighted Average Overnight Interbank Rate and Key Repo Rate



For the same reasons, the overall weighted yield on Government of Mauritius Treasury Bills increased from 2.67 per cent in February 2013 to 2.73 per cent in September 2013. The weighted yield on Three-Year Government of Mauritius Treasury Notes, however, declined from 4.06 per cent in February 2013 to 3.88 per cent in September 2013.

Yields on longer-term instruments have fallen since the April 2013 Inflation Report. The weighted yield on Five-Year Bonds declined from 4.34 per cent at the end of February 2013 to 4.28 per cent at the end of September 2013. The weighted yield on Ten-Year Government of Mauritius Bonds decreased from 7.06 per cent to 6.22 per cent over the same period. While the weighted bid margin on the Fifteen-Year Inflation Indexed Bond stood at 2.39 per cent at the end of September 2013.

5.3 Deposit and Lending Rates

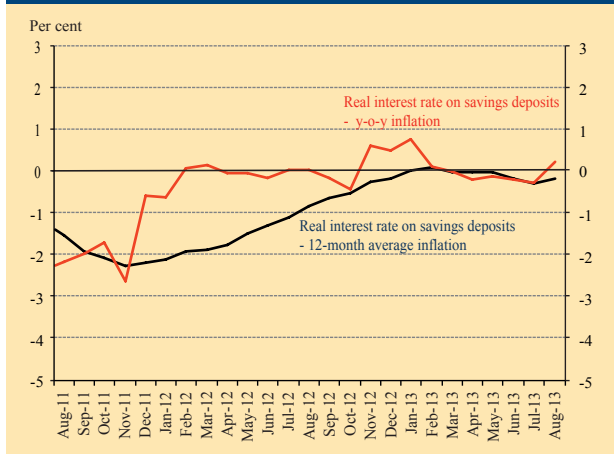
Following the 25 basis point reduction in the KRR in June 2013, banks have revised their Savings Deposits Rate (SDR) downward by the same quantum. They have also eased financing conditions by adjusting their Prime Lending Rates (PLR) accordingly. The SDR fell to within a range of 2.75-3.40 per cent at the end of August 2013, from 3.00–3.65 per cent, and the PLR decreased from 7.00-8.50 per cent to 6.75-8.50 per cent. The banks’ modal SDR and modal PLR also came down by 25 basis points to 3.40 per cent and 7.15 per cent, respectively. The weighted average deposits rate stood in a range of 3.21-3.47 per cent while the weighted average lending rate stood in a range of 8.18-8.42 per cent (Chart 5.5). Using the y-o-y measure of inflation, which dropped substantially in August 2013, a marginal increase in

the real interest rate on savings deposits, from 0.1 per cent in February 2013 to 0.2 per cent in August 2013, was observed. However, based on headline inflation, the real interest rate on savings deposits continued to be negative.

5.4 Stock Market

Since the April 2013 Inflation Report, the local stock market drifted lower for some time, reflecting to some extent the evolution of emerging market indices but managed to recoup some of its losses in 2013Q3 on better investor sentiment. Recent inflation rates do not appear to have had any major impact on stock market returns. During the period under review, the SEMDEX and the SEM-7 have increased by 5.1 per cent and 3.6 per cent, respectively, with total market capitalisation as a ratio to GDP at 54 per cent at the end of September 2013 (Chart 5.6).

Chart 5.5: Real Interest Rate on Savings Deposits



The market price-earnings (PE) ratio increased from 12.23 at the end of February 2013 to 13.51 at the end of September 2013, mainly driven by an increase in the PE ratio of the “Leisure and Hotel”, “Industry” and “Property Development” segments, while the PE ratio of the “Investment” segment dropped.

Foreign investors’ exposure to the Official and DEM markets in terms of net investment (purchases-sales) as at 30 September 2013 amounted to Rs747 million since the beginning of the year. Net investment was largely driven by net inflows in the “banking” and “hotel” sectors.

Chart 5.6: Stock Market Indices



5.5 The Domestic Foreign Exchange Market

Between the April 2013 publication of the Inflation Report and August 2013, the total turnover of spot and forward transactions amounted to US\$3,082 million, representing a daily average of US\$29.1 million. The daily average transaction on the interbank foreign exchange market amounted to US\$5.0 million. The Bank maintained its ORR program and purchased an aggregate amount of US\$32.0 million and EUR178.8 million from banks and foreign exchange dealers. The demand and supply conditions on the domestic market as well as developments on international currency market influenced the weighted average dealt rupee exchange rate.

The rupee initially depreciated against the US dollar as the latter gained on the FED’s announcement that it might scale back its monetary stimulus programme. Subsequently, the rupee recouped its losses as a result of the greenback’s broad-based weakness on international markets. The rupee continued on a broad depreciating trend against the euro over the period under review on the back of positive economic data releases in the Eurozone. Against the Pound sterling, the rupee started to appreciate after the April 2013 Inflation Report but thereafter lost ground with the gains in the GBP as the UK economy showed signs of recovery (Chart 5.7).

The nominal effective rupee exchange rate, as measured by MER11 which is based on the currency distribution of trade, remained mostly stable since the April 2013 Inflation Report although a slight depreciation was registered in September 2013. Weighed by trading-partner countries, the real effective rupee exchange rates appreciated quite substantially during the period under review, mainly on account of a depreciation of the South African rand and the Indian rupee against the Mauritian rupee (Chart 5.8).

Chart 5.8: MER11, MER12 and REER

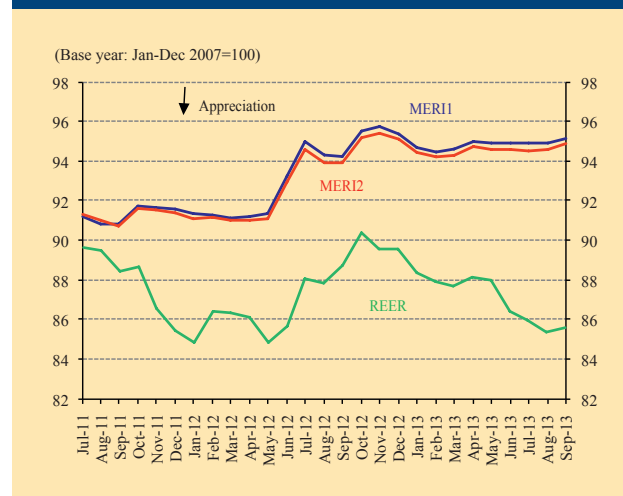


Chart 5.7: Rupee Exchange Rate Movements

