Statement by the Governor

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at the

Post Monetary Policy Committee Press Conference

Tuesday 4 February 2025

1. Ladies and gentlemen, members of the media, good afternoon.

2. Welcome to this press briefing for the first MPC meeting of the year.

3. This is also the first MPC meeting of this new committee comprising of academics and practitioners with distinguished careers in economics and finance who bring a wealth of experience and expertise to the discussions.

4. The MPC, at its meeting today, reviewed both global and domestic economic prospects and their implications for the Mauritian economy. I shall now provide an overview of the key elements covered during the MPC policy deliberations.

INTERNATIONAL ECONOMIC DEVELOPMENTS

5. The global economy is forecast to remain broadly stable, with the growth outlook in advanced and emerging economies subject to idiosyncratic risks. The IMF, in its January 2025 World Economic Outlook (WEO) Update, expects global growth to remain steady at 3.3 per cent in 2025 and 2026. Growth performances across key advanced economies were asynchronous in 2024Q3. The US economy maintained a solid pace of growth, with subsiding inflation and buoyant labour market conditions supporting consumer spending. Growth in the euro area improved, owing to a pick-up in consumption but remained subject to the headwinds in both the manufacturing and export sectors. The UK economy, however, slowed to a near-standstill in 2024Q3, owing to lacklustre manufacturing activity and subdued private consumption.

6. More recently, risks to the global economy have intensified, shaped by a number of geopolitical challenges. Prominent among these challenges is the threat from the imposition of tariffs by the US administration on several countries, including China, the Euro area, Canada and Mexico, amongst others, thus raising concerns about inflation flaring up and slower future growth.

7. Global inflation has been on a downtrend, driven by moderating global commodity prices and easing labour market pressures. However, core and services inflation in many countries have remained sticky. The latest developments taking place in the global geopolitical arena with the decision of the US administration to impose tariffs on key trading partners may nonetheless reverse this downward tendency and rekindle global inflation, with pernicious effects on countries that have a relatively high propensity to import what they consume. The materialization of this risk may delay the attainment of central banks' inflation targets and slow down the pace of rate cuts globally.

8. The risk that the US dollar strengthens amidst these geopolitical developments puts at the forefront FX pass-through considerations as other currencies adjust lower, thereby reinforcing inflationary concerns through the imported price channel.

9. Central banks have been following divergent monetary policies based on their inflation and growth outlook. Some of them have scaled down interest rate cut expectations given persistently elevated core and services inflation. The US Fed has notably cut its policy rate by less than markets were previously expecting. It maintained the status quo at its January 2025 meeting and the probability that it may do so at its next meeting in March has increased. Considering potential global inflationary risks intensifying, there is a possibility that more central banks cut short their easing cycles and edge towards rate hikes.

DOMESTIC ECONOMIC DEVELOPMENTS

10. On the domestic front, the economy expanded by 6.3 per cent in 2024Q3, up from 4.5 per cent in 2024Q2, and is estimated to grow by 5.1 per cent for the year. Growth was mainly driven by the *'Construction', 'Accommodation and food service activities', 'Transportation and storage', 'Information and Communication', 'Financial and insurance activities'* and *'Wholesale and retail trade' sectors.* On the demand side, domestic consumption continued to grow steadily while investment improved amidst higher spending in residential as well as non-residential building. The output gap is estimated to have remained positive in 2024, contributing to inflationary pressures.

11. Labour market dynamics improved in 2024Q3, with a decline in the unemployment rate to 5.9 per cent. The Wage Rate Index, reflective of labour costs across the economy, has increased rapidly. The hikes in wages increases were not commensurate with productivity gains and are likely to add to inflationary pressures.

12. The current account deficit is projected to worsen to around 5.4 per cent of GDP in 2024, from 4.6 per cent of GDP in 2023, primarily driven by a widening trade deficit that would more than offset higher tourism earnings and the surplus in the primary income account. Exports continue to be an area of concern. In volume terms, domestic exports (total exports excluding 'Ship's stores and bunkers') have been declining. Concurrently, import volume has risen significantly, partly reflecting high domestic demand.

13. The Gross Official International Reserves of the country remained broadly adequate as a buffer against external shocks, standing at US$8.5 billion as at end-December 2024 and representing 13.3 months of import cover.

14. The Bank projects GDP growth to be between 3.5 to 4.0 per cent in 2025, with the output gap expected to remain in positive territory thus contributing to underlying inflationary pressures.

INFLATION

15. Headline inflation was on a downward trajectory through 2024, reaching 3.6 per cent in December, close to the midpoint medium-term target of 3.5 per cent. This was supported by favourable global commodity price developments, as well as adjustment in domestic fuel prices. Year-on-year inflation closed the year at 2.9 per cent.

16. Core inflation measures, which provide a better assessment of underlying demand pressures in the economy, have remained sticky in 2024, indicating persistent inflationary pressures. In particular, CORE2 inflation, which excludes the price effects of food items and movements in energy and administered prices, was higher than CORE1 inflation, which excludes only the price

effects of food items. In addition, domestically-generated inflation was also elevated, considering relatively high prices of services and higher wages

17. Imported inflation subsided markedly in 2024 but this downward tendency could reverse at any time, going forward, with risks to the inflation outlook tilted to the upside. As a small open economy which imports the bulk of what it consumes, Mauritius is not immune to risks of inflationary pressures emanating globally and from climate-related events. The pass-through effect from global commodity prices to domestic inflation is relatively high, as for many small island nations. In light of the uncertainties on the global scene, the risks of imported inflation are assessed to be high. Volatility in the global FX market in the wake of the trade war could feed into the domestic exchange rate, thereby fuelling inflation through the imported price channel.

18. While inflation expectations have declined, the one-year ahead expectations still show inflation above the midpoint medium-term target of 3.5 per cent.

19. The Bank projects inflation to close the year 2025 above this midpoint target, at 3.7 per cent. However, with a potential global trade war looming in 2025, domestic inflation could turn out to be higher than currently anticipated.

MONEY MARKET

20. Excess liquidity remains an important issue and, if unaddressed through the Bank's open market operations, can hamper the smooth transmission mechanism of monetary policy and contribute to underlying inflationary pressures in the economy. This arises essentially as low yields resulting from excess liquidity contribute to negative interest rate differentials with major currencies, which in turn adds to the depreciation bias of the rupee and stymies the proper functioning of the domestic foreign exchange market.

21. Mindful of these risks, the Bank has stepped up its open market operations, removing liquidity for longer periods. Since the last MPC meeting, the Bank has issued BoM securities for an aggregate amount of Rs31 billion in the 91-Day, 182-Day and 364-Day tenors, alongside weekly issuances of the 7-Day BoM Bills. The Bank also started the issues of 2-Year BoM Notes as from January 2025, with total issuances amount of Rs6 billion to date.

22. Surplus funds at the end of the day continued to be channelled to the Overnight Deposits Facility allowing banks to earn interest. On average, an amount of Rs30.5 billion was placed on overnight deposit with the Bank since the last MPC meeting.

23. Despite yields increasing following the OMOs, interest rate differentials remain negative vis-à-vis the US dollar. These differentials are even higher when adjusted for exchange rate movements.

FOREIGN EXCHANGE MARKET

24. The Bank intervened on the market to contain excessive volatility in the exchange rate. FX interventions since the last MPC meeting amounted to US$120 million. The Bank also implemented a series of measures to contain the depreciation of the rupee as from mid November 2024.

25. As a result of the Bank's actions on the forex market, the rupee exchange rate has remained mostly stable since December 2024 despite the significant strengthening of the US dollar. The rupee has appreciated against the Euro by 1.9 per cent and against the GBP by 2.7 per cent.

FINANCIAL STABILITY

26. Financial stability has important bearings on monetary policy effectiveness. It is, therefore, essential to consider the various risks that can hamper monetary policy transmission mechanism and impact the economic outlook.

27. The risks to financial stability have remained relatively moderate. The resilience of the banking system is supported by strong capital and liquidity buffers. Liquidity risk in the banking sector is prudently managed.

28. Household sector vulnerabilities have continued to ease, indicating lower risks to financial stability compared to preceding quarters. Progress is noted on household debt sustainability, with the rise in wages coupled with lower inflation contributing to bolster debt servicing healthiness of households. Household indebtedness relative to GDP has stabilised around 38 per cent and is higher by around 3 percentage points compared to the pre-pandemic period. The quality of the household credit portfolio remains sound, with the ratio of non-performing loan to total loans stabilising around 1.8 per cent in the first three quarters of 2024.

29. Risk to financial stability from the corporate sector stayed low as corporate activity maintained good momentum and corporate earnings were elevated, resulting in improved debt serviceability. The corporate credit portfolio in the books of banks was sound, driven by dynamism across different key sectors of the economy.

30. The economy benefited from a consistent influx of credit from the banking sector. Bank credit to the private sector expanded at an annual rate of 10.0 per cent in November 2024, up from 7.6 per cent in July 2024. This growth was primarily driven by credit extended to both the household and corporate sectors.

31. The asset quality of the banking sector was robust, keeping credit risk comparatively low. The non-performing loan ratio was at 3.5 per cent in September 2024. The banking system has set aside adequate provisions, with a coverage ratio of 62.6 per cent in September 2024.

32. The latest stress test exercise confirmed the sustained resilience of the banking sector. The robust solvency and liquidity buffers are estimated to be adequate to enable the banking system to withstand macroeconomic shocks and risks arising from cross-border activities. The level of liquid assets is assessed to be suitable to absorb plausible domestic and foreign

currency withdrawals. Banks are also expected to maintain sufficient buffers and enhance their capacity to absorb shocks based on estimates for the next few quarters.

33. The Bank remains vigilant to risks to financial stability and maintains its focus on promoting price and financial stability to support sustainable economic growth.

MPC DECISION

34. I will now elaborate on the decision of the MPC.

35. The MPC thoroughly reviewed developments taking place at the global and domestic levels and deliberated on their implications on domestic growth and inflation trajectories for 2025.

36. The MPC deliberated lengthily that, at this stage, the fulcrum of policymaking is edging more towards the need to ensure that inflationary expectations remain properly anchored over the medium-term in line with the Bank's price stability mandate. The MPC deliberated that a pro-active policy measure was necessary to mitigate any risks of inflation flaring up by sustainably addressing some of the contributory factors, namely: containing excess liquidity, reversing negative interest rate differentials with major foreign currencies and addressing exchange rate pressures. The growth momentum being observed at present offers room for manoeuvring the Key Rate towards an increase.

37. As a result, the MPC unanimously decided to raise the Key Rate by 50 basis points from 4.00 per cent per annum to 4.50 per cent per annum at its meeting today, without compromising on the Bank's other macro-economic objectives. It is expected that banks shall pass on this higher rate to their customers with more attractive Savings Deposit Rates, thereby enhancing the efficacy of the monetary transmission mechanism. Debt serviceability of households and corporates, which was already sound before the rate hike, should continue to remain so.

38. With our price stability objective in mind, the MPC wanted to make sure that we leave no stone unturned in providing the appropriate bulwarks against potential slides in our rupee. Given the

forward-looking element embedded in our monetary policy framework, the MPC has raised the Key Rate in anticipation of potential future increases in inflation. We want to make sure that inflation expectations are solidly anchored and exchange rate pressures contained in Mauritius.

39. The MPC will continue to closely monitor economic developments and stands ready to meet in between its regular meetings and take appropriate actions to achieve its mandate. As Chairperson of the MPC, I must assert that, going forward, the MPC shall take the appropriate decision, given circumstances that we shall face, and that restoring price stability is our utmost priority. The business community and the population at large can rest assured about the commitment of the MPC in this sense.

40. The MPC meetings for the remainder of the year are scheduled for 7 May, 13 August and 12 November.

41. We look forward to working together to navigate the challenges and opportunities that lie ahead. On this note, I conclude my intervention.

Thank you.

4 February 2025