Minutes of the 73rd Monetary Policy Committee Meeting held on 04 February 2025

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The 73rd meeting of the Monetary Policy Committee (MPC) was held on Tuesday 04 February 2025 at 09:00 hours at the Bank of Mauritius. The following members attended the meeting:

- Dr Rama Krishna Sithanen, G.C.S.K (Governor and Chairman)
- Mr. Rajeev Hasnah (First Deputy Governor)
- Mr. Gerard Sanspeur (Second Deputy Governor)

External Members

- Ms. Sharmila Banymadhub-Chakowa
- Dr Myriam Blin
- Ms. Martine Ip Min Wan
- Dr Jameel Khadaroo
- Dr Jeevita Matadeen

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.

Inflation Developments and Outlook

1. The balance of risks to inflation in Mauritius is more tilted on the upside.

2. As a small open economy which imports the bulk of what it consumes, Mauritius, as many small island nations, is not immune to risks of inflationary pressures emanating globally mainly through relatively high pass-through effect from global commodity prices to domestic inflation.

3. Although the IMF projects global headline inflation for 2025 to decline, risks to the global inflation outlook, however, are tilted to the upside. These include expected renewed supply shocks amidst ongoing conflicts and supply disruptions in the wake of trade restrictions in the form of future US tariffs and retaliating ones. The Freightos Baltic Index, a measure of freight costs, ended the year 2024 higher than in 2023. Geopolitical factors, as well as the trade landscape are anticipated to stifle trade and to influence movements in freight costs in 2025. Furthermore, although core inflation has been on a declining path, services inflation is still high, especially in advanced economies, including the US, Euro area and UK, and can support a reversal in past inflationary trends. Adverse climate-related shocks could also exacerbate inflationary pressures on food prices. The re-apparition of global inflation could well delay the ongoing efforts by central banks to lower their policy rates in 2025 and move towards rate hikes as inflation expectations become more entrenched during the year, if unabated.

4. The January 2025 World Bank Global Economic Prospects reports that global food production remains sensitive to economic shocks, along with geopolitical conflicts and extreme weather events, which have continued to be major drivers of food insecurity across countries in 2024.

5. Although headline inflation in Mauritius closed year 2024 at 3.6 per cent in December and at 2.9 per cent on a year-on-year basis, underlying inflation metrics underscore demand pressures nestled behind the figures, when stripped of volatile items. CORE 2 inflation, which strips off price movements of food items and movements in administered and energy prices, stood higher than CORE 1 measure, which excludes price movements of food items only. Due to its relative labour intensity, CORE 2 inflation remained stubbornly sticky throughout 2024, upheld by higher prices of services and higher wages. Further attribution analysis to decomposing the inflation dynamics

underscores an important element: the decline in headline inflation in 2024 was principally due to imported inflation subsiding markedly in 2024, with domestically-generated inflation remaining relatively stickier. However, this downward tendency in imported inflation could reverse at any time, going forward, with the developments taking place globally at the geopolitical level and which risk tilting the global inflation outlook more on the upside.

6. The announcement of future tariffs by the new US administration could, through retaliatory measures by partner countries, ignite global inflation and reverse currently observed patterns of central banks' decision-making and trigger rate hikes globally. This could well escalate volatility in global financial markets and lead to further depreciation pressures on the rupee. Increased geopolitical tensions in the Middle East and Ukraine may result in renewed global supply chain pressures, and trigger higher commodity prices and shipping costs. Geopolitical factors, especially pertaining to the Middle-East, could constitute important upside risks to the global oil price outlook. Given its relatively high propensity to import and the pass-through effect, inflation in Mauritius could well be derailed from its downward trajectory of recent years and take an ascending pathway in 2025, the more so that the component that principally contributed to the downward trajectory, namely imported inflation, would change course against a backdrop of already sticky domestically-generated inflation. Finally, extreme weather conditions, both locally and abroad, could disrupt production patterns globally and trigger further rounds of price surges in agricultural products as well as other commodities and, by ricochet, contribute to domestic price pressures. While the Bank has projected inflation to close the year 2025 at 3.7 per cent which is already above its midpoint target of 3.5 per cent over the medium-term, it turns out that inflation in 2025 could well be higher than this figure with the materialization of upside risks stemming from abroad and domestically.

7. The stickiness of domestically-generated inflation could well persist in 2025. Demand pressures stemming from the positive output gap and higher real wages could add further overlays of pressures on inflation in 2025, especially the CORE 2 component. The output gap, which measures the difference between actual and potential output, remained in positive territory

with the onset of year 2025 and looks set to fuel inflationary pressures during the year. The positive growth outturn in 2024 was somewhat mirrored in improved labour market dynamics. Slack and excess capacity receded during 2024, as reflected by the decline in the unemployment rate which stood at 5.9 per cent in 2024Q3. Labour costs have increased during the year, as evidenced by the rise in the Wage Rate Index. When adjusted for productivity gains, the rise in labour costs is likely to add a further overlay of upward pressures on inflation. The economy is expected to continue to operate somewhat above its long-term trend in 2025, as gauged by the positive output gap, which indicates that demand pressures are still present and are expected to push up marginal costs for producers going forward. Higher real wages, through increase in the national minimum wage and salary adjustments, together with cost-of-living compensation in 2025Q1, are also expected to add to cost pressures in the economy.

8. Furthermore, pressures coming from the financial market could lead to a potential derailment from the price stability objective, if unaddressed. Compressed yields coming from the domestic money market have, in recent years, already contributed to negative yield differentials with currencies such as the US dollar and engendered a weakening of the rupee, aligned with persistence of continued depreciation. These negative differentials are even higher when adjusted for exchange rate effects. The excess liquidity situation in the financial system which, in the past, contributed to inflationary dynamics could, if unaddressed, worsen this negative yield differential and unleash inflationary pressures through unabated weakening of the rupee.

9. The Bank has stepped up its efforts to restore order in, both, the money and domestic foreign exchange (FX) markets since the last MPC meeting. The Bank continued to intervene in the domestic money market through its open market operations to contain the excess liquidity in the system. Since the last MPC meeting, the Bank has issued Bank of Mauritius securities for an aggregate amount of Rs32.7 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. At the end of each day, surplus funds are channeled to the Bank's Overnight Deposits Facility. The average amount held in this

account stands at Rs30.5 billion since the last MPC meeting. Regarding the exchange rate of the rupee, the Bank has also intervened on the domestic Foreign Exchange market selling US$120 million since the last MPC meeting to contain excess volatility of the rupee. A series of other measures was announced to stall the depreciation of the rupee as from mid-November 2024. Despite the strengthening of the US dollar in global markets, the rupee exchange rate has remained relatively stable against the US dollar since December 2024 and has even appreciated against the Euro by 1.9 per cent and against the GBP by 3.0 per cent.

10. Pressures from the balance of payments side could contribute to inflationary pressures, if unaddressed. The current account deficit is projected at 5.4 per cent of GDP in 2024, a deterioration from 4.6 per cent of GDP in 2023, mainly on account of widening trade deficit during the year. In volume terms, exports (excluding ships, stores and bunkers) have been declining. Imports volume has increased significantly, reflecting the ongoing impetus in economic activity and consumption, a relatively high proportion of which is imported. The deterioration in trade balance is projected to outweigh the positive outturns in the services account (due to favourable tourism performance) and primary income balances. Addressing an unfavourable balance of trade situation is crucial, going forward, due to its potential impact on the exchange rate of the rupee over the medium-term and its resulting effects on inflation mitigation.

Growth Developments and Outlook

11. Risks to the domestic growth outlook have become more balanced.

12. The economy maintained its growth momentum in 2024Q3, expanding by 6.3 per cent, up from 4.5 per cent in 2024Q2. Growth, which stood at 5.1 per cent in 2024, was broad-based and 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, consumption and investment continued to be the key engines of growth.

13. For 2025, the domestic economy is expected to expand at a slower pace than in 2024 and to be in synch with pre-pandemic averages. The construction sector is projected to remain a key contributor to output expansion amid ongoing infrastructural projects as per the electoral manifesto. The tourism sector will also continue to contribute positively to growth though tourist arrivals are expected to remain around 1.4 million in 2025. Growth impetus in the financial services sector is expected to continue as authorities consolidate efforts to cement the international reputation of the Mauritian International Financial Centre, notably by charting out blueprints for the sector, including one tailored for the fintech segment, policies to attract foreign expertise and talent, as well as initiatives to review compliance with international standards. On the demand side, improved business sentiment amid the new political landscape could support investment spending.

14. However, the country's external performance faces headwinds which could stall the growth momentum, given the growing import bill and shrinking goods export opportunities which, if unaddressed, would contribute to expanding trade deficit. Further on the downside, a potential set of tail-risk events stemming from abroad may render the growth outlook more fragile. These include, inter-alia, an escalation of geopolitical tensions; renewed supply chain frictions; and increased geo-economic fragmentation with the Trump administration. These may disrupt commodity markets and impair trade networks, with severe repercussions for economic activity globally and across regions. Uncertainty about the fate of the Africa Growth and Opportunity Act could also constitute headwinds for domestic growth. Climate-related hazards, which are becoming more frequent, represent another set of unpredictable supply-side shocks which may derail the economy from its projected growth trajectory, given its manifold implications for production, trade and prices.

15. 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 and contributing to underlying inflationary pressures.

MPC Decision

16. The MPC carefully balanced the risks to the inflation and the growth outlooks and deliberated that pro-active policy was necessary to ward off the risks of inflation looking up and skyrocketing in 2025 by sustainably addressing the underlying contributory factors, namely: containing excess liquidity, reversing negative interest rate differentials with the US dollar and mitigating exchange rate pressures. The MPC decided that, given the risks stemming from abroad and which are largely outside the Bank's control, it was crucial to ensure that inflationary expectations remain properly anchored over the medium-term in line with the Bank's price stability mandate. Successfully containing inflation expectations and mitigating any upside pressures on inflation is welfare-enhancing for the population and will contribute to enhancing their purchasing power and allowing them to better service their debt.

17. 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, without compromising on the Bank's other macroeconomic objectives. The MPC deliberated that the growth momentum being observed at present offers room for maneuvering the Key Rate towards an increase.

18. In addition to its positive effects on the money and FX markets, it is expected that banks shall pass this hike on to their customers through more attractive savings products, and contribute towards enhancing the efficacy of the monetary transmission mechanism.

19. The MPC took cognizance of the ability of the financial sector to weather the effects of the policy rate hike. A key ingredient to successful implementation of monetary policy is a sound and resilient financial system. Even more so that the Bank's new monetary policy framework is price-based, data driven and forward-looking. The risks to financial stability have been assessed to remain relatively moderate in view of robust and sound asset quality, good coverage ratio for

non-performing loans, and healthy capital adequacy and liquidity ratios. Debt serviceability of households and corporates which was already sound before the rate hike, should continue to remain so, in the aftermath of the MPC's decision. Further diagnostic exercises and relevant sensitivity analyses have demonstrated the continued resilience of the financial system in the face of simulated monetary policy decisions of various magnitudes which were all reactive to the materialization of scenario-based macroeconomic shocks of different severity. Furthermore, the external buffers of the country were assessed to be broadly adequate to withstand shocks stemming from outside. The Gross Official International Reserves of the country continue to remain 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.

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

21. The next dates of the MPC meetings have been announced as follows: 07 May, 13 August and 12 November 2025.

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