Minutes of the 71st Monetary Policy Committee Meeting held on 11 July 2024

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The 71st meeting of the Monetary Policy Committee (MPC) was held on Thursday 11 July 2024 at 09:00 hours at the Bank of Mauritius. The following members attended the meeting:

- Mr. Harvesh Kumar Seegolam G.C.S.K (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 03 April 2024. MPC members were also apprised of the latest macroeconomic projections before deliberating on the policy rate.

Global Economic Developments

2. Since the last MPC meeting, the growth momentum continued at the global level. Economic activity in the United States and in several large Emerging Market and Developing Economies (EMDEs) was resilient, despite a global financial environment marred with uncertainties associated with ongoing geopolitical tensions and the still high interest rate environment.

3. While high frequency indicators provided evidence of global growth impetus, growth trajectories slightly diverged across the entire spectrum of countries due to their underlying heterogeneities. In the US, lower-than-expected consumption spending due to high borrowing costs aligned with softer labor market conditions, collectively weighed on

growth. The euro area managed to navigate through the headwinds it faced during 2023H2 with growth outturn turning positive in Q1 of 2024 after contraction recorded in 2023Q4. The recovery was supported by economic expansions of the bloc's largest economies, namely Germany, France, Italy and Spain. Declining inflation helped partially restore purchasing power of citizens of those countries and helped give a fillip to growth. The UK pulled itself out of a technical recession observed during the latter half of 2023, due to support to economic activity provided by consumption expansion.

4. Growth performances across the main EMDEs painted a different picture. In China, encouraging high-tech manufacturing performance helped support economic activity in 2024Q1, despite headwinds facing the property sector. The Indian economy experienced a slowdown, due to a cooling off of its manufacturing and services sector. The South African economy experienced a contraction in 2024Q1 due to electricity load-shedding and ongoing sub-par performances of its manufacturing, mining and construction sectors.

5. In its April 2024 World Economic Outlook (WEO), the IMF upgraded its projection for 2024 by 0.1 percentage point to reach 3.2 per cent and projects 2025 growth rate at the same pace. Growth projections for both advanced economies and EMDEs were revised upwards by 0.2 pp and 0.1 pp for 2024 to 1.7 per cent and 4.2 per cent, respectively.

6. The Food and Agriculture Organization (FAO) food price index, went up from 119.0 in March 2024 to 120.6 in June 2024, reflecting mostly transient factors tied to crop conditions, with localized unfavourable conditions triggering hikes in price indices of some food items. The World Bank, in its Global Economic Prospects report of June 2024, forecast food prices to decline by nearly 6 per cent in 2024. However, extreme weather and climate conditions coupled with increasing trade disruptions can weigh on food prices.

7. The Global Freightos Baltic Index, which remained contained up to late 2023, increased rather rapidly as from December 2023, with a breather between February and March 2024. The crisis-induced re-routing of maritime vessels around Africa resulted in hikes in shipping costs and port congestion, aligned with policy-induced measures such as the announcement of tariffs on Chinese products which prompted frontloading of shipments.

8. Oil price movements remained driven by the decision of OPEC+ members' production cuts and supply and demand imbalances. Brent crude oil prices, which maintained an increasing trend since beginning of 2024, declined in May 2024, averaging USD82.0 per barrel. The decline reflected mostly weak fuel demand, a pile-up in inventories in the US and limited crude supply disruptions caused by the Israel-Hamas war. Crude oil prices recouped losses in June 2024 as the OPEC+ announced continued extension of its oil output cuts during the year. The US Energy Information Administration's Short-Term Energy Outlook of June 2024 forecast Brent crude oil prices to average USD84 per barrel in 2024 from USD82 in 2023. Gold prices continued to surge and reached record highs in May 2024 on concerns of geopolitical instability in the Middle East that boosted demand for the safe-haven asset.

9. Overall, global inflation remains well saddled on a downward trend and inflation in advanced nations has been converging towards targets established by their central banks, mainly on the back of favorable commodity price developments, and the effects of past monetary policy tightening. The IMF, in its April 2024 WEO, forecast global inflation to fall from 6.8 per cent in 2023 to 5.9 per cent in 2024 and further to 4.5 per cent in 2025. The decline in inflation for 2024 is expected to be largely driven by a broad-based decline in global core inflation on the back of softening labor market conditions and the effects of still-tight monetary policies.

10. Since the last MPC meeting, 82 decisions of monetary policy committee meetings globally have been to maintain the status quo, 40 decisions were about cutting rates as opposed to 7 decisions to raise rates. While the US Fed has kept its policy rate unchanged since September 2023 in the range of 5.25-5.50 per cent against still elevated inflation, the European Central Bank (ECB) lowered its key policy rate by 25 basis points to 4.25 per cent at its June 2024 meeting. This reflected largely weakening price pressures as well as an improved inflation outlook. The Bank of England (BoE), on the other hand, maintained the Bank rate at 5.25 per cent despite inflation falling back to target in May 2024. The MPC viewed that monetary policy needs to be restrictive for an extended period of time as risk to inflation outlook still remains. Among emerging economies, the central bank of Brazil was at the frontline of the easing cycle, with a cumulative 325 basis points cut between August 2023 and May 2024.

11. Data about growth performances across the advanced countries during 2024Q1 impacted on the global foreign exchange market. The US dollar which remained strong at the beginning of the year on the back of stubborn inflationary pressures leading to 'high-for-longer' stance by the US Fed, weakened in March 2024 with more subdued inflationary pressures and increased probability that the US Fed could turn dovish. Despite regaining some ground in April 2024, the US dollar weakened again in May 2024 on signs of a cooling labor market that again brought in higher odds of the US Fed cutting interest rates in 2024. The euro and the Pound sterling, on the other hand, picked up with encouraging economic data underscoring improved economic performance, with improving economic activity in the UK and the euro area.

Domestic Economic Developments

12. At 6.4 per cent, growth of the Mauritian economy was broad-based in 2024Q1, with sectors such as tourism and construction supporting the growth momentum. Construction, in particular, recorded stellar growth of 35.4 per cent, relative to 29.4 per cent in 2023Q1, on the back of ongoing infrastructure projects. The 'Accommodation and food service activities' sector, encapsulating the tourism sector, expanded by 8.8 per cent in 2024Q1 due to favourable tourism sector performance during the period. This positive momentum helped provide a fillip to other sectors such as trade and transportation. Manufacturing sector grew by 2.8 per cent during the period while the financial sector expanded by 6.1 per cent on a y-o-y basis.

13. The tourism sector remains a fulcrum for strong GDP growth. Tourist arrivals reached 635,324 for the period January to June 2024, which represented a recovery rate of 97.7 per cent over the 2019 level, and were 6.5 per cent higher compared to the corresponding period of 2023. The Mauritian destination continues to remain largely euro-centric. The European continent accounted for roughly 65 per cent of total arrivals in the first half of 2024, with France leading with a share of 37.9 per cent, followed by the United Kingdom at 16.5 per cent and Germany at 13.9 per cent. Tourism earnings which peaked at nearly Rs86.0 billion in 2023, is expected to reach new records in 2024, with Rs38.9 billion already bagged in for the period running from January to May 2024 and representing an improvement of 44.6 per cent and of 8.6 per cent relative to the corresponding period of 2019 and 2023 respectively.

14. On the expenditure side, growth was mainly driven by investment spending on major capital projects, particularly in the context of the ongoing construction boom. Investment expenditure, measured by Gross Fixed Capital Formation, maintained double-digit growth rates across the past five quarters, with growth standing at 23.7 per cent in 2024Q1. The resilience in final consumption expenditure persisted, with an expansion of 2.2 per cent in 2024Q1. Household and government spending on consumption increased by 2.0 per cent and 3.7 per cent, respectively. Net exports of goods and services remained a positive contributor to real GDP growth.

15. The labour market remained resilient in 2024Q1. Broad-based momentum in the different sectors of the economy helped support strong demand for labour, alongside positive impetus from labour market policies. These factors enabled a sustained expansion in the labour force, rising employment and falling unemployment. The latter stood at 6.3 per cent in 2024Q1, after dropping to a historical low of 6.1 per cent in 2023Q4. Further probe into the features of unemployment showed that the age structure and the gender-balance structure only slightly changed compared to 2023Q4. Ongoing pro-female employment incentives, particularly the "*Prime à l'emploi*" scheme, have been instrumental in boosting up female participation rate.

16. Inflationary pressures in Mauritius continue to appease. Headline inflation dropped steadily from 6.5 per cent in January 2024 to 4.5 per cent in June 2024.

17. Since the last MPC meeting, several forces were at play, on both the domestic and international fronts, in inhibiting inflationary pressures. Y-o-y inflation also remained entrenched on a downward trajectory, declining from 5.2 per cent to 2.2 per cent over the same period, reflecting the gradual normalization in the prices of fresh vegetables. M-o-m annualized inflation, which provides an indication of future y-o-y developments, stood in the negative territory at -3.3 per cent in June 2024, compared to 28.8 per cent in January 2024.

18. Y-o-y CORE1 inflation, that excludes the price effects of food items, receded to 2.0 per cent in June 2024, from 2.7 per cent in January 2024. CORE2 inflation, which further adjusts for

movements in energy and administered prices, dropped from 3.5 per cent in January 2024 to 3.3 per cent in June 2024.

19. Food items which account for a relatively important share of the CPI basket have experienced favorable outturn. Food inflation dwindled from 12.5 per cent in February 2024 to 2.8 per cent in June 2024, driven by improved supply of domestically-produced fresh vegetables. In addition, fuel prices (which relate to non-core2 items) contributed to disinflationary pressures as from February 2024. Prices of domestic petroleum products, namely mogas, were lowered by around 4 per cent in January 2024, which pushed down both y-o-y and annualized m-o-m fuel inflation in the negative territory through to June 2024.

20. Decomposition of inflation into goods and services inflation confirms the encouraging disinflation tendency. The decline in global commodity prices provided a breather to goods inflation so far during 2024, with y-o-y goods inflation settling at 2.2 per cent in June 2024, marking four months of successive decline. The gradual easing of labor market pressures contributed to lower y-o-y services inflation which declined to 2.6 per cent in June 2024.

21. A more granular analysis reveals that the proportion of pro-inflation items in the CPI basket has been gradually decreasing. In particular, the share of CPI items that were generating inflation of more than 7 per cent, shrunk from 52 per cent in June 2023 to around 17 per cent in June 2024. At the same time, the share of items with relatively low inflation rates (in the range of 0 to 5 per cent) worked out to 38 per cent in June 2024, while the share of items that were deflationary (less than 0 per cent) increased to roughly 39 per cent. These dynamics provide concrete evidence that inflation is gradually converging towards the Bank's target range for inflation.

22. The current account deficit as a ratio to GDP declined to 4.5 per cent in 2023, from 11.1 per cent in 2022. The improvement largely reflected the robust performance of the services and net income accounts while the trade deficit widened. Latest available data indicate that the current account deficit was at Rs8.2 billion in 2024Q1 (4.9 per cent of GDP), with improvements in the services account surplus, driven primarily by robust gross tourism earnings of Rs24.0 billion and the primary income account surplus. Looking ahead, the current account deficit is projected to narrow to around 4.0 per cent of GDP in 2024 on account of continued robust performance of the tourism sector, benefitting the services account, as well as larger surplus on the primary income account, which is expected to remain well supported from the elevated global interest rates.

23. The country continued to attract strong flows in 2024Q1, led by net inflows in the portfolio investment account of Rs47.1 billion mainly reflecting the repatriation of investments in foreign securities by banks from abroad and continued growth of GBC portfolio liabilities. Gross Official International Reserves (GOIR) as at end-June 2024 remained broadly adequate as buffers against potential external shocks. The GOIR stood at Rs389.6 billion (USD8.2 billion) as at end-June 2024, compared to Rs306.0 billion (USD6.7 billion) as at end-June 2023. Based on the imports of goods (f.o.b.) and services for calendar year 2023,

GOIR as at end-June 2024 represented 12.9 months of imports – a significantly safer buffer compared to benchmarks utilized by regional trading blocs in Africa.

24. The Bank continued to manage the rupee excess liquidity situation through the conduct of its open market operations. Longer-term operations were conducted with a view of keeping the level of structural excess liquidity in check. The Bank issued BoM Bills for an aggregate amount of Rs30.5 billion in the 91-Day, 182-Day and 364-Day tenors between 03 April and 28 June 2024. The 7-Day BoM Bills, the Bank's main instrument for monetary operations, are issued on a weekly basis at the Key Rate of 4.50 per cent. An average amount of Rs29.0 billion was placed with the Bank as Overnight Deposits Facility at the rate of 3.00 per cent on a daily basis over the period 3 April to 28 June 2024. The Bank's operations helped contain the level of rupee excess liquidity at a daily average of Rs2.6 billion over that period. More than 50 per cent of securities issued by the Bank have short tenors and mature within a year. The weighted average overnight interbank rate hovered closer to the lower bound of the policy corridor.

25. The rupee exchange rate since the last MPC has been largely driven by domestic demand and supply conditions as well as global FX market fluctuations. FX turnover stood at USD3.1 billion and net purchases of USD127 million were recorded over the period running from 03 April to 28 June 2024. Between 03 April and 28 June 2024, the rupee has depreciated by 1.6 per cent against the US dollar.

26. Financial stability risks have been well contained so far during 2024. The economy benefited from the steady flow of credit from the banking sector, with growth of 7.4 per cent registered in May 2024. Household sector vulnerabilities continued to decline. The upbeat growth momentum impacted positively on both household debt serviceability and the debt sustainability metrics. This is reflected in the quality of banks' household credit portfolio, with the non-performing loans (NPL) ratio reaching a low level of 1.9 per cent in March 2024. Similarly, vulnerability from the corporate sector has remained low. Corporate indebtedness relative to GDP declined further in March 2024 and was below pre-pandemic levels. The asset quality of the corporate sector was assessed to be broadly sound on the back of improved bottom-lines for corporates and positive growth impetus.

27. Overall, the asset quality of the banking sector remained broadly sound. The NPL ratio of the banking sector was 4.0 per cent in March 2024, and banks set aside adequate provision against NPLs.

28. The banking sector remains resilient, with strong capital and liquidity buffers. The Capital Adequacy Ratio (CAR) of the banking sector rose to 21.2 per cent in March 2024, staying well above the regulatory minimum. The liquidity buffers maintained by banks, both in rupees and major foreign currencies, were assessed to be adequate to mitigate liquidity risk. The aggregate Liquidity Coverage Ratio (LCR) was 309.4 per cent in March 2024, and the LCR for material foreign currencies was 227.0 per cent, well above the regulatory limit of 100 per cent. Stress testing exercises point towards improved resilience of the banking sector to a series of severe but plausible macroeconomic and idiosyncratic shocks.

Staff Economic Outlook

29. The domestic economy is expected to remain resilient in 2024, with strong broad-based expansion in key sectors of the economy and positive fiscal impulse. Two sectors with positive spillover economy-wide effects, namely construction and tourism, are expected to provide impetus to the growth momentum. Regarding the construction sector, a score of public and private sector development projects, as well as joint ventures between both sectors, are in the pipeline. The tourism sector is expected to benefit from increased global demand for holiday travel as a result of the fruition of past promotional efforts. Mauritius is well poised to welcome around 1.4 million tourists this year. Growth momentum in the financial sector will persist as authorities consolidate efforts to cement the international reputation of the Mauritian IFC, notably by charting out blueprints for the sector, including one tailored for the fintech segment, policies to attract foreign experts, and initiatives to review compliance with international standards.

30. On the expenditure side, aggregate demand is expected to be backed by increasing household consumption due to manifold policy support announced in the Budget 2024-25, buoyant investment expenditure on the back of large-scale capital projects by the public and private sectors, and positive fiscal impulse. Domestic economic activity is expected to remain strong in 2024, with real GDP growth projected at 6.5 per cent for the year. Risks to the domestic growth outlook have become more balanced. On the upside, faster recovery in the main trading partners due, in part, to policy rate cuts may augur well for domestic growth given the relatively high level of openness of the Mauritian economy. However, downside risks may also materialize, should the global trading environment deteriorate following further geopolitical tensions, renewed supply chain frictions, increased geo-economic fragmentation, which may disrupt commodity markets and impair trade networks, with severe repercussions for economic activity globally and across regions.

31. Inflation is expected to continue subsiding towards the Bank's midpoint target owing to favorable global commodity price developments, budgetary measures and a tight monetary policy stance keeping inflation expectations well anchored in the economy. Inflation is forecast to close at around 4.9 per cent by end-2024. Nonetheless, risks to the inflation outlook can materialize on either side: inflation may derail from its projected trajectory due to some potential upside risks that may emanate from supply-side shocks germane to geopolitical and/or climate-related events or due to further downside risks associated with further decline in global food and oil prices as well as lower-than-expected inflation rates in major trading partners.

MPC Decision

32. The MPC took cognizance of the latest international and domestic developments that have taken place since the last MPC meeting held in April 2024.

33. Growth developments so far during 2024 have been very encouraging across all major economic sectors. Inflationary pressures are rapidly easing and look set to continue declining through 2024.

34. The MPC took note that, despite these positive macroeconomic developments, the materialization of risk factors to the growth and inflation outlooks may throw both growth and inflation off their trajectories.

35. The MPC carefully balanced the risks to the growth and to the inflation outlook and considered that the Bank's decision to hike policy rates during 2022 still needed time to work through the economy, solidly anchor inflation expectations and ensure that the inflation target is attained in 2024.

36. Consequentially, 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.

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