BANK OF MAURITIUS

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Minutes of the 38th Monetary Policy Committee Meeting of 9 November 2015

The 38th meeting of the Monetary Policy Committee was held on Monday 9 November 2015 at 10:30 hours at the Bank of Mauritius and was chaired by Mr Rameswurlall Basant Roi, Governor.

Members present: Mr Yandraduth Googoolye - First Deputy Governor; Mr Mahendra Vikramdass Punchoo - Second Deputy Governor; Mr Pierre Dinan, Mr Mohammad Mushtaq Namdarkhan, Mr Nishan Degnarain, Dr Streevarsen Narrainen and Mr Guy Wong So - External Members.

Summary of Staff Report on Economic and Financial Developments

The Bank's staff reported on economic and financial developments since the 37th MPC meeting held on 16 July 2015.

International economic environment

1. **The MPC took note of the revised 2015 and 2016 global growth projections contained in the October 2015 IMF's World Economic Outlook (WEO), in which the growth performance of both advanced and emerging and developing economies were scaled down.** Global growth was being predicted at 3.1 per cent for 2015 compared to 3.3 per cent projected last July. The estimate for 2016 was reduced from 3.8 per cent to 3.6 per cent. Global growth would remain disparate across regions and subject to uncertainties. The disparity in policy outlook among major advanced economies was also noted. The US Fed's normalisation of its policy and external conditions for emerging markets, among others, could pose downside risks to global growth.

2. **Global inflation outturns moderated largely as a result of the persistent negative output gaps and declines in oil and commodity prices.** Consumer price inflation in most countries is expected to remain low. The outlook for global inflation would remain benign amid subdued global economic activity and low global commodity prices. The October 2015 WEO was projecting inflation in advanced countries at 1.2 per cent for 2016, while inflation in emerging and developing economies was forecast at 5.1 per cent.

3. **Global commodity prices dropped further due to supply glut conditions, weak global demand and a relatively strong US dollar.** Crude oil prices had fallen to levels last noted during the financial crisis in 2008. Crude oil futures were seen hovering around multi-month lows, with ICE Brent around $50/b and Nymex WTI in the mid-$40s/b. The FAO food price index shed a further 4.8 per cent during 15Q3 on account of supply factors.

4. **Global financial markets witnessed heightened volatility with the stock market turmoil in China and expectations of the Fed's normalisation of its monetary policy stance.** Major global stock markets had experienced their worst third quarter in four years. Between 16 July and 29 October 2015, the MSCI World Index and MSCI Emerging Markets lost 4.2 per cent and 10.1 per cent, respectively. The currency markets were not spared by the market turmoil, prompting the unwinding of carry trades funded in the low-yielding euro and yen. The US dollar shed some of its previous gains, inter alia, amid concerns about the Chinese economic slowdown, while the euro recovered vis-à-vis other major currencies due to better economic conditions in the area and its safe haven appeal. The Pound sterling remained supported against the US dollar due to better economic data releases and expectations of a rate hike by the Bank of England in the near future. EME currencies plunged further during 15Q3 following the devaluation of the Renminbi.

5. **Monetary policy stances across most economies remained greatly accommodative as several advanced and emerging economies reduced their key policy rates lately.** Central banks across the world continued to face different challenges, given the unevenness of the economic recovery across economies. The US Fed was tipped to start normalizing monetary policy in December 2015, while the Bank of England could follow suit sometime next year. The ECB, on its part, looked set to increase its QE stance. Among the major EMEs, the weakening Chinese economy prompted its central bank to cut further its lending rate to stimulate growth. The Reserve Bank of India cut its key interest rate for the fourth time this year amid fears of a slowdown in the Indian economy, with low inflation in the backdrop.

Domestic economic developments

6. **Growth continued to remain below potential.** Consumption had supported economic activity while investment remained weak. The setting-up of a High Powered Committee by the Mauritian government on 'Achieving Economic Miracle and Vision 2030' was a welcoming move in the current economic environment as it would provide the necessary impetus to boost investment and enable the economy to move into the high-income league.

7. **Statistics Mauritius revised down for the second time its growth projection for the economy, which was being estimated at 3.6 per cent for 2015, slightly up from 3.5 per cent in 2014**. Gross domestic fixed capital formation was projected to record its fourth consecutive year of decline in 2015 despite higher support from public investment. It would contract by 0.5 per cent, lower than the negative growth of 6.0 per cent in 2014. The investment rate was forecast to fall to 18.5 per cent in 2015. Final consumption expenditure was expected to grow by 3.0 per cent in 2015, slightly higher than 2.9 per cent in 2014. On a sectoral basis, the downgrade in 2015 growth performance would reflect the poor performance of the *construction* sector, which would record a contraction of 2.6 per cent, as opposed to a growth of 1.4 per cent estimated in June 2015. The most notable contribution would relate to the *Accommodation and food service activities*, which was posited to grow by 6.5 per cent in 2015, up from 4.1 per cent in 2014, reflecting an increase in the number of tourist arrivals.

8. **Domestic activity weakened during 15Q2 compared to a year earlier.** Real GDP increased by 3.0 per cent in 15Q2, down from 3.5 per cent in 15Q1 and 4.0 per cent in 14Q2. However, the seasonally-adjusted q-o-q growth rate pointed to an increase to 1.6 per cent in 15Q2, up from 0.5

per cent in 15Q1. Final consumption expenditure was up by 3.5 per cent y-o-y in 15Q2, a significant increase over the 2.2 per cent recorded for 15Q1 but marginally higher than the 3.4 per cent increase in 14Q2. Gross domestic fixed capital formation (GDFCF) was estimated to have increased by 0.6 per cent in 15Q2 led by the increase in *machinery and equipment,* as *building and construction work* continued to tumble. Net external demand faltered, mainly due to exports of services contracting during the quarter. From the supply side, except for the *construction* and *mining and quarrying* sectors, the gross value added of all industry groups was positive in 15Q2.

9. **Domestic inflation has remained at moderate levels on the back of subdued domestic demand conditions, low inflation in major trading partners and soft international commodity prices**. Headline inflation hit its lowest value since June 1988 at 1.2 per cent in September 2015. In contrast, y-o-y inflation picked up from 0.4 per cent in June 2015 to reach 2.0 per cent in September 2015. Core measures of inflation stayed subdued too. Inflation expectations remained well contained.

10. **Cost-push pressures in the economy were subdued during 15Q2**. The import price index rose by 2.2 per cent in 15Q2 compared to 15Q1. Overall, low global commodity prices have helped to offset the impact of the depreciation of the rupee exchange rate on inflation. Domestically, input cost pressures have been abating since early 2015, as reflected in both measures of producer price inflation. The wage rate index increased further by 1.1 per cent between 15Q1 and 15Q2, despite the economy operating below potential and the low domestic inflation environment.

11. **Labour market conditions have remained fairly stagnant.** While the unemployment rate fell from 8.7 per cent in 15Q1 to 7.8 per cent in 15Q2, it was unchanged compared to 14Q2.

12. **Money and credit dynamics firmed further since the last MPC**. Broad money liabilities grew at an annual rate of 11.7 per cent in September 2015, up from 10.0 per cent in May 2015. The annual growth rate in banks' credit to the private sector (excluding credit to GBC entities) rose from 2.5 per cent to 5.2 per cent over the same period, with additional credit granted to the corporate sector, as growth in household credit remained stable at 5.2 per cent. The major sectors contributing to the increase in corporate credit were 'financial and business', 'construction' and 'manufacturing'. The annual growth rate in the monetary base slowed to 5.0 per cent in September 2015 as a result of the Bank's liquidity management operations.

13. **The current account balance recorded a significant deficit in 15Q2 compared to 14Q2 but the country continued to build up its gross foreign reserves.** Preliminary estimates of the balance of payments showed a current account deficit of 5.2 per cent of GDP in 15Q2 compared to 3.6 per cent of GDP for 14Q2. Looking ahead, a current account deficit of 5.5 per cent of GDP was being projected for 2015, similar to 2014. The country's gross official reserves stood at an equivalent of 7.3 months of imports of goods and services at the end of September 2015.

14. **Excess liquidity in the domestic money market came down substantially since the last MPC meeting till mid-September 2015 but rose thereafter due to net redemption of securities.** Excess liquidity dropped significantly from Rs12.0 billion to Rs5.6 billion before closing at Rs8.0 billion on 15 October. The average cash reserve ratio declined steadily from 11.7 per cent on for the maintenance period ended 23 July 2015 to 9.9 per cent for the period ended 3 September 2015 before rising to 10.6 per cent for the period ended 15 October 2015.

15. **The Bank has maintained its sterilized foreign exchange intervention policy.** Out of a total amount of Rs3.5 billion injected in the system through foreign exchange interventions by the Bank over the period July to October 2015, a total amount of Rs1.3 billion was sterilized by way of rupee deposits placed by banks for a period of one year with the Bank. The total amount of Bank of Mauritius securities outstanding as at close of business on 13 October 2015 was Rs31.2 billion, while the outstanding amount of deposits placed by banks stood at Rs6.7 billion.

16. **Despite the reduction in banks' excess reserves and the associated pick-up in yields, interbank money market rates failed to adjust.** The weighted average overnight interbank interest rate edged up to 1.15 per cent in September 2015, from 0.99 per cent in July amidst low activity. The weighted average yield on 91-Day, 182-Day and 364-Day GMTBs rose by 92 basis points (bps), 74 bps and 82 bps, respectively, between July and October 2015. Broadly, a similar pattern emerged for medium- and long-term Government securities. The latest yield curves had depicted a smoother pattern following the gradual correction in the yields on securities**.**

17. **The rupee depreciated on the back of external pressures but the Bank intervened to ensure that the domestic currency reflected its fundamentals, in accordance with macroeconomic stability**. In nominal effective terms, the rupee had depreciated by about 0.7 per cent between June and September 2015. Over the same period, the real effective exchange rate of the rupee, weighed by trading partner countries, was foreseen to have appreciated by 0.4 per cent.

18. **The banking sector remained sound and well-capitalised with banks operating way above the minimum capital adequacy requirement of 10 per cent**. Overall, the capital adequacy ratio maintained by the banking sector rose from 16.6 per cent as at end-March 2015 to 17.2 per cent as at end-June 2015, indicating an adequate buffer and sufficient resilience to deal with crisis situations. Though the ratio of impaired credit to total credit had increased from 4.3 per cent as at end-December 2014 to 4.9 per cent as at end-June 2015, asset quality remained relatively sound. The coverage ratio (ratio of specific provisions to impaired credits) had improved from 37.3 per cent as at end-December 2014 to 40.0 per cent as at end-June 2015.

Staff economic outlook

19. **Bank staff had forecast that headline inflation would remain low in the near term, conditional on a set of assumptions**. Headline inflation was forecast to close the year 2015 at around 1.6 per cent and at around 3.0 per cent for 2016. Y-o-y inflation was forecast at around 2.6 per cent at end-2015 and at around 3.3 per cent at end-2016. The increase in inflation over the forecast horizon was mainly attributed to the narrowing of the negative output gap and current accommodative monetary policy stance. External factors would mildly influence domestic price pressures.

20. **Bank staff had projected real GDP growth at 3.4 per cent for 2015 and 4.2 per cent for 2016**. Real GDP growth was expected to gain momentum in 2016, as monetary conditions were projected to remain accommodative. Investment as well as external demand were anticipated to pick up. The execution of various infrastructure projects, as well as the implementation of measures contained in the Government's Vision 2030, were posited to provide the required impetus to growth.

Presentation of the draft new monetary policy framework

21. **Ms Heerah-Pampusa, Asssistant-Director, Forex Management Division, gave an update to MPC members on the status of the proposed new monetary policy operational framework.** She commented on changes that took place since the last MPC meeting. The Bank was no longer issuing Bank of Mauritius Bills for monetary policy purposes; but from September 2015 onwards, it started mopping excess liquidity through the issue of GoM Treasury Bills via an arrangement with the Ministry of Finance and Economic Development whereby the amount of Treasury Bills put on tender included an amount determined by the Bank. The Bank would service the Treasury bills that were being issued for liquidity management purposes. She noted that, as a consequence, the yield curve reflected better market conditions. The Bank would continue to monitor developments in the 3-month Treasury bills rate, which would be the operational target for monetary policy under the new framework.

Monetary policy decision

22. **Members reviewed the recent international and domestic developments and projections, and noted the sluggish global growth rate for 2015.** They observed that the global economic environment was marred with uncertainties and policy divergences would be firming due to the US expected normalization of its policy rate in December 2015 and the Bank of England queuing up for a rate hike some time next year. China's soft landing was also another source of concern as this could weigh on global growth going forward. They viewed that commodity prices were projected to remain subdued in the near term. They also perceived that global inflationary pressures would remain benign. Whilst there had been signs of improved growth in some advanced economies, downside risks to the global growth outlook would persist particularly in many emerging market economies. They noted that several advanced and emerging economies have lately reduced their key policy rates.

23. **In their discussions of the domestic economic situation and outlook, the Committee welcomed on-going work on the new monetary policy operational framework**. Members discussed some options to have an efficient policy framework in view of repairing the link between the Key Repo Rate and money market rates. They highlighted the need for an effective monetary policy transmission mechanism, which would ensure the effectiveness of policy impulses to the real sector.

24. **MPC members observed that the domestic economy was confronted with the need for pushing up growth with a soft inflation outlook.** Members viewed that the domestic inflation outlook was relatively moderate, while risks to the domestic growth outlook remained tilted to the downside. Private sector investment was yet to pick up and the need to increase private investment was viewed as a catalyst for higher growth. The MPC welcomed the decision of government to accelerate project implementation to address the declining investment trend.

25. **Members observed that, at the current juncture, inflation did not pose any serious risks.** In the absence of any major shock, they viewed that headline inflation would remain on a downward path till year-end. Potentially, there would be limited build-up in inflationary pressures until the end of 2016. Both food and energy prices would remain contained due to the benign outlook for global

commodity prices. They reiterated that the recent developments in the Rupee exchange rate did not impact negatively on the overall domestic price level. Moreover, the Members took cognizance of the Bank's sterilised interventions since January 2015 and active liquidity management since May 2015, which have contributed to restore orderly money market conditions.

26. **Consequently, MPC members viewed that there was sufficient space for monetary policy to provide an additional impetus to domestic growth and to provide the enabling environment for accelerating private investment.** Members acknowledged that the level of income was a prime determinant of the national savings rate. They also remarked that with low inflation, the real rate of interest on deposits was comfortably positive.

Voting pattern

27. **All members unanimously voted to reduce the Key Repo Rate by 25 basis points to 4.40 per cent per annum**.

28. **The MPC would continue to monitor economic and financial developments.** The MPC would also stand ready to meet in between its regular meetings, if the need would arise.

29. **The next MPC meeting is scheduled on Wednesday 17 February 2016**.

Editor's Note

According to the Bank of Mauritius Act 2004, the primary object of the Bank shall be to maintain price stability and to promote orderly and balanced economic development. The Act gives the Monetary Policy Committee (MPC) responsibility to formulate and determine the monetary policy to be conducted by the Bank. The MPC meets on a regular quarterly basis.

When the MPC met on 9 November 2015, the last available data on national accounts, employment and external trade were for 15Q2. The last data available on CPI and inflation were for September 2015.

Abbreviations and Definitions

Headline inflation is measured by the change in the average Consumer Price Index (CPI) over a twelve-month period compared with the corresponding previous twelve-month period.

Y-o-y inflation is measured by the change in the CPI for a given month compared with the corresponding month of the preceding year.

CORE1 inflation excludes food, beverages and tobacco and mortgage interest on housing loan from the CPI basket. Both headline and y-o-y CORE1 inflation measures are available.

CORE2 inflation excludes food, beverages and tobacco, mortgage interest, energy prices and administered prices from the CPI basket. Both headline and y-o-y CORE2 inflation measures are available.

Y-o-y refers to year-on-year changes.

Q-o-q refers to quarter-on-quarter changes.

GMTBs refer to Government of Mauritius Treasury Bills.

EMEs refer to Emerging Market Economies.