BANK OF MAURITIUS

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Minutes of the 37th Monetary Policy Committee Meeting of 16 July 2015

The 37th meeting of the Monetary Policy Committee was held on Thursday 16 July 2015 at 10:00 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 and Mr Guy Wong So - External Members.

Member absent (with apologies): Dr Streevarsen Narrainen – External Member.

Summary of Staff Reports on Economic and Financial Developments

The Bank's staff reported on economic and financial developments since the 36th MPC meeting held on 6 April 2015.

International economic environment

1. **The MPC took note of the revised 2015 global growth projections laid down in the July 2015 Update of the IMF's World Economic Outlook, which resulted from a downgrade in the growth performance of both advanced and emerging and developing economies.** Global growth was being projected at 3.3 per cent for 2015, 0.2 percentage point lower than the initial forecast put up last April, reflecting mostly the disappointing first quarter data in the US. However, global growth projection for 2016 was being maintained at 3.8 per cent. Global growth would remain moderate and disparate across regions. Risks to global growth remain tilted on the downside.

2. **Average global inflation would remain low amid the persistent negative output gaps and drops in oil and food prices.** Global consumer price inflation is expected to average 2.5 per cent in 2015, the lowest rate since 2009, and 3.0 per cent in 2016.

3. **Global commodity prices declined further on sustained over-supply, relatively weak global demand, a strengthening US dollar and heightened risk aversion**. International food prices slid to a near five-year low, with generalised falls across key food commodities. The oil market remains over-supplied. The expected narrowing of the demand-supply gap in 2016 may ease the downward pressure on oil prices, while possible OPEC's production cuts and geopolitical developments may pose some upside risks.

4. **Global stock markets tumbled on rising risk aversion following the failure of Greek debt talks and the sharp contraction in China's equity market**. Between 6 April and 30 June 2015, the MSCI World and MSCI Emerging Markets shed 1.6 per cent and 2.9 per cent, respectively. Except for the NASDAQ and the NIKKEI, most markets ended down during this period.

5. **Currency markets were volatile throughout 15Q2, while global monetary conditions remained generally accommodative.** The US dollar was broadly supported by the recovery in the US economy and expectations of a rate hike by year-end. The euro, which initially recovered vis-à-vis major currencies on the back of better economic conditions as a result of the ECB's QE programme, lost some ground in the wake of the Greek crisis. Key policy interest rates in most advanced economies have remained unchanged while the two largest BRICS economies have eased their monetary policy stance further to stimulate economic activity.

Domestic economic developments

6. **The economy continued to operate below its potential, reflecting underutilisation of resources.** An overall assessment of the state of the real economy in 15Q1 indicates that a negative output gap prevailed as a result of adverse shocks from domestic and external demand, which outweighed accommodative monetary conditions. Unless structural reforms unleash productivity gains, lower saving and investment rates could pose a risk to growth going forward.

7. **Statistics Mauritius cut the growth forecast of the domestic economy to 3.8 per cent for 2015 in its June release of national accounts, from its earlier estimate of 4.1 per cent.** The downgrade resulted from lower than initially forecast performance of investment and external demand. Investment growth is being projected to rebound by 5.2 per cent compared to the initial estimate of 6.7 per cent. Final consumption expenditure is forecast to grow by 3.2 per cent in 2015, up from 2.9 per cent in 2014, as a result of higher private and government consumption expenditure. At the sectoral level, *Accommodation and food service activities* is expected to register higher growth than in 2014, whereas activity in *Manufacturing* is forecast to decelerate, mainly due to lower performance of the *other manufacturing* sub-sector. After three years of contraction, the *Construction* sector is expected to grow at 1.4 per cent in 2015.

8. **Quarterly national accounts showed that real GDP growth was unchanged in 15Q1 compared to 14Q4 but higher than in 14Q1.** Real GDP increased by 3.7 per cent y-o-y in 15Q1, same as in 14Q4, but higher than the 2.4 per cent growth recorded in 14Q1. On a seasonally-adjusted q-o-q basis, the domestic economy expanded by 0.7 per cent in 15Q1, higher than the growth recorded in the preceding quarter. Consumption, which remained the main driver of real output growth, increased by 2.5 per cent y-o-y in 15Q1, while investment spending grew by 0.2 per cent in 15Q1 after contracting over the four quarters of 2014. Net external demand made a marginal contribution of 0.1 percentage point to growth in 15Q1. From the supply side, agricultural and construction activities contracted in 15Q1, while several services sectors posted commendable performances.

9. **Inflationary pressures in the domestic economy were generally contained on account of subdued demand and low international commodity prices**. Headline inflation has declined continuously to 1.7 per cent in June 2015, a level last reached in June 2010. Y-o-y inflation

dropped from 2.1 per cent in April to 0.4 per cent in June. The fall in inflation is mainly due to a rapid decline in food prices, in particular the price of fresh vegetables, due to better weather conditions and a recovery in the production of fresh vegetables. Core measures of inflation stayed subdued too. Inflation expectations remained contained in May 2015.

10. **Cost-push pressures in the economy have been muted so far, but warrant monitoring**. Domestically, input cost pressures have been abating since early 2015. This is visible in the drop in producer price inflation (both Agriculture and Manufacturing), which went into negative territory in March 2015. The impact of the depreciation of the Rupee exchange rate on inflation has been contained so far by low global commodity prices. Both the wage rate index and unit labour costs have expanded in excess of productivity gains. Wage developments in excess of productivity gains could potentially pose upside risks to inflation going forward.

11. **After three consecutive quarters of decline, the unemployment rate increased to 8.7 per cent in 15Q1, from 7.5 per cent in 14Q4 and 8.0 per cent in 14Q1.** The unemployment rate is forecast to edge up to 8.0 per cent in 2015, from 7.8 per cent in 2014.

12. **Since the last MPC meeting, broad money supply growth maintained its momentum while credit growth remained moderate, keeping broad liquidity conditions comfortable.** On y-o-y basis, broad money has been growing at around 10 per cent since March 2015, with positive contributions from all of its components. Banks' credit to the private sector (excluding credit to GBC entities) rose by 2.5 per cent in May 2015, from 1.6 per cent in April 2015. This increase reflected a higher growth in corporate sector credit, while household credit growth was flat.

13. **Preliminary estimates of the balance of payments showed a current account deficit of 6.3 per cent of GDP for 15Q1 compared to 2.9 per cent in 14Q4 and 7.6 per cent for 14Q1.** Looking ahead, a current account deficit of 6.0 per cent of GDP is projected for 2015, higher than the deficit of 5.5 per cent estimated for 2014.

14. **The Bank's effective liquidity management operations as from 18 May 2015 brought about a reduction in banks' excess reserves.** After peaking at 13.2 per cent around mid-April 2015, the average cash ratio maintained by banks declined steadily to 11.4 per cent for the monitoring period ending 25 June 2015. Bank of Mauritius (BoM) Bills of 1-year maturity as well as BoM Notes of 2-Year, 3-Year and 4-Year maturities for a total nominal amount of Rs10.9 billion were issued through auctions held in May and June 2015.

15. **Concurrently, the Bank maintained its sterilised intervention policy, which had started since the beginning of the year.** Of a total amount of Rs4.6 billion injected in the domestic money market through foreign exchange intervention in May and June 2015, a total amount of Rs3.0 billion was sterilised by way of Rupee deposits placed by banks at the Bank for a period of one year. Since the beginning of 2015, the Bank has sterilised a total amount of Rs5.5 billion.

16. **The reduction in the level of banks' excess reserves resulted in a pick-up in the weighted yields on Treasury Bills and other Government securities of higher maturities.** The weighted yields on the 91-Day, 182-Day, and 364-Day Treasury Bills increased by about 41 basis points (bps), 35 bps and 64 bps between April and 30 June 2015. A similar pattern emerged for medium-

and long-term Government securities. The yield curves between end-April 2015 and 3 July 2015 depict a smoother pattern following the gradual correction in the yields on securities**.**

17. **Since the last MPC meeting, several banks lowered their savings deposit and prime lending rates, despite an unchanged Key Repo Rate.** Such adjustments have been effected on several occasions in recent years and indicate the weak interest rate transmission mechanism from the policy rate to money market rates.

18. **The Rupee strengthened somewhat against the US dollar after the April 2015 MPC meeting as the greenback weakened on international markets.** The exchange rate of the Rupee reflected movements of key currencies on international markets as well as domestic factors, like the decision of the State Trading Corporation to purchase part of its USD requirements from domestic banks. In nominal effective terms, the Rupee, as measured by MERI1, depreciated by 0.6 per cent in 15Q2 compared to a depreciation of 7.8 per cent during 15Q1. The real effective exchange rate, based on total trade patterns, is estimated to have depreciated by about 8.5 per cent during FY14-15.

19. **Banks remained financially sound, operating way above the minimum capital adequacy requirement of 10 per cent.** The capital adequacy ratio of banks increased from 16.6 per cent as at end-December 2014 to 17.1 per cent as at end-March 2015, indicating an adequate buffer and sufficient resilience to deal with crisis situations. Though asset quality remained sound, a marginal deterioration was noted in the ratio of impaired credit to total credit, from 4.3 per cent as at end-December 2014 to 4.4 per cent as at end-March 2015. The cover ratio, which is the level of specific provision to total impaired credit, dropped from 37.3 per cent to 35.5 per cent.

Staff economic outlook

20. **Bank staff forecasts that inflation would sustain its current momentum in the short term but pick up thereafter.** Headline inflation is being estimated at 1.5 per cent in 2015 and around 3.0 per cent in 2016, conditional on the set of assumptions. Y-o-y inflation is forecast at around 2.0 per cent at end-2015 and around 4.4 per cent at end-2016. The increase in inflation over the forecast horizon is mainly attributed to the narrowing of the negative output gap and current accommodative monetary policy stance. External factors currently appear as modest contributors to domestic price pressures.

21. **Bank staff projects real GDP growth of 3.7 per cent for 2015 and 4.6 per cent for 2016.** The improvement in domestic economic growth would result from the accommodative monetary policy and projected pick-up in economic activity in main trading-partner countries. Measures announced in the Budget 2015/16 are also expected to have a positive impact on investment and business confidence, if properly implemented. The possibility for the budding Eurozone recovery to be affected by the Greek debt crisis constitutes one of the main risks to the domestic growth outlook. Domestically, growth also appears significantly dependent on the successful implementation of public investment plans.

Presentation of the draft new monetary policy framework

22. **The Governor commented on the importance of an adequate monetary policy framework and monetary transmission mechanism.** He briefed members on monetary policy making until 2006 and highlighted the need to repair the transmission mechanism of monetary policy so as to ensure that monetary policy impulses are efficiently transmitted to the real economy. He also reiterated on the need to have an efficient monetary policy operational framework, which would restore the link between the Key Repo Rate and other short-term interest rates in the domestic money market**.** He announced that the Bank has come up with a new draft framework for conducting monetary policy and invited Ms Heerah-Pampusa, Head-Middle Office & Risk Division to make a presentation on this framework to MPC members.

23. **Ms Heerah-Pampusa surveyed monetary policy making in Mauritius since independence and briefed members on the draft new operational framework.** She commented on the inefficacy of the current framework and added that the proposed new framework will enhance the role of the policy rate (Key Repo Rate) and the 3-month Treasury/BoM Bills. The framework is intended to improve the transmission of monetary policy impulses to the real sector of the economy. Under this new framework, the Bank will conduct market operations so as to steer the yield on 3-month Treasury/BoM Bills close to the policy rate. The Bank will be required to conduct regular auctions to manage liquidity conditions and maintain the overnight rate within a corridor around the policy rate.

Monetary policy decision

24. **Members commented on recent international and domestic developments and projections and noted the sluggish global growth rate for 2015.** Among the factors that could weigh on growth performance were China's soft landing, the implications of Greece's debt default on the Eurozone growth and the impact of US normalization of its interest rate. They noted that commodity prices have been going down and are projected to remain subdued in the near term. They also viewed global inflationary pressures to remain benign. The global economic environment is marred with uncertainty.

25. **In their discussions of the domestic economic situation and outlook, the Committee welcomed the proposal for a new monetary policy framework and observed that the domestic economy was confronted with the need for pushing up growth despite soft inflation outlook.** They viewed that the pace of private investment is not picking up as expected and that the uptick in the unemployment rate warrants attention. In the near term, they expect the economy to benefit favourably from the recovery in key export markets and the implementation of major public sector investment projects.

26. **Members observed that, at the current juncture, inflation does not pose any serious risks.** In the absence of any major shock, they viewed that headline inflation will remain on a downward path till year-end. Potentially, there would be limited build-up in inflationary pressures until the end of 2015. Both food and energy prices would remain contained due to low global commodity prices. They underlined that the recent developments in the Rupee exchange rate did not impact negatively on the overall domestic price level. 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.

27. **Consequently, MPC members viewed the current monetary policy stance as being appropriate.**

Voting pattern

28. **All members unanimously voted to keep the Key Repo Rate unchanged at 4.65 per cent per annum**.

29. **The MPC continues to monitor economic and financial developments** and stands ready to meet in between its regular meetings, if the need arises.

30. **The next meeting is scheduled on Monday 09 November 2015**.

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 16 July 2015, the last available data on national accounts, employment and external trade were for 15Q1. The last data available on CPI and inflation were for June 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.

Dealt exchange rate is the weighted average rupee selling rate derived from transactions of US$30,000, and above, or equivalent.

KRR refers to the Key Repo Rate.

MERI1 is the Mauritius Exchange Rate Index, a nominal effective exchange rate introduced in July 2008, based on the currency distribution of merchandise trade.

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

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