BANK OF MAURITIUS

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Minutes of the 26th Monetary Policy Committee Meeting 11 June 2012

The 26th meeting of the Monetary Policy Committee was held on 11 June 2012 at 10.00 hours at the Bank of Mauritius, with Mr Rundheersing Bheenick, Governor, in the chair.

Members present: Mr Yandraduth Googoolye, First Deputy Governor; Mr Mohammed Iqbal Belath, Second Deputy Governor; Mr Jitendra Nathsingh Bissessur, Head-Financial Markets Analysis Division, Bank of Mauritius; Mr Nishan Degnarain, Mr Pierre Dinan, Mr Alain Madelin, Mr Rajkamal Taposeea and Ms Silvana Tenreyro, External Members.

Observers: Dr Streevarsen Narrainen, Senior Economic Adviser, Ministry of Finance and Economic Development, and Mr Neetyanand Kowlessur, Chief-Economic Analysis Division, Bank of Mauritius.

Summary of Staff Reports on Economic and Financial Developments

The Staff reported on economic and financial developments since the 25th MPC meeting held on 19 March 2012.

The International Economic Environment

1. The global economic outlook had deteriorated since the March 2012 MPC meeting as the euro area crisis intensified amid increasing concerns over a possible Greek exit and Spanish banking sector difficulties. The latest data releases and leading indicators had highlighted the weakening growth momentum and prevailing uncertainty. Growth had remained extremely uneven worldwide.

2. Though the IMF had upgraded its global growth projection for 2012 to 3.5 per cent in its April 2012 World Economic Outlook Report, the worsening of underlying economic conditions had lately prompted institutional forecasters to revise downward their growth forecasts for 2012 and 2013.

3. In the United States, the economy had expanded by an estimated 1.9 per cent in 2012Q1, compared to 3.0 per cent in 2011Q4. Developments on the labour market had been fairly

subdued and consumer confidence had fallen. Leading activity indicators suggested that the growth momentum had slowed, with continuing worries about the potential fallout from the euro zone crisis and the path of domestic fiscal policy.

4. The euro zone had stagnated in 2012Q1 as stronger than expected growth in Germany offset flat growth in France and sharp contractions in peripheral countries. Unemployment had hit a record high, while consumer and business confidence had remained low. Leading economic indicators had pointed to further slowing of activity amid heightened uncertainty about the evolution of the sovereign debt crisis.

5. The British economy had contracted by an estimated 0.3 per cent for the second consecutive quarter in 2012Q1, reflecting the impact of global economic headwinds and weak domestic demand. Leading indicators signalled a muted growth outlook as risks from the euro zone crisis increased.

6. Growth in emerging economies had decelerated although it continued to outpace that of advanced countries. Recent information had indicated continued softening of the growth momentum, due mainly to weaker trading partner performance.

7. Global commodity prices had retreated since the March 2012 MPC meeting. In May 2012, the Food Price Index of the Food and Agriculture Organisation had reached the lowest since September 2008, driven by declines in sugar, dairy, oils and fat prices. Crude oil prices had declined steadily as from April 2012 on easing supply conditions and bearish economic news.

8. Inflation had seemed to be past its peak in major advanced economies and was generally trending downward in most emerging economies. Easing global inflationary pressures had allowed a number of advanced and emerging economies to maintain accommodative monetary policies to support growth.

9. Conditions in global financial markets had deteriorated as renewed euro area sovereign stress damaged global risk appetite and threatened global credit availability. Volatility had increased somewhat while equity markets had tumbled and sovereign yields in the most exposed euro zone economies had gone up.

Domestic Economic Developments

10. According to latest national accounts data released by Statistics Mauritius in March 2012, the domestic economy had expanded at a modest seasonally-adjusted q-o-q pace of 0.1 per cent in 2011Q4 compared to growth of 1.1 per cent in 2011Q3. Performance was, however, mixed across sectors.

11. Over the year to 2011Q4, real output growth had slowed to 2.4 per cent, from 3.9 per cent in 2011Q3. Except for **'wholesale and retail trade'** and **'financial intermediation'**, which had expanded at higher rates than in the previous quarter, growth had been lower in most major sectors, notably **'hotels and restaurants', 'transport, storage and communications'**, **'construction', 'real estate, renting and business activities'** and **'agriculture'**. **'Manufacturing'** output had contracted by 3.5 per cent following negative growth recorded in *'textile'* and *'other manufacturing'* while real activity in **'export-oriented enterprises'** had receded by 4.1 per cent. Statistics Mauritius projected the domestic economy to grow at 3.6 per cent in 2012.

12. After a slight pick-up in 2011Q3 **'final consumption expenditure'** growth had slowed to 2.1 per cent in 2011Q4, reflecting growth of 2.7 per cent in *'household consumption expenditure'* partly offset by a contraction in *'general government consumption expenditure'* growth. **'Gross domestic fixed capital formation'** growth had accelerated to 12.9 per cent in 2011Q4, mainly on account of a surge of 31.2 per cent in *'machinery and equipment'* following the acquisition of a power generating plant. **'Gross domestic fixed capital formation'** excluding *'aircraft and marine vessel'* was forecast to expand marginally by 0.1 per cent in 2012, with growth of 11.6 per cent in public investment partly offset by a contraction of 3.4 per cent in private investment.

13. Total exports *f.o.b* had increased by 2.6 per cent y-o-y in 2012Q1 as a rise in *'food and live animals'* exports was partly offset by a drop in *'miscellaneous manufactured goods'* exports. Total imports *c.i.f* had grown by 7.3 per cent y-o-y, mainly driven by *'machinery and transport equipment'* imports. Both the textile and tourism sectors might have been affected by weaker external demand and lower visibility. However, they had been propped up by diversification efforts into emerging markets. Over the period January to April 2012, total tourist arrivals growth had decreased by 0.2 per cent compared to the same period in 2011, driven by declines in several key markets. Tourist earnings had, nevertheless, increased by 15.6 per cent y-on-y in 2012Q1 to Rs13,819 million.

14. Provisional estimates of the balance of payments, excluding cross-border transactions of GBC1s, for 2012Q1 indicated that the current account deficit had worsened to Rs5.0 billion, from Rs3.1 billion registered in 2011Q1, and stood at 6.0 per cent of GDP. The larger current account deficit had mostly been the outcome of a higher merchandise trade deficit and a lower surplus on the *'income'* account while the *'current transfers'* and *'services'* accounts had increased compared to 2011Q1.

15. The capital and financial account, excluding cross-border transactions of GBC1s, had witnessed a turnaround in 2012Q1, recording net outflows of Rs1.9 billion as against an almost equivalent amount of net inflows registered in 2011Q1. Net inflows on *'direct investment'* had moderated to Rs0.7 billion in 2012Q1 while *'other investment'* and *'portfolio investment'* had registered net outflows of Rs4.0 billion and Rs0.3 billion, respectively.

16. The unemployment rate had come down from 7.9 per cent in 2011Q3 to 7.5 per cent in 2011Q4 but, on a seasonally-adjusted basis, had increased from 8.1 per cent to 8.4 per cent.

17. Monetary and credit developments had been subdued since the March 2012 MPC meeting. Following an uptrend to 6.3 per cent in March 2012, the annual growth rate of broad money liabilities had moderated to 6.1 per cent in April 2012. The annual growth rate of credit to the private sector had remained unchanged at 11.5 per cent in April 2012.

18. The CPI, which had picked up some momentum between February and April 2012 mainly on increases in administered price of cooking gas and prices of food products, had remained flat at 132.5 in May 2012.

19. Headline inflation had moderated further to 5.3 per cent in May 2012, from 6.2 per cent in February 2012, while y-o-y inflation had remained unchanged at 3.8 per cent for the third consecutive month. **'Alcoholic beverages and tobacco'** (+1.5 percentage points) continued to be the largest contributor to y-o-y inflation followed by **'housing, water, electricity, gas and other fuels'** (+0.6 percentage point), **'food and non-alcoholic beverages'** (+0.5 percentage point) and **'restaurants and hotels'** (+0.4 percentage point).

20. There was evidence that underlying inflation pressures had moderated, as reflected in the decline of core measures of inflation by May 2012. Y-o-y CORE1 inflation had decreased from 3.6 per cent in February 2012 to 3.4 per cent in March 2012 before stabilising at 3.1 per cent in April and May 2012. Y-o-y CORE2 inflation, which had dropped slightly from 3.4 per cent in February 2012 to 3.3 per cent in March 2012, had remained unchanged at 2.8 per cent in April and May 2012. On a 12-month average period, both CORE1 and CORE2 inflation had continued to trend downwards to reach 4.6 per cent and 3.8 per cent, respectively, in May 2012.

21. The Bank's *Inflation Expectations Survey* of May 2012 indicated that a slightly higher proportion of respondents (76.0 per cent) had expected prices to go up over the next 12 months. Most respondents continued to anticipate inflation within a range of 4.5-6.5 per cent over the next 12 months, with the mean inflation rate expected one year ahead down to 5.9 per cent.

Domestic Financial Markets Developments

22. Staff indicated that the excess liquidity in the domestic money market had averaged around Rs3.0 billion since the March 2012 MPC meeting. Except for an issue of a 364-day Bank of Mauritius Bill for an amount of Rs225 million on 15 March 2012, the Bank had not intervened on the domestic money market.

23. At the primary auctions of Treasury Bills, the weighted average yields on 91-day, 182-day, 273-day and 364-day Treasury Bills had declined to 3.30 per cent, 3.47 per cent, 3.65 per cent and 3.77 per cent, respectively, mostly reflecting the cut in the Key Repo Rate (KRR) in March 2012.

24. The weighted average rupee deposit rate and the weighted average interest rate on rupee advances had fallen between February and April 2012, in line with the decrease in the KRR. The real interest rate on savings deposits, using either the y-o-y or headline inflation rate, had remained broadly unchanged in negative territory.

25. Reflecting the US dollar broad-based strength on international markets as well as domestic market conditions, the dealt rupee exchange rate had depreciated against the US dollar. It had also lost ground against the Pound sterling but had appreciated against the euro. In nominal effective terms, the trade-weighted value of the domestic currency had appreciated between March and May 2012.

26. The Bank, in consultation with the Ministry of Finance and Economic Development, had launched the ***Operation Reserves Reconstitution*** (ORR) to build up its foreign exchange reserves and curb the increasing misalignment of the rupee with underlying economic fundamentals. It had also indicated its willingness to offer a Special Foreign Currency Line of Credit to affected sectors through banks. These measures also aimed to minimise the exchange rate risks faced by exporters, with their knock-on effects on the banking sector and financial stability generally.

Staff Economic Outlook

27. Staff assessed the output gap to have been slightly negative in 2012Q1, indicating that the economy was operating with some degree of excess capacity. Going forward, the domestic growth momentum was expected to stay positive, but subdued, as headwinds from the euro zone crisis continued to affect main export industries. Assuming that the risks in the euro zone are contained, growth in 2012 was expected to remain more or less unchanged from the forecast made in March 2012, at 3.8 per cent. However, there were clear downside risks to this scenario. In the event euro zone growth stayed negative for longer than expected, some 0.5-0.6 percentage point could be shaved off the baseline forecast given the significant trade linkages with Europe.

28. Staff forecast y-o-y inflation to reach just below 5.0 per cent while headline inflation was projected at 4.5 per cent by December 2012. The main upside risks to inflation were seen to emanate from a possible resurgence in global oil prices and the potential impact of the recently announced measures.

The Monetary Policy Decision

29. Members noted that risks to the global growth outlook had intensified since the March 2012 MPC meeting, along with growing uncertainty about the unfolding of the euro area debt crisis. Growth in most advanced economies, including the United States, euro zone and United Kingdom, as well as in the larger emerging market economies was slowing. Austerity measures introduced by a number of advanced countries to reduce government indebtedness

were showing their limits in terms of socio-economic impact. Concurrently, global inflationary pressures had eased, providing space for monetary authorities to maintain accommodative policies and boost growth. Demand and supply conditions on global commodity markets made it unlikely for prices to increase significantly in the foreseeable future but there was a persistent risk that geopolitical factors might drive prices upward again.

30. The Committee considered that the domestic economy had held up reasonably well to global economic challenges but it remained vulnerable to the subdued economic and financial developments in Europe and the United States. Domestic business and consumer confidence seemed to have weakened while the outlook for private investment growth remained poor. While uncertainty about the growth path of the domestic economy remained amid heightened risks for prolonged sub-par growth in Europe, members expected growth dynamics to stay positive.

31. Some concerns were expressed about employment growth against the current global backdrop and about the relatively high female and youth unemployment rates.

32. The MPC discussed the factors affecting the competitiveness of the country and the concerns that had arisen with regard to the rupee exchange rate. Members held the view that while the rupee exchange rate might be misaligned with underlying economic fundamentals, there were more structural issues that needed to be addressed in improving competitiveness. However, these structural changes were beyond the ambit of monetary policy. The growing imbalance between savings and investment, which tended to drive the current account deficit higher, and insufficient productivity gains relative to wage compensation required fiscal reforms to promote national savings and induce productivity increases. The MPC underlined the importance for export enterprises to capitalise on a worsening market by targeting niche segments of the market.

33. Members observed that external inflationary pressures had declined, reflecting the decelerating inflation outlook in most advanced and emerging economies. The fall in core measures of domestic inflation suggested that underlying inflation pressures had lessened. Mild pressures were also seen from domestic developments: the negative output gap showed continued slack in the domestic economy while labour market conditions were tame and the pace of growth in broad money liabilities and claims on the private sector was moderate. However, risks remained that domestic inflation could steer away from its current trajectory should the assessment on the exchange rate and commodity prices, particularly oil, turn out to be different.

34. The Committee weighed the risks to the growth and inflation outlook over the policy-relevant horizon and discussed alternative interest rate scenarios. It judged that the significant risks surrounding the global economy had clearly shifted the balance of risks in the domestic economy to the growth outlook, the more so that the risks around the most likely path for inflation appeared skewed to the downside in the near term, largely reflecting the risks arising

from depressed global demand conditions. However, the Committee cautioned that the exceptional measures announced by the Bank warranted close monitoring in view of their potential impact on domestic inflation. Members considered it essential to continue to anchor inflation expectations and minimise the risk of second-round effects. Some also underlined the need to achieve a positive real rate of interest to boost savings in the current environment.

35. Considering the high uncertainty surrounding the global economic landscape and the potential pass-through of the recent measures initiated by the Bank to inflation, the Committee concurred that the monetary policy stance was broadly appropriate. The fairly similar levels of the Key Repo Rate and expected inflation rate did not provide much room to ease monetary policy further. The ORR and the introduction of a Special Foreign Currency Line of Credit were expected to provide a breather to the export sector. Members argued that those unconventional measures had to be given time to work their way through the real economy and that it was important not to provide mixed signals about the direction of policy. Moreover, the MPC considered it crucial to tackle the structural shortcomings in the economy and deal with long-term competitiveness issues.

Voting Pattern

36. At the conclusion of the discussion, the Committee unanimously voted to keep the Key Repo Rate unchanged at 4.90 per cent per annum. One member initially voted for a cut in the Key Repo Rate but, after a second round of voting, chose to maintain the interest rate on hold to allow the impact of the recent measures to filter to the economy.

37. The MPC will maintain strong vigilance in monitoring economic and financial developments and stands ready to meet in between its regular meetings if the need arises.

38. The meeting adjourned at 16.55 hours. The next MPC meeting is scheduled on Monday 24 September 2012.

39. **Voting for the MPC action:** Mr Rundheersing Bheenick, Mr Yandraduth Googoolye, Mr Mohammed Iqbal Belath, Mr Jitendra Nathsingh Bissessur, Mr Nishan Degnarain, Mr Pierre Dinan, Mr Alain Madelin, Mr Rajkamal Taposeea and Ms Silvana Tenreyro.

40. **Voting against the MPC action:** None

Bank of Mauritius
25 June 2012

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.

In line with amendments brought to the Bank of Mauritius Act 2004 in December 2011, the composition of the MPC was revised in March 2012. Members of the MPC now comprise the Governor (Chairperson), three Senior Officers of the Bank appointed by the Governor, and 5 other persons (external members) appointed by the Minister of Finance and Economic Development after consultation with the Governor.

When the MPC met on 11 June 2012, the last available data on national accounts and employment were for 2011Q4 while the last data on external trade and the balance of payments were for 2012Q1. The last data available on CPI and inflation were for May 2012.

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.

MERI 1 is the Mauritius Exchange Rate Index, a nominal effective exchange rate introduced in July 2008, based on the currency distribution of merchandise trade.

MERI 2 is the Mauritius Exchange Rate Index, a nominal effective exchange rate introduced in July 2008, based on the currency distribution of merchandise trade and tourist earnings.

GBC1s are resident corporations which conduct business outside Mauritius. The law has recently been amended to allow them to transact with residents provided that their activities in Mauritius are ancillary to their core business with non-residents.

Other investment includes all debt liabilities between unaffiliated non-residents and residents, which are not securitised. It can be classified by institutional sector: general government, monetary authorities, banks, and other sector, and sub-classsified between short-term and long-term.

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

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