BANK OF MAURITIUS

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Minutes of the 32nd Monetary Policy Committee Meeting

3 February 2014

The 32nd meeting of the Monetary Policy Committee was held on 3 February 2014 at 9.30 hours at the Bank of Mauritius, with Mr Rundheersing Bheenick, Governor, in the chair.

Members present: Mr Yandraduth Googoolye, First Deputy Governor; Mr Issa Soormally, Second Deputy Governor; Mr Nishan Degnarain, Mr Pierre Dinan, and Mr Hemraz Oopuddhye Jankee, External Members.

Professor Jeffrey Frankel and Professor Silvana Tenreyro, External Members, attended the meeting via video-conference.

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 31st MPC meeting held on 30 September 2013.

The International Economic Environment

1. Global economic activity had firmed since the September 2013 MPC meeting, with the US and UK performing relatively better than other advanced economies. The US economy had grown at its fastest pace in two years, prompting the Federal Open Market Committee to start curtailing its unprecedented monetary stimulus. The Eurozone had emerged out of recession, with some improvement noted in the performance of peripheral economies. Emerging market economies had slowed due to persistent external headwinds, and several of them had been substantially affected by the prospects for lower quantitative easing in the US.

2. Leading indicators had confirmed the improvement in economic conditions in a number of advanced economies. US Markit surveys and regional JP Morgan Purchasing Managers'

Indexes for the Eurozone and UK had picked up in December 2013, consistent with better growth prospects. The January 2014 Update of the IMF World Economic Outlook had upgraded its projection for world output growth in 2014 though downside risks were expected to persist, particularly from the sluggish recovery and low inflation in the Eurozone.

3. While inflation had eased in several advanced economies, it had picked up in a number of emerging economies faced with currency depreciation. Global food prices had been broadly stable in 2013 on account of improving supply prospects and subdued demand. Crude oil prices had been influenced by a combination of geopolitical factors and excess supply conditions, and had remained range-bound.

4. Conditions in global financial markets had been generally upbeat since the September 2013 MPC meeting, with strong recovery in global equity markets. Monetary policy had remained accommodative in major advanced economies. However, the actual reduction of quantitative easing in the US had led to substantial declines in capital flows to some emerging economies with large current account deficits; and consequently, to significant currency depreciation. A number of those economies had subsequently tightened monetary policy to counter inflationary pressures, namely Turkey, Brazil, Indonesia, South Africa and India.

Domestic Economic Developments

5. The MPC noted that the domestic economy had continued to perform relatively well against the global backdrop. Latest data for 2013Q3 had indicated an increase in momentum, with seasonally-adjusted q-o-q growth expanding by 1.1 per cent compared to 0.7 per cent in 2013Q2. Year-on-year, output had expanded by 3.5 per cent in 2013Q3, with activity driven by key sectors, notably *'financial and insurance activities'*, *'manufacturing'*, *'accommodation and food service activities'* and *'wholesale and retail trade'*. In contrast, *'construction'* had contracted by 11.2 per cent.

6. For 2013, Statistics Mauritius had maintained its estimate of economic growth at 3.2 per cent. All major sectors, with the exception of 'construction', were estimated to have made a positive contribution to growth. For 2014, Statistics Mauritius had projected the economy to grow by 3.7 per cent.

7. 'Final consumption expenditure' growth had picked up to 2.2 per cent in 2013Q3, from 2.0 per cent in 2013Q2. *'Household consumption expenditure'* had grown at a slightly higher rate of 2.6 per cent while *'general government consumption expenditure'* had recorded positive growth of 0.2 per cent as against a contraction in the previous quarter. For 2013, Statistics Mauritius estimated that consumption had expanded by 2.4 per cent compared to 2.8 per cent in 2012. Concurrently, the savings rate for 2013 had been revised further down to 14.0 per cent, from 14.2 per cent previously.

8. 'Gross domestic fixed capital formation' (GDFCF) had contracted for a fifth consecutive quarter in 2013Q3, albeit at a slower pace of 0.6 per cent compared to 4.2 per cent in 2013Q2. Investment in *'building and construction work'* had declined by 11.3 per cent, while investment in *'machinery and equipment'* had surged by 25 per cent following the acquisition of a fishing vessel. Excluding *'aircraft and marine vessel'*, GDFCF was estimated to have contracted by 6.9 per cent in 2013 compared to a contraction of 0.8 per cent in 2012, with drops in both public and private investment.

9. Total exports, excluding *'ship's, stores and bunkers'*, had increased by 7.6 per cent y-o-y in 2013Q3, driven by higher exports in *'food and live animals'* and *'manufactured goods classified chiefly by material'*, which partly offset a fall in *'miscellaneous manufactured goods'* exports. Total imports *c.i.f.* had moved up by 7.8 per cent, mainly as a result of increases in *'food and live animals'* and *'machinery and transport equipment'* imports.

10. Tourist arrivals had increased by 2.9 per cent y-o-y in 2013 to reach 993,106. The retreat of the main French market had been compensated by higher arrivals from the UK, China, Germany and South Africa. However, while diversification efforts were paying off in terms of arrivals, tourist earnings had contracted by an estimated 6.5 per cent in 2013. For 2014, Statistics Mauritius had forecast tourist arrivals to climb to 1,025,000 while tourist earnings were projected at Rs44.5 billion.

11. The MPC noted that the current account deficit had risen slightly by Rs0.9 billion over the year to Rs11.9 billion in 2013Q3, largely due to a fall in the net invisibles surplus. However, financial flows, inclusive of cross-border transactions of GBC1s, had been adequate to finance the deficit. The overall balance of payments had recorded a deficit of Rs3.4 billion in 2013Q3 as against a surplus of Rs1.1 billion in 2012Q3.

12. Labour market conditions had remained relatively steady. The unemployment rate had declined to 7.8 per cent in 2013Q3, from 8.2 per cent in 2013Q2, but had increased to 8.0 per cent on a seasonally-adjusted basis, from 7.8 per cent in 2013Q2. Nominal wages had grown at an annualised pace of about 10 per cent q-o-q in 2013Q3. For 2013, Statistics Mauritius estimated that the unemployment rate had gone up marginally to 8.2 per cent, from 8.1 per cent in 2012.

13. Monetary and credit expansion had continued at a moderate pace. The annual growth rate of Broad Money Liabilities had gone down to 5.4 per cent in November 2013 compared with 6.7 per cent in August 2013, while the annual growth rate of depository corporations' loans to the private sector had edged down to 9.7 per cent.

14. Compared to August 2013, headline inflation had remained unchanged at 3.5 per cent in December 2013 while y-o-y inflation had increased significantly to 4.0 per cent, from 3.1 per cent. The MPC was briefed that *'food and non-alcoholic beverages'*, *'alcoholic beverages and*

tobacco' and *'transport'* had been the major contributors to y-o-y inflation in December 2013, partly reflecting increases in excise taxes and bus fares.

15. Core inflation measures had indicated an increase in underlying inflationary pressures. Y-o-y CORE1 and CORE2 inflation had reached 3.3 per cent and 3.2 per cent in December 2013, from 2.6 per cent and 2.3 per cent, respectively, in August 2013.

16. The Bank's 21st Inflation Expectation Survey carried out in November 2013 had shown that a majority of respondents expected inflation to be less than 4.5 per cent by June 2014, and within a range of 4.5-6.5 per cent by December 2014.

Domestic Financial Markets Developments

17. Staff reported that the overall excess liquidity in the banking system had increased substantially since the September 2013 MPC meeting despite an increase in the cash ratio from 7.0 to 8.0 per cent in October 2013. Excess liquidity had reached a high of Rs12.9 billion in December 2013, mainly on account of higher spending by Government towards year-end and net maturing securities. In January 2014, the Bank had conducted a reverse repurchase transaction of Rs1.0 billion and issued Rs1.5 billion of Bank of Mauritius securities. As at end-January 2014, a total amount of Rs17.4 billion of Bank of Mauritius securities was outstanding.

18. The weighted yields on Treasury Bills of all maturities had gone up following the increase in the cash ratio. Though they had fallen thereafter as excess liquidity surged, they were still higher than at the previous MPC meeting, standing at 3.26 per cent, 3.42 per cent, 3.44 per cent and 3.70 per cent, respectively, on the 91-Day, 182-Day, 273-Day and 364-Day Treasury Bills as at end-January 2014.

19. The weighted average interest rate on rupee deposits and advances had moved to 3.22 per cent and 8.07 per cent, respectively, as at end-December 2013 compared to 3.24 per cent and 8.18 per cent as at end-August 2013. The real weighted savings deposits rate, obtained using the y-o-y inflation rate, had moved from 0.19 per cent in August 2013 to negative 0.74 per cent in December 2013.

20. Reflecting the generally weaker US dollar as well as domestic demand and supply conditions, the dealt rupee exchange rate had appreciated by 0.81 per cent against the US dollar, but had depreciated by 1.31 per cent and 0.19 per cent against the Pound sterling and euro, respectively. In nominal effective terms, as indicated by the MERI1, the rupee had remained broadly stable.

Staff Economic Outlook

21. The Bank's Staff anticipated that domestic economic conditions would improve in 2014 as global economic activity recovered. Real output was projected to grow close to its potential over the forecast horizon. Consumption and investment were expected to pick up during the year as consumers and businesses became more confident about the recovery and adjusted their behaviour accordingly. Downside risks to the domestic growth outlook remained, however, from the continued process of fiscal consolidation and the need for private sector deleveraging. Moreover, the weak recovery in the Eurozone might still constrain external demand while the low Eurozone inflation could impact on the euro and, consequently, rupee exchange rates.

22. From recent short-term dynamics, measured by annualised q-o-q CPI inflation, the Bank's Staff assessed that it was likely that inflation would sustain its current momentum over the next quarter. Going forward, demand and external pressures on inflation were expected to be subdued. However, higher wages in the public sector could still have some spill-over effects as trade unions demand a similar increase for the private sector. It was noted that wages had already increased in the transport sector and negotiations were on-going for an upward revision in the sugar sector while 14 remuneration orders were under review. While the domestic exchange rate had remained range-bound, the continued dependence on foreign savings to finance the pronounced current account deficit constituted a major risk factor.

External Presentations to the MPC

23. The MPC is required by law to take into account the views of the Bank, the Finance Ministry and such other institution or organization as it considers appropriate in the discharge of its duties. In compliance with its mandate, the MPC heard the Ag. Financial Secretary, Mr Patrick Yip, who relayed the view of the Ministry of Finance and Economic Development that monetary policy needed to stay supportive to boost investment and growth in the economy. The MPC further benefited from a presentation by the Chief of the IMF Article IV Mission present in Mauritius, Mr Martin Petri, on the domestic economic outlook for 2014 and the monetary policy transmission mechanism.

24. Representations were also made by the President of the Association for the Protection of the Environment and the Consumers, Mr Suttyhudeo Tengur, and the General Secretary of the *Association des Consommateurs de l'Ile Maurice*, Mr Jayen Chellum.

25. All external presentations are summarized in Annex 1. The full set of presentations made at the MPC meeting is now available on the Bank's website at *https://www.bom.mu*.

The Monetary Policy Decision

26. The MPC concurred that the global economy had picked up since the September 2013 MPC meeting, with recovery taking hold in advanced economies, particularly the US and UK. The Eurozone appeared likely to stay out of recession, although growth was expected to remain

weak and uneven. Emerging market economies were expected to continue facing downside risks from the US Fed tapering and internal rebalancing in China. Concurrently, while the global inflation outlook remained benign, it was noted that a number of emerging economies had experienced increases in inflation as a result of the depreciation of their domestic exchange rates. They had consequently raised their policy rates while advanced economies had maintained an accommodative monetary policy stance.

27. The Committee noted that the domestic economy had continued to hold up well to the external headwinds. The recovery in global economic activity coupled with diversification efforts was projected to have a positive impact on external demand. It was expected that GDP growth would pick up to a range of 3.7-4.0 per cent for 2014, that is, an increase of 0.5-0.8 percentage points above the estimated growth of 3.2 per cent in 2013 by Statistics Mauritius. Some members were nevertheless still prudent on the international economic outlook. They pointed out that domestic growth was still fragile and should continue to be supported by an accommodative monetary policy. Other members, however, highlighted that the growth potential of the economy had come down to around 4 per cent, from 5 per cent previously. The economy was therefore growing close to its potential. Given structural imbalances, there would be a need for substantial reforms on the fiscal front for the economy to return to a higher potential output growth.

28. Members expressed continued concerns about the declining investment trends. It was expected that enhanced growth prospects in main trading-partner countries would raise business confidence and investment, and it was indeed noted that there were a number of private sector projects to which investment would be directed during the year. However, it was likely that the increase in private investment might not be enough to provide a significant boost to total investment. Public investment had dropped even though the economic situation might have called for a countercyclical Government expenditure programme. Moreover, with fiscal multipliers smaller than expected due to leakages in the form of imports, public investment might not stimulate the economy as much as desired. There was therefore a need to review both the quantum and structure of public investment.

29. The sustained fall in the domestic savings rate remained a worry for some members, especially against the backdrop of a large and deteriorating current account deficit. It was viewed that the high dependency on foreign savings had, in the light of the recent developments in some emerging economies, increased the vulnerability of the economy. Prolonged negative real interest rates on savings deposits were seen to exacerbate the problem by constraining savings and thus needed to be reversed for savers to obtain a decent rate of return. One member, however, argued that the savings rate might be understated insofar as data issues stemming from the coverage of cross-border transactions of GBC1s might have resulted in the current account deficit being overstated.

30. Members broadly agreed that employment had been rather stable given the economic circumstances. While the economy had continued to generate jobs, the share of foreign labour had risen due partly to skills mismatch on the part of domestic job-seekers and their reluctance to take on certain jobs. Members assessed that structural reforms were necessary to address the acute skills gap among the local workforce; there was little that monetary policy could do in that respect. Periodic increases in wages, unrelated to productivity gains, were also an issue that had to be addressed to improve the labour market.

31. Taking into account the upward trend in both y-o-y and core inflation measures since the September 2013 MPC meeting, members appraised the inflation outlook differently. Some members highlighted the rise in underlying inflationary pressures in the economy and noted that the prices of locally produced goods and services had had a higher impact on domestic inflation than prices of imported goods and services. On a no-policy change basis, y-o-y inflation could, in their view, rise to 5.0 per cent by the end of the first quarter of 2014; with appropriate measures, y-o-y inflation could end the year at around 4.0 per cent. For a majority of members, however, the main inflation drivers remained subdued. They notably expected that low external pressures would contribute to keep domestic inflation under control.

32. The Committee extensively discussed the large increase in excess liquidity in the banking system. The main factors that were seen to account for that surge were that: (i) the decision by government to shift towards more external financing had resulted into inflows that needed to be sterilised; (ii) the decision to accumulate reserves through the Operation Reserves Reconstitution programme had also required costly sterilisation; and (iii) special funds and Government deposits placed by the Treasury with commercial banks. Members observed that conditions had become distortionary as a result. There was a serious need to remove the excess liquidity to align money market interest rates with the key policy rate and improve the effectiveness of the monetary policy transmission mechanism. Referring to the presentation by Mr Petri, the IMF Article IV Mission Chief, members shared the opinion that Government should support the Bank in reducing the excess liquidity.

33. They were apprised that a Joint Working Group comprising Bank and Ministry of Finance and Economic Development officials had been set up for better coordination between the Bank and the Ministry. However, only 3 meetings of the Joint Working Group had been held so far, with the last meeting taking place in October 2013. Meanwhile, the Bank had already issued an outstanding amount of around Rs17 billion of its own securities. The negative carry on those issues was having a devastating effect on the balance sheet of the Bank, which could end up with steep losses during the year. While they took note of the decision of the Ministry of Finance and Economic Development who had indicated, through the Ag. Financial Secretary, that an initial amount of Rs100 million would be devoted to removing excess liquidity, some members felt that this amount was much below the estimated cost of conducting open market operations.

34. The Committee weighed the risks to the growth and inflation outlook over the policy-relevant horizon and discussed alternative interest rate scenarios. A majority considered that domestic inflation was currently within a reasonable range, and projected that inflationary pressures would remain subdued during the year. The global growth outlook was viewed as cautiously optimistic as the recovery was uneven across regions and subject to persistent downside risks. The expansion of the domestic economy was considered to be significantly dependent on the extent of recovery in main export markets. In real terms, the key policy rate was still in positive territory. A rise at this juncture could increase the burden of indebted households and penalise investment. Further, there was no evidence that the economy had been affected by the US Fed tapering. It was expected that the Ministry of Finance would coordinate with the Bank to remove excess liquidity from the banking system. In these conditions, a neutral monetary policy stance was deemed appropriate as the domestic economic recovery taking place could be jeopardised by premature monetary policy tightening.

35. The other members, however, believed that the MPC should focus on its goals of price stability, and orderly and balanced economic development. Inflationary pressures in the economy had mounted and, although no formal inflation target had yet been agreed between the Bank and the Ministry of Finance, as provided under the Bank of Mauritius Act 2004, Government had subscribed to a 3 per cent inflation objective as part of the Association of African Central Banks and Southern African Development Community convergence criteria. Meanwhile, conditions in the banking system, notably from persistently high and growing excess liquidity, had deteriorated. The country also faced greater external vulnerabilities from the continuous fall in the domestic savings rate and increasing dependence on foreign savings to finance the current account deficit. Real economic activity was recovering firmly, and it was viewed that the accommodative monetary policy stance had reached its limits in terms of stimulating private investment and growth. An acceleration of structural reforms was needed for the economy to move to a higher growth path. In light of those factors, there was ample ground to rapidly normalise the KRR to address the risks to inflation and reduce external vulnerabilities while enhancing savings and the excess liquidity situation in the economy.

Voting Pattern

36. At the first round of voting after the discussion, Mr Rundheersing Bheenick, Mr Yandraduth Googoolye and Mr Issa Soormally voted to increase the KRR by 50 basis points to contain inflationary pressures and maintain orderly market conditions. Professor Jeffrey Frankel, Mr Hemraz Oopuddhye Jankee and Professor Silvana Tenreyro voted to keep the KRR unchanged while Mr Nishan Degnarain, though in favour of a neutral monetary policy stance, viewed that a small technical adjustment of the KRR downward could be considered for more effective monetary policy transmission. Mr Pierre Dinan also voted to keep the KRR unchanged but indicated that he could have envisaged an increase of 10 basis points.

37. At a second round of voting, Mr Nishan Degnarain voted to keep the KRR on hold to maintain a neutral monetary policy stance while remaining members maintained their initial positions. The Committee thus voted with a majority of 5 to 3 to keep the KRR unchanged at 4.65 per cent per annum. The three dissenting members voted to increase the KRR by 50 basis points.

38. 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.

39. The meeting adjourned at 18.25 hours. The next MPC meeting is scheduled on Monday 28 April 2014.

40. **Voting for the MPC action:** Mr Nishan Degnarain, Mr Pierre Dinan, Professor Jeffrey Frankel, Mr Hemraz Oopuddhye Jankee and Professor Silvana Tenreyro.

41. **Voting against the MPC action:** Mr Rundheersing Bheenick, Mr Yandraduth Googoolye and Mr Issa Soormally.

Bank of Mauritius
17 February 2014

Annex 1

Summary of the presentation by the Ministry of Finance and Economic Development, including responses to questions from MPC members

The Ministry was represented by Mr Patrick Yip, Acting Financial Secretary. The main thrust of his submission was as follows:

1. The domestic growth rate for 2013 was below initial projections. Prospects for 2014 seemed better, with projected growth of 3.8-4.0 per cent, but downside risks were quite high, especially regarding the recovery in Europe, deteriorating growth prospects in France, and slow implementation of budget measures. The unemployment rate was rising, with youth unemployment an area of concern. The Ag. Financial Secretary agreed that monetary and exchange rate policy could not be a substitute for structural reforms and balance sheet adjustments. Government had, accordingly, taken appropriate structural measures to boost investment, productivity and growth and also address the issue of unemployment, especially among the youth.

2. Domestic inflation was on the downside and inflationary pressures would remain subdued in 2014, as a result of both declining international prices and the measures taken in the Budget 2014 to protect and enhance the purchasing power of consumers. Public sector pay increases had minimal impact on inflation. The MPC needed to take into account the impact of any interest rate decision on consumers and households who had to service their mortgages and other loans.

3. The budget deficit was higher than initially estimated and the discounted public sector debt stood at around 55 per cent of GDP in 2013. There was need to consolidate public finances and pursue fiscal adjustment to bring back public debt on a downward path to meet the statutory target of 50 per cent of GDP by 2018. There was limited scope for fiscal policy to stimulate growth. Thus, it was essential that monetary policy remained supportive to help the business sector to increase its capacity to invest and grow and create jobs.

4. The Ministry had always been concerned with the excess liquidity situation and its implication for financial stability and for effectiveness of monetary policy. It agreed that coordination needed to be improved on that issue and was of the view that this should be taken up at the level of the Joint Working Committee on liquidity. At the end of 2013, the Ministry had taken some measures to avoid aggravating the excess liquidity situation. It had raised additional funds of about Rs2.3 billion from the market and tried to convince statutory bodies to deposit their funds with the Bank. In addition, the Ministry was committing an initial amount of Rs100 million from the Budget to meet the cost of open market operations during 2014.

5. The Ministry viewed that there was absolutely no case for raising the KRR and recommended to keep the KRR unchanged.

Summary of the presentation by Mr Martin Petri

6. Mr Petri gave a brief summary of the economic outlook for 2014: growth was forecast at 3.7 per cent while total investment was expected at around 23 per cent of GDP. Y-o-y inflation was forecast at 4.5 per cent and headline inflation at 3.8 per cent. The budget deficit would remain at 4.5 per cent of GDP while the current account deficit would reach 8.7 per cent of GDP relative to 9.1 per cent in 2013. Reserves were assessed to be comfortable at 4.4 months of imports and authorities could consider continuing building buffers.

7. The Bank had issued Bank of Mauritius Bills and increased the cash ratio to reduce excess liquidity, but this was not enough to align the interbank rate with the KRR. The disconnect between these rates was considered harmful for monetary policy and the financial system because it implied a loss of control over the monetary transmission mechanism and financial disintermediation because banks might not want to take deposits and might have an incentive to engage in potentially risky business.

8. There seemed to be 2 monetary transmission mechanisms: one through the KRR to bank deposits and lending rates, and the other through the interbank rate which would affect the marginal cost for banks. The KRR pass-through to the lending rate seemed to work. While the pass-through to interbank interest rates did not appear effective, mainly because of excess liquidity, it did have some effect. In the presence of excess liquidity, banks might try to reduce their cost of deposits, leading to a bigger difference between deposit rates and the KRR. So there might still be a transmission mechanism through the interbank rate. It might also affect large creditors as banks might often do deals with them at rates that might be different from the Prime Lending Rate.

9. To improve the transmission mechanism, the Ministry of Finance should issue government paper for monetary policy purposes - around Rs30 billion. The Bank would decide on the quantity and the Ministry on maturities in line with its debt policy. The Bank would have to pay interest on government deposits to share costs. The issue of a single instrument should help to develop the government securities market and the interbank market.

10. There should be negotiation between the Bank and the Ministry with regard to the interest rate to be paid by the Bank on government deposits, which was a fair way of sharing the cost of monetary policy. Ultimately, the cost of monetary policy would be borne by the Ministry through the profit and loss of the central bank. It was just a question of timing. The need to pay interest on government deposits would have an impact on profitability but it was necessary for the central bank to conduct monetary policy to achieve its objectives. The loss for the Bank

would be greater if it issued its own securities as the cost would then be fully borne by the Bank.

11. Moving to a flexible inflation targeting would likely make monetary policy more effective although there were a number of factors to consider.

Summary of the presentation by Mr Suttyhudeo Tengur

12. APEC was of the view that the voice of consumers, pensioners and other fixed-income earners had been ignored by the MPC, which continued to maintain a low interest rate. The increase in y-o-y inflation since August 2013 indicated that inflationary pressures were building up in the economy. With the recent rise in the price of retail food on the local market, inflation expectations for both the short-term and long-term were also on the rise.

13. Bank credit to the private sector had grown much faster than the real economy could sustain. As a result, there was excess liquidity in the banking sector due to the multiplying effect of credit, which in turn led to credit supply exceeding demand. Since this was caused by the easing of the interest rate, there was a need to mop up the excess liquidity by tightening monetary policy.

14. Savings had fallen considerably over the last few years; the negative real interest rate was not conducive to savings. Private investment had also slowed down while government investment in public infrastructure was high. The biggest investment of the private sector had been in IRS/RES projects, which were sold at very high prices, thus allowing private companies to make huge profits.

15. The increasing imbalances in the financial sector and rising current account deficit suggested that interest rates should increase to discourage consumption and give sufficient incentive to save. A higher interest rate would also prevent speculative activities.

Summary of the presentation by Mr Jayen Chellum

ACIM recommended raising the KRR by 25 per cent for the following reasons:

16. The savings rate had diminished over the years and there was need to reverse the serious trend of savings rate losses. The fact that the savings rate was so low compared to the inflation rate was an important factor why many savers had moved their money from banks to ‘invest’ in dubious schemes outside banks. An increase in interest rates might encourage more people to save in banks. In addition, higher interest rates would attract more foreign direct investment.

17. Inflation was expected to be higher in 2014 and this should be tackled beforehand. Importers often mentioned the link between currency exchange rate and increase in import prices. Moreover, the potential risk of inflationary pressures was very high due to the excess liquidity situation. There was need for co-ordination between the central bank and the Ministry to mop up that excess liquidity. One solution would be to increase the KRR.

18. ACIM enquired from MPC members whether past decisions had had expected results in terms of growth rate, job creation and competitiveness gains.

19. ACIM recommended raising the KRR by 25 basis points. However, in view of high interest rate spreads and bank profitability, banks should maintain lending rates at their current levels.

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 2012, the MPC was reconstituted in March 2013. Members of the MPC comprise the Governor (Chairperson), the 2 Deputy Governors, 2 other persons appointed by the Prime Minister and 3 other persons, not being Directors or employees of the Bank, appointed by the Finance Minister.

When the MPC met on 3 February 2014, the last available data on national accounts, employment, external trade and the balance of payments were for 2013Q3. The last data available on CPI and inflation were for December 2013.

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.

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.

The Federal Open Market Committee of the US Federal Reserve system sets monetary policy in the US and oversees open market operations.

KRR refers to the Key Repo Rate.

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.

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

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