BANK OF MAURITIUS

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Minutes of the 25th Monetary Policy Committee Meeting
19 March 2012

The 25th meeting of the Monetary Policy Committee was held on 19 March 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 Pierre Dinan, Mr Rajkamal Taposeea and Mr Nishan Degnarain, External Members.

Also attended: Ms Silvana Tenreyro and Mr Alain Madelin, External Members, via teleconference.

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 24th MPC meeting held on 5 December 2011.

The International Economic Environment

1. Since the December 2011 MPC meeting, intervention by the European Central Bank and other measures taken by euro area governments to address the sovereign debt crisis had contributed to alleviate financial market stresses and improve funding conditions. Leading indicators pointed to a nascent recovery in the global economy although some vulnerabilities remained.

2. In its January 2012 World Economic Outlook Update, the IMF had downgraded its global growth projection by 0.7 percentage point to 3.3 per cent in 2012 and had lowered its forecasts for advanced, emerging and developing economies. Most recent institutional forecasts had, however, upgraded the global economic outlook in 2012, with JP Morgan revising its initial global growth forecast of 2.0 per cent to 2.2 per cent and IMF Managing Director stating *"the world economy has stepped back from the brink and we have cause to be more optimistic"*.

3. Latest economic data in the United States indicated that the economy was on a path of recovery. The economy had grown at an estimated annual pace of 3.0 per cent in 2011Q4 compared to 1.8 per cent in 2011Q3. The labour market had improved and ISM activity indicators suggested that the economy would continue on its upward trend.

4. The euro zone economy had contracted by 0.3 per cent q-o-q in 2011Q4, with muted output growth in France and a contraction in Germany. The region had recently shown signs of stabilisation. Leading indicators pointed to a modest contraction of activity in 2012Q1 as the evolution of the debt crisis continued to pose downside risks to the euro zone growth outlook.

5. The British economy had contracted by an estimated 0.2 per cent q-on-q in 2011Q4 as manufacturing and construction real activity was scaled back. The UK manufacturing and services PMIs slipped in February but were still consistent with a modest expansion in output in 2012Q1.

6. Growth in emerging economies had generally slowed in 2011Q4 although the underlying outlook had remained broadly positive. Leading economic indicators suggested that growth would continue to be weaker in the first quarter in most large emerging economies on soft external demand conditions but would pick up later during the year.

7. Global commodity prices had rebounded from levels reached in December 2011. The Food Price Index of the Food and Agriculture Organisation had increased on higher prices of oils, sugar, most cereals and meat while dairy prices were marginally lower. Crude oil prices had picked up in January and February 2012, supported by better-than-expected US economic data amid geopolitical tensions in the Middle East.

8. Inflation had eased in a number of trading partner-countries. Inflationary pressures had decreased slightly although upside risks from firming commodity prices were starting to build into the inflation outlook. A number of advanced and some emerging economies were maintaining accommodative monetary policies to support growth.

9. There was more optimism and confidence in financial markets following the coordinated efforts undertaken to address the sovereign debt crisis and the stronger data coming out from the United States. Sovereign yields had fallen while equities had rebounded from their recent lows and currencies had broadly stabilised within ranges.

Domestic Economic Developments

10. According to national accounts data released in December 2011, the domestic economy had expanded at a seasonally-adjusted q-o-q pace of 1.3 per cent in 2011Q3, up from 0.7 per cent in 2011Q2.

11. Over the year to 2011Q3, real output growth had decelerated to 3.7 per cent, from 4.4 per cent in 2011Q2, reflecting a slowdown in several key sectors of the economy. Output growth in **'manufacturing'** moderated to 1.6 per cent, with higher growth in *'other manufacturing'* offset by a slowdown in *'textile'* and a contraction in *'food'*. A slowdown in the growth of **'hotels and restaurants', 'transport, storage and communications'**, **'financial intermediation'** and **'agriculture'** was also noted. Real activity, however, remained buoyant in **'real estate, renting and business activities'** and picked up in the distributive trade sector while **'construction'** switched back to a positive growth rate. In 2011, growth was estimated at 4.0 per cent, as against an initial forecast of 4.1 per cent.

12. **'Final consumption expenditure'** growth had picked up to 2.6 per cent y-o-y in 2011Q3, reflecting higher growth in *'household consumption expenditure'* partly offset by an easing in *'general government consumption expenditure'* growth. Following three consecutive quarters of contraction, **'Gross domestic fixed capital formation'** grew by 0.2 per cent y-o-y in 2011Q3, reflecting a lower contraction of 1.1 per cent in *'building and construction work'* and a recovery to positive growth in *'machinery and equipment'*. Excluding *'aircraft and marine vessel'*, **'gross domestic fixed capital formation'** was estimated to have stagnated in 2011 as public sector investment growth of 0.6 per cent offset a contraction of 0.5 per cent in private sector investment.

13. Most recent available information showed that total exports *f.o.b* had declined by 3.2 per cent y-on-y in 2011Q4 while total imports *c.i.f* had risen by 7.9 per cent. For 2011 as a whole, total exports *f.o.b* had increased by 9.2 per cent while total imports *c.i.f* had increased by 9.8 per cent. The textile sector had shown a fair degree of resilience to the crisis so far, supported by market diversification efforts and full order books. In the tourism sector, tourist arrivals and tourist earnings had increased by 3.2 per cent and 8.6 per cent, respectively, in 2011. Tourist arrivals had contracted by 3.0 per cent y-on-y in January 2012, driven by declines in several key markets, but increased by 2.5 per cent y-on-y in February 2012.

14. Provisional estimates of the balance of payments for 2011Q4 indicated that the current account deficit had deteriorated to Rs11.2 billion, almost double the size of the deficit recorded in 2010Q4, largely as a result of a worsening merchandise trade deficit and lower surpluses on the **'income'** and **'current transfers'** accounts. However, the **'services'** account surplus was moderately higher than in 2010Q4.

15. In 2011Q4, **'direct investment'** recorded net inflows of Rs0.8 billion while **'portfolio investment'** posted net outflows of Rs0.2 billion. **'Other investment'** increased from Rs0.7 billion in 2010Q4 to Rs6.5 billion in 2011Q4.

16. The seasonally-adjusted unemployment rate had increased from 7.5 per cent in 2011Q2 to 8.1 per cent in 2011Q3.

17. Money and credit aggregates continued to register moderate growth rates. The annual growth rate of broad money liabilities had picked up to 5.2 per cent in January 2012, following several months of deceleration. The annual growth rate of credit to the private sector, which had slowed during 2011Q4, had increased to 12.7 per cent in January 2012.

18. The CPI was flat in February 2012 after it had increased by 1.5 index points in January 2012.

19. Headline inflation had eased steadily, from 6.6 per cent in November 2011 to 6.2 per cent in February 2012 while y-o-y inflation had declined from 7.0 per cent in November 2011 to 4.1 per cent in February 2012. **'Alcoholic beverages and tobacco'** (+1.6 percentage points) had been the largest contributor to y-o-y inflation followed by **'food and non-alcoholic beverages'** (+0.6 percentage point) and **'housing, water, electricity, gas and other fuels'** (+0.5 percentage point).

20. Core inflation measures had moderated by February 2012. Y-o-y CORE1 inflation had declined from 5.5 per cent in November 2011 to 3.8 per cent in December 2011 before edging up to 4.2 per cent in January 2012. It had thereafter fallen to 3.6 per cent in February 2012. Y-o-y CORE2 inflation had dropped from 4.1 per cent to 3.0 per cent in December 2011 but had stayed flat at 3.4 per cent in the first two months of 2012. On a 12-month average period, CORE1 and CORE2 had fallen continuously from 6.1 per cent and 4.9 per cent in November 2011 to 5.6 per cent and 4.5 per cent, respectively, in February 2012.

21. The Bank's *Inflation Expectations Survey* of February 2012 revealed that 68.1 per cent of respondents expected prices to go up over the next 12 months. Most respondents expected inflation to be within a range of 4.5-6.5 per cent over the forecast horizon, with the mean inflation rate one year ahead slightly up to 6.4 per cent.

Domestic Financial Markets Developments

22. Staff noted that domestic money market liquidity had remained adequate since the December 2011 MPC meeting. A net amount of Rs639.5 million of Government securities had been issued while the Bank had issued Rs500 million of Bank of Mauritius Bills in January 2012 as part of its open market operations.

23. The overnight weighted average interest rate on the interbank market had fluctuated between 2.00 per cent and 3.58 per cent since the last MPC meeting. 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 3.83 per cent, 4.06 per cent, 4.27 per cent and 4.37 per cent, respectively.

24. The weighted average rupee deposit rate and the weighted average interest rate on rupee advances had fallen between November 2011 and January 2012, reflecting the cut in the Key Repo Rate in December 2011. The real interest rate on savings deposits, using either the

headline or the y-o-y inflation rate, had improved slightly in January 2012 but still remained negative. In 2011, the saving rate had declined to 15.4 per cent of GDP.

25. Reflecting international currency movements and domestic market conditions, the dealt rupee exchange rate had appreciated against the US dollar, euro and Pound sterling. In nominal effective terms, the trade-weighted value of the domestic currency as measured both by MERI1 and MERI2 had appreciated marginally by 0.3 per cent between December 2011 and February 2012.

Staff Economic Outlook

26. Staff viewed that the domestic growth momentum remained positive although it had slowed. The output gap was assessed to be slightly negative, indicating some degree of spare capacity within the domestic economy. Going forward, signs of recovery in major trading partner-countries provided support to the domestic growth outlook. Unless downside risks from renewed strains in the eurozone sovereign debt markets materialised, staff projected that domestic GDP growth would decline to 3.8 per cent in 2012, from a previous estimate of around 4 per cent.

27. On a no-policy change basis, staff forecast headline inflation to decline to around 5.3 per cent by June 2012 while y-o-y inflation was projected to reach 4.8 per cent in June 2012 and 4.7 per cent by December 2012. Although underlying inflationary pressures had eased slightly, increasing global food and oil prices could represent an upside risk to the inflation outlook.

The Monetary Policy Decision

28. Members noted that downside risks to the global growth outlook were still important although fears of a global recession had receded. There were signs of stabilisation in the euro zone following the implementation of recent measures by European authorities to address the sovereign debt crisis and some of the largest countries within the area, such as Germany and France both of which are of export interest to Mauritius, were holding up well to the crisis. The US economic outlook was improving while emerging economies continued to record appreciable growth rates in spite of a slight slowdown in China and India. Global inflationary pressures had eased, providing central banks in most advanced and in some emerging economies the flexibility to pursue accommodative monetary policies, but risks to the global inflation outlook were skewed to the upside due to rising oil and commodity prices.

29. The domestic economy had been resilient to the euro area crisis so far although growth had slowed in some key export sectors. Members noted that business and consumer confidence had remained subdued and expressed concerns about the low pace of private investment growth and the possibility that public investment growth might be constrained by implementation capacity. Looking further ahead, while some uncertainty remained, the domestic growth outlook was expected to be positively affected by the improving underlying fundamentals in the global

economy and a brighter outlook for the euro zone than at the December 2011 MPC meeting. The domestic growth momentum was thus expected to slow a little before the signs of recovery in target markets began to change the outlook for exports. Some members were, however, of the view that continuing uncertainty in the global economy called for prudence. The Committee noted that the January 2012 IMF Article IV Consultation mission had commented favourably on the monetary policy stance and macroeconomic policy-making in the country. In the same vein, Moody's had placed Mauritius on positive watch for a possible upgrade.

30. The MPC took note of labour market developments and discussed the employment outlook. Opinions differed on the relevance of monetary policy in solving the structural and micro-level problems in the labour market. Some members were concerned about the possibility of a sharp deterioration in the labour market and were of the view that co-ordinated efforts could help in preventing job losses in the short-run. Others in the Committee assessed the unemployment situation as largely structural, with a lack of skilled labour in certain segments of the market, and highlighted the need for productivity increases and other adjustments to take place in the real economy to remain globally competitive.

31. Members were of the view that external inflation pressures had declined slightly. With regard to domestic developments, although both measures of core inflation were lower between November 2011 and February 2012, the absence of a clear-cut trend, especially for CORE2, might point to some underlying inflationary pressures. The output gap, which had remained negative but close to zero for most of 2011, indicated that while some economic slack had persisted, the domestic economy had been growing close to its trend rate. The moderate pace of growth in broad money liabilities and claims on the private sector had suggested mild inflation pressures from monetary developments. The course of domestic inflation in the near to medium term was, however, likely to be significantly affected by the renewed strength in commodity prices, particularly oil.

32. The Committee weighed the risks to the growth and inflation outlook over the policy-relevant horizon and discussed alternative interest rate scenarios. The global backdrop had reduced the risks to the domestic growth outlook although they remained skewed to the downside. Inflation pressures had receded but the Committee acknowledged increased upside risks to the inflation outlook from rising commodity prices. Some in the Committee considered it important to continue to anchor inflation expectations and minimise the risk of second-round effects. They also underlined the need to achieve a positive real rate of interest to boost savings in the current environment. Other members were, however, less concerned with inflation risks, placing more emphasis on the downside risks to growth. The view was forcefully expressed that many aspects of inflation were controllable through administered prices and the annual wage-setting process, which were both important drivers of domestic inflation.

33. The Committee concurred that a cut in the Key Repo Rate was warranted. Opinion was, however, divided with regard to the magnitude of the decrease. A majority on the Committee

viewed that the downside risks to the domestic growth outlook still significantly outweighed the upside risks to inflation. The remaining members were of the opinion that, while the risks to the domestic growth outlook were still important, the upside risks to the inflation outlook had increased and could start posing a threat to price stability, given that inflation was still at an elevated level relative to partner countries.

Voting Pattern

34. At the conclusion of the discussion, after a second round of voting, the Committee voted with a majority of 5-4 to cut the Key Repo Rate by 50 basis points to 4.90 per cent per annum. The four members initially voted to cut the Key Repo Rate within a range of 15-25 basis points but, after a second round of voting, voted to cut the Rate by 25 basis points, arguing that a cut of 25 basis points was the maximum that could be prudently envisaged at this juncture.

35. 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.

36. The meeting adjourned at 17.23 hours. The next MPC meeting is scheduled on Monday 11 June 2012.

37. **Voting for the MPC action:** Mr Nishan Degnarain, Mr Pierre Dinan, Mr Alain Madelin, Mr Rajkamal Taposeea and Ms Silvana Tenreyro.

38. **Voting against the MPC action:** Mr Rundheersing Bheenick, Mr Yandraduth Googoolye, Mr Mohammed Iqbal Belath and Mr Jitendra Nathsingh Bissessur.

Bank of Mauritius
2 April 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 19 March 2012, the last data available on national accounts and employment were for 2011Q3 while the last data on external trade and the balance of payments were for 2011Q4. The last data on CPI and inflation were for February 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.

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.

ISM activity indicators are manufacturing survey data collected in the United States by the Institute for Supply Management.

PMI refers to the Purchasing Managers' Index of financial activity, reflecting purchasing managers' acquisition of goods and services.

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

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