Rundheersing Bheenick: Latest decisions by Mauritius's Monetary Policy Committee

Remarks by Mr Rundheersing Bheenick, Governor of the Bank of Mauritius, at the post-MPC Press Conference, held at the Bank, Port Louis, 14 June 2011.

(English version of the creole transcript)

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Ladies and gentlemen from the Press, I extend a very warm welcome to you all. I have invited you here this morning to comment on the decision taken by the Monetary Policy Committee (MPC) yesterday. I will also answer your questions. As usual, I have by my side my two fellow deputy Governors, who are also members of the MPC, and you may set your questions directly to them if you wish.

It would be good to place the final decision of the MPC in its proper context. The context brings us to the end of last year, when, at the meeting of September 2010, the MPC had decided unanimously to lower the Key Repo Rate by 100 basis points because the Mauritian economy was showing signs of slowing down and business sentiment was gloomy.

It would be good also to take stock of what other central banks were doing at the time. Indeed, there were no central banks lowering their policy rate, much less by 100 basis points. We were going against the tide, because we believed that the Mauritian economy was then in need of a lifeline. So we went for a very drastic cut of 100 basis points. It was a calculated risk. It was clear that after taking such a risk, the MPC would soon have to take things back in hand. And that is precisely what the MPC did after a period of six months – remember we had said we would leave the conditions unchanged in the market during that period.

As from the month of March 2011, we began a process called normalisation of interest rates. Normalisation means that the interest rate must be positive in real terms, beyond the expected inflation rate – this is what we call, in technical terms, to stay ahead of the curve. When we raised the rate by 50 basis points in March, we emphasized that the interest rate had to be normalised. The message was clear: firstly, this increase of 50 basis points, and secondly, the normalisation process would continue.

At the last meeting, the MPC considered the state of the Mauritian economy and, at the same time, reviewed global economic conditions. There are some encouraging trends at the local level, but also some potential source of concern that could increase downside risks in future – we will be coming back to these later. At the same time, there are signs of *overheating* on the domestic front, so that there is a school of thought that says we should leave the rate unchanged, keeping the monetary policy stance on hold, until the clouds, that threaten some economies at the global level, dissipate.

Unfortunately, inflationary pressures have persisted. For the month of April, for example, the *year-on-year* inflation showed a small decline, barely measurable, from 7.2 percent to7.0 percent. It was too early to say that it was a reversal of trend. Eventually, when the May figures were released, the *year-on-year* inflation rose to 7.1 percent, no longer showing a downward trend. In other words, inflationary pressures still persist, despite the hike in interest rate of 50 basis points at the MPC meeting in March 2011. At the same time, if we look at other measures of inflation, that is to say, the *Core 1* and *Core 2* inflation, also based on the *year-on-year* methodology, they confirm that the underlying inflationary pressures still persist. This is an indication that we must continue to tighten our approach to monetary policy and this is what we have done on the domestic front. If inflationary pressures do not abate, we intend to continue on the same track in order to get ahead of the curve. In other words, the normalisation process will continue.

There are some who believe that the economy is rapidly slowing down and the balance of payments is a major source of concern. They also point out that FDI flows fell significantly in the first quarter of 2011, and unemployment rose slightly from 7.3 to 7.8 percent last year. According to them, these are factors that should be considered to maintain the *status quo,* that is, no increase in the Key Repo Rate. But our reading is a little different – we believe that the performance of the Mauritian economy is fairly good. Earlier this year, we thought that growth would be around 4.4 percent. Presently, the growth forecast of the Central Statistics Office is 4.5 percent, and since March, we at the Central Bank, had forecasted that growth would be 4.6 percent. Now we have every reason to believe that it could be above 4.6 percent.

Let me explain: growth of exports in our main sectors, whether textiles, seafood and tourism, is buoyant. The order books are full for the textile sector. Since our competitors have higher levels of inflation, for example in China, we believe that prospects are improving for our exporters. Our export revenues reached a record level of 15.2 billion rupees in the first quarter of 2011 (quarter on quarter) compared to the last five years. Tourist arrivals for the first quarter are also a record. We believe that the current estimate of tourist arrivals for the year, which is around 980,000, may in fact surpass the onemillion mark. There are unprecedented levels of growth to date, 25 percent in one case and 40 percent in others. Of course, these growth rates are for smaller markets, not for major ones, but they show that the diversification efforts and promotional campaigns, conducted by the MTPA and others, are beginning to bear fruit. There are constraints such as air access, and if these constraints are reviewed and corrected, there is no reason why we may not exceed the figure of one million tourist arrivals. So, the tourism sector is doing very well. But we need to focus on target markets; there are traditional markets, two or three markets that are in bad shape. The English Market and the Italian market are on the decline, so is the Belgian market. Europe is losing ground in some areas.

Let me come back for a moment on what is happening locally before proceeding to the international front. I was saying that FDI flows had fallen very drastically. If we take the figures for the first quarter of 2011, they represent about 25 percent of the FDI flows we had received during the first quarter of 2010. As you are all aware, we depend mainly on these flows for our balance of payments equilibrium. Our balance of payments, in terms of visible trade, is in deficit. We make up for this deficit by the revenues from services and FDI flows and by draw downs from foreign currency loans by Government. If the trends we observed in the FDI flows do not reverse, we may have problems further down the line. These problems may affect our economic fundamentals drastically and could even affect the value of the rupee. We believe this is a concern not only for the Central Bank, but also for the country, and a signal to authorities concerned to redouble their efforts to continue to attract more FDI flows, which would enable us to continue on our path to development, in the same way as we have done so far. We hope that this decline is one-off and will be corrected rapidly. Anyway, a single quarter is not enough to make forecasts. And we have reasons to believe that the figure of 16 billion rupees, which the Board of Investment has estimated as FDI flows for 2011, could be achieved; otherwise we could face difficulties later.

The third point is the issue of employment. If we make a very brief reading of the situation in terms of employment, we find that the unemployment rate has increased during the first quarter. Normally during the first two quarters of the year, the unemployment rate increases on account of seasonal factors. But in general, the rate of unemployment is not a concern, since the climate at the global level itself is not conducive to job creation. So, if in Mauritius, we have an unemployment rate which is just under 8 percent, there are countries where unemployment exceeds 15 percent and could even reach 20 percent. Given a crisis situation, we do not believe that we would encounter major problems with unemployment in macroeconomic terms. However, in microeconomic terms, we have a problem. There is a mismatch between the demand for jobs and job creation. Nevertheless, in 2010, there have been 11,300 jobs created, notwithstanding the employment of foreigners. We believe that this year, about 9,500 jobs will be created, including 500 jobs for foreigners. Job creation will therefore continue in Mauritius. But we must renew our efforts in re-skilling, in view of creating jobs in sectors that are growing, rather than in areas where people usually seek employment, like the civil service. The outlook is more interesting in the ICT and BPO sectors, for instance. So unemployment is not an immediate issue, but it is not the case for inflation. After a review of the situation on the domestic front, the MPC chose to rather focus on control of inflation than on fears over growth.

Let us now move to the international scene. As you know, the crisis is still here. There are some major economies, very important to us, which are in very bad shape, especially the US market. The end of the QE2 could create more volatility for the dollar and we still do not know what will happen after that. So we must exercise great vigilance in relation to the value of our rupee which could appreciate on the back of a weakening dollar. The problems confronting the euro area still persist. China is having problems with inflation, and it is currently having recourse to outsourcing to Vietnam and Cambodia. So, internationally, there are major concerns. Despite this, the general view is that during the second quarter, the situation will improve and there will be recovery at the global level.

There are concerns over food and commodity prices, as well as energy prices. You are probably aware that at the last OPEC meeting, no consensus was reached to increase production. And if demand in the global economy is too high and oil production does not increase, it may result in a hike in oil prices. The good thing is that Saudi Arabia has indicated its intention to continue to increase production unilaterally. If the global recovery for the second quarter is much stronger than the first quarter, there is a risk that food and commodity prices start going up again – we must be prepared for a further increase in food and commodity prices. A positive note was that, when the FAO index rose, there was no corresponding increase in the prices of the foodstuffs that Mauritians tend to consume, namely, dairy products, cereals and rice. But if there is recovery, there is a risk that food and commodity prices and oil prices might go up again – which will represent a new source of inflation for us.

This brings us to the need of exercising control over rising prices in Mauritius – we welcome Government's initiative to set up *L'Observatoire des Prix*. This is an excellent initiative indeed. But *L'Observatoire des Prix* alone will not solve the problem of rising prices. It is a tool among many others, just like monetary policy is a tool among many others. In the case of *L'Observatoire des Prix*, it must be supported by greater efforts geared towards making changes in the consumption pattern of people and those that determine prices, in other words, changes in consumer behaviour and price-setting behaviour. The two must go together, otherwise *L'Observatoire des Prix* would not contribute towards keeping inflation at reasonable rates. We hope that *L'Association des Consommateurs* and other efforts in the field of financial education would lead to changes in consumption patterns through better informed consumers.

Some people have expressed concern that there might be in Mauritius what is called stagflation. Stagflation had made the headlines in the late 60s, early 70s, to describe the problem which the British economy was facing at that time. We are very far from this situation – we have a high growth rate, not far from our trend growth rate. Firstly, a feature of stagflation is that the economy should be stagnating. Growth of 4.6 percent is not at all what we could call a stagnant economy. Secondly, there must be a high rate of inflation, perhaps double-digit inflation, if not an inflationary trend that points to double digits. Our inflation rate, depending on which measure you are using, is 4.8 percent (*CPI* measure), or 7.1 percent (measured *year-on-year*) for the last month. It is true that the trend is upward, but unfortunately for the proponents of stagflation and fortunately for us, inflation is far from a double-digit inflation. Inflation expectations are well-anchored. Our last *Inflation Expectations Survey* brought it out very well – there is a majority of people who believe that inflation will remain within the range of 5 to 8 percent. 5 to 8 percent inflation is not what one would expect in an environment of stagflation. The last element of stagflation is that there is no job creation, and rising unemployment. In Mauritius, there is job creation – more than 9,500 jobs including 500 jobs for foreigners will be created in 2011. Therefore forget about the notion of stagflation in Mauritius! Our economy is quite buoyant; we are optimistic that we will go beyond the 4.6 percent growth. That is why we opted to continue the normalisation process so that inflation does not come to play the spoilsport.

Some additional points: The Monetary Policy Challenge (*MP Challenge*). We will be launching our fifth edition of *MP Challenge* at the end of the month, and we hope there will be more participation this year. As you know, the *MP Challenge* is an invitation to college students and young academics to form a team to simulate the process of "monetary policy making" in Mauritius. And we set up a separate panel to evaluate entries. In this context, we have recourse to the University of Mauritius or the University of Technology. We are part of the panel, of course, but we trust the representatives of the universities to evaluate the entries. We hope there will be a good response – last year there were 23 participants, we hope that this year there will be still more.

My Second Deputy Governor mentioned earlier about business sentiment. It is good to point out that there have been very positive feedbacks from the *Business Sentiment Surveys* conducted by the Mauritius Chamber of Commerce and Industry. We hope that by the end of the year, the Bank of Mauritius will be able to launch a *Business Sentiment Survey*, targeting a sample of respondents slightly different from that targeted by the Mauritius Chamber of Commerce and Industry, which primarily targets its own members.

We hope to launch this survey before the end of the year since we have had good results from the *Inflation Expectations Surveys*. These surveys have been successful and we believe we can expand the range of surveys that we have in Mauritius.

Another very positive point I want to make is on productivity in general and specifically, on capital productivity, which has consistently increased last year compared to the previous year. This partly reflects the investments made by our enterprises in previous years to enhance their level of technology. We have concerns about the decline in public investment, the GDFCF. We are still more concerned about the even more substantial decline in private sector investment. We hope that measures will be taken to reverse this downward trend. We hope firstly that there will be an increase in the GDFCF and that secondly its composition will favour private sector investment. The prospects are not good in private sector investment, most of which, excluding purchases of aircraft and ship, consists of construction projects, IRS projects and hotel projects that are now completed. Several other projects in the IRS are still pending and are unlikely to find financing. So investment is a source of concern.

What about the savings side? The reduction in the gap between inflation and savings rates charged by banks has resulted in an increase in the level of savings in Mauritius. It was a source of great concern to us when two years ago, we had raised this issue. At that time, the level of savings had reached around 12 percent, now it exceeds 16 percent. It's a good trend; we hope that, with this increase in interest rate, which should be reflected in the savings deposit rate charged by banks, investors will be even more encouraged.

And to help you compare Mauritius with other countries, we will circulate two tables – one to highlight the rate of inflation in countries that are relevant to Mauritius or in comparable countries. From the table, you will see that there are only three countries that have a higher inflation rate than Mauritius, namely India, Indonesia and Romania. All other countries have an inflation rate lower than that of Mauritius. A big effort is required to bring back our inflation rate in the ranks. A continuous effort should be considered by everyone to control all sources of inflation. The second table that we will circulate will show that the monetary policy stance of the Bank of Mauritius is not different from that of other central banks. The table will show you what other central banks have been doing in recent months in terms of monetary policy and interest rates. These two tables will allow you to situate Mauritius vis-à-vis other countries, as it is important to gauge the differential between us and other countries.