Harvesh Seegolam: Current economic conditions and outlook

Statement by Mr Harvesh Seegolam, Governor of the Bank of Mauritius, at the post Monetary Policy Committee (MPC) press briefing, Port Louis, 28 November 2023.

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Ladies and gentlemen, members of the media, good afternoon.

Welcome to this press briefing for the third Monetary Policy Committee (MPC) meeting of the year, marking the 69th sitting of this Committee.

As you may recall, at the two previous MPC meetings held during the year, we emphasised on the need to allow some time for our new Monetary Policy Framework to become entrenched into the operational aspects of the banking sector and financial market operators.

The Bank continues to monitor progress made by market players in embracing the new framework, while taking note of the challenges identified and adjustments needed, if any. The Bank is cognizant of the need to continuously review the framework so that it suits the requirements of our evolving economic environment.

In this respect, the Bank is following up on its overhauling process of the monetary policy framework and is engaging in extensive consultations with reputed central banks and other international organisations. This rightly underscores our aspiration to align our monetary policy framework with the best practices in other central banks and monetary authorities.

Let us now zero-in on the topic of the day.

At its meeting today, the MPC discussed lengthily domestic economic prospects, whilst considering the latest developments taking place on the international front.

I shall now elaborate on the essence of those elements covered extensively in the MPC policy deliberations.

International Economic Developments

The global economy remains resilient and continues to recover despite divergences noted across regions and sectors. The IMF, in its World Economic Outlook of October 2023, projects growth at 3.0 per cent for 2023, unchanged from the last projection made in July 2023, and higher by 0.2 percentage point compared to its April 2023 projection of 2.8 per cent. The US economy showed signs of improvement in 2023Q3 supported by robust consumer spending amid a strong labour market, while continued sluggishness was observed in the euro area and in the UK. The Chinese economy is still facing the effects of the downturn in its property sector, while India is well poised as one of the fastest growing economies.

Purchasing Managers' Indices (PMIs), key leading indicators of economic activity, pointed towards continued expansion in 2023Q3, albeit a lower growth in global services and a downturn in global manufacturing were noted. The lower growth in global services could be attributed to a contraction in the level of new order intakes and falling backlogs of work notably in the US as well as in Europe.

Headline inflation continues to decline mostly due to the normalisation of food prices and easing supply chain conditions. Core inflation is also declining at a much slower pace as a result of the tight labour market conditions and stickier services inflation across many countries. The IMF, in its World Economic Outlook of October 2023, projects global core inflation to decline gradually from 6.4 per cent in 2022 to 6.3 and 5.3 per cent in 2023 and 2024, respectively.

Crude oil prices declined in October after maintaining an uptrend in 2023Q3. Production cuts from the OPEC kept upward price pressures on crude oil, while geopolitical conflicts in the Middle-East portend to potential supply disruptions. On the other hand, global food prices maintained their declining trend on higher supplies and strong competition among exporting countries, as well as subdued global import demand. The Freightos Baltic Index, which measures global container freight rates worldwide and used as a bellwether for shipping costs, declined at a slower pace in 2023Q3.

There are increased expectations that the rate tightening cycle might be over in certain countries and is nearing so in others, while inflation is on the decline. The vast majority of central banks have so far opted to leave their monetary policy stance unchanged amidst lower inflationary pressures. Since the beginning of the year, out of 481 MPC decisions globally, 263 decisions (representing roughly 55 per cent) have been to leave policy rates unchanged. We see evidence that this proclivity to keep the status quo has become more entrenched as we navigate into the third quarter of 2023 with 77 decisions out of 137 (representing 56 per cent) representing unchanged policy rate decisions. Since the last MPC meeting held on 15 September 2023, 67 out of 101 global policy rate decisions (representing 66 per cent) related to keeping monetary policy unchanged.

In advanced economies, major central banks have opted for 'high for longer' stance as dis-inflation strategy by keeping their policy rates unchanged at their respective monetary policy meetings and stated that they would continue to assess their macroeconomic situation and undertake a careful re-balancing of risks to their outlooks before deliberating on whether to adjust their respective monetary policy stance in forthcoming meetings.

Domestic Economic Developments

The domestic economy remained on a steady growth path in 2023Q2, following robust performances in 2022Q4 and 2023Q1. The economy expanded by 6.0 per cent in 2023Q2, up from 5.8 per cent in 2023Q1. Economic activity continues to showcase signs of resilience, with the 'Accommodation and food service activities', 'Construction' and 'Transport and storage' sectors being the locomotives of growth amidst the strong momentum in tourist arrivals and ongoing major infrastructural projects.

The tourism sector, being one of the key pillars of the domestic economy, heralds encouraging performance for the year, underpinned by continued strong demand for the Mauritian destination. Around 1,026,700 tourists visited the island from January to

October 2023, representing 93.1 per cent of the 2019 level, and almost 45 per cent higher compared to the same period of 2022. In line with the resurgence in tourist arrivals, tourism earnings were also buoyant, aggregating Rs60,798 million during the period January to September 2023, higher by 46 per cent compared to the corresponding period of 2022 and well above the 2019 level. We project tourism earnings at Rs85.0 billion for 2023, significantly higher than the 2022 level of Rs64.8 billion. Going forward, the tourism sector is expected to maintain its momentum, benefitting from pent-up demand for holiday travel, increased flight connectivity and diversification of markets.

Labour market conditions remained robust in 2023Q2. The unemployment rate maintained its gradual decline and dropped to 6.4 per cent in 2023Q2. The female unemployment rate has increased slightly, standing at 9.1 per cent in 2023Q2, while youth unemployment rate declined to 18.1 per cent – the lowest reading since 2010. Labour market conditions are expected to improve further as the domestic economy sustains its growth momentum.

The current account deficit as a ratio to GDP declined to 11.5 per cent for 2022, from 13.1 per cent registered in 2021. The improvement largely reflected the considerably better performance of the services account. The improvement in the current account persisted during January to September 2023, with 2023Q1 registering a deficit of only 2.9 per cent of GDP, the lowest since 2018Q1.

The current account deficit is projected to narrow significantly to reach 5.6 per cent of GDP in 2023 on account of continued healthy performance of the tourism sector as well as larger surplus on the primary income account, which is expected to benefit from the elevated global interest rates and continued growth in residents net foreign assets.

Gross Tourism earnings continue to surge, with the period January to September 2023 registering Rs60.8 billion, rising by 46.1 per cent compared to Rs41.6 billion during the corresponding period a year ago. Moreover, for the fiscal year 2022-23 gross tourism earnings reached a record high of Rs81.3 billion compared to Rs39.6 billion in the previous fiscal year.

The Mauritius IFC continues to attract robust financial flows as global cross-border investment activities remain resilient despite challenging global conditions brought about by the lingering Russia-Ukraine war and heightened tensions in the Middle East. With respect to the non-GBC financial flows, the country recorded a 34.0 per cent increase in gross foreign direct investment (FDI) flows to the tune of Rs13.5 billion in 2023H1, led primarily by the 'real estate' and 'food and accommodation' sectors, reflecting positive dynamics and buoyant investor sentiment in these sectors.

The Gross Official International Reserves (GOIR) position continues to remain at a comfortable level, providing adequate buffer against external shocks. The GOIR stood at US$6.7 billion as at end-October 2023, representing 10.0 months of import cover.

Inflation

Inflation in Mauritius eased further in October 2023 supported by the normalisation of global supply chains and easing of global commodity prices. Headline inflation remained on a downward trajectory and moved from double digit reading of 10.0 per cent in July 2023 to 8.4 per cent in October 2023. The year-on-year inflation maintained its downward trend from 5.9 per cent in July 2023 to 4.6 per cent in October 2023.

Underlying inflationary pressures, as gauged by Core inflation measures, also moderated in 2023Q3, reflecting to some extent the dissipation of the second-round effects of the supply shocks witnessed earlier. On a 12-month average basis, CORE1 inflation subsided from 8.0 per cent in July 2023 to 6.3 per cent in October 2023, while CORE2 inflation retreated from 6.7 per cent in July 2023 to 5.8 per cent in October 2023.

Analysis of the price dynamics of items that constitute the CPI basket were encouraging as items in the CPI basket that were viewed as 'highly inflationary', i.e. generating above target range inflation of more than 5 per cent, have dropped from around 68.1 per cent in March 2023 to around 46.3 per cent of the CPI basket in October 2023. In contrast, items that were 'deflationary', i.e. having less than 0 per cent inflation, have increased from 5.1 per cent to 13.7 per cent over the same period.

With y-o-y inflation already below 5 per cent, inflationary dynamics provides concrete signs that headline inflation is gradually converging towards the Bank's target range for inflation.

Money Market

The Bank continues to conduct open market operations in line with the new Monetary Policy Framework implemented since the beginning of the year. The main tool for monetary policy operations, namely the 7-Day BoM Bills, are issued at the Key Rate of 4.50 per cent, while banks avail of the Overnight Deposits Facility at their discretion.

Since the last MPC, weekly issuance of 7-Day BoM Bills averaged Rs1.8 billion, and Overnight Deposit Facility placed with the Bank averaged Rs24.1 billion. As part of longer-term operations, the Bank also issued BoM Bills for an aggregate amount of Rs24 billion in the 91-Day, 182-Day and 364-Day tenors between 15 September and 15 November 2023.

In order to mop up the structural excess liquidity from the banking system, the Bank issued Two-Year BoM Notes for a total amount of Rs12.2 billion up to mid-October 2023.

These operations by the Bank have resulted in a significant decline in rupee excess liquidity to a daily average of Rs3.4 billion over the period 15 September to 15 November 2023. The Bank has also mopped up an amount of Rs7.8 billion through foreign exchange interventions since the previous MPC meeting.

The level of outstanding BOM instruments issued to manage excess liquidity dropped to Rs128.1 billion as at 17 November 2023, with a major proportion of 53 per cent maturing within one year, as compared to Rs140.5 billion as at 15 September 2023.

The new operating target, the overnight interbank rate, hovered between 3.10 per cent and 3.35 per cent over the period 15 September to 15 November, which is close to the lower bound of the interest rate corridor of the new MP framework.

Foreign Exchange Market

The recovery of the domestic FX market remained encouraging in 2023. Over the period 15 September to 17 November 2023, total turnover stood at USD2.0 billion, constituting an increase of 8 per cent relative to USD1.8 billion registered in the corresponding period of 2022.

Since the beginning of September 2023, the Bank has resumed its regular FX interventions to ensure adequate supply of FX on the market in view of end-of-year stock building by importers. An aggregate amount of USD225 million was sold to banks between 06 September and 15 November 2023. Since the beginning of the year, the Bank has sold a total amount of USD310 million.

In my last MPC press statement, I had mentioned that the Bank has enough firepower to intervene in the FX market to address any shortfalls. Let me reassure the market that this continues to be the case. In parallel, we are pursuing efforts to monitor and detect any case of exchange rate manipulations or deviations from best market practices among FX participants. We want to ensure that our exchange rate is immune from manipulative practices and that it continues to reflect our economic fundamentals as well as domestic and international market conditions. Since 15 September 2023, the rupee has appreciated by 1.6 per cent against the US dollar and this confirms what I averred to in my last MPC statement that the appreciation will continue as conditions in the FX market normalize.

Financial Stability

I will now give an overview of the key developments in respect of the stability of the banking and financial system.

But first I will start with a few highlights on the stability of the global financial system. In its October 2023 Global Financial Stability Report, the IMF underscored the importance of both price and financial stability to support sustainable economic growth. The prompt response of central banks worldwide and in Mauritius has successfully set inflation on a downward trajectory. However, interest rates may need to stay higher for longer in many economies – advanced and emerging economies alike – to bring down inflation to the desired level. Despite high interest rates, there is optimism about a soft landing of the global economy, thus avoiding an acute recession and extreme financial markets volatility.

High interest rates obviously require close monitoring and complementary measures to uphold the stability of the banking and financial system. The Bank continuously monitors risks to financial stability as part of its core functions and has been upgrading its toolkits to make better assessments, including its stress testing framework and its Systemic Risk Indicator.

The sustained progression of the domestic economy has undeniably helped to contain risks in the macrofinancial environment. In particular, the systemic risk landscape has been positively influenced by improving economic conditions, financial market dynamics, robust banking sector performance and a deceleration in household credit growth. The Systemic Risk Indicator has, on average, fallen in the first three quarters of 2023 relative to 2022.

The household and corporate sectors have demonstrated remarkable resilience even though interest rates went up by a cumulative 265 basis points since the beginning of 2022. The current monetary policy stance together with receding inflation and strong economic dynamism have alleviated financial stability concerns from both sectors. Debt servicing costs have stabilised while corporate earnings have continued to grow with strong economic momentum.

The evolution of macroprudential metrics indicates subsiding risk from the household sector. Further progress was observed in key debt servicing metrics – such as the household debt service cost-to-income and the household debt-to-GDP metrics. These metrics remain close to pre-pandemic levels. The asset quality of the household sector was sustained at around 1.9 per cent in September 2023.

The targeted measures by banks and the fiscal authority have been providing some relief to the hard-pressed segment of the household sector. Debt restructuring by banks has eased the financial burden of vulnerable borrowers. The total value of restructured loans rose to Rs52.5 billion in June 2023, up by 2.9 per cent from March 2023. Nonetheless, the quality of restructured loans has improved, signifying lower overall credit risk.

The corporate sector continued to thrive. Falling corporate indebtedness relative to GDP coupled with growing earnings have reduced financial stability risk from the sector. The asset quality of the corporate sector in the banking system stayed broadly sound.

The economy continued to be supported by bank credit flows. Credit to the private sector expanded at an annual rate of 6.5 per cent in September 2023, compared to 7.5 per cent in July 2023. Demand for household credit was the main driver of bank credit, growing by 11.8 per cent in September 2023 relative to 12.2 per cent in July 2023. Housing loan growth decelerated, rising at an annual rate of 12.8 per cent in September 2023 from 18.4 per cent in June 2023. Corporate credit rose by 2.8 per cent in September 2023, compared to 4.4 per cent in July 2023, suggesting that growing earnings was supporting the funding requirements of the corporate sector.

The credit portfolio of the banking sector remained sound. The NPL ratio of the banking sector was estimated at 4.7 per cent in September 2023, up from 4.6 per cent in June 2023. The NPL coverage ratio stood at 53.2 per cent in September 2023.

Banks maintained ample capital and liquidity buffers. The aggregate Capital Adequacy Ratio (CAR) was at 20.3 per cent in September 2023, well above the minimum regulatory requirement. The Liquidity Coverage Ratio (LCR) of the banking sector also stood above the regulatory floor of 100 per cent, with aggregated LCR at 278.9 per cent in September 2023 while the LCR for material foreign currencies was 213.1 per cent.

The Bank's stress test results showed continued resilience of the banking sector, based on its upgraded framework. The new stress testing framework includes forward-looking elements and new modules to cater for evolving macrofinancial conditions. As the domestic economy expands further, banks are expected to consolidate their buffers to absorb potential shocks.

The Bank continues to monitor risks to the stability of the financial system, while focussing on its price stability mandate.

Mauritius Investment Corporation (MIC)

Before I come to the MPC decision, let me quickly underscore the pivotal role played so far by the Mauritius Investment Corporation (MIC) in our economy.

As you may be aware, the MIC has played a key role in assisting systemic corporates in their recovery process post-COVID, thereby safeguarding the safety, soundness and stability of the financial system of Mauritius. It has also played an important part in the Bank's investment strategy and in diversifying the Bank's portfolio. I am pleased to enlighten you that the entity has performed well during the financial year 2022-2023.

From inception to 30 June 2023, MIC's Assets Under Management (AUM) increased to reach nearly MUR 83 billion. Investments undertaken by MIC have generated value and benefitted the economy.

As you would recall, I mentioned in May 2020 that the MIC would be a strategic tool to generate value for future generations. We expect profits from operations to continue to increase.

Going forward, the ongoing recovery in economic activity, both globally and domestically, can only be expected to solidify the performance of the MIC and improve its performance. This will, by ricochet, strengthen the Bank's financial performance and endow it with further ammunition to conduct its monetary policy operations effectively.

MPC Decision

I now come to the decision of the MPC.

The MPC thoroughly reviewed developments taking place at the global and domestic level, and deliberated on their implications on domestic growth and inflation trajectories for 2024.

The MPC took note of the steady decline in the different measures of inflation, which indicates that the process of dis-inflating the economy back to our targeted inflation range is well on track. Headline inflation is now projected to close 2023 at around 7.0 per cent and reach 4.0 per cent by end-2024, barring any shocks. A mix of domestic and international factors are expected to contribute to downward pressures on inflation. The normalisation in global food and energy prices and the reduction in freight costs are expected to restrain import price pressures. The lingering effects of past policy rate hikes are helping in keeping core inflation from gaining traction and anchoring inflation expectations.

The toolkits that we deploy to gauge short-term dynamics, which comprise an assortment of High-frequency indicators, nowcasting and near-term forecasting tools, all provide encouraging signs that the robust strength in domestic economic activity, is likely to persist for the remainder of 2023 and throughout 2024. As a result, the Bank projects real GDP growth to remain firmly entrenched at above 7.0 per cent in 2023.

The growth momentum is expected to be underpinned by broad-based expansions across the main engines of economic activity, notably 'Accommodation and food service activities', 'Construction' and 'Financial services' sectors. It is worth mentioning that tourist arrivals are expected to revert to pre-pandemic levels in 2024, and would greatly support the momentum in other related sectors. 'Construction' will be a key contributor to growth as well, with important infrastructure development projects going into full swing. Firmer growth performance is expected for 'Financial and insurance activities', on account of proactive efforts by relevant authorities to consolidate the status of Mauritius as an IFC of international repute and of substance on a wide assortment of areas including AML-CFT, Fintech, digitalization, and cyber-security.

Renewed optimism in aggregate demand indicators is expected to support domestic activity, with solid growth in consumption, investment and net exports. Household consumption spending will improve as inflation dynamics enable a swift recovery in real wages, alongside policy support by Government. Progress in major development projects is expected to drive the robust expansion in investment spending, going forward.

The MPC took note that the strong growth performance that spans across a wide spectrum of sectoral activities, is occurring against a backdrop of declining inflation. Both outcomes are encouraging and reflect the fact that the macroeconomic stance and direction in which we are firmly embarked on, is the correct one. Here, I would like to emphasise the role the MPC had played during 2022 by raising the policy rate by a cumulative 265 basis points and which has now started to bear dividends.

However, the MPC acknowledged that both the growth and inflation outlooks, while strong, are susceptible to adverse risk factors stemming from abroad and over which we have absolutely no control, that could derail these trajectories and worsen policy trade-offs. The Committee examined several hypothetical case scenarios and carefully balanced out risks to the inflation and growth outlooks under each. Severe downside risk scenarios hypothesizing a set of tail-risk events influencing the external sector were also duly considered.

Based on a cost-benefit welfare-centric exercise, the Committee deliberated that we should continue to allow time for the effects of past rate hikes to work through the economy so that medium-term inflationary expectations are not dislodged. This is crucial to assess the ongoing success of our dis-inflation efforts and will ensure that projected inflation is well saddled on a downward trajectory and be in conformity with our inflation target range by 2024. As a result, the MPC unanimously decided to maintain the Key Rate at 4.5 per cent.

The MPC will continue to monitor the economic situation closely and stands ready to meet in between its regular meetings, if the need arises.

The next meeting of the MPC will be announced in due course.

Rest assured that the Bank will continue to serve the best interests of the Mauritian population. This has always been the case and shall always be the case.

Thank you. I now welcome your questions.