Post-budget 2011 – The Monetary Policy Stance

What is at issue here is a question of social choice. To address it, a strong leadership is a must

At its last meeting which was held in September 2010, the Monetary Policy Committee (MPC) of the Bank of Mauritius unanimously decided to cut the Key Repo Rate by 100 basis points to 4.75 per cent. The main arguments put forward were that with inflation remaining subdued in the domestic market and given the weakening growth prospects in the country's main export markets, substantial monetary easing was necessary to give further support to the ongoing economic restructuring and provide the opportunity for embarking on a major drive to improve productivity and national competitiveness.

We then had the Economic Restructuring and Competitiveness Programme (ERCP) to bring in a new dynamism in the main productive sectors of the economy and the SME sector. Now, with budget 2011, what, besides creating a Sovereign Wealth Fund to ensure greater stability in the Forex market and devoting more resources to rebalancing growth and boosting productivity, will be the likely stance of the Monetary Policy? A cursory glance at the output gap, the level of liquidity in the banking system, the growth of credit, inflationary expectations and the external environment gives us an indication of the likely stance of the next Monetary Policy Committee.

Real output is still below potential and the negative output gap will be contributing to keep inflationary pressures emanating from the supply side in check. There is still excess liquidity of nearly Rs 4.2 billion in the system despite efforts by the Central Bank to mop it up. The Bank of Mauritius (BoM) had to "*issue notes of longer-term maturities, ranging from two to four years, to pick up the slack created by net redemption of Government paper. The amount of Bank of Mauritius paper outstanding now totals Rs 7.3 billion, comprising bills of Rs 3.8 billion and notes of Rs 3.5 billion*".
Surprisingly, the increasing liquidity in the system has not been accompanied by increasing demand for loanable funds. Credit to the private sector which picked up in the second quarter of 2010 dropped back to a 2.9% growth in the third quarter. It is not surprising that the Governor is concerned that *"our banks perhaps (are) becoming too risk averse. Is there an unmet demand for loans in parallel with excess liquidity in the system? If so, aren't we failing to tap our full growth potential?."*
As for inflationary expectations, there are upside risks for the short-to medium-term inflation outlook. The seventh Inflation Expectations Survey revealed that 84.5% of respondents expected prices to go up. The mean inflation rates of respondents worked out to be 3.1%, 3.6% and 4.3% respectively for the twelve months ending December 2010, June 2011 and December 2011.
As far as the external environment is concerned, recovery is stalling and is still in danger of petering out altogether; the advanced economies continue to expand at a lower pace. The lowering of the Repo Rate has provided only a temporary reprieve. It has not stimulated much borrowing either from households or cautious business. Banks are holding on to their excess reserves. If all the cheap money eventually spurred much higher economic growth, these reserves would have turned into loans. There is thus

very little reason for continuing with the lowering of the Repo Rate as the Central Bank will only be *"pushing on a string".*

Monetary Aggregates

% Change	Q2-09	Q3-09	Q4-09	Q1-10	Q2-10	Q3-10
Net Claims on Non Residents	4.9	0.4	5.2	3.5	-0.1	-7.0
Domestic Credit	1.6	0.0	-0.6	1.1	4.1	1.3
-Claims on Private Sector	1.5	-0.6	0.1	1.0	4.4	2.9
Broad Money Liabilities (BML)	1.8	0.3	2.3	2.1	1.5	-0.7
Monetary Base	-4.4	-31.3	56.6	6.2	3.1	6.1

The Governor of the Central bank calls for some intensive soul-searching when he queries us on whether it is *"healthy for many… to continue to worship at the altar of a weak rupee? Should we saddle our poorer compatriots with the additional burden of paying for currency depreciation?"*

The pro-depreciation lobby may however point to the deteriorating trade deficit which is expected to peak at some Rs 70 billion in 2010. But total exports for the year 2010 are expected to be of the order of Rs 66,500 million, higher than the Rs 63,000 estimated in October for the National Accounts figures.

Extrernal Trade

Extrernal trade (Rs Million)	2006	2007	2008	2009	2010
Trade balance (cif)	-42,829	-51,329	-64,195	-56,622	-69,500
Exports, f.o.b.	74,171	69,708	67,970	61,681	**66,500**
Imports(cif)	-117,000	-121,037	-132,165	-118,303	-136,000

The total export proceeds for the third quarter of 2010, comprising domestic exports, re-exports and ships' stores and bunkers amounted to Rs 17,650 million, showing increases of 2.0% compared to the previous quarter and 9.4% with respect to the corresponding period of 2009. Domestic exports, which accounted for 76.7% of total exports, went up by 3.4% from Rs 13,086 million in the previous quarter to Rs 13,537 million in the third quarter of 2010. Export proceeds from "Miscellaneous Manufactured Articles", contributing 48.5% of total exports from January to September 2010, increased by 4.7% compared to the first nine months of 2009 to reach Rs 21,495 million. The major component of this section, "Articles of Apparel & Clothing

Accessories" representing 81.0% of exports of this section, decreased slightly, by 0.4% to be exact. So there is very little ground for postulating that our exports had been disadvantaged by an appreciation of the rupee.

Appreciation of the Rupee

Main textile exporters' currency	Nominal Exchange rate changes (%)	Nominal Exchange rate changes (%)	Real Exchange rate changes (%)	Real Exchange rate changes (%)
	Rs to Euro	**Rs to $**	**Euro Mkt**	**$ Mkt**
	Jan- Oct 10	Jan - Oct 10	Jan - Oct 10	Jan - Oct 10
Mauritian Rupee	3	0	3	-2
Indian Rupee	6	3	16	10
Indonesian Rupiah	6	3	11	6
Malaysian Ringgit	11	9	13	7
Pakistani Rupee	1	-1	13	7
Thai Baht	12	9	15	9
South African Rand	10	7	13	7
Tunisian Dinar	-3	-6	-1	-6
Moroccan dirham	1	-2	2	-4
Egypt pound	-2	-5	-1	-7
Kenyan shilling	-3	-6	-2	-7
Turkey Lira	6	4	14	8
Appreciation = +ve				

For the first ten months of 2010, a comparative analysis of the textile producing countries showed that, with very few exceptions, the rupee has not been appreciating excessively against the Euro and the dollar. In real terms, we are one of the few countries that are not registering excessive appreciation -- meaning that we have been more or less able to maintain our external competitiveness. This will not be welcome to our exporters lobby for they must be regretting the good days of 2006 and 2007 -- you recall the fillip that they got from an excessive depreciation of the rupee and we collected its resulting effect: the spoils of a high inflation of 10.1% in 2006 and 8.8% in 2007. And on this we agree with the Governor of the BoM who is categorical: *"A sliding rupee will push up prices in our import-dependent economy, reduce disposable incomes of consumers, and result in a net transfer of national wealth to richer exporters. Ultimately, what is at issue here is a question of social choice. To address it, a strong leadership is a must."*

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