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MCB Focus

Economic Outlook

June 2019

MCB GROUP

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RECENT DEVELOPMENTS

The international landscape

Just over a year ago, all the bellwethers of worldwide economic activity looked promising and were spreading confidence about a synchronous wave of growth acceleration across all regions of the world. One year later, much has changed and there is now a growing sense of pessimism about the state of the world economy. In particular, the global economic upswing has visibly started to sour, with a combination of challenges notably regarding trade relationships as well as geopolitical events in selected emerging market and developing economies having raised uncertainty levels. Against this backdrop, the World Bank has cut its prediction for the growth in world output for this year in the June edition of its Global Economic Prospects. According to the report, *"heightened policy uncertainty, including a recent re-escalation of trade tensions between major economies, has been accompanied by a deceleration in global investment and a decline in confidence"*. The Bank's latest global health check corroborates the views expressed by the IMF in its World Economic Outlook of April last. The Fund had, it can be recalled, slashed its global growth outlook for 2019 by 20 basis points relative to its January forecasts to 3.3% – the weakest growth pace since the financial crisis – with a modest improvement to 3.6% anticipated in 2020 and 2021, underpinned mainly by a projected pickup in a number of emerging market and developing economies.

Furthermore, whereas some tentative signs of growth stabilisation are projected over the second half of the year, the near term global growth outlook is subject to several downside risks:

- A further escalation of trade tensions involving major economies would exert further drags on confidence and investment. Specifically, the IMF estimates that US-China tariffs, including those implemented last year, could reduce world output by about USD 455 billion in 2020, representing 0.5% of nominal global GDP;

- Renewed episodes of substantial financial market stress could have pronounced and widespread consequences notably in emerging markets, in view of rising levels of indebtedness;

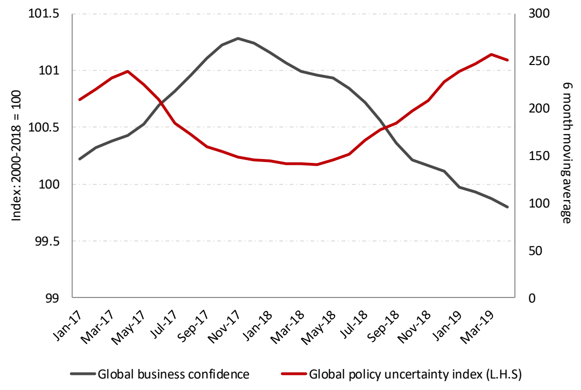
- A failure of policy stimulus to prevent a sharper slowdown in major economies such as the Euro area or China could have non-negligible ramifications for emerging market and developing economies;

- Tensions in various parts of the world, including in Korean Peninsula, Middle East and North Africa, South Asia, sub-Saharan Africa or Ukraine could severely disrupt activity in the regions; and

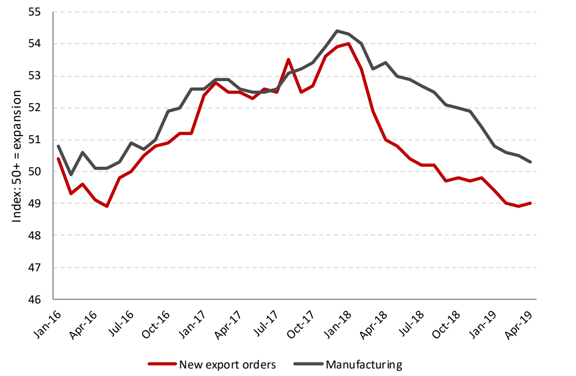
- More extreme climatic conditions, such as extensive droughts and heat, could impair agricultural harvest and contribute to increased desertification

Figure 1 **Impact of policy uncertainty and weakening business confidence**

Amidst trade tensions, uncertainty has increased while business confidence has kept on falling…



…which weighed on trade and investment globally



Note: Manufacturing and new export orders are measured by Purchasing Managers' Index (PMI)

Source: World Bank Global Economic Prospects June 2019

Concerning our key export markets, following a sharp slowdown in activity levels in the second half of 2018, growth in the euro area rebounded to 1.2% in the first quarter of 2019 when compared with the corresponding period of 2018, with economic recoveries in both Germany and Italy. That said, while wage growth and accommodative macroeconomic policies, including fiscal easing should continue to provide support to household spending as stressed in the latest OECD Interim Economic Outlook, policy uncertainty, weak external demand and low confidence are likely to continue taking a toll on investment and trade growth in the 19-member region. As for the UK, almost three years after the referendum, the Brexit saga remains unresolved, with the EU having granted the UK an extension of the deadline to October 31 (from March 29 as initially agreed). In spite of a pickup in economic activity observed during the first three months of 2019 driven, notably, by a rise in inventories, the range of potential Brexit outcomes varies from 'no deal' to 'no Brexit', thereby compounding uncertainty, impacting business sentiment and depressing investment. Further, the Bank of England recently indicated it expects economic growth to be flat in the second quarter of the year, and stressed that downside risks to growth had increased. As regard the US, economic activity expanded at a stronger-than-expected pace during the first quarter of the year, with robust labour market growth. A detailed assessment of the underlying growth dynamics, however, paints a less rosy picture. In fact, the key contributors to the first quarter performance were (i) external trade, owing to a sharp deceleration in import growth amidst slowing demand in the context of the ongoing trade spat with China; and (ii) a build-up of unsold inventories, which are expected to exert a drag on growth over the coming quarters. Against this backdrop, the Federal Reserve has, lately, indicated that it will closely monitor the implications of incoming information for the economic outlook and will act as appropriate to sustain the expansion. Economic growth is, as the situation stands, expected to moderate in the short term as the effects of the recent fiscal stimulus wane and tariff increases and associated retaliatory actions weigh on activity. With regard to China, notwithstanding the boost from fiscal stimulus, economic growth is projected to slow in the near term on the back of the impact of tariff increases from the US. In India, the continued recovery in investment and robust consumption amidst improved financial conditions and some expected fiscal and quasi-fiscal stimulus as well as recent structural reforms should support an upturn in real GDP growth over the periods ahead. As for South Africa, which features amongst our key markets for textile and tourism, its economic growth is on course to improve only marginally over the near term, reflecting a modest reduction in policy uncertainty in the wake of the elections. Regarding the region as a whole, growth in sub-Saharan Africa is projected, as per the IMF, to pick up to 3.5% and 3.7% in 2019 and 2020 respectively. The economic context remains challenging, with weakening external demand, persistent policy uncertainty and domestic growth bottlenecks more than offsetting easing external financing conditions and a slight recovery in commodity prices. Yet, upon excluding the region's two powerhouses, namely South Africa and Nigeria from the computations, real GDP growth rates for the sub-Saharan African region are expected to stand at 5.0% and 5.1% respectively for 2019 and 2020.

As for crude oil prices, they have pursued a general uptrend during the first half of the year, averaging USD 64 per barrel, supported notably by production cuts among OPEC and its non-OPEC partners as well as the decision of the US to terminate waivers for its sanctions on Iran. On the other hand, production in the US has continued to grow, with the country consolidating its position as the world's largest oil producer. Moving forward, as per the World Bank, oil prices – inferred from the average of Brent, Dubai and West Texas Intermediate prices – are likely to stand at USD 66 per barrel in 2019, i.e. 3.4% down from the corresponding level of 2018, before averaging around USD 65 per barrel in 2020. On the currency markets, the US Dollar remained at relatively high levels against a broad range of currencies, aided by continuing strong economic readings, notably first quarter GDP and jobless rate data. Additionally, the strengthening of the greenback was supported by wide interest rate differentials and bond spreads, spells of risk aversion, which prompted flows to liquid and safe havens, and the repatriation of funds by US companies to take advantage of cuts in US corporate taxes.

The domestic scene

Main thrusts of the National Budget

Locally, the main event capturing attention relates to the unveiling by the Government of its National Budget 2019-2020 on June 10. A key objective thereof is to boost growth with a view to graduating Mauritius to the league of high-income countries while fostering a more inclusive nation, backed by better sharing of income and wealth. The authorities stressed their intention to further enhance business facilitation and position Mauritius as a regional platform for trade and investment, notably towards Africa. Additionally, policies have been earmarked towards promoting sustainability principles as well as nurturing a healthier lifestyle for the population amidst a clean, safe and secure environment. In line with previous pronouncements, the Budget reaffirmed the ambition of the authorities to upgrade the infrastructure set-up across a broad spectrum of areas, notably spanning the road, airport, sea port, utilities and general social facilities. In this respect, while implementation levels would continue to warrant constant monitoring, total public investment is, as per the authorities ,estimated at Rs 207.4 billion over the five years spanning 2019/20 to 2023/24, out of which Rs 63.2 billion is planned to emanate from private participation in public sector projects.

Official Medium Term Macroeconomic Framework

The significance of budgetary announcements can be appraised through a careful dissection of the interconnected forecasts provided in the authorities' Medium Term Macroeconomic Framework (MTMF). As per the latter, nationwide investment rate is projected to stand at 19.4% of GDP in FY 2019/20, before plateauing at 19.0% of GDP during FY 2020/21 and 2021/22. Statistically, the trends on the investment front would, at a sectorial level, be reflected by means, notably, of an anticipated deceleration in construction growth, by virtue of the exceptionally high base effect triggered by the notable growth registered therein in recent years. Another perceptible observation is that in spite of support from budgetary measures, exports of goods and services is, as per the MTMF, expected to remain subdued in the years to come, thus contributing to the persistence of an elevated current account deficit. In fact, the latter could offshoot officially projected levels in view of the impact of measures enunciated in the Budget which have a high import content while any potential adverse moments in the external value of our rupee would also weigh in the balance. Overall, in light of the above official projections by the authorities, it appears that it would, as the situation stands, be quite challenging to achieve the official economic growth forecasts of 4.0% in FY 2019/20, 4.1% in FY 2020/21 and 4.2% in FY 2021/22. Accordingly, a lower GDP growth outcome would negatively impact fiscal and debt metrics projected by the authorities.

Main areas warranting attention

While it is interesting to note that the National Budget identified some initiatives that are aimed at boosting the country's socio-economic development, it remains to be ascertained whether the pronouncements will, in the absence of deep structural reforms, be meaningful enough to enable the country's key economic pillars to confront dynamics affecting their current growth momentum and bolster competitiveness levels amidst the demanding operating context, alongside stimulating the emergence of new economic sectors. Furthermore, whereas the effective operationalisation of initiatives remains a key influence, the ability of budgetary measures to reap optimal socio-economic gains in the short run and beyond is likely to hinge on several success factors, notably the need to (i) guard against the potentially distortionary outcomes of some earmarked policy measures that may impact on the optimal allocation of resources; and (ii) uphold sound, sustainable and credible fiscal and public debt management

Guarding against the potentially distortionary outcomes of some policy measures

In addition to budgetary pronouncements made in previous years with regard to the country's fiscal regime, further differential treatments and tax holidays have been announced on the income tax front. The main ones include the provision for: (i) a reduced corporate tax on profits of 3% derived by Freeport operators or private Freeport developer engaged in manufacturing; (ii) extension of income tax holiday and VAT refunds to a wider range of sectors/activities including marina development and income derived from Intellectual Property assets developed in Mauritius, peer-to-peer lending and bunkering of low sulphur heavy fuel oil as well as other green initiatives; (iii) differential rates with respect to personal income tax, with multiple exemptions and reliefs; (iv) the introduction of an attractive tax regime to promote development of real estate investment trusts. Furthermore, additional subsidies and grants were announced, notably to (i) provide for a guaranteed price to sugar planters on the first 60 tonnes of sugar accrued to them; (ii) improve access to social housing; (iii) maintain the retail prices of rice and flour; (iv) facilitate the acquisition of buses with fully electric engines; and (v) redynamise flight routes to Shanghai and Kenya. With respect to the financial sector, in line with previous budgetary announcements and with a view to fostering adherence with international codes and practices, notably amidst demands addressed by the European Union and the OECD, further amendments were brought to the fiscal regime of banks and financial institutions. The main measures in this year's Budget include (i) a tax rate of 5% applicable on the chargeable income of a bank in excess of its chargeable income in the base year (year of assessment 2017/2018) if the bank grants at least 5% of its new banking facilities, to any of the following (a) SMEs in Mauritius, (b) enterprises engaged in agriculture, manufacturing or production of renewable energy in Mauritius and (c) operators in African or Asian countries; (ii) an increase in the rate of the Special levy, from 4% to 4.5%, applicable on operating income for a bank having operating income exceeding Rs 1.2 billion in a year, with provisions made to cap total levy payable and exempt income derived by banks from Global Business Companies; and (ii) extension of the 80% partial exemption regime to cover other specific activities such as companies engaged in leasing and provision of international fibre capacity, companies engaged in reinsurance and reinsurance brokering as well as those engaged in the sale, financing arrangement and asset management of aircraft and aviation related advisory services.

As the situation stands however and, as stressed in previous editions of MCB Focus, while the afore-mentioned fiscal developments would assist towards accelerating the development of selected segments, such incentives would end up providing only short-term and temporary support. In fact, their medium and long-term efficiency and competitiveness impact still need to be prudently scrutinised insofar as the country is further departing from the low, simple and predictable fiscal system that has served to boost the investment climate for several years. All in all, in light of recent developments and given the challenging operating context, it is deemed primordial that the administration of the fiscal regime, both in terms of its cost and complexity, be effectively coped with, while ensuring that our tax system remains, in its scope, predictability and transparency, supportive of the strategic development and international competitiveness endeavours of economic sectors.

Upholding sound, sustainable and credible fiscal and public debt management

Another key success factor towards ensuring that budgetary announcements achieve their goals and ambitions is the adoption of a credible, robust and transparent medium-term fiscal consolidation agenda, with a particular emphasis on controlling recurrent expenditure. Alongside assisting in reducing debt vulnerabilities, the latter would help the economy to be impregnated with greater flexibility to respond to shocks and create an adequate fiscal space for financing envisioned growth-inducing expenditures on a sustained and comprehensive basis. It can be recalled that, while the statutory requirement is to reduce public sector debt to 60% of GDP by end of June 2021, fiscal and debt metrics have warranted attention lately in view of the unsteady economic context, the notable uptrend in recurrent expenditure as a % of GDP and the execution of major infrastructure projects. However, the Government plans to reach the statutory debt target earlier by disposing of certain non-strategic assets (by selling equity of the amount of Rs 5 billion and Rs 6 billion in 2019/20 and 2020/21 respectively), while also using part of the "accumulated undistributed surplus" held at the Bank of Mauritius. As regard the latter, the Government identified Rs 18 billion, which is equivalent to 3.5% of GDP, as financing from the Bank of Mauritius for the payment of the external debt (Rs 15.7 billion as early repayment and the remaining balance as scheduled repayment). Accordingly, the Bank of Mauritius Act will be amended to allow use of funds from the Special Reserve Fund for fiscal purposes, which seems broader than the declared intention of using the funds for meeting external debt obligations. That being said, it remains important that the ability of the Central Bank to effectively conduct monetary policy and manage the exchange rate of the rupee is not undermined, the more so given the unsteadiness of our balance of payments observed recently. As stressed in a report by the European Central Bank, entitled 'Profit distribution and loss coverage rules for central banks' states that: *"an appropriate policy should reconcile the conflict between the need to transfer resources to the national budget, as otherwise there would be an opportunity cost for society, and the central bank's need to establish buffers from time to time against its perception of the risks in its balance sheet arising from the overriding requirements of monetary policy execution. It should have a neutral impact on the conduct of monetary policy and on the business cycle, and it should ensure the maintenance of an appropriate (and certainly non-negative) level of capital adequacy".*

ECONOMIC OUTLOOK

Figure 2 **Main economic indicators**

	Unit	2015	2016	2017	2018[1]	2019[2]
Real sector						
GVA at basic prices	Rs bn	364	386	403	424	444
GDP at market prices	Rs bn	410	435	457	483	508
GVA growth (at basic prices)	%	3.1	3.6	3.6	3.6	3.6
GDP growth (at market prices)	%	3.6	3.8	3.8	3.8	3.8
Gross Domestic Saving	% GDP	10.4	11.0	10.0	9.1	9.6
Gross Fixed Capital Formation	% GDP	17.4	17.2	17.4	18.7	19.7
Private sector investment	% GDP	12.6	12.8	13.3	14.1	13.7
Public sector investment	% GDP	4.7	4.4	4.1	4.6	6.0
Headline inflation	Dec, %	1.3	1.0	3.7	3.2	1.0
Unemployment rate	average, %	7.9	7.3	7.1	6.9	6.8
Fiscal sector						
Budget balance	FY, % GDP	-3.9[a]	-3.5	-3.5	-3.2	-3.2
Public sector debt	Dec, % GDP	63.4	64.2	63.5	64.9	64.6[b]
External sector						
Balance of visible trade	Rs bn	-74.7	-81.0	-100.2	-112.1	-126.3
Current account balance	% GDP	-3.6	-4.0	-4.3	-5.8	-7.3
Overall balance of payments	% GDP	4.9	6.0	6.2	3.4	1.9[b]
Memorandum item:						
Per capita GDP	*USD*	*9,228*	*9,598*	*10,407*	*11,070*	*11,282*

(1) MCB revised estimates (2) MCB revised forecasts

[a] The budget deficit for 2015 in the table relates to the January to June period as per official disclosures and based on computations from GDP for 2015H1

[b] Assuming the planned early repayment of external debt will occur in the second half of FY 2019/20

Sources: Statistics Mauritius, Ministry of Finance & Economic Development, Bank of Mauritius & MCB staff estimates

Economic growth

Revised outlook for 2019

On the heels of the prevailing international conjuncture and developments characterising the domestic economy, we now expect real growth in gross value added at basic prices to stand at 3.6% in 2019. Our updated growth estimate, which undershoots our prognosis of February last by 20 basis points, is on par with the revised forecast by Statistics Mauritius, made in the context of the March issue of the National Accounts, whereby the official growth prognosis was trimmed down by 0.2 percentage point, relative to their December figures. As for real GDP growth at market prices, we have revised our forecast downwards by 0.1 percentage point to 3.8%. The latter prognosis is 10 basis points lower than the revised Statistics Mauritius figure. This divergence is mainly explained by a marginally lower nominal GDP and a lower forecasted real growth rate for taxes on products net of subsidies after factoring in differences in the associated deflator and budgetary announcements to, *inter alia*, lower excise duties on petroleum and cooking gas and increase subsidies. Reflecting the reduction in our growth prognosis and a lower GDP deflator, nominal GDP at market prices is now expected to stand at Rs 508 billion this year compared to our prior forecast of Rs 517 billion.

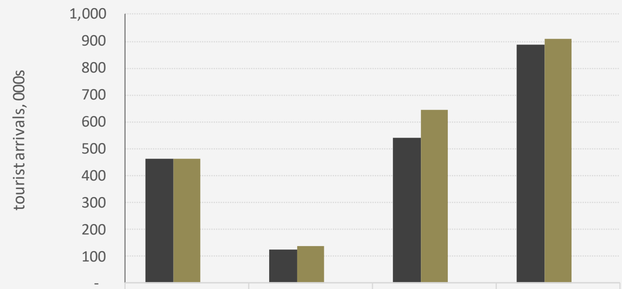
Basically, in spite of a noteworthy expansion in construction activities in line with the execution of large-scale infrastructure ventures, nationwide output growth is anticipated to be plagued by the testing economic conditions in some of our main markets and the heightened competitive environment internationally. Against this backdrop, we have downgraded our outlook for the tourism sector, which is now expected to post only a moderate outcome this year, after factoring in the year-on-year decline of 0.9% in total arrivals registered during the first five months of the year, with a more worrying drop of 3.0% observed in respect of arrivals by air. Beyond arrivals figures, the hotel industry should remain under close monitoring this year as a result of the dynamics impacting its gross receipts, especially considering that total tourism earnings have declined by nearly 9% during the first four months of the year, with a broadly similar outcome being observed in respect of average receipt per tourist. Moreover, even if such comparative analysis warrants circumspection – by virtue of different base levels as well as the fact that the destinations are characterised by varying value propositions and source markets – it is worth noting that the country's regional competitors, notably Seychelles, Maldives and Sri Lanka, have witnessed generally important increases in tourist arrivals in recent times (see Box I). As for the export oriented manufacturing sector, despite the appreciable growth in the seafood segment in line with market access headway, it is set to post a restrained outcome this year on account mainly of a contraction being expected in the textile industry. In the same vein, despite support from budgetary measures, the domestic oriented sector should continue to evolve at tepid pace owing to competitive pressures and lingering structural inefficiencies. Regarding the trade sector, it should grow at a pace which is broadly in line with last year's outcome. Elsewhere, within the agriculture sector, despite support from the budgetary measure to provide a subsidised guaranteed price of Rs 25,000 per ton for the first 60 tons of sugar accruing to planters in respect of crop 2019, real value added in the sugar industry is set to contract this year on the back of slower sugar extraction rate notably linked to unfavourable climatic conditions restraining production levels and higher competitive pressures, notably in the EU where beet sugar has gained prominence. From another angle, the ICT sector is on course to uphold its fairly robust growth thrust, while a resilient, albeit somewhat moderating, performance is on the cards in financial and business services amidst the gradual transition of sector operators to the new environment triggered by the coming into force, in April last, of the full provision of the amended India-Mauritius Double Taxation Avoidance Agreement. In fact, as per the Indian Department of Industrial Policy and Promotion, FDI flows routed through Mauritius have almost halved during the fiscal year April 2018 – March 2019 period to reach USD 8.1 billion, as compared to USD 15.9 billion for the previous corresponding fiscal year.

Box I: Key trends and challenges for tourism in Mauritius

Performance of Mauritius against direct regional competitors

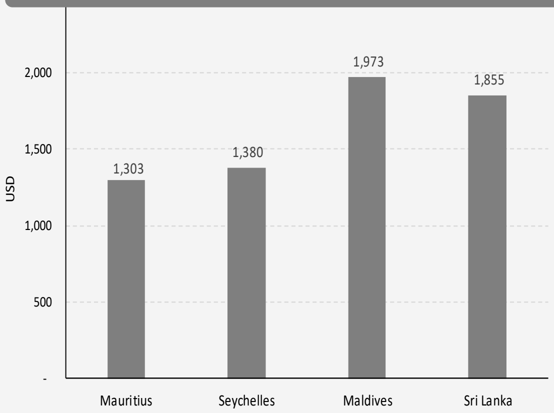
- According to the survey of inbound tourism by Statistics Mauritius, there has been a fall in the perception of the level of security and the quality of the environment in Mauritius. Worryingly, a smaller share of tourists perceive Mauritius better than our direct regional competitors, namely Maldives and Seychelles. This has been accompanied by the latter destinations faring better in terms of tourist arrivals recently. Indeed, during the first four months of 2019, while Mauritius has seen a year-on-year fall of arrivals of 0.1%, Seychelles, Maldives and Sri Lanka all posted growth rates of 12.9%, 19.7% and 2.2% respectively.
- Furthermore, according to the UNWTO Tourism Highlights 2018, tourism receipts per head were higher for our direct regional competitors compared to Mauritius in 2017, particularly in Maldives and Sri Lanka.

Tourist arrivals



	Mauritius	Seychelles	Maldives	Sri Lanka
Jan - Apr 2018	461,382	122,801	539,816	888,353
Jan - Apr 2019	460,870	138,617	646,092	907,575
Change	-0.1%	12.9%	19.7%	2.2%

Tourism receipts per head (2017)



New trends shaping the tourism industry

- The rise of digital platforms: The availability of digital tools, such as Skyscanner, Booking.com and TripAdvisor, that help travelers compare, book and share their recommendations with others has created a new set of challenges, by shifting the power to travelers and platforms. It has also enabled the expansion of peer-to-peer accommodation like Airbnb, challenging traditional tourism offerings across the supply chain and adding another level of intricacy to the sector.
- Changing tourist profiles: The rising use of digital platforms and the changing demographic profile of tourists are intrinsically linked. Indeed, the rising share of millennials and Generation Z travelers is revolutionising global tourism owing to the fundamental change in their behavioural and consumption patterns.
- New types of tourism: Evolving tourist profiles are driving different types of tourism like ecotourism, which takes travelers on low-impact trips to environmentally fragile areas of the world. Similarly, sports and adventure tourism is one of the fastest growing areas of the global travel and tourism industry, while youth tourism, which caters essentially for young travelers who prefer budget accommodation and independently-organised and flexible travel schedules, is also another fast growing sector in the tourism industry.

Sources: UNWTO, Statistics Mauritius, National Bureau of Statistics Maldives, National Bureau of Statistics Seychelles, Department of Census and Statistics - Sri Lanka

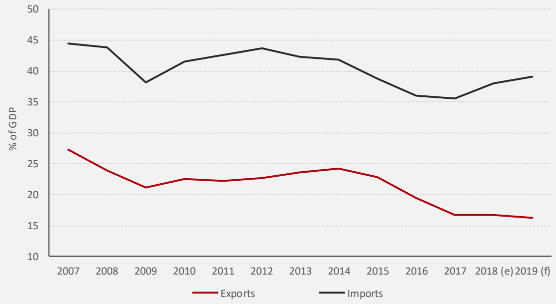
From an expenditure perspective, the downward revision in our growth prediction for this year partly reflects a marginal deceleration now being anticipated in private sector investment on account of soft economic conditions and a higher base triggered by an upward revision in the real growth rate for 2018 as per Statistics Mauritius. As such, the ratio of private sector investment to GDP, which stood at an estimated 14.1% last year, would drop to 13.7% in 2019. On the other hand, the country's expansion would be predominantly spurred by a double-digit growth in public sector investment, reflecting principally the ongoing implementation of large-scale infrastructure-upgrading ventures, albeit with a high import content. Specifically, 75% of works in relation to Phase 1 of the Metro Express project have reportedly been completed, while the execution of several projects under the Road Decongestion Programme have progressed in recent months, along with the construction of sports facilities amongst others. Consequently, the share of public sector investment to GDP would increase by 140 basis points to stand at 6.0% this year, assuming that the planned acquisition of aircraft will be undertaken by means of an operating lease mechanism and/or a sale-and-leaseback arrangement. This would contribute to the gross fixed capital formation ratio rising to 19.7% of GDP, compared with a corresponding ratio of 18.7% for 2018. Of note, the latter ratio was revised upwards by 70 basis points by Statistics Mauritius following the uplift in private sector investment for year 2018, notably in respect of non-residential outlays. On another note, our lower economic growth forecast, relative to our February projections also reflects a more pessimistic outlook as regard the country's external position. Whereas net exports of services are anticipated to remain in positive territory, concerns prevail with regard to the country's net exports of goods. Indeed, while exports of goods improved by 7% in year-on-year terms during the first quarter of the year, partly on the back of a low base effect triggered by the cumulative effect of several years of contraction, a significant hike has been registered in the value of imports during the latter period, aggravated by the depreciation of the rupee observed since the beginning of the year. Such trends are likely to continue over the coming quarters amidst the expected acquisition of one-off items such as wind turbines and metro trains. On this basis, net exports of goods would exert an influential drag on nationwide activity levels this year by rubbing off more than two percentage points from the real growth in national output. Overall, whilst being partly understandable given the slow-moving demand and mounting uncertainties in some of our key trading partners notably UK, these outcomes warrant attention as they put into light the persistently limitative nature of our productivity and competiveness foundations, which tend to prevent the country from optimally tapping into international markets for goods and services. This ever more underscores the imperative for Mauritius to meaningfully bolster its exports competitiveness as a foundation for long-term economic growth, the more so when considering the small size of our economy and the fact that the net impact of current household consumption patterns on output is generally limited by its relatively high import content.

As the situation stands, the balance of risks to our growth outlook remains tilted on the downside. Key events that could adversely impact our current forecast include (i) a further deterioration in the external context

Box II: Evolution of trade indicators and their significance for the Mauritian economy

Trade in goods

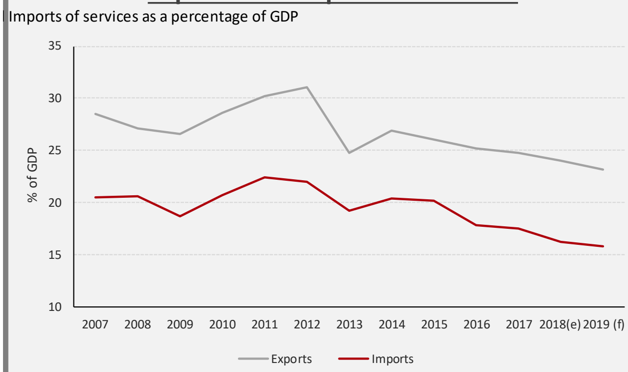
Exports and imports of goods



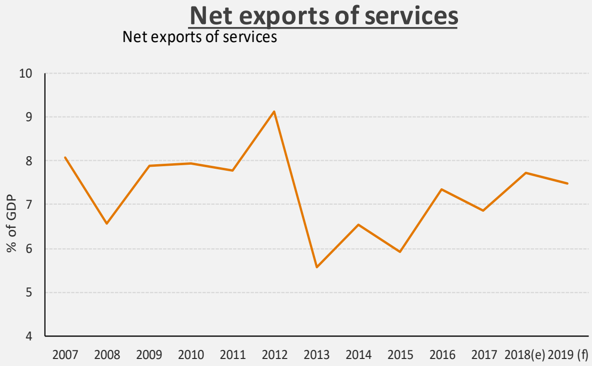
Net exports of goods

Trade in services

Exports and imports of services

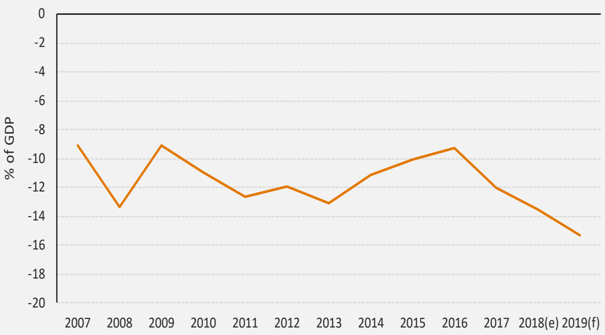


Net exports of services

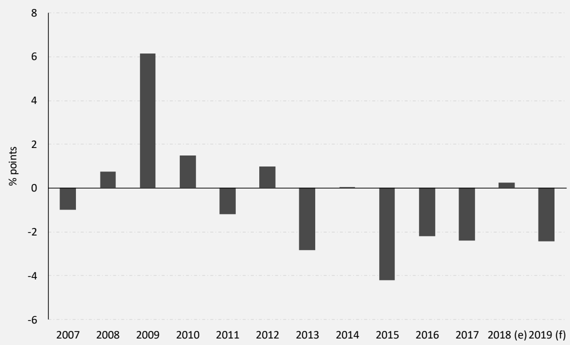


Net exports of goods and services

Share of GDP



Contribution to real GDP growth



(e) MCB revised estimates (f) MCB revised forecasts

Sources: Statistics Mauritius & MCB Staff estimates amidst an escalation of geopolitical tensions, triggering lower-than-forecasted growth notably in our main export markets; (ii) a sharper-than-expected tightening of global financing conditions leading to a reduction in financial flows and impacting macro-financial stability; and (iii) a higher-than-forecasted hike in commodity prices – notably oil – that could exacerbate the country's external imbalances and fuel inflationary pressures.

Preliminary projections for 2020

With regard to our short to medium-term outlook, nationwide economic expansion is likely to remain highly correlated to the evolution of public sector investment, given the sheer magnitude of infrastructure-upgrading ventures earmarked by the authorities. In fact, when measured in real terms, public sector investment grew by an estimated 14.7% in 2018 and is forecast to expand by around 35% in 2019, assuming the planned acquisition of aircraft will be financed through an operating lease framework and/or sale-and-leaseback. At the sectorial level, the rise in public sector investment is reflected in the evolution of the construction sector, which, it can be recalled, has grown at a notable pace lately (by 28% in real terms on a cumulative basis during the 2017-2019 period). For 2020, even if public sector investment is expected to remain high, in absolute terms, in line with the Public Sector Investment Programme of the authorities, assuming an average implementation rate on par with historical trends, the resulting real growth rate for the construction sector would, by virtue of the high base effect, be significantly lower than that observed of late. In the same vein, while only a modest recovery is expected in the tourism sector, the textile industry is expected to remain in difficult territories. As for the financial sector, a resilient outcome is expected amidst the increasingly challenging operating context. On another note, value added in the wholesale and retail trade sector would be boosted by the expected pick-up in household consumption in the wake of announced measures to increase disposable incomes while the ICT sector would, in all likelihood, sustain its relatively robust growth performance. Against this backdrop and in the absence of wide-ranging structural reforms, economic growth is, as per our preliminary observations, projected to marginally decelerate next year, with real GDP growth at market prices expected to stand at around 3.5%.

On the expenditure side, as hinted above, due to a high base effect, real growth in public sector investment is anticipated to be relatively lower than observed in recent years, thus reining in country's growth performance. On the other hand, a rebound is foreseen in private investment, driven by the implementation of real estate development and smart city projects and the construction of new and upgrading of existing hotels. Furthermore, as a persisting source of apprehension, net exports of goods and services would continue to post a subdued outcome in view of the prevailing conjuncture. Overall, our baseline growth forecast is subject to both upside and downside risks, and will be recalibrated over time as relatively more pertinent insights are garnered in respect of: (i) the evolution of global economic conditions and ensuing impact on the performance of our key export sectors; and (ii) the pace and depth at which budgetary measures will be deployed with a key case in point being the effectiveness of policies by the authorities to further gear up the investment facilitation framework and domestic productivity and competitiveness levels.

Other indicators

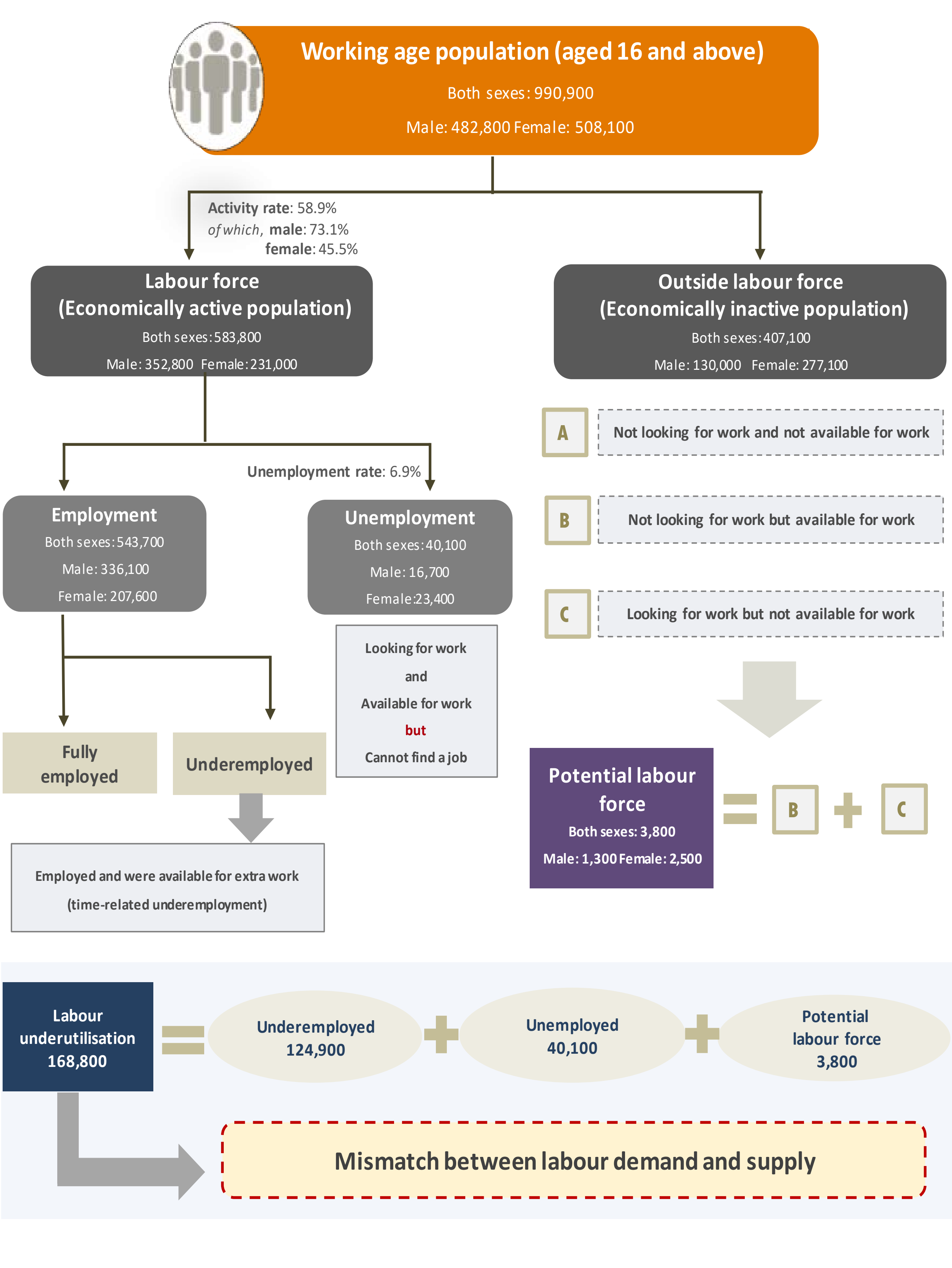
Inflation

Against the backdrop of low global inflation, amidst, notably, contained oil prices, soft economic activity worldwide and subdued domestic demand, headline inflation has maintained its downward trajectory in recent times. The indicator stood at 1.0% in May 2019, compared to 4.7% for the twelve months ending May 2018. Looking ahead, inflationary pressures are likely to remain broadly contained over the coming months, with headline inflation foreseen to stand at 1.0% as at December 2019, after making allowance for the statistical impact of prior marked hikes in the consumer price index and muted international commodity prices. This outlook also markedly factors in the recent budgetary pronouncements to reduce excise duties on selected items as well as cuts in the prices of gasolene, diesel and Liquefied Petroleum Gas. That said, while inflation should, in all likelihood, remain manageable in the short term, any build-up of inflationary pressures, emanating for instance, from a resurgence of international oil prices, should be closely monitored, the more so, after making allowance for the depreciation in the value in the rupee, which has fallen by 4.1%, 3.3%, 5.3% respectively against the US Dollar, Euro and British Pound since the start of the year on a point to point basis. Indeed, from a policy perspective, the IMF stressed in its latest assessment of Mauritius that: "*the current monetary policy framework of implicit inflation targeting has served Mauritius well, but moving toward a more formal framework with a clearly defined medium-term inflation objective could help to enhance monetary policy credibility and better anchor inflation expectations, thereby providing greater flexibility to respond to shocks.*"

Unemployment

Alongside being compounded by enduring labour market imperfections, net job creation in Mauritius is being hampered by the restrained evolution of domestic output. As such, whereas nationwide unemployment rate is forecast to improve marginally to 6.8% this year, compared with 6.9% in 2018, latest official statistics released for year 2018 offer some disquieting insights. Particularly, out of the total unemployed people: (i) nearly 50% were aged below 25 years; (ii) 26% studied up to the tertiary level; (iii) around 66% had worked in the past, with a large share in the tertiary sector; and (iv) unemployed women are generally more qualified

Box III: Key labour market metrics (Year 2018)



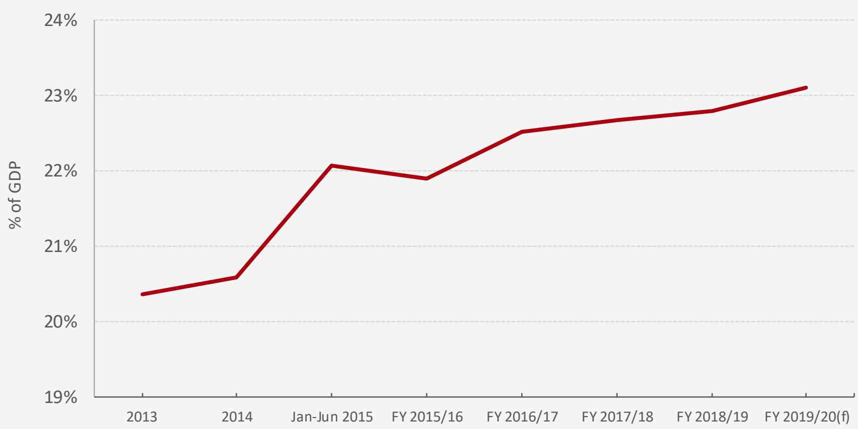
Sources: Statistics Mauritius and MCB Staff estimates than unemployed men, but they are, on average, in unemployment nearly three months longer than men. Moreover, when analysing the labour market indicators, it can be further observed that the ratio of total employment to the working age population dropped to 54.9% last year. From a more wide-ranging perspective, the activity rate of Mauritius, which is computed as the share of the labour force out of the population aged above 16, fell by 0.7 percentage point in year-on-year terms to 58.9% in 2018. Mainly dragged down by a female participation rate of 45.5%, the national indicator is low when compared to peer countries with broadly similar levels of economic development like ours where corresponding activity rates of 70% or more can been witnessed. Beyond this outcome, the economically inactive section of the working age population – defined as those outside the labour force – stood at 407,100 last year, representing a rise of some 10,000 when compared to 2017. Altogether, total labour underutilisation, which is obtained as the sum of the amount of unemployed, underemployed and those in the potential labour force, worked out to 168,800 in 2018. This represents nearly 29% of the labour force, and warrants close attention as it shines light on the persistent level of mismatch that exists between demand and supply of labour within the economy. Overall, the afore-mentioned trends and labour market dynamics call for our scrutiny to the extent that they tend to expose the country to a relative deficiency of labour inputs and a lack of intellectual capital compared to what it could potentially have afforded and, thus, losing out on a potential source of economic growth. Fundamentally, alongside materially boosting labour participation rates and tackling deep-rooted labour market hindrances, there is a compelling case for tackling notably youth unemployment levels. While the recent National Budget formulated some initiatives in this direction (notably with the creation of a National Skill Matching Platform and a Skill Development Authority), further actions are deemed necessary to suitably reduce existing age disparities with respect to employment creation. This should thus provide Mauritius with an influential tool to fuel its growth and development aspirations.

Public finance

In FY 2018/19, the budget deficit is officially estimated at 3.2% of GDP, in line with previous projections, with the indicator standing at 4.0% excluding grants. In fact, while an under-spending was witnessed on the capital side, overall revenue mobilised undershot previous estimates, led, to a large extent, by lower-than-projected external grants from India and China as well as lower-than-expected proceeds emanating from taxes. For FY 2019/20, the authorities expect budget deficit to remain unchanged at 3.2% of GDP, with the shortfall rising to 4.4% when excluding grants. Basically, the projected hike in the acquisition of non-financial assets amidst the deployment of infrastructure projects and a marked increase in recurrent expenditure - the indicator's share of GDP is projected to deteriorate to attain 23.1% of GDP as at FY 2019/20, compared to 22.8% as at FY 2018/19 - reflecting essentially higher compensation of employees and social benefits, would be offset by an anticipated rise in tax receipts, while capital revenue will be significantly boosted by the receipt of Rs 6.3 billion from external grants. Moving forward, the budget deficit, it is as per official projections, expected to further decline, with the imbalance expected to attain 3.1% in 2020/21 and 2.8% of GDP in FY 2021/22. Nonetheless, it is worth stressing that the predictions for the years ahead will hinge on an appreciable and sustained expansion in nationwide economic activities, which, as mentioned previously, appears challenging when factoring in the testing economic conditions both locally and internationally as well as the anticipated plateauing in the nationwide investment rate. Besides, as another key operational instrument to guide economic policies aiming to support debt dynamics, the primary balance is likely to register yet another deficit in FY 2019/20, amounting to 0.6% of GDP, with the shortfall position expected to remain on the cards in the next couple of years, as per the statement of Government operations, despite savings on interest payments related to the early repayment of external debt.

From a policy perspective therefore, the exercise of sufficient fiscal prudence remains crucial, to create adequate fiscal space for realising our growth ambitions over the periods ahead. Overall, the adoption of ambitious and extensive fiscal consolidation measures is deemed important, particularly in respect of the execution of appropriate adjustment measures on the expenditure side – notably on the recurrent front - to progressively and more weightily reduce non-productive outlays alongside making allowance for the higher pension spending pressures likely to arise over the medium to long term in view of the ageing of the country's population. Concurrently, it is important to uplift the country's growth potential in support of higher revenue generation, while striving to maintain the key tenets of our low, simple and predictable tax system.

Figure 3 **Evolution of recurrent expenditure**



Source: Ministry of Finance and Economic Development

External front

In the light of the marked rise of 28% in the country's trade deficit during the first quarter of the year when compared with the corresponding quarter of 2018, we have downgraded our outlook for the balance of trade for this year, with the imbalance being now estimated at about Rs 126 billion, representing 25% of GDP. In particular, despite measures announced towards encouraging the diversification of export markets and enhancing the competitiveness of the value proposition of operators, exports of goods are foreseen to post a relatively contained evolution this year, amidst heightened trade tensions on the global front and difficulties faced by our key trading partners. Conversely, in spite of benefiting from a relatively contained outlook for international commodity prices, a significant rise is expected in the import bill, on account mainly of outlays associated with the implementation of large-scale ventures, as well as the impact of an anticipated weakening of the rupee vis-à-vis the greenback. In turn, the sizeable balance of trade deficit would offset the surpluses being anticipated in both primary income and services accounts, thus engendering a significant widening in the current account deficit to 7.3% of GDP this year. The latter would trigger a sharp narrowing in the Balance of Payments surplus to just under 2% of GDP, after factoring in sustained inflows on the capital and financial account, inclusive *inter alia* of the project-based disbursement of the tranches relating to the line of credit received from the Government of India and assuming that the ouflow related to early repayment of Rs 15.7 billion (representing 3% of GDP) of external debt is undertaken in the second half of FY 2019/20. Importantly, the evolution of the BOP should be subject to scrutiny over the coming periods, when considering that a cumulative deficit of Rs 9.1 billion was registered therein during the second half of the last calendar year. Particularly, the ramifications of potential shifts in investor sentiments amidst the stringent operating framework confronting the global business segment should warrant attention along with the likely spillover effects of mounting uncertainties on the global front.

J. Gilbert Gnany
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June 20, 2019

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