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Post-Budget Outlook

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MCB GROUP

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Introduction

This paper analyses the potential implications on Mauritius Inc. of measures announced in the National Budget 2021-22, with emphasis laid on their ensuing impacts on GDP and other key macroeconomic variables. The table below provides our updated forecasts with the underpinning rationale and explanations thereof elaborated in subsequent sections.

Main economic indicators

	Unit	2017	2018	2019	2020[1]	2021[2]	2022[3]
Real sector							
GVA at basic prices	Rs bn	403	422	438	379	409	450
GDP at market prices	Rs bn	457	481	498	429	464	509
GVA growth (at basic prices)	%	3.6	3.6	3.2	-14.7	4.7	6.6
GDP growth (at market prices)	%	3.8	3.8	3.0	-14.9	4.8	6.5
Gross Domestic Saving	% GDP	10.0	9.0	8.8	7.9	7.9	7.7
Gross Fixed Capital Formation	% GDP	17.4	18.8	19.6	18.1	19.3	19.9
Private sector investment	% GDP	13.3	14.2	14.3	13.7	14.0	14.3
Public sector investment	% GDP	4.1	4.5	5.3	4.4	5.3	5.5
Headline inflation	Dec, %	3.7	3.2	0.5	2.5	3.2	2.8
Unemployment rate	average, %	7.1	6.9	6.7	9.2	8.9	7.8
Fiscal sector							
Budget balance	FY, % GDP	-3.5	-3.2	-3.2	-13.6	– 5.6 [a]	-6.0
Budgetary Central Government debt [a]	FY, % GDP	59.3	57.0	57.8	75.0	85.9	84.1
Public sector debt (as per the Public Debt Management Act) [a] [b]	FY % GDP	64.5	63.4	65.3	70.4	78.8	85.6
External sector							
Balance of visible trade	Rs bn	-100.2	-112.1	-119.8	-95.9	-111.1	-119.7
Current account balance	% GDP	-4.6	-3.9	-5.4	-12.7	-12.9	-8.1
Overall balance of payments	% GDP	6.2	3.5	6.6	-4.9	-2.7	1.2
Memorandum item:							
Per capita GDP	*USD*	*10,407*	*11,124*	*11,059*	*8,660*	*9,003*	*9,568*

(1) Revised estimates *(2) MCB revised forecasts* *(3) MCB forecasts*

(a) Budget deficit for FY 2020/21 and debt figures for FY 2020/21 onwards exclude the impact of any payment made in relation to the Betamax Judgement

(b) As from 2020, public sector debt are computed in net terms by excluding cash and cash equivalent and equity investment held by Government and public sector bodies in private entities, in line with the amended Public Debt Management Act

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

National Budget 2021-22

Key thrusts of the Budget

The National Budget 2021-2022 was presented on the 11th June amidst a still challenging context, with the global battle against COVID-19 being far from over even as the expanding vaccine coverage lifts sentiment amongst investors and the general public. The Budget, which is entitled 'Better Together', aims at accelerating the pace of recovery of the Mauritian economy and building resilience to sustain a high long-term growth path. Policies have been earmarked to, amongst others, stimulate nationwide investment, with emphasis on the construction of large-scale infrastructure ventures and community development amenities, encourage local production and support SMEs. Also, measures were announced to spur the development of new growth pillars such as the biotechnology and pharmaceutical industry to spearhead vaccine production and manufacturing of medical devices and the green energy sector with the complete phase-out of coal use by 2030 having been announced. Moreover, the authorities intend to promote the country's digital transformation, notably through the set-up of a Digital Industries Academy and initiatives to facilitate digital payments, while incentives have also been introduced to enhance our attractiveness and openness to foreign capital, talent and expertise and improve ease of doing business. Further, measures have been announced to modernise the financial services sector, including the roll out of a Digital Rupee, set-up of a single desk for FinTech related applications and a series of amendments to the operational and regulatory framework.

Main areas warranting attention

While several of the announced measures can be viewed positively as they attempt to support the economic recovery in the wake of the pandemic and boost socio economic development, achieving the country's ambitions and targets call for a careful assessment of the implications of the Budget pronouncements, with specific areas deserving attention, as detailed in the following sections.

Ensuring the effective and comprehensive operationalisation of measures

Essentially, the effective operationalisation of identified measures is critical to helping economic operators confront the ramifications of the pandemic and having an important bearing on the macroeconomic projections formulated. A key focus area relates to the speed at which envisioned projects – in particular those forming part of the Public Sector Investment Programme (PSIP) – are implemented. Indeed, the achievement of targets formulated by the authorities in the context of the Medium Term Macroeconomic Framework would rely on an exceptionally high project implementation rate, which represents a challenge when considering that, historically, a notable share of enunciated projects forming part of the PSIP has not materialised in a timely manner. Actually, the implementation rate of PSIP projects – as measured by the proportion of planned expenditure that is actually spent in a given fiscal year – has averaged 58% during the past five years. In fact, a number of projects announced in this Budget had already been earmarked in previous budgets, such as the construction of the Rivière des Anguilles Dam, 12,000 Social Housing Units, port breakwater, etc. On a positive note, to monitor the implementation of measures, it has been announced that a Project Implementation and Monitoring Agency would be set-up, while the High-Level Committee on private sector investment projects would meet on a monthly basis under the chair of the Prime Minister.

From a holistic perspective, to ensure that optimal gains are reaped over time, the pronounced policies could have been dovetailed with additional structural reforms to enhance the country's competitiveness levels. As detailed in a recent report by the World Bank (see next page), further emphasis should be laid, amongst others, on boosting productivity, rekindling private investment in productive sectors, supporting our Africa expansion strategy as well as giving a fillip to the expansion of sectors with high potential, such as the blue economy. Moreover, while the objective of developing new economic pillars such as the green energy sector and biotechnology and pharmaceutical industry can be lauded, such endeavours should be backed by clearly-defined processes and modalities to ensure that underlying targets set (e.g. fostering the transition to 60% of renewable energy contribution to total energy by 2030, thereby phasing out coal use) are effectively met.

At another level, while steps formulated to reinforce the institutional set-up – notably through the creation of an Industrial Financial Institution and a Regulatory Impact Assessment Agency – can be positively viewed, the objectives and mandates of these institutions should be clearly articulated to maximise their effectiveness. Another case in point relates to the investment objectives and parameters of the Mauritius Investment Corporation given that, while it primarily focused on assisting systemically important companies impacted by COVID-19 in its initial year of operation, it has recently broadened its scope of intervention as exemplified, *inter alia*, by announcements in the Budget pertaining to its investment to address the issue of water shortage in Rodrigues or the purchase of land in the context of smart city development. In the same vein, in view of its widened set of responsibilities and heightened strategic involvement, it is crucial that the Economic Development Board be endowed with adequate capabilities to ensure an optimal service delivery.

Guarding against the potentially distortionary outcomes of some policy measures

In another respect, the Budget has introduced some further fiscal incentives, including: (i) the extension of income tax holidays (e.g. Family Offices and Fund and Asset Managers) and tax credits; (ii) reduced corporate tax rates applicable to private universities setting up in Mauritius; (iii) the broadening of the scope of the partial exemption tax regime to cover licensed investment dealers and activities relating to the leasing of locomotives and train including rails leasing; (iv) the allocation of tax incentives for research and development; and (v) negotiable benefits for companies investing at least Rs 500 million under the Premium Investor Certificate. Overall, while some immediate benefits of the fiscal developments can be highlighted, notably towards fostering social progress, providing breathing space in some instances as well as supporting

World Bank: Zoom on structural reforms to help Mauritius bounce back stronger from COVID-19

A recently-released Economic Memorandum by the World Bank, entitled: "Mauritius Country Economic Memorandum, Through the Eye of a Perfect Storm – Coming Back Stronger from the COVID-19 Crisis" indicates that the best way forward for Mauritius, in the wake of the pandemic, is to focus on its proven ability to adapt and preserve its social contract by laying the foundations for future inclusive and sustainable growth. To the latter ends, the report advocates for the adoption of a new series of structural reforms to address long-standing structural challenges. The key priorities thereof are summarised below.

Key reforms proposed by the World Bank

1. Unlock productive private investment

With most traditional growth sectors facing decline or significant uncertainty in the medium term, developing new productive economic activities and raising the productivity in mainstay sectors is more urgent than ever; new thinking is required in Mauritius' industrial policy model to accomplish a shift towards higher and more productive private investment.

- Promoting Competition
- Closing the skills gap
- Opening Space for PPPs
- Redirecting state support towards innovation
- Sustainable management of natural resources

2. Restore external competition

Mauritius is outgrowing comparative advantage in low complexity, labor intensive activities, but opportunities exist for upgrading within and across industries, as well as regionalisation of production chains

- Leverage FDI
- New trade agreements
- Address price distortions

3. Maintain inclusiveness

In an environment of rising social needs and tightening fiscal space, policies to maintain Mauritius' inclusive development model will require adjustments to cope with the root causes of inequality and the COVID-19 shock.

- Targeted social protection system
- Integrating more low-income earners into the labour market
- Reducing the large disparities in learning outcomes

4. Do more with less

While a fiscal expansion was needed to support households and businesses during the pandemic, Mauritius now faces the challenge of fostering fiscal sustainability over the medium term. To balance economic recovery with fiscal consolidation, Mauritius would have to do 'more with less'. This requires gradually unwinding pandemic-related expenditure measures once the economy recovers, but also halting the longer-term upward trend in current expenditure without jeopardising social and economic development priorities.

- Flexible, market-friendly planning process
- Integrated performance Monitoring & Evaluation tool
- Enhancing implementation capacity
- Strengthening public-private dialogue

Source: World Bank, "Mauritius Country Economic Memorandum, Through the Eye of a Perfect Storm – Coming Back Stronger from the COVID-19 Crisis" the take-off of new activities, the short and long term efficiency and competitiveness impact of such measures should be carefully appraised insofar as Mauritius should uphold as far as possible optimal allocation of resources notably by fostering the necessary level playing field across similar activities and guard against even further departing from the low, simple, harmonised and predictable fiscal regime that has, over the years, enabled it to improve its business climate and boost foreign investment.

Upholding sound, sustainable and credible fiscal and public debt management

The severity of the contraction in economic growth in the wake of the pandemic and the Government's sizeable fiscal policy response to support businesses and individuals, particularly through the Wage Assistance and the Self-Employed Assistance Schemes, have contributed to a significant deterioration in the country’s fiscal metrics. The budget deficit is officially estimated by the authorities at 5.6% of GDP in FY 2020/21 after making allowance for the exceptional contribution of Rs 60 billion (13.6% of GDP) from the Bank of Mauritius (Rs 33 billion of recurrent revenue and Rs 27 billion of capital revenue). Besides, after factoring in the equity purchase of Rs 11.9 billion relating to the National Property Fund, the Government borrowing requirements reached a significant Rs 40 billion (9.1% of GDP) in FY 2020/21. On the whole, central Government debt increased to 85.9% of GDP, while public sector gross debt rose to around Rs 419.1 billion (95% of GDP) as at June 2021. After netting out cash and cash equivalent and equity investment held by Government and public sector bodies in private entities, public sector net debt stood at 78.8% of GDP.

While the above-described deterioration of fiscal indicators is in line with trends being witnessed worldwide in the wake of the pandemic, a key priority as the pandemic subsides would be to balance the economic recovery with appropriate medium-term fiscal consolidation plans in support of an orderly growth path. This is all the more crucial given that Moody’s Investors Service recently indicated that: *“Although the government’s projected fiscal balance is now closer to our own forecasts, the larger deficit in fiscal year 2021 and slower pace of fiscal consolidation point to Mauritius' debt burden stabilizing at a higher level, a credit negative.”* Whilst the authorities are targeting to reduce the fiscal imbalance in the years ahead, the budget deficit is, nonetheless, projected to remain relatively high despite the quite ambitious revenue projections and the financing of some large-scale infrastructure projects through Special Funds. That said, it is interesting to note that the authorities have set out cost and risk control benchmarks/targets to further improve debt sustainability. As such, interest payment on Government debt is expected to be brought down to around 2.5% of GDP by June 2024, below the set target of 3.5%, with 64.3% of Government debt being issued at fixed rates of interest in June 2024. Furthermore, with the aim of increasing debt affordability, the benchmark for interest payment as a ratio of recurrent revenue would remain at 10.5%. Furthermore, with a view to reducing foreign exchange rate risks, the authorities expect the share of foreign debt in the Government debt portfolio and public sector debt portfolio to be maintained at their present benchmarks of 20% and 25% respectively. For its part, the currency composition of Government foreign debt would be further diversified by increasing the share of other currencies. At the same time, to broadly reflect the currency composition of export proceeds of the country, the benchmark for the share of USD in public sector debt would be set at around 38% and that of EUR at 35% with other currencies constituting 27% of the portfolio. Besides, with a view to containing refinancing risks, the benchmark for the average time to maturity of Government debt would be raised to 5.5 years (compared to 4.9 years in June 2020) while the share of debt falling due for payment within one year will be contained at 22%.

Official Medium Term Macroeconomic Framework

As per the authorities' Medium Term Macroeconomic Framework (MTMF), real GDP growth is projected at 9% in FY 2021/22, partly reflecting the cumulative effect of the contractions witnessed during the last two financial years. Thereafter, GDP growth is officially projected at 6% in FY 2022/2023 and FY 2023/2024. In addition to factoring in the rollout of the vaccination that should enable an early reopening of the country's borders and hence pave the way for a recovery in the hospitality sector with positive multiplier effects in the economy, the authorities expect that the latter figures would be mainly driven by a sustained improvement in investment, with the indicator's ratio to GDP rising above 20% as from FY 2021/22 as per the official targets. As for other sectors, the authorities expect a pickup in domestic-oriented activities and retail trade, while ICT and financial services should sustain their growth momentum.

That said, the achievement of growth targets would remain challenging, insofar as this would depend on the interplay between a set of factors including: (i) a much higher rate of implementation of projects forming part of the PSIP relative to its historical pace; (ii) the extent of the anticipated rebound in private sector investment; and (iii) the speed of recovery in tourism. The latter would, in turn, depend notably on the take-up in long-haul travel, the 'colour coding' of the Mauritian destination in source markets and conditions for travel therein, our ability to tap into visitors from non-traditional markets who usually exhibit a longer length of stay and the air access capacity, principally in respect of the national airline. Conspicuously, a lower GDP growth outcome than foreseen by the authorities would exert a negative bearing on the achievement of related macroeconomic projections formulated in the MTMF, particularly regarding fiscal metrics. For instance, a lower GDP growth outturn would make it even more difficult to achieve the targeted increase of 33% in tax receipts in FY 2021/22 – which, if materialised, would trigger a rise in its share of GDP to 22.0% i.e. higher than its pre-pandemic level – while also having ripple effects on budget deficit and public debt, which are set to decline, but remain at relatively high levels in years ahead. At another level, whilst picking up in years to come, exports of goods and services as a share of GDP would remain well below their pre-pandemic level, thus contributing – in conjunction with the impact of the high import content of infrastructure ventures – to keeping the current account deficit at elevated levels.

Economic outlook

Economic growth

Updated estimates for 2021

For 2021, we have kept our growth forecast, when measured at market prices, unchanged at 4.8%, i.e. close to the latest IMF projection. In fact, in the wake of the Budget pronouncements, we have somewhat upgraded our projected growth for the construction sector in view of the line-up of projects announced under the Public Sector Investment Programme that are set to be initiated this year – although the bulk of spending is set to occur next year – coupled with a slightly improved outlook for private capital outlays. The upward revision has been offset by the marginal downgrades in: (i) high-contact intensive sectors such as arts, entertainment and recreation and education sectors following the maintenance of some restrictions in the country; and (ii) the tourism sector amidst the still challenging sanitary conditions in key regional source markets, notably South Africa, where the progress on the vaccination campaign remains slow. Overall, while our baseline prognosis already takes account of the complex operating context, it is worth noting that the growth outlook remains subject to downside risks. Tourism will remain the discriminant factor with persisting uncertainties characterising the take-up in long-haul travel in spite of the announced re-opening of the country's borders as well as our ability to diversify into non-traditional source markets. In fact, as per our model scenarios, our growth projection could be cut by up to 90 basis points in the worse-case scenario of a lower rebound in the tourism sector which carries a moderate probability, whilst a better outcome would still be possible, with our optimistic scenario pointing to a quarter percentage point uplift relative to our baseline case, albeit with a low probability.

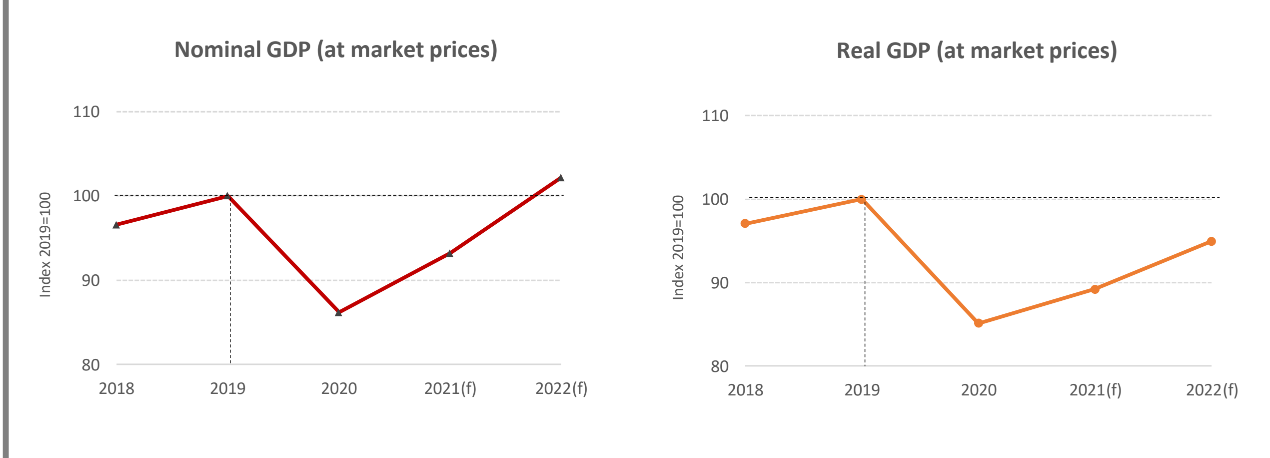
Revised projections for 2022

Looking ahead, economic activity is set to gather further steam in 2022, with our forecast of real GDP growth at market prices having been upgraded by a noticeable margin, relative to our May projections, to 6.5%. In addition to being engendered by the cumulative effect of the sharp contraction observed in 2020 and the restrained activity levels this year, this prognosis rests essentially on: (i) a general recovery in economic conditions within our main export markets; (ii) the progressive upturn in the tourism sector, with positive spill-over effects in the economy through the indirect, induced and catalytic channels; and (iii) a prompt operationalisation of articulated budgetary measures. In respect of the latter, a strong expansion is expected in public investment amidst Government's intentions to further strengthen the infrastructure set-up, with focus laid on: (i) enhancing land transport, port and airport infrastructure; (ii) upgrading water storage capacity, distribution structures and flood management systems; (iii) investment in renewable energy projects; and (iv) social housing and community development. In parallel, the economy is set to benefit from a pickup in private sector investment, driven, in particular, by a notable growth in the residential segment amidst dedicated budgetary measures aimed at further stimulating this segment as well as the execution of identified ventures, such as smart cities. Overall, the ratio of gross fixed capital formation to GDP is projected to rise by 60 basis points to attain 19.9% next year. From an expenditure standpoint, however, whilst both investment and household consumption would contribute positively to growth next year, we should bear in mind that their net impact on output is constrained by their high import content.

From a sectorial perspective, higher nationwide investment levels should trigger a noteworthy upturn in construction activities next year. Furthermore, as hinted above, economic growth would be underpropped by a significant rebound in the tourism sector, following the marked contraction observed in 2020 and another decline expected this year. That said, activity levels in the latter industry would stay well below the pre-pandemic position next year amidst uncertainties prevailing both on the demand side – in view of conditions in key source markets – and on the supply side, notably in respect of air capacity. For its part, the textile-manufacturing sector should sustain an appreciable performance amidst the anticipated pickup in private demand from our key trading partners, while domestic-oriented activities should be positively impacted by dedicated budgetary measures to encourage local production. Likewise, a recovery is envisaged in the retail trade segment in line with the expected pickup in household spending. Moreover, ICT and financial services – which displayed resilience during the COVID period – are poised to uphold their growth momentum next year. In respect of the latter sector, it is worth noting that the Budget has made provisions for a further reinforcement of the regulatory framework to accelerate the completion of the Financial Action Task Force (FATF) action plan. In respect of the latter, the authorities are increasingly confident that the country will exit the FATF list of 'jurisdictions under increased monitoring' in a near future and, as a result, the European Union's list of High Risk Third Countries.

That said, our growth outlook for next year remains subject to notable downside risks, relating, *inter alia,* to the extent of the recovery in the tourism sector, the pace of implementation of envisioned infrastructure projects and initiatives to further gear up the investment facilitation framework. Moreover, whilst nominal GDP is expected to return to its pre-pandemic level next year, the domestic economy would not reach its 2019 levels before 2023, when gauged in real terms.

Evolution of GDP in nominal and real terms



(f) forecast
Sources: Statistics Mauritius. MCB Staff estimates

Other indicators

Inflation

Since the beginning of the year, headline inflation has maintained a downward trajectory, with the indicator standing at 1.8% in May 2021. Looking ahead, inflationary pressures are likely to build up over the periods ahead, with headline inflation foreseen to reach 3.2% as at December 2021. In addition to factoring in the impact of prior increases in freight costs and in prices of Mogas stemming from higher international oil prices, cigarettes, basic food items such as rice and vegetables and other raw materials for construction, this outlook – which is higher than our previous forecast – captures the recent budgetary pronouncements to introduce an additional levy of Rs 2 per litre of Mogas and gas oil and increase the excise duty on cigarettes and alcoholic products. As for next year, headline inflation is expected to pursue its uptrend, peaking above the 4% mark during the second quarter amidst the pickup in economic activities, before moderating in the latter months to stand at around 2.8% as at December 2022, barring exceptional events, notably relating to the evolution of global commodity prices and exchange rate dynamics.

Unemployment

In spite of the significant economic downturn, nationwide unemployment was contained at 9.2% in 2020 as per official figures that are based on the technical definition of the International Labour Organization. This essentially reflects the support from dedicated measures, in particular the Wage Assistance and Self-Employed Assistance schemes. For this year, the indicator should remain at broadly similar levels, at around

8.9%, after making allowance for: (i) the impact of the second lockdown; (ii) prolonged closure of borders until July; and (iii) extension of the afore-mentioned schemes for the three-month period up to September 2021 for tourism-related companies. That said, after factoring the sharp fall of 20,900 observed in the labour force which stood at 570,100 last year, a rise can be expected therein as from the final quarter of the year - upon the second phase of the reopening of the country's borders - with the national activity rate gradually picking up. As the corollary thereof, the economically inactive section of the population which attained 431,600 in 2020 compared to 405,600 in 2019 – amidst the sharp increase in potential labour force to 42,000 as a result of the lockdown – should embark on a declining path. Yet, labour underutilisation – which includes those in potential labour force, the unemployed and those in time and skills-related underemployment – is anticipated to have risen to an estimated 38% of the labour force as at June 2021 as per our computations compared to its already-elevated pre-pandemic level of 27%. As for 2022, net job creation should be positively impacted by the acceleration in the pace of economic activity and budgetary measures, including provision of training and re-skilling and extension of the Youth Employment Programme. Overall, nationwide unemployment should improve, but stay at above pre-pandemic levels, at around 7.8%.

Public finance

The budget deficit is officially estimated at 5.6% of GDP in FY 2020/21, excluding the impact of any payment made in relation to the Betamax Judgement. Upon inclusion of the latter, the budget deficit would rise by 1 percentage point based on the figures provided in the 'Estimates of Supplementary Expenditure' of the Supplementary Appropriation (2020-2021) (No.2) Bill that has not yet been voted on and enacted. Of note, the deficit was initially expected to be balanced as per projections formulated by the authorities in last year's budget and was subsequently revised to 3% in the context of official pronouncements made in April last. On the revenue side, total revenue is estimated at Rs 155.5 billon for the year ending June 2021, after making allowance for the exceptional contribution of Rs 60 billion from the Bank of Mauritius (with Rs 32 billion charged to the Special Reserve Fund and the balance of Rs 28 billion reckoned as advance against future profits of the Central Bank distributable to Government). This outcome is Rs 7.4 billion below the budget projections, reflecting mainly lower-than-expected receipts emanating from taxes on goods and services, corporate profits as well as lower grants from foreign Governments. On the expenditure front, recurrent expenditure shot up to attain 30.9% of GDP, driven largely by the sizeable support measures provided by the authorities, particularly the Rs 22 billion disbursed under the Wage Assistance and Self-Employed Assistance Schemes, while capital expenditure was impacted by the transfer of Rs 31.7 billion to Special Funds.

With regard to FY 2021/22, the overall budget deficit is expected to narrow to 5% of GDP as per figures formulated by the authorities. Total expenditure is projected to drop by nearly 10% because of the lower transfer to Special Funds with the accumulated sum therein to be leveraged to finance mainly infrastructure projects. On the revenue front, in addition to being driven by a significant increase in property income from Rs 1.8 billion in FY 2020/21 to Rs 11.4 billion in FY 2021/22, reflecting principally a significant hike in 'withdrawals from income of quasi corporations' (notably from Financial Services Commission, Mauritius Ports Authority, State Trading Corporation and Central Electricity Board), the authorities expect a substantial rise in tax receipts – underpinned notably by a 41% rise in value added taxes and a 45% rise in corporate tax revenue. This appears challenging to achieve in view of the testing environment. Besides, the recurrent revenue in the Consolidated Fund includes an amount of Rs 7.8 billion relating to CSG contributions which could have been segregated given that they are earmarked for the payment of the additional Rs 4,500 for the universal pension to retirees of 65 years of age as from 2023. Overall, as per our baseline scenario, budget deficit would end up being higher, at around 6% of GDP in FY 2021/22 after factoring in the impact of a lower than officially projected nominal GDP outcome and a lower-than-budgeted tax revenue, albeit partly offset by an expected under-spending on the capital side. On another note, as another key operational instrument to guide economic policies aiming to support debt dynamics, the primary balance is officially projected to register another deficit in FY 2021/22, amounting to 2.3% of GDP, with the shortfall position foreseen to narrow marginally in the next couple of years.

From a policy perspective therefore, the implementation of fiscal consolidation measures is deemed important as the economy recovers from the pandemic with a view to placing public debt on a declining path and keeping the debt burden within manageable levels, to guard against potentially adverse dynamics. This notably calls for the exercise of proper fiscal discipline on the expenditure side - particularly on the recurrent front - to progressively and more weightily reduce non-productive outlays alongside making allowance for the higher pressures on spending likely to arise amidst 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 a competitive tax regime.

External front

On the external front, the large imbalances continue to warrant attention in view of the challenging conditions prevailing in several of the country's key markets, the pressures on the import bill amidst hikes in commodity prices as well as the increase in freight costs, while currency dynamics are also weighing in the balance. For the current year, we have maintained our forecast for the country's balance of trade deficit broadly unchanged at about Rs 111 billion, i.e. around 24% of GDP. Next year, the trade deficit is anticipated to deteriorate to reach just under Rs 120 billion on account of a marked rise in the import bill due to the purchase of machinery and transport equipment and higher demand for petroleum to support the recovery that would more than offset the pickup foreseen in exports of goods. Overall, the current account deficit is, in view of the modest pickup expected in tourism receipts, anticipated to stand at 12.9% of GDP in 2021, with the worsening relative to our prior projection explained by a downward revision in grants anticipated from foreign Governments that has more than offset the impact of higher primary income. In 2022, the current account deficit should benefit from the anticipated recovery in the tourism sector, with the imbalance narrowing to 8.1% of GDP. For its part, the Balance of Payments is expected to benefit from the projected recovery in capital and financial flows. In particular, the lines of credit and financial assistance received from foreign Governments and international agencies as well as the partial rebound in private capital flows, inclusive of capital raised by local financial institutions on international markets and through the private sector window of Development Finance Institutions, should contribute to a narrowing in the BOP deficit to around 2.7% of GDP this year. A return to surplus territory can be anticipated next year as the country's international transactions pick up and gather momentum.

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