Occasional paper **No: 87**

MCB Focus

Economic Update

April 2022

MCB GROUP

TABLE OF CONTENTS	PAGE

Figures

Boxes

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Main economic indicators

Figure 1 **Main economic indicators**

	Unit	2018	2019	2020	2021[1]	2022[2]
Real sector						
GDP at market prices	Rs bn	481	498	430	463	513
GDP growth (at market prices)	%	3.8	3.0	-14.9	3.9	6.2
Gross Domestic Saving	% GDP	9.0	8.8	8.2	9.8	9.5
Gross Fixed Capital Formation	% GDP	18.8	19.6	17.9	19.2	18.9
Private sector investment	% GDP	14.2	14.3	13.6	14.8	14.4
Public sector investment	% GDP	4.5	5.3	4.3	4.4	4.5
Headline inflation	Jun, %	4.3	1.0	1.8	2.2	7.7
Unemployment rate	average, %	6.9	6.7	9.2	9.4	7.9
Fiscal sector						
Budget balance	FY, % GDP	-3.2	-3.2	-13.6	-6.0	-6.0
Budgetary Central Government debt	FY, % GDP	57.0	57.8	75.0	87.2	79.4
Public sector gross debt	FY, % GDP	63.4	65.3	83.4	96.2	88.5
External sector						
Balance of visible trade	% GDP	-23.3	-24.1	-22.2	-28.7	-31.1
Current account balance	% GDP	-3.9	-5.4	-12.6	-13.8	-14.3
Overall balance of payments	% GDP	3.5	6.6	-4.9	11.9	3.9
Memorandum item:						
GDP at market prices	*USD bn*	*14.1*	*14.0*	*11.0*	*11.2*	*11.8*
Per capita GDP	*USD*	*11,124*	*11,058*	*8,665*	*8,825*	*9,298*

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

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

International developments

Russia's invasion of Ukraine is hogging headlines worldwide since 24th February. Alongside constituting a major humanitarian crisis, the war is compounding a global economy that is yet to fully recover from the pandemic shock and was already showing signs of weaknesses. Whilst the magnitude of the economic impact of the war remains highly uncertain and will ultimately depend on its duration and policy responses, it is clear, as recently outlined by the IMF that: *"the conflict is a major blow to the global economy that will hurt growth and raise prices".* Such concerns are corroborated by the OECD in its March Interim report, with the agency estimating, as an initial assessment, that the ongoing conflict could slash global GDP growth by over 1 percentage point and raise global inflation by nearly 2½ percentage points this year.

In fact, although Russia and Ukraine account for only 2% of global GDP and a similar proportion of total global trade, the war is having spillover effects to the rest of the world through three main channels. First, the war is exacerbating the rise witnessed in commodity prices like food and energy that will push up inflation further, in turn dampening the value of incomes and weighing on demand. Russia and Ukraine are major commodity producers, and disruptions have caused global prices to soar. In particular, Brent traded close to

USD 140/barrel in March – its highest level since 2008 – amidst the supply concerns before receding lately, whilst remaining volatile. The US Energy Information Administration expects Brent price to average USD 102 in the second half of the year. Likewise, food prices have jumped, with wheat, for which Ukraine and Russia make up nearly 30% of global exports, reaching an all-time high in March. Secondly, over and above the historic surge in refugee flows, European countries in particular face renewed risks to global supply chains due to disrupted trade routes. It is worth highlighting that the rise in global shipping costs associated with supply chain disruptions in 2021 could, as per a recent study by the IMF, account for 1.5 percentage points of the increase in inflation this year. As a third channel of transmission, dampened business confidence and higher investor uncertainty is weighing on asset prices, contributing to heightened market volatility and tightened financial conditions which can potentially result in capital outflows from emerging markets.

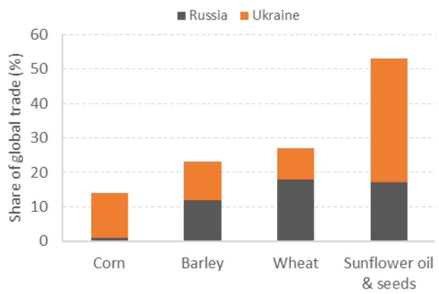
The extent of the damage these developments cause will vary widely across regions and countries. On top of the economic carnage expected in both Russia and Ukraine, European countries are likely to be the hardest hit on account of their strong energy reliance on Russia. Alongside raising their forecasts for inflation in the euro area by some 2 percentage points, both the European Central Bank and the OECD have cut their growth forecasts therein for this year. The downward growth revision reflects the drag the supply and energy shocks are expected to exert on the three largest economies, notably Germany, France and Italy. For its part, the United States has few ties with Ukraine and Russia, thereby diluting direct effects to some extent. Nonetheless, the war is set to have spillover effects on economic activity, with the Federal Reserve having slashed its median estimate for US economic growth by 120 basis points to 2.8% in March. The growth outlook for the United Kingdom was revised downwards from 6% to 3.8%, with inflation now expected to reach about 8% in the second quarter. Elsewhere, the Chinese economy is being beset by an outbreak of Omicron-linked infections which has triggered the lockdown of Shanghai – its biggest city and financial hub. Coming to the region, recovery prospects in sub-Saharan Africa are projected to be more muted with many commodity importers being impacted by higher energy and food prices along with reduced tourism and potential difficulty in accessing international capital markets. Notably, record wheat prices are concerning for a region that imports around 85% of its supplies, one third of which comes from Russia or Ukraine.

As regards financial markets, global equities dipped as risk-off sentiment was triggered by the war and concerns over the firm hawkish monetary stance adopted by major Central Banks. In the fixed income space, most developed markets sovereign bond prices lost grounds as Central Banks brought forward the expected path of their tightening cycle amidst continued inflationary pressures. In particular, the FED's strong hawkish stance to curb rising prices is sparking concerns over the negative impact of abrupt tightening policies on US output and global growth. For its part, US dollar has benefited from both its safe haven trait, as investors shift from risky assets to safe assets, as well as rising US yields. Similarly, spot gold price has followed a general ascent on the back of rising risk aversion from the war, although high level of volatility prevails.

Box I: Global economic fallout of the Russia-Ukraine conflict

Importance of Russia and Ukraine

Global players in the agri-food market



Energy and commodity market

- *Russia is the 2nd largest producer of gas and 3rd largest oil producer in the world.*
- *About 60% of Russia's oil exports go to Europe; while 40% of the EU's natural gas currently comes from Russia*
- *Ukraine is a crucial transit hub for oil & gas between Russia and the EU*
- *Ukraine has the 2nd largest iron ore reserves in the world*

A key downside risk has materialised amidst the Russian invasion of Ukraine…

More than a month into the war

- *Russian President Vladimir Putin launched a full-scale invasion of Ukraine in the early hours of February 24*
- *Russia has been hammered with severe punitive sanctions, including asset freezes and export bans*
- *Peace talks between Russia and Ukraine are ongoing*
- *The UN says more than 10 million people have been displaced in Ukraine*

…beyond the humanitarian damage in Ukraine, the economic fallout is being felt worldwide…

Key channels of transmissions

Commodity price shock

Higher commodity prices on the back of concerns around supplies, the destruction of physical infrastructure and sanctions

Supply chain disruptions

Disrupted trade routes and cargo flows and restrictions on air links are compounding the existing supply-chain bottlenecks

Financial market shock

Heightened uncertainty and volatility leading to rising credit spreads, falling equity prices and an erosion in confidence

Materially changing the global economic backdrop

- Near-term drag on global growth
- Persistent inflationary pressures
- Additional fiscal strains
- Monetary policy challenges
- Market volatility
- Food insecurity
- Refugee crisis

…prompting the OECD to revise its growth prospects and inflation outlook..

Year 2022

Impact on GDP growth		
World Economy	▼	1.1 pp
Euro area	▼	1.4 pp
United States	▼	0.9 pp

Impact on inflation		
World Economy	▲	2.5 pp
Euro area	▲	2.0 pp
United States	▲	1.4 pp

Sources: Moody's Investor Service, OECD, UNCTAD and various press articles

Revised growth forecasts for Mauritius

Revised estimates for 2021

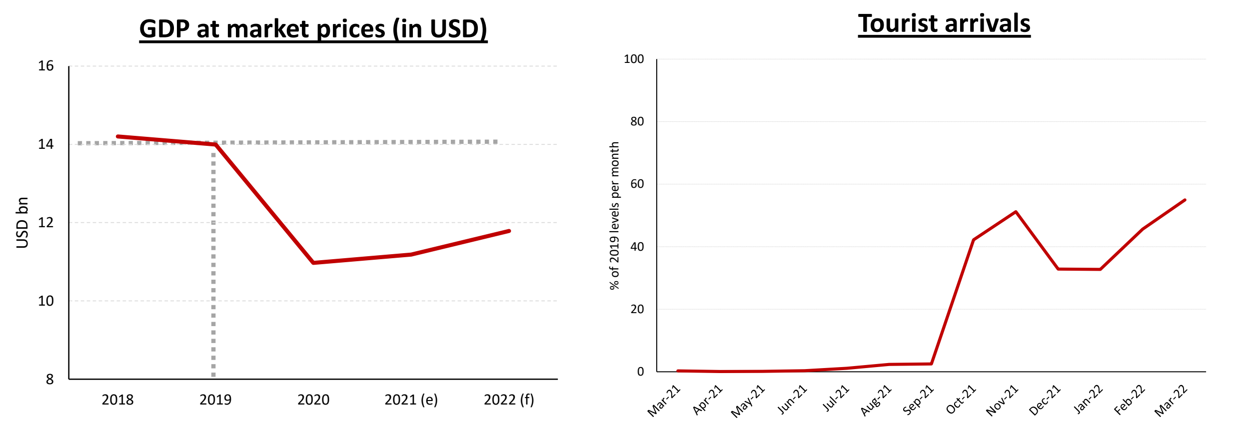
For 2021, Statistics Mauritius has, in the context of its latest Quarterly National Accounts, revised its estimate for real GDP growth at market prices to 4.0%, representing an 80 basis points downgrade from the official figure released in December last. This downward revision has been mainly prompted by the contraction in taxes on products net of subsidies. After factoring in a lower growth in the latter, we have cut our estimate for real GDP growth at market prices by 10 basis points to 3.9%, relative to our January figures. For its part, nominal GDP in rupee terms improved by nearly 8% to an estimated Rs 463 billion in 2021. Whilst improving by 10% on a nominal basis, exports of goods and services remained well below the pre-pandemic level. On the other hand, the country's imports grew by 23.6%, fueled *inter alia* by the rise in consumption whose net impact on real output is generally constrained by its high import content. As the corollary thereof, gross domestic savings to GDP ratio remained below the 10% mark last year, thereby causing the resource gap to stay at an elevated level of 9.4%. Such dynamics are cause for concern as they tend to accentuate our dependence on foreign capital flows in the long run. Overall, when measured in USD, GDP increased marginally from USD 11 billion in 2020 to USD 11.2 billion last year. As a result, per capita GDP rose by 1.8% to attain USD 8,825 in 2021, i.e. over 20% below its pre-pandemic level.

Updated projections for 2022

While we have very limited economic exposure to the two countries, the global fallout of the ongoing Russia-Ukraine conflict is inevitably going to have notable indirect effects onto the domestic economy. A precise and thorough assessment of the toll on nationwide activity levels is quite complex at this stage given the uncertainty over the duration and magnitude of the war. However, there are already visible signs that the sharp rise in input costs resulting from the jump in commodity and energy prices and disrupted supply chains would, coupled with the downward revisions in our main trading partners, weigh on the strength of the recovery being witnessed locally as depicted in Box II. On the expenditure front, the higher price and cost pressures are set to constrain domestic consumption and restrain the anticipated rise in nationwide investment alongside exacerbating the level of visible trade deficit which would, this year, exceed 30% of GDP for the first time in the country's history. At the output level, rising costs and prices would weigh on value added notably across the manufacturing, retail trade and construction sectors, thereby rubbing off 65 basis points from our growth forecast formulated in January last. This would however be partly offset by the upgrade in our projection for tourist arrivals for this year – with our estimate being now higher than our previous figure by some 8% – after factoring in forward bookings notably for the fourth quarter, the recent lifting of travel restrictions with respect to France, Reunion and South Africa as well as market diversification objectives envisioned in the short-term plan of the authorities. Overall, we expect the country's growth rate to stand at 6.2% in 2022, representing a 50 basis points cut from our January figures.

Whilst tourist arrivals in the first quarter of 2022 stood at only some 45% of the pre-pandemic level, encouraging progress is being made in respect of some European markets, such as UK and France. That said, although we have, as highlighted above, revised upwards our projection for arrivals for this year, the target of one million tourists by December 2022 announced by the authorities appears ambitious in view of: (i) the potential knock-on effects of the conflict on our key European markets and the rise in air ticket prices; and (ii) air connectivity challenges and seat availability. As for other sectors, production capacity across the retail trade and manufacturing sectors is set to be impacted by the notable rise in raw material prices, elevated freight costs and logistic issues while labour shortages continue to warrant attention. In the same vein, whilst the construction sector would remain a key growth driver on account of public investment in infrastructure ventures and private capital spending notably in the logistics, energy and real estate sectors, soaring material prices - which make up a large portion of the cost of a new build - would restrain the expansion in the residential building segment. Financial services should sustain a robust expansion with banking operators capitalising on their financial soundness and regional diversification inroads. The exit of Mauritius from the FATF grey list and from the European Union black list should reinforce trust in and boost the competitiveness of our International Financial Centre. The ICT sector is set to register another appreciable expansion while the sugar industry would recover despite being faced with adverse climatic condition at the start of the year on the back of a pickup in demand for special sugar from China and India following the signing of free trade agreements and an improvement in EU sugar prices. On the whole, the level of national income as gauged by GDP at market prices is, after factoring in a higher deflator, estimated at Rs 513 billion, compared with our previous estimate of Rs 508 billion. When measured in US dollars, nominal GDP at market prices would improve to USD 11.8 billion this year, which remains some 16% below the pre-pandemic level.

Figure 2 **Evolution of nominal GDP and tourist arrivals**



(e) Revised estimate *(f) MCB revised forecasts*

**The country reopened its borders fully as from 1st October 2021*

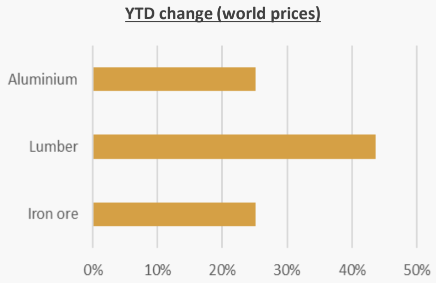
Sources: Statistics Mauritius and MCB staff estimates

Box II: Ramifications of the Russia-Ukraine conflict on input costs in Mauritius

Freight costs

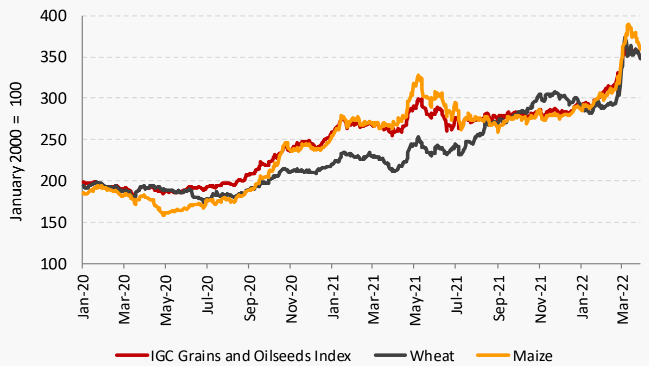
The Russia-Ukraine war could cause global shipping rates which were already high post the pandemic to double or even triple

Construction



***Cement price** on the domestic front has increased by **around 20%** since 2019*

Retail trade



Textile

*Cotton price saw a **23% YTD increase on world markets***

Such dynamics would put pressure on the country's already-elevated import bill

Key components of Mauritius' import bill (2021)						
	20% Machinery	**19%** Food & live animals	**18%** Manufactured goods	**17%** Mineral fuels & lubricants	**12%** Chemicals & related goods	**10%** Other manufactured articles

Sources: Investing.com, International Grains Council , Statistics Mauritius and various press articles

Risks to the growth outlook

While our baseline scenario continues to envisage an acceleration in activity levels for this year, the growth outlook is subject to a high level of uncertainty, with the escalation of the conflict between Ukraine and Russia adding to existing policy challenges linked to the pandemic. As such, whilst it was deemed to be broadly balanced in our January issue of MCB Focus, the balance of risks to the domestic macroeconomic picture is now tilted on the downside, although upside risks remain, as depicted in the following illustration.

Box III: Risk assessment

Scenario	Description and expected impact	Probability of occurrence
Downside	• Relative to our baseline, the intensification of the war triggers a further rise in commodity prices and disrupts the supply chain, giving rise to higher and more persistent global inflationary pressures with ripple effects on input costs on the domestic front. Besides, the spillover recessionary effects of the war in our key markets in Europe would dampen demand for our exports of goods and services. Moreover, higher energy and commodity prices would impact real income of households, leading to higher subsidy spending by the Government which complicate fiscal consolidation plan	Moderate
	• A more virulent and highly transmissible variant emerges, as per the WHO worse case scenario, further disrupting economic activities, delaying the recovery of contact intensive activities projected in our baseline, thereby widening the fiscal financing deficit. The global travel industry takes a further hit, with adverse consequences on the tourism industry	Low to moderate
	• Risks related to natural disasters materialise, affecting economic activity, disrupting agricultural production and increasing food inflation	Low
	• Delays in implementing a credible and coherent strategy to restore fiscal and debt sustainability, eventually leading to the further downgrade of the country's sovereign credit rating	Low to moderate
	• A prolonged period of inflationary pressures worldwide leading to abrupt or larger-than-expected monetary tightening in major advanced economies, thereby triggering outflow of capital and financial flows with adverse consequences on our balance of payments and reserve position	Moderate
Baseline	• Economic activity is supported by a rebound in tourist arrivals and the positive developments from the exit of the Mauritian IFC from the European Council list of high-risk third countries, but rising input costs weigh on the value added of manufacturing, retail trade and construction sectors	Moderate to High
	• Growth in overall investment being mainly driven by large-scale government ventures, with a positive growth in private sector investment, albeit at a lower pace than previously thought in view of the higher inflationary environment	Moderate
Upside	• Relative to our baseline, efforts to reach a negotiated settlement of the war progress faster with positive spillover effects on the global economy, leading to stabilisation of commodity and energy prices, thus attenuating pressures on input costs and higher inflation risks on the domestic front. Besides, the recovery in our key markets occurs at a faster pace than foreseen in the baseline, with positive impact on the country's exports of goods and services	Low
	• A quicker pickup in tourist arrivals, albeit still remaining below the 2019 level, stemming from a faster pace of normalisation of activity levels in our key markets coupled with higher air seat capacity and success in market diversification efforts by the authorities	Low to Moderate
	• A higher-than-envisioned growth in respect of nationwide investment, spurred by the enhancement of project implementation capabilities at both public and private sector levels backed, for instance, by continued rapid adoption of digital technologies as well as renewed investor confidence in the Mauritian jurisdiction following the removal from the EU and FATF lists	Low to moderate

Source: MCB Staff estimates

Box IV: Key pillars for transforming our economic and social paradigm

In addition to the provision of timely, temporary and targeted support measures to address immediate imperatives, a comprehensive set of structural reforms is deemed essential to enable the country elevate its potential growth rate over the medium term. Whilst not being prescriptive, some key pillars that could assist in fostering a higher, sustained and more inclusive growth path for the country are outlined below.

The ultimate **objective** → **Stronger and more resilient future for Mauritius and its people**

Laying grounds for a: **More competitive economy** + **More fulfilling society** + **A greener nation**

Main pillars to boost the country's potential output

1. **Conducive investment framework and widened economic space**
   Strengthen and diversify our global involvement to boost exports of goods and services backed by further improvement in the business framework
2. **Local production**
   Stimulate local production for increased resilience and sufficiency (e.g. ensure food security and embracing circular economy principles)
3. **Social inclusiveness and harmony**
   Strengthen the country's social stability and promote healthy living conditions
4. **Green economy**
   Achieve sustainable and environment-conscious growth and development
5. **Digital and innovative economy**
   Maximise the potential of a smart economy
6. **Human capital accumulation**
   Uplift the talent pool, whilst enhancing human capital accumulation
7. **Judicious economic management**
   Foster sound policy-making in support of the country's ambitions (e.g. by creating adequate fiscal space)

Key enablers underpinning our actions

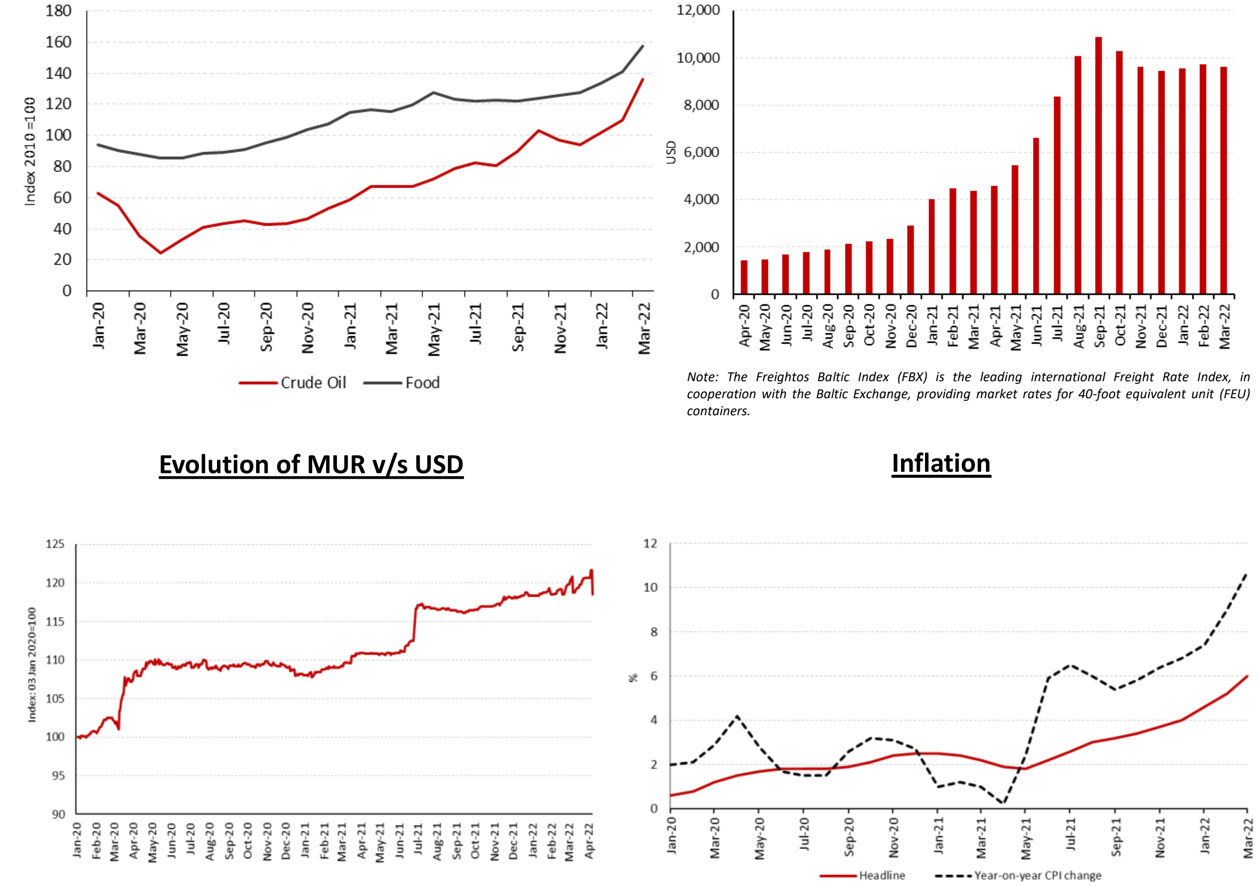
1. Establishing a **coherent and well-defined roadmap** for the realisation of our long-term socio-economic goals, aided by realistic and time-bound targets and objectives
2. Establishing **reliable legislative and administrative safeguards** to achieve optimal project implementation, alongside underpinning the responsible and pragmatic allocation and utilisation of funds, in alignment with set guidelines
3. Fostering **institutional empowerment and accountabilities**, aided by the recourse to clear performance assessment criteria and indicators and continuously **strengthen the institutional and governance framework** for further improving the business climate
4. Promoting **strong and well-calibrated public-private sector partnerships**, helped by strong working ethos, transparent modalities and clear objectives
5. Improving and simplifying **labour market mechanisms**, while addressing the skills mismatch by investing in the reform of the education system alongside boosting the **recourse to foreign expertise and capital,** notably in the high-skilled segment to help expedite the realisation of the complex and expensive ventures
6. Restoring the key tenets of the country's competitive advantages, which had over time stood us in good stead, especially **the low, simple, predictable and non-distortionary tax system**
7. Enhancing the **speed and reliability of Internet connectivity,** while further reducing the cost of access and encouraging innovation
8. Adopting well-designed policies to better **manage our environmental resources** in view of growing climate risks while supporting the country's **transition to a green economy**

Other indicators

Inflation

As highlighted before, the rise in food and fuel prices and further pressures on freight costs amidst disruptions to supply chains stemming from the Russia-Ukraine war are aggravating the already elevated inflationary pressures worldwide. In Mauritius, considering that imported items bear a significant weight in the Consumer Price Index basket, such global disturbances are poised to feed into higher pressures on prices. Against this backdrop, we have revised upwards our forecasts for inflation for this year. Notwithstanding price control measures on essential products as well as subsidies on electricity bills for specific residential tariffs, headline inflation accelerated from 4.0% in December 2021 to 6.0% in March 2022 on the back of upward price pressures from fuel and food items coupled with hikes in non-alcoholic beverages and rises in fresh vegetable prices amidst successive episodes of adverse climatic conditions and higher fertiliser costs. Likewise, year-on-year inflation pursued its uptrend from 6.8% in December 2021 to 10.7% in March 2022.

Figure 3 **Key factors contributing to the high inflationary environment**



Note: The Freightos Baltic Index (FBX) is the leading international Freight Rate Index, in cooperation with the Baltic Exchange, providing market rates for 40-foot equivalent unit (FEU) containers.

Note: An increase (decrease) in the index indicates a depreciation (appreciation) of the rupee.

Note: i) Headline inflation is measured by comparing the average level of prices, as measured by the monthly CPI, during a twelve-month period.
ii) Year-on-Year inflation rate is computed as the change in the CPI for a given month compared with the same month .

Sources: Statistics Mauritius, Bank of Mauritius, World Bank and Freightos

Moving forward, headline inflation should sustain its upward trajectory, taking into consideration the second-round impact of recent price hikes and pressures on the rupee, notwithstanding the intervention by the Bank of Mauritius on the domestic foreign exchange market on April 8. The indicator is set to reach 7.7% in June 2022. Its evolution over the coming months would be largely scenario-based given the highly uncertain environment. Under our baseline scenario, headline inflation as at year end would remain close to our forecast for June provided that: (i) there is a relative stabilisation of the rupee in the period ahead; and (ii) price control measures introduced are extended in a timely, temporarily and targeted fashion in order to address potential socio-economic implications. Bearing in mind the distortionary effects of the latter measures as established in economic theory and evidenced empirically, the phasing out of subsidies should, however, be carefully managed when the situation normalises. In 2023, inflation should, *ceteris paribus,* embark on a downtrend as the high base effects weigh in the computations with an acceleration in the pace of decline in the second part of the year. Nevertheless, there are notable risks that could cause headline inflation to end up at a higher rate than envisaged in our baseline amidst uncertainty regarding the Russia-Ukraine war which could trigger further commodity and energy price shocks. The shock triggered by the war has, in fact, compounded rising inflationary pressures which are now a key concern for policy makers worldwide. Indeed, major Central Banks such as the US FED are poised to tighten monetary policy more aggressively, although the pace of normalisation is set to remain data dependent. In Mauritius, the Bank of Mauritius raised the key repo rate by 15 basis points to 2% in March amidst growing inflationary pressures, with the possibility of further hikes not to be dismissed amidst rising interest rate differential vis-à-vis developed markets, although the negative output gap in relation to the pre-pandemic level could weigh in the balance, thereby potentially implying a less than proportional increase in the policy rate on the local front relative to major Central Banks such as the Bank of England and the US Federal Reserve.

Unemployment

Latest official statistics released for the last quarter of 2021 depict a gradual improvement in labour market aggregates in the wake of the reopening of the country’s borders and the gradual uptick in activity levels on the local scene. Although increasing on an average basis to 9.4% in 2021, nationwide unemployment rate dropped from 9.5% in the third quarter of 2021 to 8.1% in the fourth quarter of 2021, with youth unemployment rate decreasing from 26.4% to 24.2%. Importantly, whilst remaining higher than the corresponding level in 2020, the inactive population dropped by 27,300 relative to the third quarter of 2021 to stand at 456,900 at the fourth quarter, two thirds of which are female. As the corollary thereof, the labour force increased by 28,900 from the third to the fourth quarter of last year, contributing to a 2.7 percentage points rise in the national activity rate to 54.8%. The labour market situation is set to improve further this year, with nationwide unemployment attaining 7.9%, which, however, remains higher than the pre-pandemic level of 6.7%. Yet, labour underutilisation – which incorporates those in potential labour force, the unemployed and those in time and skills-related underemployment – should continue to warrant attention. This category which was already elevated at 27% of the labour force prior to the pandemic is likely to have been aggravated in the wake thereof. In respect of the latter, a recent paper by the IMF indicates that COVID-19 may have caused workers worldwide to become less willing to work in contact-intensive sectors and voluntarily quitting the labour force – a phenomenon often labelled as the "Great Resignation".

Public finance

After falling from its high of 13.6% to GDP in FY 2019/20 to 6% in FY 2020/21 backed by the exceptional contribution of Rs 60 billion from the Bank of Mauritius on account of the negative impact of COVID-19, the authorities expect the downward trend in the budget deficit to continue as per the Medium Term Macroeconomic Framework released as part of last year's Budget. On our side, we have kept our forecast for budget deficit unchanged at 6.0% of GDP for FY 2021/22, whilst awaiting for the resolutions to be announced in the forthcoming National Budget. The anticipated rise in recurrent expenditures, relative to our January estimates, is likely to be compensated by the impact of the higher nominal GDP following a higher deflator effect. For its part, Central Government debt has sustained its improving trend to attain 80.9% of GDP as at December 2021 as per official figures, while public sector debt – when gauged in both gross and net terms – also followed downward path. A slight drop in debt ratios is anticipated as at June 2022, in line with the ongoing pickup in economic activities. That said, the fiscal situation will, as it is the case worldwide, continue to call for vigilance, especially in view of the current context. As per a recent article by the IMF: "*The uncertain outlook and heightened vulnerabilities make it critical to achieve the right balance between policy flexibility, nimble adjustment to changing circumstances, and commitment to credible and sustainable medium-term fiscal plans.*" Towards the latter ends, a key priority is to increase revenue mobilisation in the least distortive manner and create conducive conditions for higher nationwide economic expansion alongside exercising vigilance to properly calibrate and prioritise expenditures the more so in view of rising pressures from the ageing of the population. Subsequently, this will enable the country to maintain its credibility vis-à-vis its rating agencies and preserve the investment-grade status of its credit profile in support of endeavours to tap into international financial markets, alongside duly supporting financial services sector operators in their regional expansion strategies.

External front

The sharp rise in input costs in the wake of the Russia-Ukraine conflict coupled with elevated freight charges are set to exacerbate the country's already high level of external imbalances. As such, we have further worsened our projection for the visible trade deficit for this year to some 31% of GDP, which is 4 percentage points higher than our January forecast. Particularly, the sizeable terms of trade shock emanating from the notable hike in import prices of a range of items including food, oil, construction materials and machinery equipment would more than offset the moderate pickup expected in exports of goods. In turn, despite benefiting from a noteworthy improvement in tourism receipts and a further rise in primary income, the current account deficit is set to deteriorate to 14.3% of GDP this year. The balance of payments should, nonetheless, remain in a surplus position, amidst sustained levels of capital and financial flows in particular through the global business sector. The BOP surplus is, however, expected to be at a lower magnitude than the Rs 55 billion seen last year, with the latter having been further boosted by large receipt of financial assistance from foreign Governments and international agencies as well as the Special Drawing Rights (SDR) allocation of Rs 8.3 billion from the IMF. That said, the positive outcome on the balance of payments should continue to be subject to our monitoring in view of the highly volatile nature of capital flows which exposes the country to vulnerabilities in the event of a sudden loss of appetite – especially in the current global context – that could impact real and financial sector activities.

J. Gilbert Gnany

Chief Strategy Officer April 8, 2022

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