Occasional paper **No: 88**

MCB Focus

Economic Outlook

July 2022

Disclaimer

TABLE OF CONTENT — PAGE

Introduction	**5**
Recent developments	**6**
The international landscape	**6**
The domestic scene	8
○ National Budget 2022/23	8
○ Rebasing of National Accounts estimates	10
Economic outlook	**11**
Economic growth	11
Other indicators	15

Figures

Figure 1:	Main economic indicators	5
Figure 2:	Change in nominal GDP at market prices following the rebasing of National Accounts	10
Figure 3:	Summary of key National Accounts revisions	11
Figure 4:	Evolution of GDP growth and per capita income	12
Figure 5:	Evolution of inflation rates	16
Figure 6:	Zoom on the external position of Mauritius	19

Boxes

Box I:	The world economy facing risks of lower growth and higher inflation	7
Box II:	Pickup in tourism sector: Mauritius vs regional peers	13

Page intentionally left blank

Introduction

This paper provides an update on the economic outlook of Mauritius in the wake of the latest developments occurring on the international front as well as the presentation of the National Budget 2022-23 and the rebasing of National Accounts estimates on the domestic scene following data obtained from the Census of Economic Activities carried out in 2018. The table below provides our revised macroeconomic aggregates with the underpinning rationale thereof elaborated in subsequent sections.

Main economic indicators

Figure 1 Main economic indicators

	Unit	2018	2019	2020	2021	2022[1]	2023[2]
Real sector							
GDP at market prices	Rs bn	500	512	448	481	536	593
GDP growth (at market prices)	%	4.0	2.8	-14.6	3.6	6.0	5.5
Gross Domestic Saving	% GDP	13.0	11.9	9.8	10.3	10.4	11.9
Gross Fixed Capital Formation	% GDP	18.0	19.1	17.1	19.5	19.1	18.8
Private sector investment	% GDP	13.7	13.9	13.0	15.4	15.0	15.0
Public sector investment	% GDP	4.4	5.2	4.1	4.1	4.1	3.8
Annual average headline inflation	Dec, %	3.2	0.5	2.5	4.0	10.2	4.6
Unemployment rate	average, %	6.9	6.7	9.2	9.1	7.9	7.6
Fiscal sector							
Budget balance	FY, % GDP	-3.2	-3.2	-13.6	-5.0	-4.0 [a]	-3.5 [a]
Public sector gross debt	FY, % GDP	63.4	65.3	83.4	96.2	87.4 [a]	78 [a]
Public sector debt (as per the Public Debt Management Act) [b]	FY, % GDP	63.4	65.3	70.4	79.2	77.3 [a]	72.9 [a]
External sector							
Balance of visible trade	% GDP	-22.4	-23.4	-21.3	-27.6	-32.7	-27.9
Current account balance	% GDP	-3.8	-5.0	-8.9	-13.3	-13.9	-8.9
Overall balance of payments	% GDP	3.3	6.4	-4.7	11.5	1.6	5.2
Memorandum item:							
Per capita GDP	*USD*	*11,559*	*11,359*	*9,044*	*9,154*	*9,459*	*9,954*

[1] MCB revised forecasts [2] MCB forecasts

[a] The fiscal sector figures for FY 2021-2022 and 2022-2023 are as per the projections made in the National Budget 2022 - 2023 and approved in the National Assembly and are, as such, not adjusted for changes in nominal GDP estimates

[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

Recent developments

The international landscape

The world is paying a heavy price for the war in Ukraine. In addition to the escalating humanitarian costs, high-frequency data portray a global economy that is grappling with a series of destabilising shocks amidst surging commodity and energy prices and the aggravation of supply-chain issues fueling higher inflation as well as the pronounced tightening of monetary policy across advanced economies. The war-related disruptions are acting together with the shutdowns in major cities and ports in China to slow global economic activity. Against this backdrop, the IMF has already hinted that it would slash the global growth forecast for this year for a third time when the Fund publishes its World Economic Outlook Update in July. This comes after the recent global growth downgrade by the OECD and the World Bank, with both organisations also stressing that the uncertainty around the outlook remains high with a number of prominent risks. The World Bank warned that: "*the world economy is again in danger. This time it is facing high inflation and slow growth at the same time. Even if a global recession is averted, the pain of stagflation could persist for several years*".

By virtue of its proximity to the war-stricken region, Europe is being hit the hardest. The European Central Bank (ECB) has lowered its growth forecast for the single-currency area in 2022 to 2.8%, down from 3.7%, with the risk of stagflation being increasingly mentioned and some member countries potentially falling into technical recession in the near term. Inflation figures for the euro area hit a record high of 8.6% in the year to June, prompting the ECB to indicate its intention to act in a determined and sustained manner with its monetary tightening cycle set to begin later this month. In the US, with year-on-year inflation beating expectations to attain 8.6% in May, the Federal Reserve (FED) has resorted to a more aggressive tightening stance, raising its benchmark rate by 75 basis points in June - the biggest increase since 1994 - with expectations as per FED economic projections made in June that rates could end 2022 at 3.4% – up from the March projections of 1.9%. Additionally, the forecast for GDP growth in the US has been cut to 1.7% in 2022, down from 2.8%, whilst expectations for 2023 and 2024 have been revised to less than 2%. Similarly, growth prospects in the UK are expected to dim as monetary tightening and war spillovers continue to weigh in the balance. In China, growth lost momentum amidst stringent COVID-19 restrictions and weak real estate investment. Concomitantly, food insecurity and narrowing fiscal space are creating rising headwinds for sub-Saharan Africa, though oil-exporting countries are expected to partly benefit from rising commodity prices.

Across asset classes, oil prices have remained highly volatile, hovering in the range of USD 100 - 120/barrel, albeit falling lately amidst potential ramifications on oil demand of the rising global recessionary fears. On the currency front, rising safe-haven flows translated into a stronger US dollar. Meanwhile, financial markets remained beset by a sharp tightening with the US FED having taken a more hawkish stance. Pursuant to the latter development, US Government bond yields rose whilst equity prices took a dip, with S&P 500 registering, during January-June 2022 its worst first half performance since 1970.

Box I: The world economy facing risks of lower growth and higher inflation

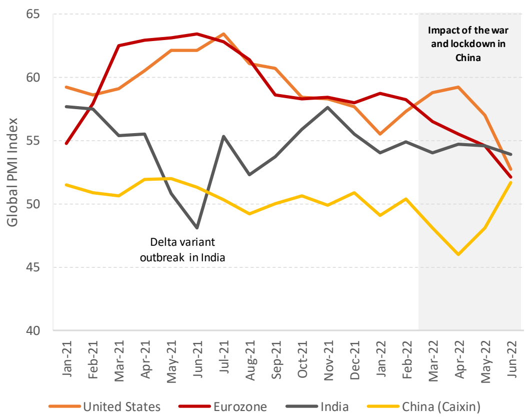
Fears of stagflation are looming..

A series of dynamics are rattling the global economy

- **Strains in global supply chains**
- **Rising geopolitical tensions amidst Russia-Ukraine conflict**
- **Lingering effects of the COVID-19 crisis and slowdown in China**
- **Rising food & energy prices adding to inflationary pressure**
- **Growing concerns about food security**
- **Tighter financial conditions amidst monetary tightening**

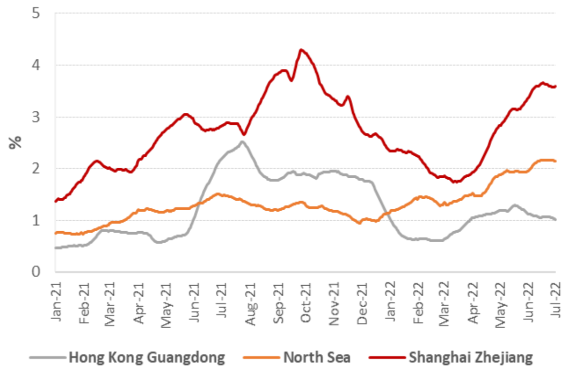
...with leading indicators signaling increasing weaknesses...

Manufacturing industries remain hamstrung by supply chain bottlenecks and the war...

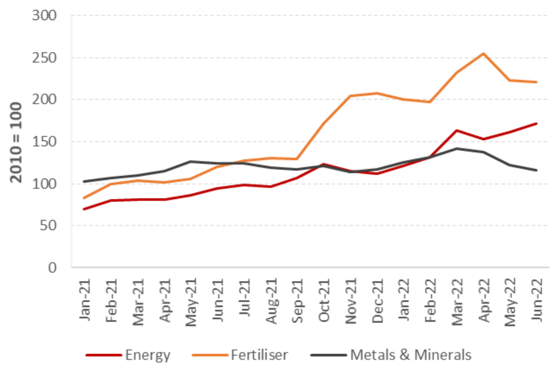


Port congestion remains visible amidst COVID-19 restrictions in China...

% of global container ship cargo capacity tied up and unable to be loaded or unloaded

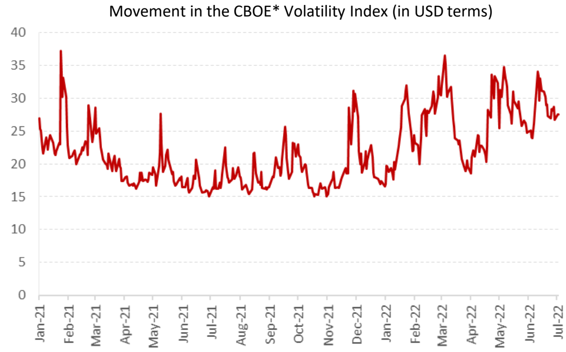


Increased volatility in the commodity market fueling higher inflation...



Asset markets remain volatile amidst uncertainty associated with the war...

Movement in the CBOE* Volatility Index (in USD terms)



**CBOE stands for Chicago Board Options Exchange*

Sources: Investing.com, Kiel Institute, IHS Markit, World Bank and OECD

The domestic scene

National Budget 2022/23

Key thrusts of the Budget

The National Budget 2022-2023 was presented on 7th June amidst a particularly challenging context, with the war compounding the fragile post-COVID global recovery and leading to soaring inflation as well as tighter financial conditions worldwide. In line with the trend observed in recent years, the Budget laid emphasis on social spending with measures announced notably to tackle the rising cost of living, including subsidies on selected staple products, rise in old age pensions and other social aids and support to low and lower middle income earners. Measures have also been proclaimed to encourage local production notably with the creation of food security clusters and provision of grants and preferential loan schemes, support SMEs, assist export operators and lift the share of renewable energy in our energy mix to achieve the target of 60% by 2030 with an intermediate objective of 40% by 2025. Moreover, moves have been initiated with the aim of improving the ease of doing business and enhancing the country's openness to foreign talents.

Main areas warranting attention

Operationalisation of announced measures

A key challenge is to ensure that earmarked intentions are tackled and realised in a comprehensive and prompt manner backed by an effective monitoring mechanism to optimise socio-economic gains therefrom. In particular, the implementation rate of envisioned projects – mainly those forming part of the Public Sector Investment Programme (PSIP) – should be carefully watched given delays generally observed in the materialisation of such ventures. 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 period 2016-2021, with the corresponding rate falling to 54% during the last financial year. While the objective of boosting food security and accelerating the country's transition to renewable energy can be lauded, a holistic and strategic vision coupled with the elaboration of a clear and comprehensive action plan is deemed necessary for their effective execution. At another level, while the proposed set-up of a venture capital Fund by the Mauritius Investment Corporation (MIC) could serve as a complementary source of financial support for SMEs, its effective operationalisation warrants attention given the need to cater for the more complex nature of this asset class. Furthermore, this measure constitutes a further broadening of the MIC's scope of intervention relative to its initial mandate.

Effectiveness and potential distortionary effects of some policy measures

The Budget has introduced additional fiscal incentives, including: (i) the extension of income tax holidays (e.g. Freeport operators and developers and planters registered with the Economic Development Board as well as agricultural practices under the Integrated Modern Agricultural Morcellement Scheme); (ii) exemption from Registration Duty for specific activities; (iii) introduction of a negative excise duty scheme for the purchase of electric vehicles by individuals and provision of duty-free for all hybrid vehicles; (iv) VAT refund under the Meetings, Incentives, Conferences and Exhibitions scheme; and (v) exemption from corporate tax and social security contributions for foreign employers of premium visa holders. While proclaimed fiscal initiatives should provide breathing space in some instances as well as promote earmarked activities, they have to be complemented by a set of structural reforms to achieve broader objectives. Furthermore, the short and long-term efficiency and competitiveness impact of these incentives should be carefully assessed insofar as Mauritius is 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. This, in turn, warrants attention in view of the mixed signaling effect on the investment community that could, amongst others: (i) contribute to a sub-optimal allocation of resources; (ii) increase the risk of a rechanneling of capital and financial flows to other competitor jurisdictions that are gearing up on their value proposition; and (iii) potentially impact the country's ability to retain local human expertise and attract foreign talents in specific fields.

Achievement of official macroeconomic targets

Coming to the official forecasts made in this year's National Budget, the authorities have, in the context of the Medium Term Macroeconomic Framework (MTMF) revised down their economic growth estimate for FY 2021/22 from a previous projection of 9% to 6.9% on the basis notably of a lower than targeted outturn in tourism. For periods ahead, the country's growth rate is projected to attain 8.5% in FY 2022/23 before standing at 5% during FY 2023/24 and FY 2024/25. The MTMF notes, however, that the growth outlook is subject to significant downside risks arising notably from an escalation of the Russia-Ukraine war and sharper increase in fuel and food prices. Indeed, it appears challenging, especially in the absence of structural reforms for materially improving the country's competitiveness levels and transforming our economy, to achieve the growth targets formulated by the authorities. In fact, alongside factoring in the recovery in tourism, the nationwide output forecasts made in the MTMF are anchored on a sustained uptrend in the investment rate to 21.3% of GDP in FY 2022/23, 21.6% in FY 2023/24 and 21.8% in FY 2024/25. The latter is, in turn, essentially founded on a notable rise in private sector investment given that public sector investment as a share of GDP is expected to decline marginally when considering the historical implementation rate of projects falling under the PSIP as mentioned above. A lower economic growth outcome than foreseen by the authorities would affect related macroeconomic projections formulated in the MTMF, particularly regarding fiscal metrics, although the impact on relevant ratios would be tempered by the recent rebasing of National

Accounts estimates. The budget deficit is, in fact, projected to decline when excluding net expenditure made through Special and other extra-budgetary funds while Government borrowing requirements for FY 2022/23 is projected to drop after factoring in budgeted equity sales of Rs 22 billion. From a policy perspective, however, the recourse to 'off-budget' items should be gauged carefully in view of its impact on the fiscal position, with the IMF having called for fiscal consolidation to be made through credible revenue and expenditure measures in its recent statement as part of the 2022 Article IV Mission.

At another level, after improving marginally in FY 2022/23, exports of goods and services is, as per the MTMF projections made prior to the National Accounts rebasing exercise, set to decline in periods ahead. This warrants attention given the importance of exports for our economy. That said, the fall in imports of goods and services as a % of GDP expected by the authorities should enable a narrowing in the current account deficit.

Rebasing of National Accounts estimates

Statistics Mauritius has undertaken a major revision of national accounts estimates for the period 2018 to 2021 following data obtained from the Census of Economic Activities (CEA) conducted in 2018. The benchmarking exercise carried out brought some improvements in the estimation process and coverage.

Overall, nominal GDP has been revised upwards by some Rs 14 – 19 billion, representing an increase of 2.8% to 4.3% over the period 2018-2021 compared with a rise of around Rs 4 – 5 billion, equivalent to an increase of 1.2% to 1.3% observed during the previous rebasing exercise. For 2022, the revised GDP is around Rs 20 billion higher than its implied estimated level in the old base, using projected sector growth rates and deflators by Statistics Mauritius.

Figure 2 **Change in nominal GDP at market prices following the rebasing of National Accounts**

Year	Before rebasing	After rebasing	Change
	Rs billion		(%)
2018	481.3	500.0	3.9
2019	498.3	512.0	2.8
2020	429.9	448.5	4.3
2021	465.1	480.5	3.3

Source: Statistics Mauritius

Following the above exercise, industries' shares of output were updated. Notably the share of "Financial and insurance activities" rose by 0.6 percentage point to 12.3% and "Professional, scientific and technical activities" increased by 0.4 percentage point to 5.4% while the share of "Wholesale & retail trade; repair of motor vehicles and motorcycles" and "Agriculture, forestry and fishing" each decreased by 0.3 percentage point. The revisions in real GDP growth are moderate. Of note, last year's growth outcome has been trimmed down by 40 basis points to 3.6%. Regarding other expenditure metrics, while no significant changes is noted in national investment, exports of services has risen following the inclusion of GBC services.

Figure 3 **Summary of key National Accounts revisions**

Indicator	Change
Nominal GDP at market prices	Increase of 2.8% to 4.3% throughout 2018 to 2021
Industry share of output	Change in industry share of GDP ranging from -0.3 to 0.6 percentage points
Final Consumption Expenditure	Change in the ratio as % of GDP ranging from -4.0 to -0.5 percentage points
Investment	No significant changes in nominal amount; Change in investment rate ranging from -0.8 to -0.5 percentage point
Net exports of goods and services	Following change of methodology with the inclusion of GBC services in exports of services, the deficit in net exports of goods and services is narrowed by 45% to 60% throughout 2018 to 2021
Gross Domestic Saving rate	Increase of around 0.5 to 4 percentage points between 2018 and 2021

Source: Statistics Mauritius

Economic outlook

Economic growth

Revised estimates for 2022

In view of the sharp deterioration in global economic conditions, our latest baseline forecasts reflect a further downgrade of the domestic economy's growth outlook for this year with the level of uncertainty around the output level remaining very high. In fact, taking into account the afore-described rebasing of the statistical base, real GDP growth at market prices is expected to attain 6.0% in 2022, representing a 20 basis points cut from our previous projection made in April. This updated estimate is in line with the latest IMF projection.

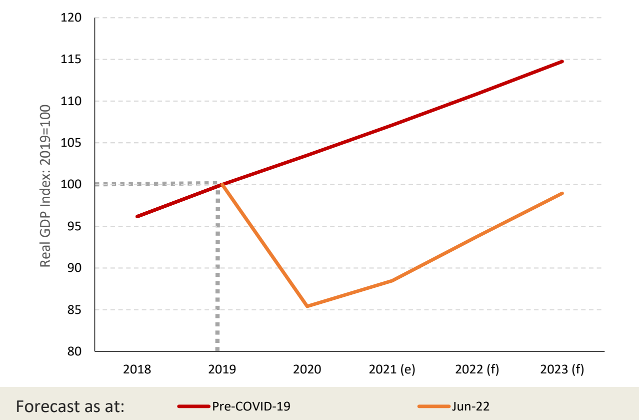
On the expenditure front, the war's impact on food and energy prices coupled with pressures on the rupee are weighing on household consumption although the subsidies on selected necessities and income support announced in the Budget should somewhat cushion the impact thereon. In any case, the net impact of consumption expenditure on output is generally constrained by its relatively high import content. Growth in nationwide investment is also set to be lower than foreseen on the back of a higher deflator effect triggered by the persistent rise in input costs. This would restrain the expansion in nationwide investment, in particular private residential investment, even though Budget measures should provide some support to the latter segment. Public investment would be impacted to a lesser extent with the indicator being supported by spending on the completion of large-scale ventures. The visible trade deficit is set to widen by a significant margin on the back of deteriorating terms of trade.

At the output level, the downward revision in our growth prognosis is prompted essentially by a combination of marginal reassessments of some sectorial forecasts in the wake of the lower growth outlook in our main trading partners and the ramifications of more prolonged supply chain disruptions and surging costs and prices. In particular, notwithstanding relief from budgetary measures, we expect a more restrained outcome in manufacturing activities, especially within the textile and food segments. Additionally, in line with the further rise in cost of materials, a less prominent expansion is envisaged in the construction sector while real estate activities should also evolve at a more tempered pace given the difficult context. Nonetheless, economic growth should be underpinned by a marginally better performance in the tourism industry despite prevailing air connectivity constraints as well as the testing economic conditions in some of our key markets. On the other hand, as outlined in Box II, whilst arrivals in Mauritius stood at an estimated 58% of the 2019 levels during the January – June 2022 period, Maldives and Seychelles, which had reopened their borders well before Mauritius, have returned close to pre-pandemic levels, at 94% and 84% respectively during the same period, thanks, notably, to a successful market diversification strategy. Besides, support to growth should come from the continued momentum of the ICT sector, as well as the good showing of the financial services industry with banking operators capitalising on their strong fundamentals and regional diversification headways.

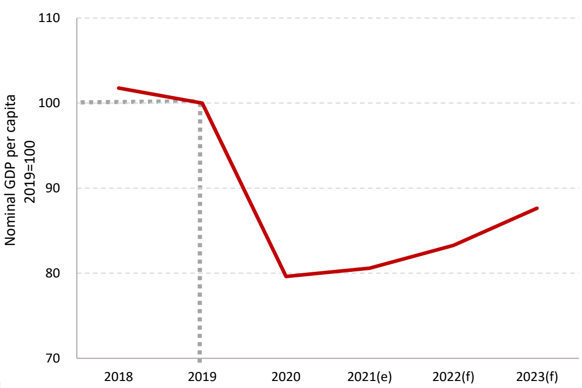
Overall, our estimate for national income as gauged by GDP at market prices for this year has, after factoring in a higher deflator effect and the impact of the revised National Accounts aggregates, been revised upwards relative to our April figures, to Rs 536 billion. Prior to the benchmarking exercise, GDP in 2022 would have attained around Rs 517 billion this year. In constant rupee terms, GDP remains however some 6% below the 2019 levels. When measured in USD, GDP would improve marginally to USD 12.0 billion this year from USD 11.6 billion in 2021. As a result, per capita GDP would improve to USD 9,459 this year, which remains some 17% below the pre-pandemic level.

Figure 4 **Evolution of GDP growth and per capita income**

Mauritian economy: Pre-COVID vs Post-COVID path



Evolution of GDP per capita (USD)



(e) Revised estimates *(f) MCB forecasts*

Sources: IMF WEO database April 2022, Statistics Mauritius and MCB staff estimates

Box II: Pickup in tourism sector: Mauritius vs regional peers

One of the main pillars of small island developing states, the tourism sector is recovering from the COVID-19 shock..

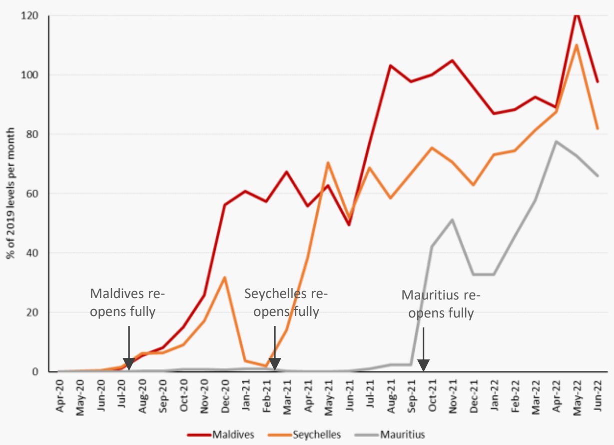
Mauritius	
58% of 2019 levels *Arrivals (Jan- Jun)*	**USD 289 million** **60% of 2019 levels** *Tourism earnings (Jan-Mar)*

Maldives	
94% of 2019 levels *Arrivals (Jan- Jun)*	**USD 1.4 billion** **136% of 2019 levels** *Tourism earnings (Jan-Mar)*

Seychelles	
84% of 2019 levels *Arrivals (Jan- Jun)*	**USD 130 million** **88% of 2019 levels** *Tourism earnings (Jan-Mar)*

Notes:
1. June figures for Mauritius are based on staff estimates
2. Figures for tourism earnings were converted in USD for the respective periods

Pickup in tourist arrivals relative to pre-pandemic levels



For the period Jan-May 2022

Mauritius: Top 5 markets account for nearly 67%
France (26.8%); UK (15.1%); South Africa (10.7%); Germany (10.1%); Reunion (4.1%)

Maldives: Top 5 markets account for around 51%
India (14.0%); UK (12.5%); Russia (9.5%); Germany (8.5%); Italy (6.4%)

Seychelles: Top 5 markets account for 48%
France (14.5%); Germany (11.4%); Russia (10.5%); UK (6.6%); UAE (5.0%)

Zoom on selected initiatives to revamp the tourism industry

Mauritius

- ***Premium VISA** – Live Work Play concept*
- ***'Relaunching Tourism as One Mauritius' strategy***
- ***Target campaigns:***
  - *'Where Else but Mauritius' for India*
  - *Plans to attract tourists from GCC countries and Reunion*
- ***10-year blueprint** for the tourism sector as per budget pronouncement*

Maldives

- ***Open** air access policy*
- ***One island one resort concept***
- ***Homestay tourism***
- ***Marketing campaigns** on global news agencies **such as BBC and CNN***
- ***"Experience Live from Maldives"** series*
- *Investment in **digital technology***
- ***Visit Maldives** launches campaign with **Veepee** in France*

Seychelles

- ***Increased** liberalisation of air access*
- *Promotion of sustainable tourism through the **Seychelles Sustainable Tourism Label***
- ***Private events** such **as 'Recovery in Tourism'** for Saudi Arabia*
- ***Media, trade and marketing activities** by Air Seychelles in Israel*
- *Roadshow to tap into the **Baltic states market***

Sources: Statistics Mauritius, Ministry of Tourism (Maldives), National Bureau of Statistics (Seychelles), Central Bank of Seychelles, Bank of Mauritius, Various press articles

Preliminary projections for 2023

With regard to 2023, nationwide economic expansion is projected at 5.5% as per our current baseline scenario with the country returning close to its pre-pandemic level in real terms by year-end. While the domestic economy would remain beset by the high inflationary environment and persistent headwinds notably across our key markets, activity levels should be driven by the continued recovery in the tourism sector, although arrivals would remain slightly below the 2019 levels. This would, in turn, generate positive multiplier effects across related economic activities. Export oriented manufacturing enterprises are also expected to fare better next year despite remaining faced with some pressures. GDP growth would also be supported by private sector investment, on the back of ventures in the green energy sector in line with budgetary announcements, although heightened input costs would continue to take a toll notably on its 'Building and construction work' sub-component, in particular residential building. Furthermore, the relative decline anticipated in public sector investment following the completion of key infrastructure ventures in 2022 would constrain the expansion in the construction sector. As for the financial services sector, it should post another appreciable outcome on the back of the pickup in economic activities. On another note, value added in the wholesale and retail trade sector would be supported by the expected upturn in household consumption, albeit constrained by the high inflationary environment, while the ICT sector would, in all likelihood, sustain its solid growth performance. Overall, our baseline growth forecast for 2023 is subject to both upside and downside risks, and will be reassessed over time as we gather more pertinent insights in respect notably of developments on the international scene - especially economic conditions across our key export markets – and the evolution of energy and commodity prices amidst the war and the spillover effects thereof on output and inflation in the domestic economy.

All in all, when making allowance for the revised statistical base, nominal GDP at market prices would rise to Rs 593 billion in 2023. When computed in US dollars, nationwide GDP is projected to attain USD 12.6 billion next year which remains below its level of USD 14.6 billon and USD 14.4 billion seen respectively in 2018 and 2019. In this respect, per capita GDP, which dropped to its lowest point in a decade following the pandemic hit in 2020, is set to improve further to USD 9,954, which is still some 12% below its pre-crisis position.

Moving forward, the domestic economy is expected to converge to its current potential growth rate of around 3½ percent over the medium term, with the latter estimated to have dropped in the absence of structural reforms from its corresponding rate of 4.2% a decade ago.

Other indicators

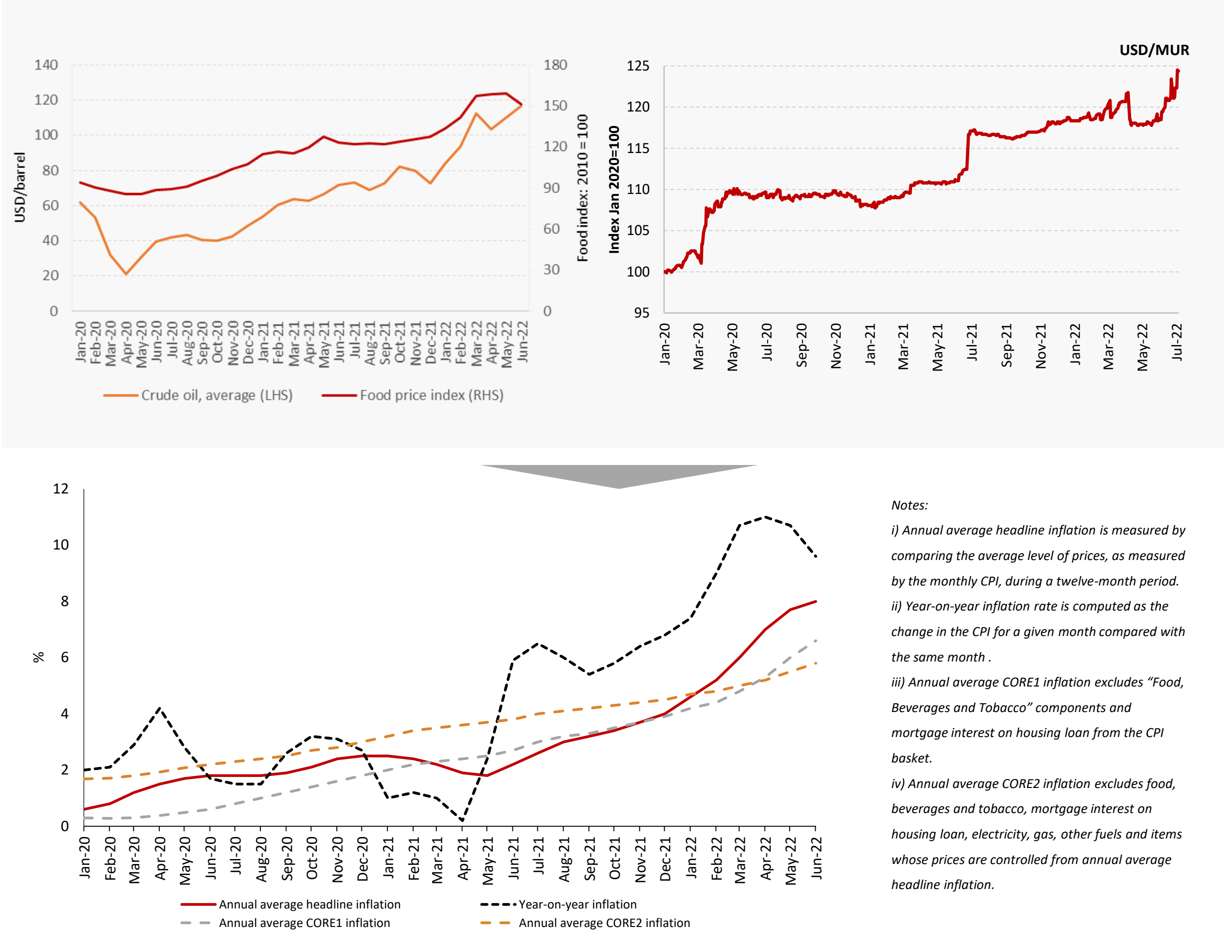
Inflation

As highlighted before, the ramifications of the war in terms of higher commodity prices and heightened supply disruptions have exacerbated inflationary pressures worldwide. On the domestic front, despite the fall in vegetable prices lately and successive FX interventions by the Bank of Mauritius seeking to support the rupee, the Consumer Price Index has remained under pressure. Indeed, there have been further hikes in food as well as gasolene and diesel prices, while excise duties on cigarettes and alcoholic drinks have also been increased. Against this backdrop, the annual average headline inflation has sustained its uptrend to stand at 8.0%. Year-on-year inflation attained 9.6% in June while core measures of inflation – which exclude prices of highly volatile items such as food, gas and other fuels and constitute a more reliable indicator of whether inflationary pressures are broad-based and permanent – also sustained their upward path. Looking ahead, whereas the expected further fall in vegetable prices should provide some relief to the price index, annual average headline inflation is expected to rise further to attain 10.2% level as at December 2022. This is an upward revision from our April forecast, largely attributable to the impact of continued pressures on the rupee and the increase in prices of selected essential products following the revocation of the Consumer Protection (Maximum Price of Essential Goods) Regulations 2021. In fact, prices of these products have, effective 1 July, been placed under price control under the mark-up regime. That said, the evolution of inflation over the coming months would remain scenario-based given the highly uncertain context.

As for next year, inflation should, although remaining high for the most part of the year, embark on a downtrend as the high base effects weigh in the computations but the pace thereof would hinge largely on the evolution of commodity and energy prices on the global scale and currency dynamics. As per our baseline scenario, annual average headline inflation should hover around 4.6% by December 2023, with upside risks remaining high on the agenda. From a policy perspective, the Bank of Mauritius has raised the Key Repo Rate by an additional 25 basis points in June following its 15 basis points increase in March last, with the policy rate now standing at 2.25%. Over the periods ahead, the higher inflationary environment coupled with the worsening interest rate differentials amidst the aggressive tightening of rates globally - notably by the US FED, point towards further hikes in the Key Repo Rate. That said, the negative output gap in relation to the pre-pandemic level would weigh in the balance, thereby potentially implying a less than proportional rise in the policy rate on the local front.

Figure 5 **Evolution of inflation rates**

Rising food and oil prices alongside the continued rupee depreciation are weighing on inflation



Sources: Statistics Mauritius, Bank of Mauritius and World Bank (Pink Sheet)

Unemployment

In line with the rebound in economic activities and the provision of support measures by the authorities, nationwide unemployment rate is estimated to have improved marginally to attain 9.1% last year and further to 8.7% during the first quarter of the year, albeit remaining above the pre-pandemic level. This downtrend is set to pursue over this year and next, with the joblessness rate reaching 7.9% and 7.6% respectively. Whilst such trends are encouraging *per se*, apprehensions subsist concerning the inherent strength of the labour market, while the country's ability to address structural rigidities and boost net job creation on a sustained basis continues to call for close scrutiny. A key trend warranting attention over the past few years relates to the country's activity rate that has remained at relatively low levels when compared to several of our peer economies. The pandemic has exacerbated the situation with a significant amount of people shifting into the inactive section of the population, thus causing the nationwide activity rate to drop to 52.8% last year from 56.9% in 2020, with female participation rate falling to 41.1%. While a modest improvement has been witnessed during the first quarter of the year with nationwide activity rate attaining 54.5% and female participation standing at 41.9%, the latter rates remain well below their pre-crisis levels.

Furthermore, labour underutilisation which incorporates those in potential labour force, the unemployed and those in time and skills-related underemployment remains a key concern. This category which was already elevated at 27% of the labour force prior to the pandemic is officially estimated to have risen further to 204,300 in 2021 (i.e. 38% of the labour force) with nearly 70% thereof being in skills-related and time-related underemployment. Measures announced in the Budget, notably the monthly 'Prime à l'Emploi' of Rs 15,000 for the first year of employment of 10,000 youths between 18 and 35 years and women up to 50 years, should provide support to youth and female employment with the joblessness rate for the latter groups estimated at 27.7% and 10.6% respectively last year. However, further actions are deemed necessary to durably boost job creation and productivity levels with emphasis laid *inter alia* on the re-skilling and training of our human capital and the adoption of a holistic strategy for attracting foreign talents, especially in the high-skilled segments.

Public finance

As per the official Medium Term Macroeconomic Framework, the budget deficit for FY 2021/22 is maintained at 5% of GDP with the higher spending on the recurrent expenditure side being offset by an underspending on the capital budget. With regard to FY 2022/23, the deficit is expected to narrow to 4% of GDP as per figures formulated by the authorities. On the expenditure side, capital expenditure is set to drop to Rs 18.4 billon compared to Rs 23.3 billion in the previous financial year while recurrent expenditure is forecast to shot up to Rs 154.5 billion, owing notably to the rise of 18% in social benefits. However, these expenditures exclude the net expenditure of Rs 19 billion (around 3.5% of GDP) earmarked for next FY through Special and other extra-budgetary funds. On the revenue side, in addition to the Rs 11.4 billion to be collected from CSG contributions by employers and employees, the authorities expect a significant rise in tax receipts – driven notably by a 19% rise in value added taxes and a 25% rise in corporate tax revenue. Besides, Government borrowing requirements is projected by the authorities to drop to Rs 3.2 billion (0.6% of GDP) after factoring in budgeted equity sales of Rs 22 billion (3.8% of GDP) relating amongst others to the sale of Maubank and National Insurance Corporation as per official pronouncements. Overall, central Government debt is, on the heels of afore-mentioned dynamics and after catering for a higher deflator effect, projected to drop from 77.3% of GDP in FY 2021/22 to 68.1% of GDP in FY 2022/23, while public sector gross debt would attain around Rs 449.6 billion (78% of GDP) as at June 2023. After netting out cash and cash equivalent and equity investment held by Government and public sector bodies in private entities, public sector net debt would narrow to 72.9% of GDP. From a holistic perspective, the achievement of afore-described fiscal projections appear quite challenging in view of: (i) the unsteady global landscape which would impact the targeted GDP growth rate for FY 2022/23 and the projected expansion in tax revenue; and (ii) uncertainties regarding the timely materialisation of the earmarked equity sales. Furthermore, the progressively rising interest rate environment – both locally and abroad – would warrant attention amidst the increase in debt servicing costs.

As for the coming years, the country's fiscal metrics are projected to improve further as per the authorities. Whilst such trends coupled with the cost and risk control benchmarks/targets contained in the debt management strategy of the authorities are encouraging, further fiscal consolidation is crucial to restore fiscal space and ensure debt sustainability. In this context, the IMF has, in its recent statement as part of the 2022 Article IV Mission, stated: *"As the economy exits the pandemic, reinstating fiscal rules, including a medium-term debt anchor, would help preserve fiscal sustainability and reduce debt vulnerabilities, while allowing for flexibility to address shocks. Reforming the pension system remains a critical step to support fiscal sustainability. Any medium-term fiscal consolidation plan will have to address the disparity between pension spending and pension revenue."* Concurrently, fostering a sustainable fiscal position also hinges on boosting the potential GDP which, in turn, requires the espousal of a set of structural reforms while restoring our competitive tax regime.

External front

On the heels of the significant rise of some 55% in the trade deficit during the first four months of the year relative to the corresponding period of 2021, we have further downgraded our forecast for the balance of visible trade deficit for this year to around 33% of GDP. In fact, whilst a moderate rebound is foreseen in exports of goods, the import bill is set to be markedly higher after factoring in the purchase of metro terminals and helicopter and the persistent increases in prices of several items including food, oil and construction materials amidst the war. The impact of the rise in import prices can be gauged by the drop of 9.9 points in the terms of trade index to 84.7 during the first quarter of the year relative to the last quarter of 2021, with the recent weakening in the euro against the greenback poised to further pressurise the index. This would, in spite of higher tourism receipts and a surplus in primary income lead to a worsening in the current account deficit, with the indicator projected at 13.9% of GDP this year. During the first quarter of the year, reflecting the higher current account deficit and a drop in capital and financial flows, the balance of payments (BOP) recorded a deficit estimated at Rs 12.6 billion. That said, we expect the latter deficit to be more than offset in coming quarters amidst sustained levels of capital and financial flows in particular through the global business sector, with the BOP remaining in a surplus position this year.

Figure 6 **Zoom on the external position of Mauritius**

Note: Following the benchmarking exercise in the June 2022 National Accounts, data prior to 2018 are not strictly comparable

(e) Revised estimates *(f) MCB forecasts*

Sources: Statistics Mauritius, Bank of Mauritius and MCB staff estimates

Next year, the balance of visible trade deficit is projected to remain well above the historical average, albeit declining to around 28% of GDP mainly on the back of a narrowing in the country's import bill, with commodity and energy prices set to drop, as per the IMF and World Bank, while an upturn is also expected in merchandise exports. In turn, after factoring in higher tourism earnings and a further rise in primary income, the current account deficit is forecast to narrow to 8.9% of GDP. On the whole, when factoring in the projected capital and financial flows, we expect the BOP surplus to improve next year. Nevertheless, the positive outcome on the BOP should continue to be subject to our monitoring given the unsteady global financial environment, with potential sudden shifts in capital flows the more so amidst the aggressive monetary policy tightening cycle across major central banks which impact interest rate differentials.

J. Gilbert Gnany

Chief Strategy Officer July 8, 2022

Sources

Bank of England

Bank of Mauritius

Central Bank of Seychelles

European Central Bank

Federal Reserve Bank

Government Information Service, Mauritius

IMF Blog, *Various articles*

IMF, *press release on Mauritius*

IHS Markit

Investing.com

Kiel Institute

Maldives Monetary Authorities, Monthly Economic data

MCB Focus, *Previous issues*

MCB Strategy, Research & Development, Staff Estimates

Ministry of Finance & Economic Development, *National Budget Speech 2022-23, Public Sector Investment Programme 2022/23- 2026/27, Various Other Publications and Pronouncements*

Ministry of Foreign Affairs and Tourism, Seychelles

Ministry of Tourism, Maldives

National Bureau of Statistics, Seychelles

OECD, *Economic Outlook: The Price Of War, June 2022*

Selected Internet and Newspaper articles

Statistics Mauritius, *Quarterly National Accounts Estimates, External Trade, Labour Force, Employment and Unemployment, Rapid Continuous Multi-Purpose Household Survey, International Travel and Tourism, & Various Publications*

World Bank, *Commodity Price data (Pink Sheet), Global Economic Prospects, June 2022*

MCB GROUP