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MCB Focus

Economic update

February 2018

MCB GROUP

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THE INTERNATIONAL LANDSCAPE

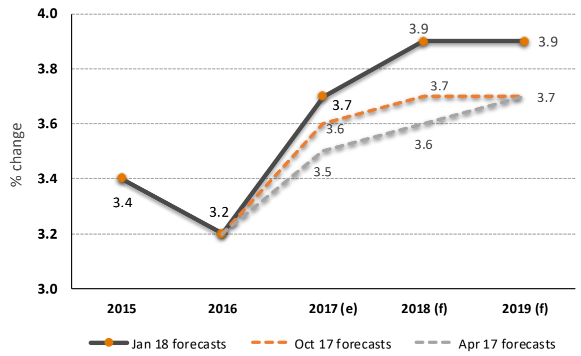
Some time back, several observers on the worldwide scene seemed resigned to the prevalence of weak global growth patterns. However, as the unfolding upturn in global economic activity levels has continued to strengthen, talks of 'secular stagnation' have been progressively abandoned for a new catchphrase, which is 'synchronised growth.' According to the World Bank, "*A broad-based cyclical global recovery is underway, aided by a rebound in investment and trade, against the backdrop of benign financing conditions, generally accommodative policies, improved confidence, and the dissipating impact of the earlier commodity price collapse."* In this context, the IMF has, in its latest World Economic Outlook Update, further elevated its near term projections for global growth, when compared to its October forecasts. Thus, after expanding by an estimated 3.7% in 2017, the world economy is predicted to grow by 3.9% for both 2018 and 2019, which represents an upward revision of 20 basis points in each case and is the fastest pace of growth recorded in seven years. Yet, while such a prognosis is welcome news, the recovery process remains incomplete. The Managing Director of the IMF, Christine Lagarde, has in fact, recently indicated that *"there are still far too many people left out from the recovery. In fact, about one fifth of emerging markets and developing countries saw their per capita incomes decline in 2017."* Additionally, although risks to the world growth outlook appear broadly balanced in the short run, they remain tilted to the downside over the medium term. On the upside, the firming up of global activity could turn out to be stronger in the event principally that the recovery in activity levels and easier financial conditions reinforce each other. Nonetheless, potential headwinds could derail the global upturn if they materialise, including: (i) financial market correction that could dampen business confidence amidst rich asset valuations and compressed term premiums; (ii) a build-up of vulnerabilities in case financial conditions remain loose amidst generally contained inflationary pressures; (iii) the recourse to inward-looking policies and increased protectionism by nations; and (iv) non-economic factors such as geopolitical tensions, notably in East Asia and the Middle East, political uncertainties, civil strikes, extreme weather conditions, and terrorism.

The upward revisions to the global outlook have been mainly attributable to the improved prospects for advanced economies, underpinned by the likelihood that favourable global financial conditions and business sentiment would support demand and stimulate exports. Notably, after picking up by a significant margin in 2017 on the back of strengthened private investment, growth in the US is anticipated to gain further steam in the short term. In fact, the IMF upgraded its growth forecast from 2.3% to 2.7% in 2018 and from 1.9% to 2.5% in 2019. Overall, the country is expected to benefit from higher external demand and, in particular, the offshoots of the tax reform and the associated fiscal stimulus. Strikingly, the effect of the tax policy package on output in the US and its trading partners has, according to the IMF, contributed to around half of the cumulative upward revision to the global growth over 2018-2019. As for the euro area, year-on-year growth attained 2.8% in the third quarter of 2017, which is the strongest rate since the first quarter of 2011, helped by policy stimulus and improved external trade dynamics, while the overall unemployment rate declined to 8.7% in

Box I: Highlights of international developments

Global activity levels

World GDP growth



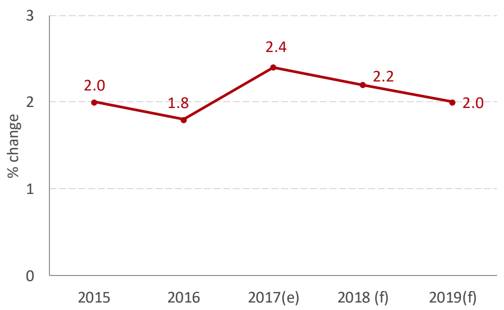
Broadest based recovery

120 economies (accounting for **¾ of world GDP**)

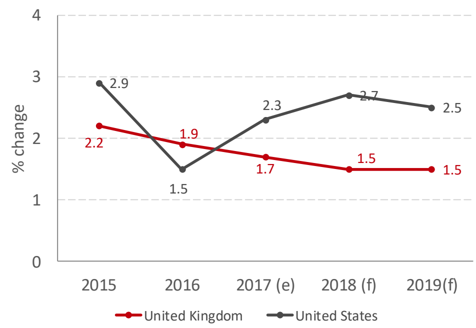
saw an upswing in 2017

Growth forecasts across regions

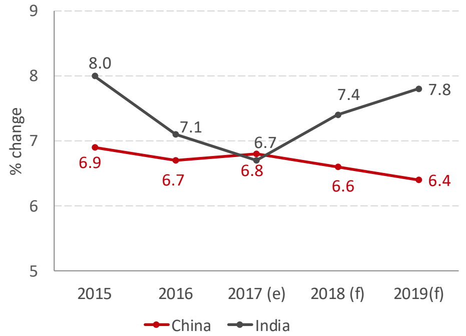
Euro Area



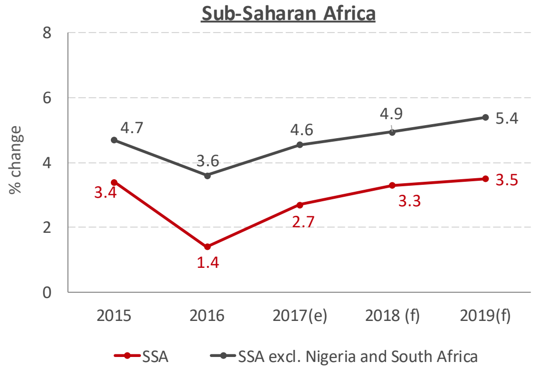
United Kingdom and United States



China and India

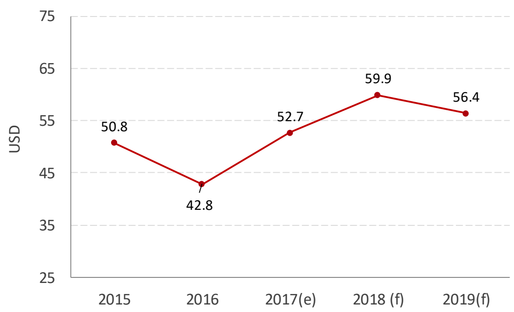


Sub-Saharan Africa

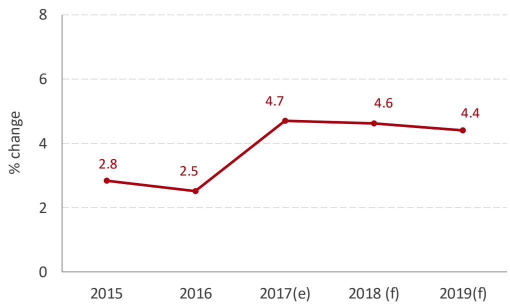


Projections for other indicators

Average oil price



World trade volume (Goods & services)



(e) estimates (f) forecast

Sources: IMF World Economic Outlook and MCB Staff estimates

December last, representing the lowest level since January 2009. On the heels of this momentum, growth is foreseen to remain in a favourable zone looking ahead, with the forecasted rates for 2018 and 2019 having been uplifted by 30 basis points in each case. However, growth is anticipated to post a downtrend in both years, as domestic demand wanes in relative terms after the strong gains of 2017 and policy stimulus is steadily slowed down. With respect to the UK, growth is expected to drop to 1.5% this year and remain at this level in 2019. While domestic demand is likely to be impacted by rising inflation and slow-moving wages, activity levels and business investment would be pressurised by elevated uncertainty levels linked to the Brexit process, with the direct outcomes of negotiations being engaged with the EU on exit terms and future trade arrangements remaining to be ascertained. As regard emerging market and developing economies, a key observation is that, while remaining appreciable, growth in China would edge down in the near term, partly due to policy tightening. Conversely, growth in India would gain further steam in periods ahead. Concerning sub-Saharan Africa, output growth is, on average, projected to improve to 3.3% in 2018 and further to 3.5% in 2019 on the back of firming commodity prices and gradually strengthening domestic demand. Yet, growth would remain in a challenging zone, partly given difficulties faced by larger economies to boost private investment. In particular, forecasted growth for South Africa has been downgraded by 20 and 70 basis points for 2018 and 2019 respectively, with the expansion rate thus likely to hover below the 1% mark for both years. This outlook is mainly attributable to the repercussions of lingering political uncertainty on business confidence and investment. When excluding South Africa as well as another powerhouse, namely Nigeria, from the computations, sub-Saharan Africa is projected to expand by more favourable rates of 4.9% and 5.4% for 2018 and 2019 respectively.

In another light, a combination of factors including the mending of global conditions, weather events in the United States, the extension of the OPEC+ agreement to limit production as well as geopolitical tensions have led to a generally marked increase in crude oil prices in recent months. In fact, though they have somewhat receded in recent periods, Brent oil prices have risen by about 29% between August 2017 and the beginning of February 2018, while even exceeding the USD 70 per barrel threshold in late January. In line with recent trends and market dynamics, both the Fund and the World Bank expect oil prices – inferred from the average of Brent, West Texas Intermediate and Dubai Fateh spot prices – to stand at just below USD 60 per barrel in 2018, which will represent an increase when compared to the corresponding 2017 figure. As for next year, the IMF anticipates oil prices to decline slightly to attain around USD 56, while the World Bank projects a marginal increase therein to USD 59. On the currency markets, in spite of the economic momentum and a further interest rate hike by the Federal Reserve in December, the US dollar has pursued a marked downtrend over the past months, particularly vis-à-vis the euro as well as some other currencies, presumably attributable to the rally in commodity prices, unfolding political developments in the US and the improving economic sentiment that specific countries have been depicting. Ahead, the evolution of the greenback is likely to be largely dependent on evolving economic developments in the US and on the worldwide scale, with a key area that might garner prominence relating to the US tax policy reform, which could exert upward pressures on the currency as corporates repatriate funds into the country.

THE DOMESTIC SCENE

Lately, the institutional environment has been in the limelight following the enactment of the Economic Development Board (EDB). The latter commenced operation as a statutory body on 15 January 2018, following the merger of the Board of Investment, Enterprise Mauritius and the Financial Services Promotion Agency. Its key objectives are to: (i) provide institutional support for strategic planning and ensure greater coherence and effectiveness in policy formulation; (ii) promote Mauritius as an attractive investment and business centre, a competitive export platform as well as an international financial centre; (iii) take care of the country's branding for investment promotion; and (iv) facilitate inward and outward investment and ensure a conducive business environment. In addition, the institution is *inter alia* mandated to act as a single interface with all investors and liaise with relevant authorities for the registration of investors and to facilitate the issue of permits or licences. While the EDB can *per se* be viewed as a step in the right direction to help achieve further economic progress in a more coherent manner, its operationalisation calls for close monitoring. Looking ahead, a key success factor for the institution is to guard against the risk that the multiplicity of objectives as well as the often complex range of responsibilities linked to its very functions and powers could potentially render its functioning sub-optimal. Besides, it will benefit if endowed with adequate physical and human resources to fulfill its roles, notably in terms of the capabilities that will enable it to properly comprehend the multifaceted policy challenges associated with emerging/looming megatrends spanning the global economic and technological spheres.

On another note, the authorities have set forward to establish a blueprint for the financial services sector in its attempt to further develop Mauritius into a reputable and sophisticated International Financial Services Centre of substance. While fostering compliance with international codes and standards, notably in relation to information exchange and cooperation, a key objective is to formulate a set of strategies and policies that will position the Mauritian IFC as an efficient and competitive jurisdiction. Another key development that recently unfolded on the local front pertains to the introduction of a national minimum wage. While the measure can, in itself, be welcomed as a useful tool to achieve social inclusiveness aspirations, its impact on the performances of SMEs and competitive positioning of the export oriented manufacturing sector needs to be monitored.

With regard to macroeconomic indicators, while some sectors continued to post dimmed performances during the first three quarters of 2017 on the back of the challenging local and international context, several segments maintained their appreciable growth rates as per latest available official estimates, notably construction, ICT, financial and business services and tourism. Updated figures for the latter show that total arrivals increased by 5.2% in 2017 as a whole, mainly spurred by notable performances posted with respect to several European markets and, to a lower extent, South Africa. On another note, headline inflation has pursued a generally sustained uptrend since the beginning of 2017 before attaining 4.0% as at January 2018. During this period, the consumer price index has been impacted by hikes in the prices of food and non-alcoholic beverages, alcoholic beverages and tobacco as well as gasolene and diesel. Of note, the prices of vegetables have been particularly hit during the course of last month on the back of notable floods that have hit the country. After making allowance for observed trends and assessing that inflationary pressures would not intensify in the foreseeable future, the Monetary Policy Committee of the Bank of Mauritius kept the Key Repo Rate unchanged at its meeting in November last to support growth. With respect to the fiscal sector, it can be noted that, after having pursued an upward trend during the past four years, a slight decline was observed in the share of public sector debt to GDP, which stood at 63.2% as at December 2017. Whereas this outcome has moved closer to the statutory ceiling of 60% to be attained by end of the fiscal year ending June 2021 as per the Public Debt Management Act, the sustainability of public finances warrants scrutiny when viewed from a holistic perspective, in particular when factoring, for instance, the line of credit obtained from India, though the latter is technically not accounted for in the official definition of public sector debt given its envisioned structuring and treatment. As underscored in the IMF Article IV Consultation Report on Mauritius : *''Rising public debt, including contingent liabilities of the central government, has left Mauritius' gross financing needs more exposed to adverse real growth, real interest rate, and fiscal shocks."*

On the external front, the magnitude of our imbalances has remained a cause for concern as gauged by the trade deficit registering a year-on-year increase of nearly 22% to reach around Rs 89.5 billion over the January to November 2017 period. In addition to facing up to higher imports mostly due to the incurrence of higher commodity prices on average, the deficit was engendered by a non-negligible drop in the country's total exports of goods, especially linked to 'articles of apparel and clothing' and 'telecommunications equipment parts and accessories' amidst the delicate, albeit improving, global context and the prevalence of market access strains. Besides, whereas remedial measures have been put into place by the authorities, operators across specific areas were confronted by upward pressures on the rupee during prolonged periods, pursuant notably to the prevalence of high liquidity conditions in foreign currency markets in Mauritius. Given our competitiveness imperatives, such trends have warranted attention, the more so when considering that headline inflation has pursued its ascent during the period. In fact, in its Article IV Consultation Report on Mauritius, which was released in December last, the IMF stated, that *"The overvaluation of the real exchange rate has increased".* Indicatively, the effective exchange rate of the rupee appreciated by more than 2% on a year-on-year basis in January 2018. Conspicuously, the appreciation of the local currency has been quite acute when measured against the US dollar, with latest available figures showing that the point-to-point firming up has been to the order of 8.6% during the year ending January 2018. On the heels of the worsening balance of trade deficit which occurred in spite of the marked weakening of the US dollar in which most of our imports are denominated and notwithstanding an improved surplus on the income account, the current account deficit deteriorated by around 37% during the first three quarters of 2017, while its share of national output was estimated at around 5.8%. On the other hand, though it declined when compared to the preceding year's corresponding period, the balance of payments has stayed in a comfortable surplus position during the timeframe under review, backed by sustained elevated inflows of direct investment.

UPDATED FORECASTS

ECONOMIC GROWTH

Figure 1 Main economic indicators

	Unit	2014	2015	2016(1)	2017(1)	2018(2)
GDPmp	*Rs bn*	392	410	434	460	490
Per capita GDP	*USD*	10,151	9,228	9,589	10,467	11,542
GDP growth (at market prices)	*%*	3.7	3.6	3.8	3.7	3.9
GDP growth (at basic prices)	*%*	3.6	3.1	3.6	3.6	3.9
GDS	*% GDP*	10.6	10.4	11.0	10.9	11.1
GFCF	*% GDP*	18.9	17.4	17.3	17.3	18.4
Private sector investment	*% GDP*	14.0	12.6	12.8	13.0	13.2
Public sector investment	*% GDP*	4.8	4.7	4.4	4.3	5.2
Headline inflation	*Dec, %*	3.2	1.3	1.0	3.7	3.7
Budget balance	*CY, % GDP*	-3.2	-	-	-	-
Budget balance	*FY, % GDP*	-	-3.9*	-3.5	-3.5	-3.2
Public sector debt	*Dec, % GDP*	60.7	63.6	64.5	63.2	62.9
Balance of visible trade	*Rs bn*	-77.3	-74.7	-81.0	-97.7	-104.0
Current account balance	*% GDP*	-5.6	-5.0	-4.3	-6.3	-6.6
Overall balance of payments	*% GDP*	5.9	4.9	6.0	2.9	3.1
Unemployment rate	*average, %*	7.8	7.9	7.3	7.1	6.9

(1) Revised estimates (2) MCB revised forecasts

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

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

Revised estimate for 2017

Against the backdrop of afore-described developments characterising the domestic economy and the global environment, our growth estimate for 2017 is maintained at 3.7% when measured at market prices. The latter figure estimate undershoots the official prognosis by 20 basis points after making allowance for (i) a slightly lower real expansion rate for taxes on products net of subsidies; and (ii) a marginally lower estimate for the country's economic growth at basic prices. In fact, our figure for the latter indicator stands at 3.6%, which is 10 basis points below the official estimate owing to an expected marginally lower expansion in total investment.

Updated forecast for 2018

As per current indications, the country's economic expansion is likely to improve slightly this year when compared to 2017. Thus, while staying close to the prognosis formulated by Statistics Mauritius, the IMF and World Bank, real GDP growth is, as per our baseline scenario, predicted to increase to 3.9% when measured at both market and basic prices. Yet, after taking stock of our socio-economic ambitions and albeit moving closer to the country's current potential growth, the forecasted expansion rate is set to remain sub-par, the more so when juxtaposed against the firming up of the global recovery process. When compared to our October last forecast, our projections represent a downgrade of 10 basis points in each case, prompted essentially by a combination of marginal reassessments of some sectorial forecasts and the delayed kick-start of key projects forming part of the Road Decongestion Programme relative to our October predictions. Noticeably, in the wake of recent floods that have hit several cultivated areas, the non-sugar agriculture sector is now forecast to post a more inhibited performance than previously expected, while our already modest prediction for sugar has been further scaled down, to some extent reflecting signs that export prices on the European market would be lower than previously anticipated, partly linked to supply-side pressures prevailing in the aftermath of liberalising market access therein. Here, it is worthwhile to note that, along with these segments and despite measures executed to boost activity levels, several strategically-important sectors of the Mauritian economy – notably the export- and domestic-oriented manufacturing industries – are foreseen to post restrained growth in value added this year, mainly owing to uncertain market access and local structural bottlenecks. In another respect, a marginally less upbeat outlook is now being nurtured for the tourism sector, after notably factoring in the increasingly competitive market environment. Yet, in spite of the statistical impact of the high base effect attributable to the good outcomes of the last couple of years, the sector would continue to post an appreciable growth and cast a prominent impact on real GDP growth owing to its competitiveness and market diversification breakthroughs and the partial liberalisation of the country's air access. Noteworthy performances are also likely to be registered by the ICT and financial and business services industries, although some global business operators are likely to face up to challenges in adapting to the evolving operating environment, in particular in relation to their endeavours to diversify into new markets and broaden the product base. For its part, while the sector is set to stay as a key driver of nationwide growth in output this year when taking into account the line-up of announced large-scale infrastructure projects, we have, at the same time, downgraded our outlook for construction compared to our prior forecast given relatively less optimistic predictions on the investment front.

Figure 2 **Evolution of real GDP growth forecast for 2018**

Forecast as at	Statistics Mauritius (Official National Accounts)	Bank of Mauritius	IMF	World Bank	MCB
June 17	-	-	-	3.5	4.0
July 17	-	-	-	-	-
Aug 17	-	-	-	-	-
Sept 17	-	4.2	-	-	-
Oct 17	-	-	4.0	-	4.0
Nov 17	-	4.2	-	-	-
Dec 17	4.0	-	4.0	-	-
Jan 18	-	-	-	3.8	-
Feb 18	-	-	-	-	3.9

Sources: Statistics Mauritius, Bank of Mauritius (Minutes of Monetary Policy Committee meeting), IMF (World Economic Outlook) and Article IV Consultation Report December 2017, World Bank (World Bank Global Economic Prospects) & MCB staff estimates

In fact, we have lowered our forecast for growth in public investment. This is principally due to further delays that have been witnessed as regard the execution of specific projects forming part of the Road Decongestion Programme. Actually, in addition to an extension of time on the bidding, the decision of the Road Development Authority to award a contract for the construction of Grade Separated Junctions at Pont Fer/Jumbo/Dowlut roundabouts and the A1-M1 bridge linking Coromandel to Sorèze was challenged by one of the bidders. The Independent Review Panel ordered an annulment of the decision to award the contract to the selected bidder and further ordered a re-evaluation of the bids, while an application for a judicial review of the said decision was, thereafter, lodged before the Supreme Court. That said, we do expect the decision to award the contract to be taken soon, although this situation implies a delay compared to our prior forecast whereby we had expected the above-mentioned projects to start in January last. Moreover, growth in private capital spending is predicted to be somewhat lower than forecasted in October last, owing mainly to a marginal downgrade for the pipeline of projects in the tourism sector and the execution of ventures linked to the energy sector.

Nonetheless, the country's growth performance is still foreseen to be predominantly driven by a notable expansion in national investment in 2018. Noticeably, in spite of the sizeable import content associated with contemplated ventures, an important growth in public sector investment is being expected, with the indicator's share of GDP to increase by 90 basis points to stand at 5.2%. Basically, the sheer magnitude of projects announced by the authorities suggests, by itself, that the subsequent impact on real GDP growth should be quite important if at least part of envisioned ventures are instigated within a reasonable timeframe and/or if unfolding projects witness are implemented at an accelerated pace when compared to works undertaken last year. Notably, public investment should benefit from the unfolding of the Metro Express mega-project, with on-site works between Port Louis and Rose Hill having started since January. Besides, works for the construction of the Decaen flyover along Motorway M1 to connect the traffic to the City Centre have been initiated. Furthermore, several investment-upgrading projects have been announced by the authorities for execution across different fields. It is, however, worth observing that, while some of them are likely to unfold during the course of this year, the majority of the key envisioned undertakings are – in line with official pronouncements and after taking on board the time taken for them to go through the relevant procurement and tendering processes – only scheduled to be instigated as from 2019 or onward. Illustratively, as part of the next phase of the Road Decongestion Programme, earmarked ventures encompass the A1-A3 Link Road to connect the Port Louis-St Jean Road to the Black River Road, Phases 2 and 3 of the Ring Road project as well as other projects deemed as a priority by the authorities, mainly a new flyover at Quay D, the Jin Fei Project and the Urban Terminals at Victoria and Immigration Squares. Other important projects that have *inter alia* been earmarked include the upgrade of water distribution network through the pipe renewal programme, the enhancement of the drainage system, the further extension and modernisation of port infrastructures, capacity upgrade at the airport, and the reinforcement of power generation and distribution set-ups.

For its part, private sector investment is anticipated to grow further this year, with its share of GDP increasing by 20 basis points to stand at 13.2%, supported by the realisation of specific ventures, especially those related to Smart Cities, tourism and energy, alongside being, in the latter case, aided by the recourse to PPP-type financing structures for specific projects. Overall, the national investment ratio is expected to improve by a relatively appreciable margin to attain 18.4% of GDP in 2018. This outcome, however, still largely undershoots the level advocated to gratifyingly enhance the country's growth pattern and achieve social aspirations. In another respect, the quality of investment warrants due scrutiny, especially when considering the following aspects: (i) the multiplier impact of higher capital expenditure on activity levels and job creation; and (ii) the productive efficiency and commercial viability of specific undertakings.

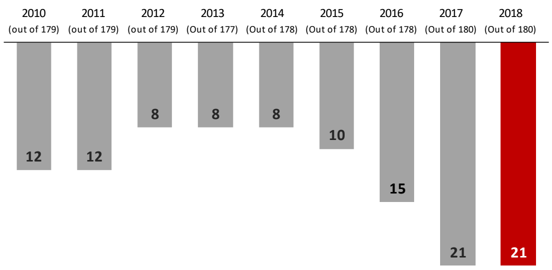
On another note and as a major source of apprehension, net exports of goods and services would again post a subdued evolution this year and continue to exert a drag on the country's expansion rate. While its share of national output is foreseen to further deteriorate, net exports of goods and services are, as per our estimations, anticipated to rub off around one percentage point from the real GDP growth being envisioned for 2018. Tellingly, in addition to be fuelled by the evolving trade landscape and difficulties encountered by specific export markets, such outcomes testify to the limitative nature of the country's productivity and competitiveness foundations, which is particularly discernable in a context when the world trade volume for goods and services is on course to post another appreciable growth this year as the momentum unclenched since mid-2016 continues to strengthen. Indeed, notwithstanding headway realised in some areas, pockets of concern prevail regarding the intrinsic ability of the local economy to (i) display adequate resilience when confronted by external shocks; (ii) cope with foreign market access constraints and competitiveness imperatives that continuously surface on the regional and international markets; and (iii) fittingly and opportunely capitalise on international growth-inducing avenues. These idiosyncratic limitations are deemed to be instigated by the persistence of supply-side bottlenecks and domestic imbalances, which especially relate to (i) the effectiveness of the institutional and governance set-up; (ii) the efficiency of product and labour markets; (iii) the appeal and adaptability of the business and investment facilitation framework when factoring in the demands and necessities spawned by the international economic and market landscapes; (iv) the dissemination of innovative technologies across sectors; and (v) human and capital productivity levels. Along similar lines, the recent findings of the 2018 Index of Economic Freedom of The Heritage Foundation make for interesting reading. While Mauritius preserved its 21st spot among the 180 countries under review and solid attributes of the economy were highlighted, the report stressed that, *"Despite a relatively flexible labor market, there is a skills mismatch between supply and demand, with a shortage of skilled labor at the technical and middle-management levels."*

Box II: Index of Economic Freedom – Positioning of Mauritius

For over two decades, the Index of Economic Freedom, published by The Heritage Foundation, has measured the impact of liberty and free markets around the globe, and the 2018 Index confirms the strong positive relationship between economic freedom and progress. Countries are graded and ranked on 12 measures of economic freedom that evaluate the rule of law, government size, regulatory efficiency, and the openness of markets. As highlighted in the report, *"Economies rated "free" or "mostly free" in the 2018 Index enjoy incomes that are more than twice the average levels in all other countries and more than five times higher than the incomes of "repressed" economies."* In the latest report, Mauritius retained its leading position in the sub-Saharan African region. Furthermore, the country's ranking remained unchanged relative to last year, i.e. at 21st spot amongst the 180 countries under review.

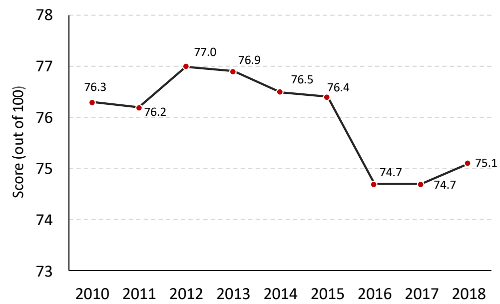
Evolution of Mauritius' score and rank in the Index of Economic Freedom

Overall Rank

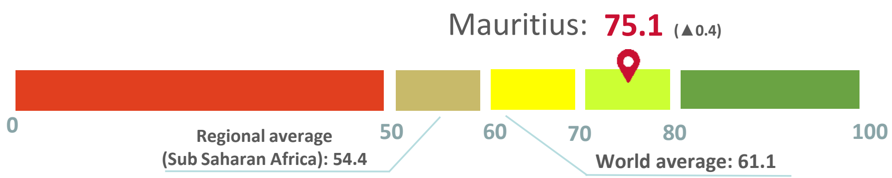


Note: Lower ranking corresponds to an improvement in freedom

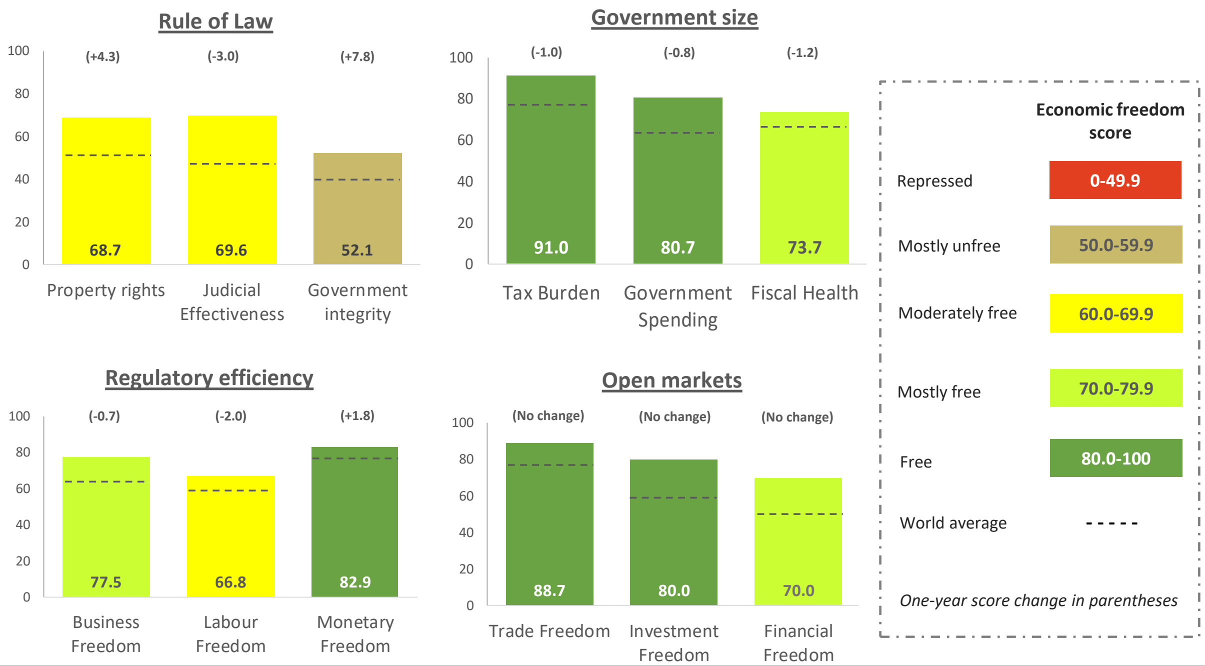
Overall Score



Spotlight on the country's performance in Index of Economic Freedom 2018



Score of Mauritius by category



Source: 2018 Index of Economic Freedom, The Heritage Foundation

RISKS TO THE GROWTH OUTLOOK

Bearing in mind the unsteady and dynamic context, it is essential to remain vigilant in our appraisal of the baseline growth projections that are formulated for the Mauritian economy. This cautiousness is ever more warranted when considering the country's long-standing structural challenges, which, as mentioned before, would tend to impede activity levels by influencing the quality of its resistance to and recuperation from potential exogenous shocks. Overall, the risks to the domestic real GDP growth outlook are broadly balanced for this current year, while being tilted to the downside over the medium term. In fact, with regard to 2018, while our current baseline real GDP growth forecast is set at 3.9%, our view is that it could feature within the 3 ¾% - 4.1% range, based on simulations that consider investment patterns, sectorial performances, total factor productivity dynamics and the evolution of the global environment. As for the medium term, real GDP growth could potentially end up being subject to noticeable strains when the anticipated stimulus linked to unfolding capital spending initiatives gradually shades off. In other words, as the implementation of infrastructure-upgrading ventures draws towards completion, domestic imbalances and structural inefficiencies could, at such a conjuncture, gather a prominently perceptible weight in stifling output levels if, meanwhile, no meaningful supply-side policies are put in place to rekindle productivity levels and improve the business environment.

Upside risk to our outlook

As is stands, there is some upside potential to our baseline growth performance. This would principally emanate from the extensive and fast-tracked execution of announced infrastructure undertakings, especially those contained in the Road Decongestion Programme, on the back of upgraded capabilities. As such, the country's overall project implementation rate would overshoot trends observed in recent years. Simultaneously, a better growth performance could, albeit to a relatively lower extent, be propelled by other potential developments, notably encompassing a greater-than-expected expansion in private investment and a higher propensity of operators to leverage growth opportunities. Such developments might arise as a result of (i) the adoption of ambitious economic policies by the authorities to further gear up the investment facilitation framework and the country's productivity and competitiveness levels; and (ii) a significantly higher economic rebound posted by our key export markets. All in all, the growth outcome for 2018 could be uplifted to up to 20 basis points as per our computations, with such a prognosis being however characterised by a low probability of occurrence after factoring in prevailing dynamics shaping up the operating context.

Downside risk to our outlook

On the other hand, the baseline growth prospects for this year could be clouded by a confluence of factors. In this respect, our estimations show that growth for 2018 could be pinned down by up to 15 basis points, with this outcome being marked by a low to moderate probability of occurrence. Regarding the key downside risks, they, notably, relate to the following: (i) a lower-than-envisaged execution rate of the Public Sector Investment Programme, reflecting protracted delays in materialising contemplated infrastructure ventures, partly attributable to potential lengthy postponements in the final award of relevant contracts; and (ii) dampened sectorial performances due to a deterioration of the business climate amidst a sub-optimal implementation of the economic transformation agenda as well as a derailing of the global recovery process. Additionally, downside risks could emanate from the ramifications and spillover effects of potentially larger-than-expected increases in oil prices amidst heightening geopolitical tensions, albeit coming off with quite a relatively negligible impact.

OTHER INDICATORS

Unemployment

After further declining in 2017 as per our estimations, the nationwide unemployment rate is, as per our baseline scenario, anticipated to edge down further to 6.9% this year, notably driven by expanding economic activities across sectors. Yet, while being positively viewed *per s*e, such a trajectory calls for due scrutiny for several reasons. In the first place, while methodological limitations subsisting at some levels highlight the need for a careful reading of prevailing tendencies, the intrinsic job creation capability of the country across economic sectors is still viewed as being impeded by the prevalence of labour market rigidities and the economy's restrained growth pattern. Against this backdrop, the unemployment path is still regarded as sub-optimal, the more so when considering our social development ambitions and our relative lack of natural resources for underpinning growth ambitions. In addition, a key trend observed over time and requiring the necessary limelight relates to the general drop in the country's activity rate – i.e. the ratio of the labour force to population aged 16 years or more – to abnormally low levels when compared to several of our peer economies. Latest official data demonstrate that the country's overall activity rate or labour participation rate stood at 59.2% in the third quarter of 2017, with the female participation rate depicting a more worrisome rate of 45.2%. On the other side, the economically inactive section of the population stood at 402,200 during this period, representing a rise of some 6,800 when compared to the third quarter of 2016 and of 10,900 relative to the second quarter of 2017. Overall, such labour market trends are viewed as quite worrisome insofar as they threaten to impede our future economic development on the basis of the country being subject to proportionately lower factor inputs than it could have possibly afforded and, thus, missing out on a potential source of economic growth. As per the 'Washington Center for Equitable Growth' organisation, "*Simply relying on the unemployment rate as an indicator of the health of the job market masks underlying problems…In order to fully understand the current state of the labor market, policymakers need to take into account not just the unemployment rate, but also other indicators of how the labor market is functioning, including the labor force participation rate.*" Overall, alongside pursuing efforts to buttress meaningful employment creation across sectors, a key priority for the Mauritian economy is to materially boost its labour participation rate as an influential tool to fuel its growth aspirations. In particular, it is insightful to refer to the World Bank's recent report on Mauritius and titled 'Mauritius: Addressing inequality through more equitable labor markets', in which it stressed that: *"Female participation in the labor force is crucial to the functioning of labor markets for both efficiency and equity reasons. Unleashing* *additional and valuable human capital resources into the economy contributes to making the economy more productive, thus helping it to attain its full potential."* At another level, it is deemed advisable to buttress statistical capabilities with a view to increasing the coverage of labour statistics in order to better capture and appraise underlying trends towards contributing to enhance informed policy-making.

Inflation

After making allowance for the statistical impact of prior sustained and, in some instances, marked increases in the consumer price index, the ascending trajectory being pursued by headline inflation is on course to be generally maintained during the first few months of 2018. Nonetheless, headline inflation is expected to recede during the second semester of the current year as the repercussions of earlier price movements become increasingly diluted in the computation, though the slide is likely to be restrained by projected pressures on the price index. On balance therefore and while discounting exceptional events, headline inflation is projected to stand at around 3.7% as at December 2018. Basically, the latter outlook overshoots our earlier forecast by 50 basis points, after mainly making allowance for (i) higher-than-expected increases in the prices of vegetables amidst adverse climatic conditions, which notably impacted the consumer price index by a significant margin this January; and (ii) higher-than-foreseen increases in international oil prices, especially in line with recent trends observed. In other respects, probable rises in administered prices cannot be discounted, although these developments are not likely to be of an overly high magnitude, while exchange rate developments should deserve close attention. Indeed, whereas inflationary pressures have been tempered by rupee strength lately, we cannot discard the risk of a further strengthening of the greenback on international markets amidst US corporate tax reforms, as the latter could, as mentioned before, trigger major repatriation of funds by US corporates. Overall, with a view to guarding against adverse nationwide economic effects, signs of building inflationary pressures deserve careful monitoring from a policy perspective, while concomitantly making allowance for other elements for informed decision-taking, especially the country's still fragile growth trajectory and other considerations such as the persistent upward pressures on the rupee. Of note, the IMF has highlighted the need to bring the headline figure down to historical norms of about 3%. In this spirit, it shed light on the requirement to establish a formal medium-term inflation objective to foster the successful implementation of a new monetary policy framework as well as better anchor policy actions and tackle inevitable trade-offs that can rise when implementing related initiatives.

Public finance

Bearing in mind our relatively elevated public sector debt levels, the country's budgetary position continues to call for close inspection, the more so when considering our economic development aspirations for the short and longer runs. With respect to FY 2017/18, the authorities expect the budget deficit to decline to 3.2% of GDP. Notwithstanding an expected significant rise in capital outlays linked to the deployment of infrastructure projects – albeit to a lower extent than previously projected after reflecting the lead time confronting the execution of envisioned major infrastructure-upgrading projects – and slightly higher-than-expected recurrent expenditures, the improved budget outturn would be mainly underpinned by an anticipated notable rise in revenue from taxes on goods and services amidst expanding economic activities, the receipt of external grants and the rationalisation of special funds. All in all, while recognising the need to promptly implement projects that will upgrade the country's capabilities, it is essential that both the level and quality of fiscal imbalances be effectively catered for. In this respect, a holistic view of debt levels is warranted to the extent that, when making allowance for the contingent liabilities of the Central Government, the financing needs of Mauritius are, as highlighted by the IMF, left more exposed to potential real and fiscal sector shocks. Overall, in addition to generating suitable fiscal space for spurring growth, efforts to contain the evolution of the public debt within manageable levels 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 assisting financial sector operators in their regional expansion strategies.

External front

In light of trends observed so far, on both the exports and imports side, we have downgraded our outlook for the balance of trade deficit for 2017, with the imbalance being now estimated at close to Rs 98 billon, which represents a deterioration of nearly 21% compared to the preceding year. For 2018, the trade deficit is set to break through the centurial threshold and attain around Rs 104 billion, representing 21% of GDP, amidst (i) a contained rise in exports given strains on our competitiveness levels and the still soft economic conditions in specific markets such as UK and South Africa; and (ii) a notable hike in imports linked to the undertaking of major infrastructure projects. Of note, the deterioration of the trade deficit could have even been more pronounced had the US dollar, in which most of our imports are denominated, remained, on average, at similar levels as those depicted in 2017. For its part, after deteriorating by a significant margin to attain 6.4% of national output in 2017, the current account deficit is projected to rise further in 2018. Basically, it is foreseen to account for around 6.7% of GDP this year, despite support stemming from a surplus on both the income and services accounts. With respect specifically to the latter account, its performance is likely to be notably driven by higher gross tourism receipts in line with an expected further expansion in arrivals, whilst being impacted by the foreseen rental payments associated with the delivery of two planes through operating leases. Overall, whereas the forecasted surplus has, once more, been revised downward, the balance of payments is estimated to have stayed in a positive zone in 2017, with a broadly similar outcome being envisaged to be realised in 2018 amidst sustained appreciable levels of capital and financial flows, inclusive *inter alia* of the project-based disbursement of the tranches relating to the grant and the lines of credit received from the Government of India.

MAIN CHALLENGES

As it delves further into 2018, the Mauritian economy remains exposed to an inquisitive sentiment on the heels of the persisting pressures on its real, fiscal and external sectors. In particular, the sub-optimal real GDP growth trajectory expresses the necessary grounds that the country has to cover in order to turn the corner. Against this backdrop and amidst the rapidly changing and exigent global landscape, the key salute for the country is to resolutely widen and deepen its economic transformation programmes, which should enable it to achieve desired socio-economic gains, alongside accelerating its graduation to the high-income nation league. In this respect, while the envisioned nationwide infrastructure push-up is foreseen to provide due stimulus by upgrading capacity and boosting activity levels, the direct ramifications of many of those projects on nationwide growth are likely to be mainly of a short to medium term nature. As such, alongside promptly and extensively bolstering the quality and stretch of the country's physical assets – while preserving the efficiency and commercial viability of investments incurred, backed by the meaningful recourse to Public Private Partnerships – the implementation of deep-rooted structural reforms to restructure and rebalance the economy should, as a key offshoot, help to nurture a sound and dependable footing to achieve high real GDP growth on a sustainable basis. Beyond this element, the IMF stated, when referring to the global environment that, *"The current cyclical upswing provides an ideal opportunity for reforms. Shared priorities across all economies include implementing structural reforms to boost potential output and making growth more inclusive."* As for Mauritius, due focus on structural policies should enable it to elevate its potential growth rate – which is the level of growth that it can achieve over the long run after making full use of all its available resources – to around or above the 5% mark over the medium term. This will help to strengthen the country's ability to properly tackle exogenous shocks and deliver higher living standards. However, accomplishing such aspirations is not an easy task given the persistence of domestic imbalances that, as hinted before, continue to foster subdued productivity and external competitiveness levels, while the extent and quality of our market access and connectivity warrant attention in the wake of the exigent global set-up, characterised conspicuously by market liberalisation pressures. Also, towards coping with local inadequacies, a major challenge for stakeholders is to smartly juggle with policy trade-offs when being confronted by multifold economic priorities, alongside tackling the generally limitative nature of project implementation capabilities.

UPGRADING OUR COMPETITIVENESS LEVELS

With a view to guiding the country's economic transition and shoring up our potential growth, it is creditable to take cognizance of intentions conveyed by the authorities to transform and modernise the economy towards achieving growth dividends and generating augmented wealth levels. While making sure that the economic strategies contemplated and designed at different levels are synchronised, the authorities face up to the test of ensuring that earmarked policy measures are well conceptualised, packaged, sequenced, executed and disseminated. At a more granular level, the onus is for the country to combat supply-side deficiencies subsisting at various levels in a resolute and widespread fashion. This can, notably, be attained by (i) further removing bottlenecks and excessive red tape that impede the ease of doing business and the quality of the investment facilitation framework; (ii) improving and simplifying labour market mechanisms, while addressing the skills mismatch; (iii) buttressing the employability and mobility of the local talent pool, alongside encouraging enhanced human capital build-up, towards boosting labour force participation and shoring up the country's total factor productivity; (iv) embracing a more outward-looking, albeit sufficiently cautious, strategy of further opening up our economy to foreign capital as well as talent and know-how, notably in the high-skilled segment; and (v) re-engineering, in an accelerated fashion, the operational, strategic and governance framework of parastatal bodies as well as improving the quality and breadth of the national institutional arrangements. In this respect, while stressing the need to assign due attention in tackling any coordination and capacity challenges that may arise, empirical studies have widely shown that a strong and trustworthy institutional framework – which is anchored on robust transparency and accountability principles, clearly-defined objectives and a sound governance set-up – is vital to (i) foster the effective materialisation of economic policies and ensure that they come to fruition within assigned timeframes; and (ii) pave the way for macroeconomic policies to generate suitable gains for businesses and the population at large. In another spirit, Mauritius should benefit from the active promotion of research and development endeavours by industries as a stepping stone for increasing the pace and depth at which innovative practices are adopted across the country, considering the positive externalities that newly-created intellectual assets can provide for the development of a high value-added knowledge economy which is able to develop and maintain a competitive advantage in fast-growth industries that are operating within the global sphere. At the end of the day and as a major axis of our economic orientations, the creation of a more productive and competitive economy is, in light of the small size of the domestic market, deemed vital to help Mauritius (i) further expand and diversify its economic base and its regional and international market space; (ii) boost its exports of goods and services amidst the current economic context; and (iii) establish international trade as a pivotal engine to achieve high and balanced GDP growth over time.

ENABLERS FOR GROWTH

Overall, embracing key enablers will help to realise the full stretch of our envisioned macroeconomic objectives within reasonable timeframes and with acceptable success rates. Key examples can be delineated as follows: (i) boosting project implementation capabilities, backed *inter alia* by a thoughtful improvement of procurement and tendering mechanisms underpinning the allocation of contracts and further strategic investments in information and communications technology; (ii) the holding of regular and productive consultations with stakeholders amidst well-calibrated public-private sector collaboration; and (iii) removing any potential

Box III: Zoom on the importance of strong public institutions

Former US President Barack Obama once said: *"Africa doesn't need strong men, it needs strong institutions"*. Indeed, well-functioning institutions play a pivotal role in providing a conducive environment for economic growth and wealth creation. The following is a selection of empirical references focusing on the significance of public institutions in enhancing economic performances, as highlighted in: (i) Chapter 3 of the IMF's World Economic Outlook 2003; (ii) a World Bank paper entitled 'The role of Institutions in Growth and Development'; and (iii) Element 6 of the OECD post 2015 reflections series.

Key findings of selected reports

IMF

- 'Good' institutions establish an incentive structure that reduces uncertainty and promotes efficiency—hence contributing to stronger economic performance
- Institutional measures have a statistically significant impact on GDP per capita. The aggregate governance measure of institutions is alone capable of explaining nearly three-fourths of the cross-country variation in income per head. Improving the quality of institutions in Cameroon, for example, to the average level of institutions for all countries in the sample would increase GDP per capita by almost five-fold
- Institutions have a strong and significant impact on GDP growth. For instance, annual growth in sub-Saharan Africa would increase by 1.7 percentage points if countries in this region adopted the average quality of institutions

World Bank

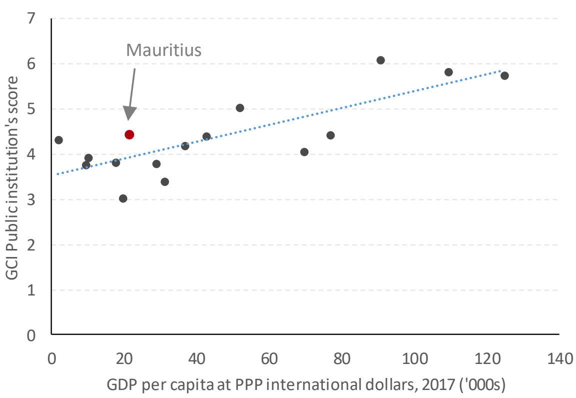
- Institutions matter for economic growth because they shape the incentives of key economic actors in society. In particular, they influence investments in physical and human capital and technology and the organisation of production.
- Making or imposing specific institutional reforms may have little impact on the general structure of economic institutions or performance if they leave untouched the underlying political equilibrium
- Countries that have reformed their institutions and moved onto different and better development paths, such as Singapore, Republic of Korea or China, have been able to do so because their political equilibrium changed in a way that gave more power to those who wanted to push through reforms

OECD

- Capable and adequately-resourced public organisations are key to the delivery of public services and form an essential part of the enabling environment for attracting investment and supporting private sector development
- Government organisations which uphold principles of integrity and disclosure, and are subject to objective and thorough oversight processes, are more accountable to the public and less susceptible to corruption and the mismanagement of funds

Significance of public institutions in impacting income per head

Strength of public institution v/s GDP per capita



- For the sake of comparison with Mauritius, countries with a land mass of below 20,000 km² have been considered in the scatter diagram (with geographical smallness used as a proxy for the lack of resources and constrained domestic market size). For each country, the strength of public institutions – as extracted from the 2017/18 edition of the World Economic Forum's Global Competitiveness Index – has been plotted against GDP per capita in 2017
- A positive correlation of 0.8 is detected between the strength of public institutions and income per head

Sources: Chapter III, IMF World Economic Outlook April 2003, The role of Institutions in Growth and Development , World Bank, and Element 6 of the OECD post 2015 reflections series and MCB Staff estimates distortions that can hamper the soundness and perennity of sectorial and investment activities, alongside generally preserving the simple, predictable and low fiscal regime that has played a meaningful role to maintain the country's competitive edge for years. Besides, reinforcing the soundness of the Government's fiscal balances can be viewed as a key focus area, especially given the need to create adequate leeway to execute pro-growth initiatives as well as safeguard the investment-grade rating of the country and its ease of access to international financial markets. In another light, reforms should prove effective if they are carefully designed in close alignment, amongst others, with sectorial circumstances and institutional dynamics. With respect to the soundness of the policy environment, allowing for due coherence in initiatives adopted will play an influential role in enhancing the credibility of decision-makers vis-à-vis stakeholders, sending the right signals to investors and safeguarding business confidence. It can, additionally, be underscored that the reform agenda will work out if encompassing policies are pragmatic, targeted, predictable, transparent and fair. Alongside, a key success factor is to steer clear of any pitfalls that the political business cycle can potentially instigate, in particular those that threaten to hamper the judiciousness and long-term perspective of envisioned economic policies if left unmonitored and unaddressed.

ENDING NOTE

French poet, Charles Baudelaire, once asserted that *"Tout ce qui est beau et noble est le résultat de la raison et du calcul [Everything that is beautiful and noble is the product of reason and calculation]."* Indeed, amidst the current challenging, albeit improving operating context, the Mauritian economy is left with no choice than to be shrewd and sensible enough to identifying its weak spots and embrace lasting solutions that will re-ignite the engines of growth. Ultimately, identifying the appropriate challenges, adopting the right approaches and taking decisive decisions should help to transform Mauritius into a resilient, creative, flexible and knowledge-based economy that is capable of swiftly fending off exogenous shocks and harnessing expansion opportunities. Simultaneously, the economy should be better positioned to further diversify and broaden its economic space and foster increased international openness. While embarking on this route should prove beneficial to Mauritius Inc., promoting multi-stakeholder collaboration, participation and engagement should be pivotal in achieving the Pareto efficient allocation of resources and optimise the welfare of our socio-economic fabric.

J. Gilbert Gnany
Chief Strategy Officer

February 9, 2018

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