Mauritius—Assessment Letter for the World Bank and African Development Bank

September 29, 2009

Mauritius has a long and sustained track record of implementing strong policies, and the authorities have responded appropriately to the global financial crisis by easing macroeconomic policies. While the crisis response has halted the decline in public debt, the public finances are fundamentally sound and external debt is sustainable. In light of the flexible exchange rate, the country's current reserve position is comfortable, and banks have remained liquid and profitable. With these strong economic fundamentals and an effective institutional policy framework, Mauritius is well placed to weather the current challenges.

Recent Economic Developments and Short-Term Outlook

The Mauritian economy is suffering from second-round effects of the global financial crisis, with economic growth slowing but expected to remain positive. Direct financial spillovers have been limited, reflecting conservative investment practices of Mauritian banks. As a result, banks had little direct exposure to subprime and other affected assets, and have remained liquid, profitable, and well-capitalized, thus far. The stock market has moved in tandem with global trends.

The global crisis is affecting Mauritius primarily via a sharp drop in external demand for tourism and textiles, and a fall in capital inflows. As a result of these developments, economic growth is projected to slow to 2 percent in 2009—down from 5.3 percent in 2008—with depressed imports likely to keep the current account deficit in single digits, as a share of GDP. At the same time, inflation, which has dropped below 1 percent (year-on-year) in August, is expected to stay subdued for the remainder of this year.

Economic Policy Response

In light of the global financial crisis, the authorities have responded with an appropriate easing of macroeconomic policies:

- ***Fiscal policy.*** The government is implementing a fiscal stimulus package of about 5 percent of GDP spread over 2009-10. The targeted and temporary stimulus measures focus on advancing planned infrastructure spending and providing financial relief to those firms hit hardest by the global crisis. These stimulus-related expenditures will lead to a deterioration of the fiscal deficit during 2009-10 (Box 1). To keep the deficit and the debt dynamics under control, the government has also introduced partially offsetting adjustment measures in its recent budget, which should help bring the primary balance back to a small surplus by end-2011. Public debt has declined sharply in recent years but still stands at around 60 percent of GDP, and medium-term fiscal policy will need to aim at bringing it down further to reduce potential vulnerabilities. Financing on favorable terms will thus be important to keep both the public finances and debt ratio on a sustainable path.

- ***Monetary policy.*** The Bank of Mauritius (BoM) shifted to an accommodative stance in the fall of 2008, when it cut the repo rate by 250 basis points and reduced reserve requirements. Since then, the policy rate has been left unchanged. In addition, the central bank has preemptively established a foreign currency credit line—which has only been drawn thus far by one bank, to a very limited extent.

- ***Exchange rate policy.*** The BoM has refrained from interventions in the foreign exchange market since December 2008. This has kept official reserves at a comfortable level, while resulting in a depreciation of the rupee by 4 percent, in nominal effective terms, between end-December 2008 and end-August 2009.

Box 1. Fiscal Policy Stance and Measures

Based on the budget approved in May 2009, and in light of the government's fiscal stimulus package, Mauritius is expected to record a deficit, including grants, for the six month budget (July-December) of 5 percent of GDP (about 4 percent for full calendar year 2009) and in FY 2010 of again around 5 percent of GDP.

- ***Revenue are projected to decline across the board:*** Customs and excise revenues are falling because of lower imports; VAT because of lower domestic consumption, including significantly lower spending by tourists; real estate taxes due to depressed activity; corporate taxes because of a lower level of profits, reflecting depressed demand together with actions to preserve employment; and dividends because of lower profitability of state owned enterprises.

- ***Spending is projected to increase.*** Starting in the first half of 2009, the authorities began to implement the stimulus package announced in December 2008 that is targeted and temporary. As programs get into full gear, spending is expected to accelerate over the next 18 months. During this period, the stimulus package accounts for about 5 percent of GDP of which 3 to 3.5 percent of GDP will be carried out through dedicated funds. The latter were established at the end of the 2007/08 fiscal year, when funding was set aside as a contingency against an economic slowdown, and were stocked up further in FY2008/09.

External Sector Vulnerabilities

Economic vulnerabilities have been reduced in recent years and risks appear manageable. The main risks arise from much lower demand for tourism, textiles, and real estate development. Also, continued turmoil in global financial markets and reduced appetite for emerging market assets could diminish FDI inflows further and reduce activity of the important Global Business Companies. However, the external position remains sustainable and medium-term risks, including for external debt sustainability, are manageable. In addition, the solid level of international reserves (as of July about 6 months of imports) provides a welcome cushion, while the orderly depreciation of the rupee is helping export competitiveness, without having hindered a significant decline in inflation.

Relations with the IMF

The 2008 Article IV consultation was completed on July 2, 2008. The next consultation is expected in the fourth quarter of 2009.