

**Mauritius: 2004 Article IV Consultation—Staff Report; Staff Statement; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Mauritius**

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2004 Article IV consultation with Mauritius, the following documents have been released and are included in this package:

- the staff report for the 2004 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on April 1, 2004, with the officials of Mauritius on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on June 18, 2004. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a staff statement of July 21, 2004 updating information on recent developments.
- a Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its July 21, 2004 discussion of the staff report that concluded the Article IV consultation.
- a statement by the Executive Director for Mauritius.

The document listed below has been or will be separately released.

Selected Issues Paper and Statistical Appendix

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

MAURITIUS

**Staff Report for the 2004 Article IV Consultation**

Prepared by the Staff Representatives for the 2004 Consultation with Mauritius

Approved by Juan Carlos Di Tata and Martin Fetherston

June 18, 2004

- The 2004 Article IV consultation discussions were held in Port Louis during March 19-April 1, 2004. The mission met with the Deputy Prime Minister and Minister of Finance, The Honorable Mr. Pravind Jugnauth; the Governor of the Bank of Mauritius, Mr. Rameswurlall Basant Roi; the Financial Secretary, Mr. Krishnanand Gupta; other senior government officials, and representatives of the private sector and trade unions.
- The staff team comprised Mr. McDonald (head), Mr. Yao, Ms. Kim, Mr. Mikhael, (all AFR) and Mr. Porter (FIN). Mr. Ismael (Advisor, Executive Director for Mauritius) also participated in the discussions.
- Mauritius is on the standard 12-month consultation cycle. At the conclusion of the 2003 Article IV consultation on June 30, 2003, Executive Directors noted that sound macroeconomic policies have established the conditions for investment and growth and the strong performance of the economy over the last two decades. Directors observed that the key challenges in the medium term will be to: (1) explore the scope for further economic diversification; (2) address the problem of persistent unemployment; and (3) contain the budget deficit and overall public debt in order to minimize the risks to medium-term macroeconomic stability.
- Mauritius accepted the obligations of Article VIII, Sections 2 (a), 3, and 4 on September 29, 1993, and its exchange system is free of restrictions on the making of payments and transfers for current international transactions. Mauritius also maintains a liberal capital account. It last availed itself of Fund resources in July 1986 and settled all repurchase obligations in May 1991. Since June 2002, Mauritius has been included as a creditor in the Fund's financial transaction plan.
- Appendix I presents an assessment of public and external debt sustainability. Mauritius's relations with the Fund, including technical assistance, are summarized in Appendix II, and its relations with the World Bank Group in Appendix III. The quality and timeliness of Mauritius's reporting of core data and other economic and financial statistics are, in general, satisfactory for conducting surveillance. Statistical issues are discussed in Appendix IV, progress toward the Millennium Development Goals in Appendix V, and a draft PIN is included in Appendix VI.

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## EXECUTIVE SUMMARY

**Following a weak growth performance in 2002/03 (July-June), real GDP is expected to have increased by around 4½ percent in 2003/04, largely reflecting the recovery of sugar production and strong construction activity.** The overall fiscal deficit is estimated to have declined slightly to 5½ percent of GDP in 2003/04, and the external current account surplus to have remained unchanged at about 2½ percent of GDP. Inflation is expected to decline to around 4 percent by the end of the fiscal year.

**Real GDP growth is projected to remain under 5 percent in 2004/05, and medium-term growth is likely to slow to around 4 percent per annum.** While moderate growth is expected in the tourism, information and communications technology (ICT), and sugar sectors, the textile sector is expected to decline further.

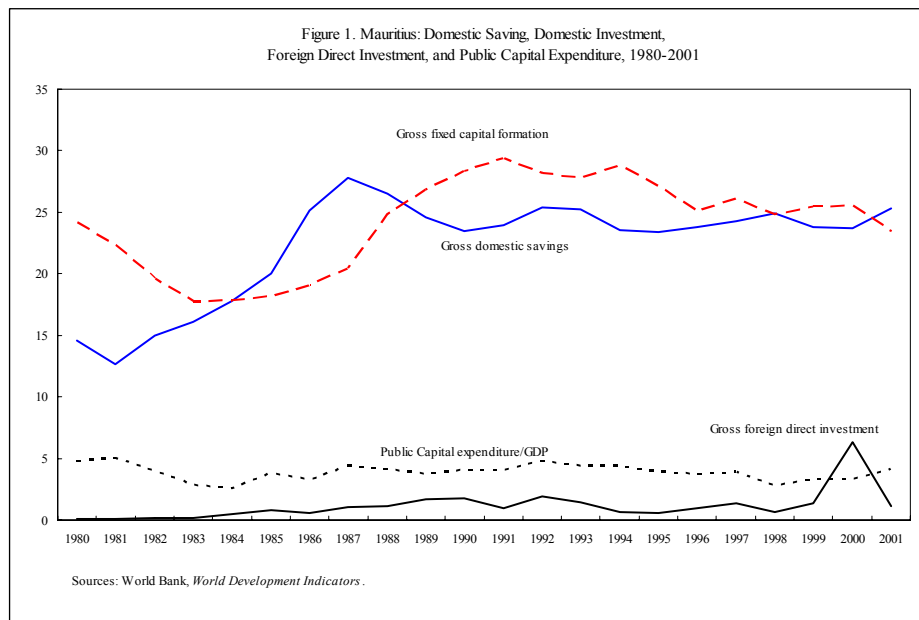
**Mauritius's immediate and medium-term challenges are threefold.** First, there is a need to diversify and transform the economy, especially in light of the expected loss of trade preferences in the sugar and textile sectors. Second, the authorities must undertake structural reforms to lessen labor market rigidities. Third, persistent budget deficits need to be reduced if medium-term fiscal sustainability and macroeconomic stability are to be preserved.

**Medium-term fiscal consolidation is essential to avert unsustainable debt dynamics that could jeopardize the economy's growth prospects and macroeconomic stability.** The government should aim to stabilize the public debt/GDP ratio in 2004/05 by reducing the deficit to around 4¾ percent of GDP. Reductions in the fiscal deficit of around 1 percent of GDP annually in subsequent years would reduce the public debt/GDP ratio to around 66 percent by 2007/08, from above 70 percent in 2003/04. Sustainable fiscal policy would need to be accompanied by prudent monetary and exchange rate policies to protect the economy from downside risks.

**In line with the FSAP recommendations, the authorities have taken steps to strengthen the financial system.** The government is expected to pass draft laws to revise the Bank of Mauritius Act and the Banking Act at around the time of the announcement of the 2004/05 budget. The authorities have also taken a number of actions to strengthen the Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) framework.

## I. INTRODUCTION AND MEDIUM-TERM CHALLENGES

1. **Mauritius’s social and economic success during the past quarter century has been impressive.** This success owes much to the high quality of institutions, including a well-functioning multi-party democracy, an independent judiciary, and a strong sense of the “rule of law.”<sup>1</sup> Good institutions and appropriate policies have led to a more than doubling of per capita income, a narrowing of income disparities, and a marked improvement in social indicators. Since the early 1990s, however, unemployment has risen steadily, owing to labor market rigidities and a structural skills mismatch.
2. **Remarkably, Mauritius’s development has been financed almost entirely from domestic savings,** which have been intermediated through an efficient domestic banking system. Foreign Direct Investment (FDI) has played a minor role (Figure 1).
3. **Mauritius’s immediate and medium-term challenges are threefold.** First, there is a need to diversify and transform the economy, especially in light of the expected loss of trade preferences in the sugar and textile sectors. Second, Mauritius must undertake structural reforms to increase labor market flexibility. Third, persistent budget deficits need to be reduced if medium-term fiscal sustainability and macroeconomic stability are to be preserved.



<sup>1</sup> According to the 2003 reports of the World Economic Forum and Transparency International, Mauritius is among the top five African countries for quality of public institutions and perception of corruption.

4. **While the timing of the phasing out of textile preferences has been defined, there is less certainty in the case of sugar exports.** Textile quotas will be phased out with the expiration of the WTO Agreement on Textiles and Clothing (ATC) in January 2005. Given its relatively high per capita income, Mauritius does not qualify for the third-country fabric provision under the U.S. African Growth and Opportunity Act (AGOA). Therefore, unlike other nations benefiting from preferential access to the U.S. market under AGOA, Mauritius cannot import raw fabric from non-AGOA countries, placing the country at a relative disadvantage. The preferential access afforded to sugar exports by the European Union (EU) is currently under review.<sup>2</sup>

5. **Mauritius's unemployment has increased rapidly since 1991 primarily among low-skilled workers** concentrated in the sugar and textile sectors.<sup>3</sup> Unless significant labor market reform takes place, the unemployment rate may worsen in coming years.

6. **While external debt remains at a relatively low level, domestic public debt sustainability is a major concern.** According to sensitivity tests carried out by staff, total public debt could become unsustainable in the medium-term in the absence of significant fiscal adjustment, thereby jeopardizing growth prospects and macroeconomic stability.

7. **The authorities' response to the challenges identified in Fund surveillance in recent years has been uneven.** For example, while some attempt was made to enhance prospects for medium-term fiscal sustainability in 2002/03 through the introduction of revenue-enhancing measures, the tax base remains relatively narrow. The authorities have also been slow to address key structural reforms, particularly with respect to the labor market and the strengthening of the fiscal position of key state-owned enterprises. However, in the last year, some progress was made in addressing the challenges identified by Executive Directors during the 2003 Article IV consultation. Specifically, the authorities have: (i) attempted to revitalize the sugar and textile sectors through the implementation of cost-saving measures in the former and the facilitation of the restructuring of viable firms in the latter; (ii) made a number of improvements in line with the FSSA recommendations, and issued guidance notes on AML/CFT; (iii) implemented an automatic pricing mechanism for petroleum products; and (iv) introduced the Bank of Mauritius (BOM) Bill to control liquidity in the banking system. Undertaking further reforms in the near term will prove difficult and will require a strong commitment by the authorities, especially in light of upcoming elections (Box 1).

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<sup>2</sup> The WTO recently convened a panel to consider the challenge to the EU's sugar export subsidies brought by Australia, Brazil, and Thailand.

<sup>3</sup> The 2000 Census reported that 90 percent of the unemployed have not completed the high school certificate.



### Box 1. Political Developments

**Mauritius has a multiparty democratic system.** The transfer of the premiership took place on September 29, 2003, in line with a coalition agreement reached in 2000 between the Mouvement Socialiste Militant (MSM) of Sir Anerood Jugnauth and the Mouvement Militant Mauricien (MMM) of Mr. Paul Bérenger. As a result, Mr. Bérenger relinquished the finance portfolio to become the new Prime Minister to complete the final two years of the five-year term of office, while Sir Anerood gave up the premiership and became president. The new MSM leader, Mr. Pravind Jugnauth—son of the president—is the new deputy prime minister and finance minister. The opposition Labour Party’s victory in the December 2003 by-election for the National Assembly seat vacated by Sir Anerood has given new impetus to opposition activities. The next general election will take place in 2005.

## II. RECENT ECONOMIC DEVELOPMENTS

8. **Real GDP growth is expected to rebound to around 4½ percent in 2003/04 (July-June), following a disappointing 2¾ percent in 2002/03.** This largely reflects the recovery of tourism and sugar production, the latter due to favorable weather, and continued strong construction and transportation activity. However, high domestic production costs and increased competition have continued to affect adversely the Export Processing Zone (EPZ) sector, which registered negative growth for the second consecutive year. The unemployment rate rose to 10.2 percent in 2003, from 9.7 percent in 2002.

9. **Budget execution for the first eight months of 2003/04 (July-February) was broadly in line with the target of reducing the deficit to 5.5 percent of GDP, from 6.2 percent in 2002/03.** This improvement reflects primarily higher tax and nontax revenue. Total expenditure remained broadly unchanged at 26½ percent of GDP.

10. **There is a danger that public debt could become unsustainable as a result of continuing central government fiscal deficits.**

The total public debt, which was equivalent to 66 percent of GDP in 1999/00, rose to about 80 percent in 2002/03. At the same time, the debt service

burden rose by over 40 percent from 2001/02 to 2002/03, accounting for a large share—20 percent—of current expenditure. Moreover, with most of the debt concentrated in short-term

Central Government Finances, 1999/00-2003/04 1/					
(In percent of GDP)					
	1999/00	2000/01	2001/02	2002/03	2003/04 Rev. Budg. Est.
Total revenue and grants	20.9	18.2	18.4	20.3	20.9
Tax revenue	18.1	16.1	15.7	17.4	17.8
Nontax revenue and grants	2.8	2.0	2.7	3.0	3.1
Total expenditure and net lending	24.7	23.9	24.4	26.5	26.4
<i>Of which:</i> Current expenditure	20.8	21.4	20.3	21.2	21.2
Capital expenditure	3.0	3.1	3.7	4.7	4.8
Net lending	0.1	-1.3	0.4	0.7	0.4
Overall balance	-3.8	-5.7	-5.9	-6.2	-5.5
Primary balance	-0.4	-1.3	-2.6	-1.9	-1.5

Sources: Ministry of Finance; and IMF staff estimates and projections.

1/ Fiscal year from July to June.

securities, there is significant rollover and interest rate risk. Recognizing these risks, in 2003/04 the government has mostly financed its budget deficit by drawing on its deposits at the BOM. External public debt remains relatively low at a projected 19 percent of GDP in 2003/04.

11. **The overall balance of 30 nonfinancial public sector corporations shifted from a deficit of 0.6 percent of GDP in 2001/02 to a surplus of 0.9 percent in 2002/03.**<sup>4</sup> The Central Electricity Board (CEB) continues to face financial difficulties, in part because of its inability to pass on to consumers the higher international price for fuel oil—a major input in electricity generation. The financial position of the State Trading Corporation (STC) is expected to improve following the introduction in early April 2004 of an automatic mechanism for adjusting the prices of petroleum products.<sup>5</sup>

Selected Economic and Financial Indicators, 1999/00-2003/04 1/

	1999/00	2000/01	2001/02	2002/03 Prov.	2003/04 Est.
	(Annual percentage changes, unless otherwise indicated)				
GDP at constant market prices	2.7	7.6	4.3	2.7	4.4
Consumer prices (period average)	5.3	4.4	6.4	5.1	3.9
Unemployment rate (in percent)	7.7	8.8	9.1	9.7	10.2
Real effective exchange rate 2/	5.7	2.7	-1.9	-1.0	0.8
	(In percent of GDP at market prices)				
Overall fiscal balance (including grants)	-3.8	-5.7	-6.0	-6.2	-5.5
External current account balance	-1.6	3.4	5.4	2.6	2.6
Total public debt	65.8	64.4	70.5	80.5	72.8
Net international reserves of the Bank of Mauritius 3/ (In months of prospective imports, c.i.f.)	4.1	5.0	5.4	6.9	7.5

Sources: Mauritian authorities; and Fund staff estimates.

1/ Fiscal year from July to June.

2/ Trade-weighted period averages (a negative sign signifies a depreciation). Figure for 2003/04 represent the percentage change from July to December 03.

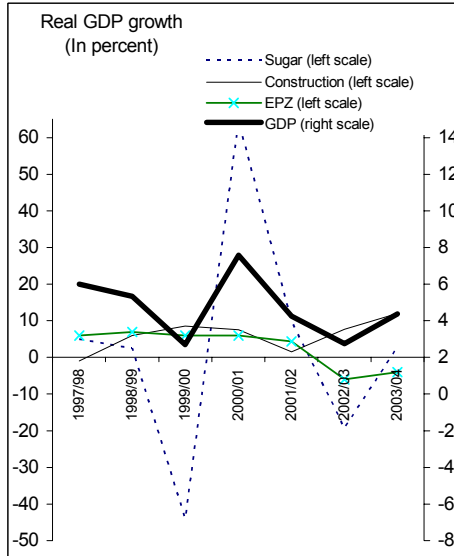
3/ In months of imports, c.i.f.

<sup>4</sup> There is insufficient information available to prepare projections for the public corporations for 2003/04.

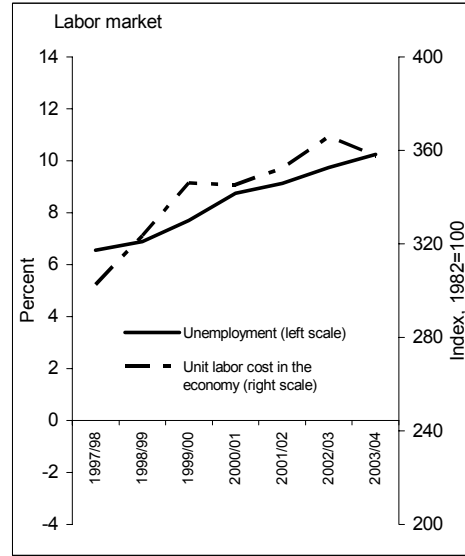
<sup>5</sup>This has led to increases of 4.6 and 9.6 percent in gasoline and diesel prices, respectively, since April 2, 2004.

**Figure 2. Mauritius: Real Sector Developments**

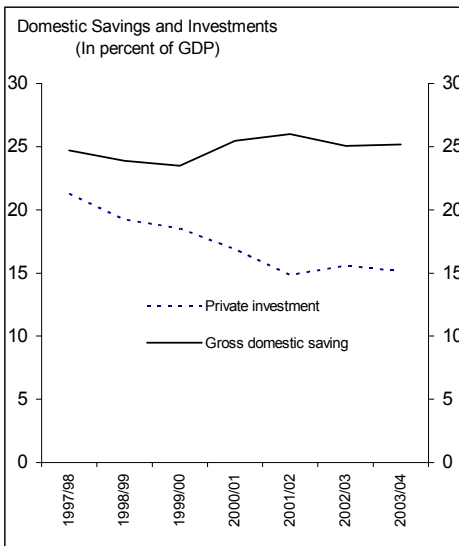
*Real GDP growth is expected to rebound, supported by the sugar and construction sectors, but the EPZ sector remains weak.*



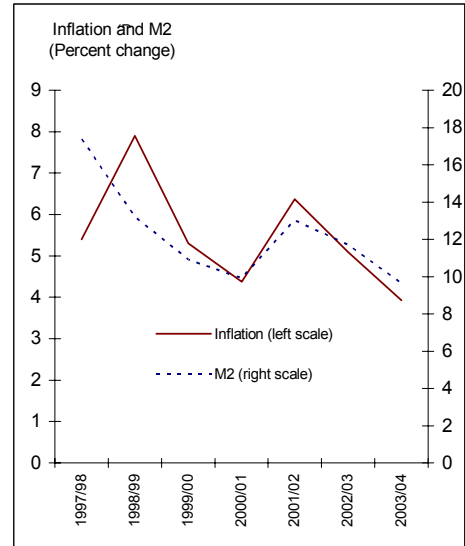
*Unemployment continued to rise in line with high cost of labor.*



*Savings remained high, while private investment fell...*



*...and inflation declined.*



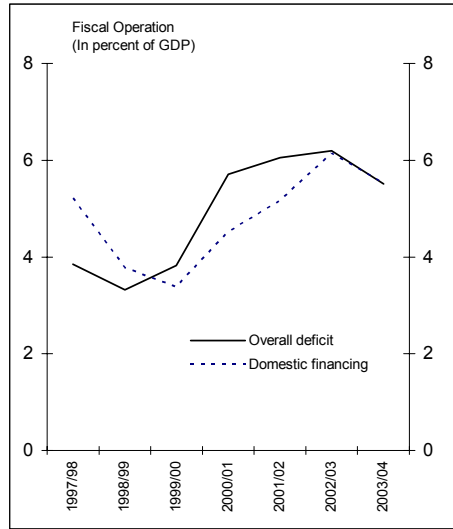
12. **Low and stable inflation has generally been achieved, largely due to a relatively successful implementation of an informal inflation targeting framework.** Average annual inflation fell to around 4 percent in 2003, from 6.4 percent in 2002, in line with the central bank's inflation target. The growth of credit to the private sector slowed in 2003, owing in part to the weaker performance of the textile sector. The outlook is for a further moderate fall in inflation over the near term, as demand pressures remain subdued.

13. **Key interest rates have been trending downward over the last two years, although real lending rates remain high.** The BOM lowered its Lombard rate in five steps by a total of 200 basis points, to 9½ percent in late January 2004. These actions reflect the judgment that inflationary risks have subsided, and a desire to provide a stimulus to economic activity. However, given the weaknesses in key sectors of the economy, banks have been cautious in advancing credit to segments of the private sector. This, together with the drawdown in government deposits, which has not been fully sterilized by the BOM, has led to a situation of excess liquidity in the banking system. As a result, interest rates in the interbank market have fallen to an all-time low of less than one percent at end-March 2004, leading to a steepness at the short end of the yield curve. Declining inflationary expectations over the last two years have led to a gradual decline in interest rates, resulting in a reduction in the differential between the yield curve of Mauritius and that of the U.S.

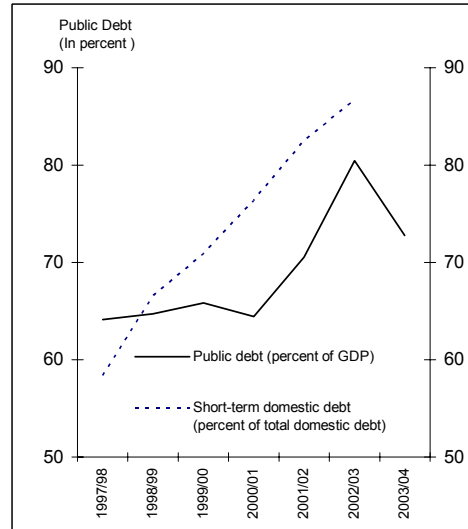
14. **The overall balance of payments surplus is projected to decline from 6½ percent of GDP in 2002/03 to below 2 percent in 2003/04.** The current account is projected to remain in surplus in 2003/04, with a recovery of the tourism sector offsetting a widening in the trade deficit. The capital and financial account is projected to register a small deficit of 0.8 percent of GDP in 2003/04, compared with a surplus in 2002/03. FDI flows are expected to weaken in 2003/04.

**Figure 3. Mauritius: Fiscal Developments**

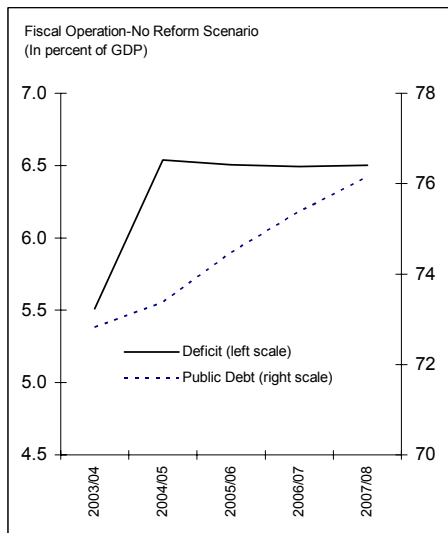
*Fiscal imbalances have reemerged since 2000/01, and have largely been financed domestically.*



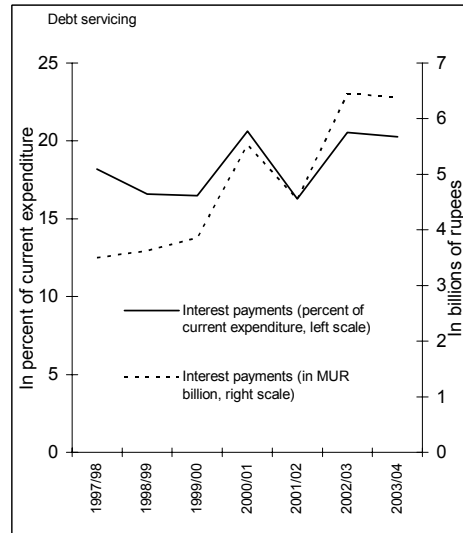
*This has resulted in mounting public debt, mostly short-term bills.*



*Without fiscal consolidation, there is danger that the public debt could become unsustainable...*

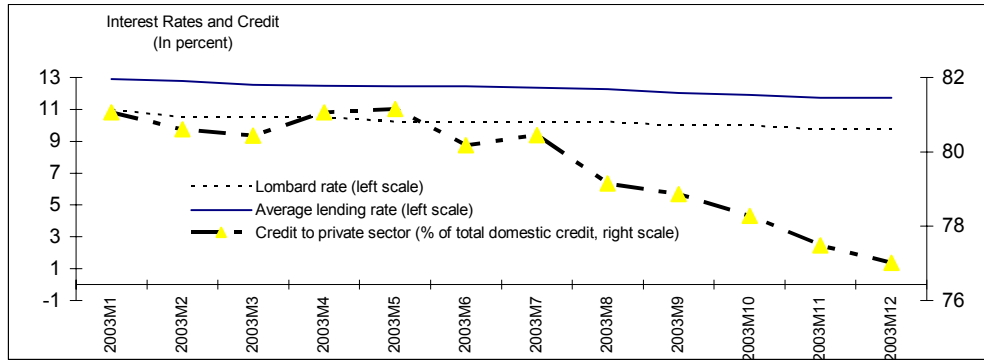


*...as debt servicing becomes an increasing proportion of current expenditure.*

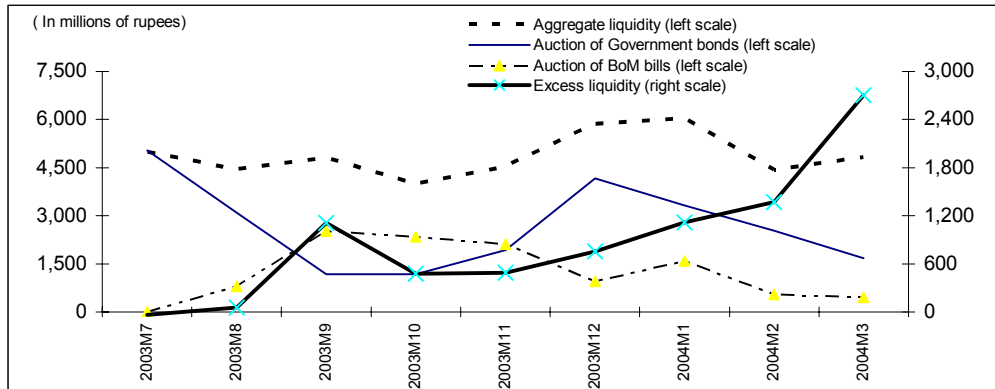


**Figure 4. Mauritius: Monetary Developments**

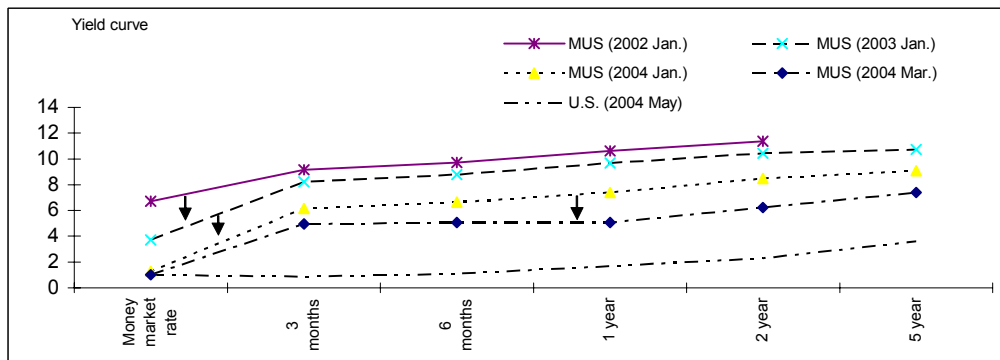
*The BOM lowered Lombard rates to stimulate activity, but credit to the private sector was sluggish.*



*Together with the drawdown in government deposits, there is excess liquidity in the banking system...*

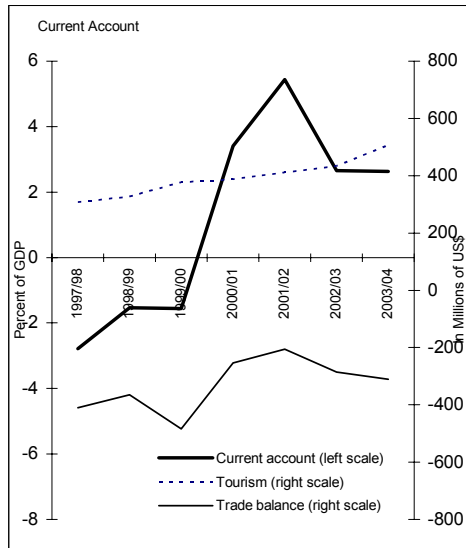


*The differential between the U.S.'s and Mauritius's yield curves has narrowed over the last two years.*

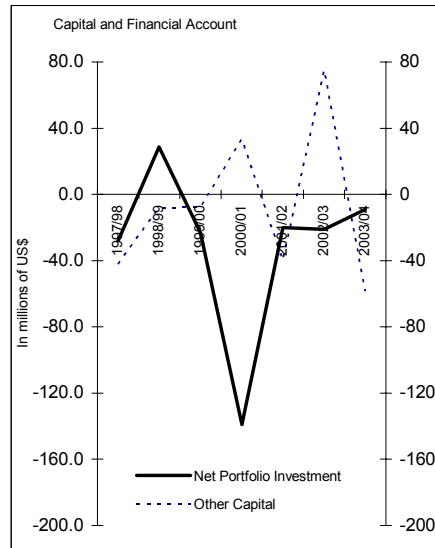


**Figure 5. Mauritius: External Developments**

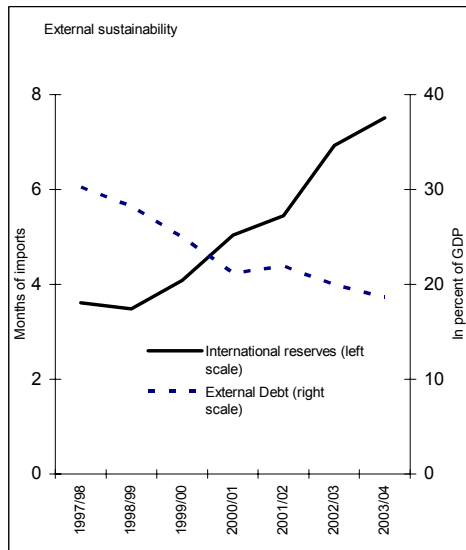
*Current account surplus is expected, as increased receipts from tourism offset the widened trade deficit.*



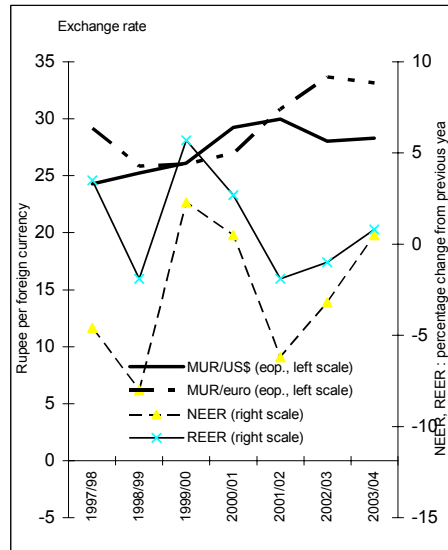
*Net portfolio inflows recovered, while other capital inflows declined.*



*International reserves continued to rise, while external debt declined...*



*...and the government allowed the rupee to appreciate (depreciate) against the US dollar (euro).*



### III. REPORT ON POLICY DISCUSSIONS

15. **The policy discussions centered around the medium-term challenges of diversifying the economy and preserving fiscal sustainability and macroeconomic stability.** The main focus was on: (i) the authorities' medium-term strategy to improve the competitiveness of the economy and strengthen growth prospects; (ii) the budget performance in 2003/04, fiscal polices for 2004/05, and medium-term fiscal consolidation; and (iii) the appropriateness of monetary and exchange rate policies.

#### A. Medium-Term Growth Sources and Prospects

16. **The economy is expected to grow by about 4¾ percent in 2004/05, largely led by a continued recovery in sugar production.** Tourism is expected to strengthen further, reflecting an increase in visitor arrivals from the U.K. and India, while the expansion in the construction sector should continue with the building of several new hotels. Other sectors that are expected to contribute to growth include wholesale and retail trade, transport, information and communications technology (ICT), and financial services. However, the outlook for exports from the EPZ sector remains weak, with several large textile firms in the process of relocating their operations to China in anticipation of the ending of the quota system governing world trade in textiles.

17. **Medium-term growth is expected to slow to around 4 percent per annum—significantly below the average of almost 6 percent over the past three decades.** This reflects a weaker outlook for the traditional pillars of the economy—sugar and textiles (Box 2)—and the effects of persistent rigidities in the labor market. New sectors, such as the ICT sector, are expected to contribute increasingly to growth but their starting point is low.

18. **The authorities expressed concern about the medium-term prospects for the real economy, and indicated that they were taking steps to improve the outlook for the traditional sectors while creating an environment conducive to the development of other sources of growth.** The authorities have been preparing for the potential loss of preferences for sugar by implementing reforms to reduce gradually production costs. Major reforms have been the introduction of a voluntary retirement scheme, which has resulted in an almost 30 percent reduction in the workforce (7,900 employees), and the consolidation of milling operations. Efforts are also under way to diversify sugar-related activities, including the production of electricity as by a product of the sugar sector for sale to the national electricity company, and rum and ethanol production. The mission encouraged the government to intensify these efforts and to complete an ongoing mid-term review of the sugar sector strategy.

19. **The authorities also indicated that they were assisting the restructuring of the textile sector through technical advice and development finance.** The government remains hopeful that AGOA's third country fabric provision will be extended to Mauritius in the near future. However, many Hong Kong-based textile firms, which account for about 25 percent of textile employment and 30 percent of exports are likely to leave Mauritius in the



## **Box 2. Growth Impact of the Elimination of Trade Preferences<sup>1</sup>**

**The baseline growth projection for the medium term is 4 percent per annum.** In 2004/05, this scenario envisages a growth rate of 4.8 percent based on an increase in sugar production of 16 percent following a bumper crop in 2004, and a decline in the EPZ sector of 3.5 percent. However, sugar production is expected to decline the following year. The weak performance of the sugar and EPZ sectors is expected to continue into the medium term, reflecting increased global competition, a reduction in the area used for sugarcane production, and a gradual disinvestment of some foreign textile companies. These developments are expected to be balanced by the capability of the Mauritian economy to adjust partially to the changing international business environment through the restructuring of the economy and the development of other sources of growth, including in the ICT and the financial services sectors.

**The baseline scenario, however, faces several downside risks.** Structural reforms could take longer than expected; and the shocks to both the sugar and textile sectors could be even more severe. This will depend on the resolution of the challenge to the EU sugar subsidies by Australia, Brazil, and Thailand and developments in the textile market during the post-ATC period.

**In a moderately adverse scenario, the shocks are expected to have a more substantial but gradual impact in the next three years.** Sugar prices are assumed to fall to US\$0.16 per pound in 2005, and further to US\$0.10 per pound in 2007. The textile sector would shrink by 8 percent in 2004/05, 15 percent in 2005/06, and 8 percent in 2006/07, stabilizing thereafter. The impact of this scenario, relative to the baseline, would be to reduce GDP growth by about  $\frac{3}{4}$  of a percentage point in 2004/05,  $1\frac{1}{2}$  percentage points in 2005/06, and  $\frac{1}{2}$  a percentage point in 2006/07.

**In an extremely adverse scenario, the shocks would have a much stronger impact on the different sectors of the economy.** One assumption—although with low probability—would be for the WTO panel to decide on the complete liberalization of sugar trade starting in 2005. This would most likely cause sugar prices to drop to around US\$0.10 per pound. The other assumption is a more dramatic impact on the textile sector following the phasing out of the ATC preferences. This could lead to the closure of all textile firms categorized as either vulnerable or at risk under the Textile Emergency Support Team (TEST) initiative, in addition to the relocation of foreign and some local companies to cheaper production sites. The impact on the textile sector would be a decline of between 20 and 30 percent in 2004/05 and 2005/06. This scenario would lead to a reduction in the baseline medium-term growth projection by an average of between  $2-2\frac{1}{2}$  percentage points a year.

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<sup>1/</sup> Please see accompanying selected issues paper.

next two to three years, owing to rising labor costs<sup>6</sup> and the removal of quotas that currently constrain exports from countries such as China. This would increase the already high unemployment rate, and its incidence among low-skilled workers (see Box 3).<sup>7</sup> The mission welcomed the establishment of the Textile Emergency Support Team (TEST), which is designed to facilitate the rehabilitation of viable textile enterprises through the provision of corporate diagnosis services and the consolidation and streamlining of various initiatives. These initiatives include the provision of financial resources from the National Equity Fund for capitalization and spinning activities, as well as enterprise modernization schemes supported by the Development Bank of Mauritius.<sup>8</sup> The authorities agreed that there is a need to intensify the retraining of displaced textile workers so that they can be absorbed by other sectors.

20. **Notwithstanding prevailing uncertainties, the authorities were optimistic about the growth prospects for the tourist sector.** Plans are being implemented to construct about 20-25 hotels (representing additional capacity of about 40 percent) in the next three years. This increase in capacity, however, is coming at a time when the hotel occupancy rate has declined. More generally, a consistent strategy needs to be developed to market Mauritius as a tourist destination, since the envisaged rapid expansion may conflict with preserving the country's image as an "upper-end" tourism product. Moreover, issues related to the expansion of air access may need to be resolved in order to increase tourist arrivals.

21. **The government continues to view the emerging ICT sector as providing a new source of growth for the economy over the medium term.** Nonetheless, the mission noted that the outlook for the sector appeared less favorable than a year ago, owing to considerable global competition. The authorities indicated that, based on current commitments, the recently completed cyber tower will have an occupancy rate of around 40-60 percent during the first year, and that 3,000 new jobs would be created by end 2004. However, significant uncertainty remains, as many Indian firms that initially expressed interest in establishing operations in Mauritius seem to have changed their plans.

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<sup>6</sup> Hourly textile labor costs in Mauritius are three times those of Pakistan, and more than twice those of China, India, and Madagascar.

<sup>7</sup> See also the accompanying selected issues paper on labor market issues.

<sup>8</sup> The mission also supported the establishment of the Corporate Debt Restructuring Committee, which will oversee the restructuring of the debts of those firms found to be viable. This committee has been established under the auspices of the TEST, and is chaired by the Managing Director of the BOM.

### Box 3. The Mauritius Labor Market<sup>1</sup>

**Reforms in Mauritius’s labor market should include the introduction of decentralized wage bargaining and the elimination of restrictions on worker redeployment and terminations.**

**The labor market is highly regulated, with restrictions on the redeployment of workers, wages and benefits, and terminations.** The government establishes a separate set of labor market regulations—which specify the duties and wages of each narrowly defined occupation—for most industries, which inhibits the ability of firms to redeploy workers.<sup>2</sup> The annual tripartite wage setting process typically indexes economy-wide wage growth to inflation, while terminations tend to be both costly and time consuming, usually requiring approval by the Termination of Contracts of Services Board.

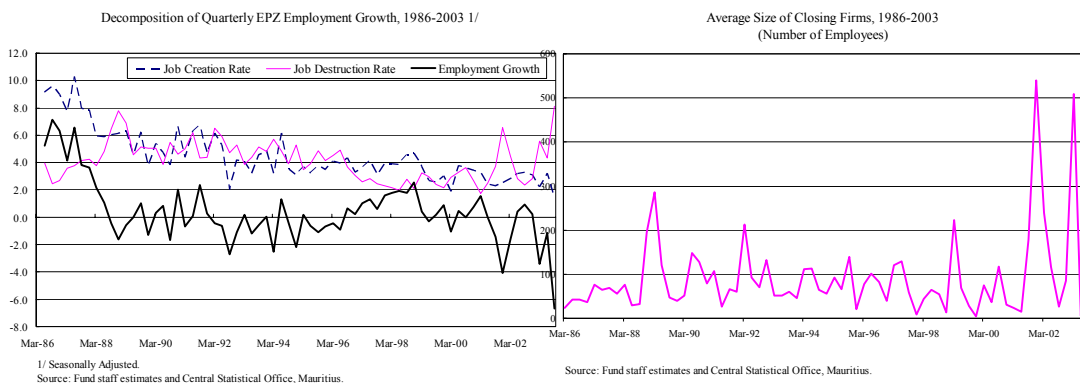
**In addition to the relatively high unemployment, unemployed workers are facing exceptionally long spells**—with an average unemployment duration of 20 months—and a **less dynamic labor market**, with relatively low quarterly job creation.

**Moreover, the highly regulated nature of the labor market unnecessarily reduces the employment opportunities for low-skilled workers.** By increasing the relative wages paid to low-skilled workers, these regulations reduce the incentive to create new jobs and make existing jobs more insecure. Limits on the ability of firms to redeploy workers have similar effects, while restrictions on terminations reduce the incentives to create new jobs. Although these restrictions in particular do not apply to some key sectors—such as the EPZ sector—they inhibit the creation of new jobs for low-skilled workers in other areas. This differential regulatory treatment will become increasingly important as the economy adjusts to the loss of trade preferences.

Structural changes in the market for low-skilled workers may already be becoming apparent. The first figure below shows that 2002-03 constitutes a period of historic weakness in EPZ employment, mainly driven by a sharp rise in the rate of job destruction. Moreover, there has been a sharp rise in the average size of EPZ firms closing down.

1/ Please see accompanying selected issues paper.

2/ These regulations do not cover the EPZ sector, and are not expected to cover new ICT activity.



## B. Structural Reforms

22. **In addition to the sectoral issues described above, the discussion on structural reforms focused on the labor market and private sector involvement in the economy.** The mission urged the authorities to move ahead with labor market reforms. The government noted that comprehensive measures had been taken to overhaul the education system in order to increase the access of students to educational facilities, and to improve the quality and relevance of the curriculum at all levels, especially at the secondary school level. Staff acknowledged that these reforms would help alleviate the skills mismatch, but stressed that other important factors affecting the labor market also needed to be addressed. In particular, the mission favored the adoption of firm-level wage bargaining and the simplification of the numerous regulations governing the ability of firms to redeploy and terminate workers. The authorities agreed on the importance of reforming the various labor market institutions, but indicated that it was difficult to carry out substantive changes during an election year. Trade union representatives acknowledged that there was some need for improving labor market flexibility, but cited the importance of wide-ranging consultation among all stakeholders.

23. **The authorities recognize that the benefits of labor market reforms are likely to materialize only over the medium to long term.** They expressed concern about the present high unemployment rate and its large component of unskilled workers. While there is evidence that the income of this group is being supported to a large extent by informal household transfers, the authorities and staff agreed that additional measures, such as public work programs and training, should be considered to ameliorate their situation.

24. **The mission encouraged the authorities to promote further private sector participation in the economy, including foreign direct investment.** Private sector development could be enhanced by reducing state involvement in commercial activities, such as electricity, and the importation of petroleum products, rice, and cement. The authorities were of the view that the small size of the domestic market and relatively high labor costs constrained FDI flows. The mission welcomed the draft bill designed to facilitate public-private sector partnerships in infrastructure investments. This initiative will enhance prospects for domestic and foreign direct investments and will relieve the burden on the budget to finance large investment projects.

## C. Fiscal Policy

25. **The fiscal policy discussions focused on addressing persistent deficits and their impact on medium-term debt sustainability.** Without significant policy reform, the fiscal deficit for 2004/05 is expected to rise to about 6½ percent of GDP. If the fiscal deficit remains at this level over the medium term, public sector debt could rise to over 76 percent of GDP by 2007/08.<sup>9</sup> The mission proposed a medium-term path to reduce gradually the deficit

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<sup>9</sup> In this case, public finances would become significantly vulnerable, and the debt could exceed 100 percent of GDP by 2007/08 under a combination of plausible negative shocks.

to 2 percent of GDP by 2007/08, which would allow the public debt to fall to about 64 percent of GDP by the end of the period. Sensitivity analysis shows that when deficits are reduced, public sector debt would also be resilient to external shocks and would quickly return to a stable level, even in the event of a combination of temporary interest rate and output shocks. Consistent with the proposed medium-term path, the mission proposed that the authorities reduce the fiscal deficit to 4.7 percent of GDP in 2004/05.

26. **On the revenue side, the mission suggested a number of measures for 2004/05.** These included: (a) broadening the income tax base; and (b) applying the VAT to some items that are currently exempted or zero rated. The mission reiterated the need to include a number of fringe benefits in taxable income, subject interest and dividend income to a withholding tax, and reduce the generous allowance for capital investment. Staff also recommended broadening the base of the VAT to cover electricity and processed and nonraw foods. These reforms, together with some other nontax measures, could yield some 0.7 percent of GDP in 2004/05.

27. **Regarding expenditure, the mission highlighted the need to prioritize spending, and to review the effectiveness and coverage of the current generalized subsidies on rice and flour.** In addition, the mission suggested: (i) further trimming of the capital budget and phasing some projects over the next several years; and (ii) lengthening the maturity structure of the domestic debt (Box 4). Regarding the latter, the staff urged the government to create a debt management unit. The proposed lower primary deficit would reduce the borrowing requirement of the budget and lower interest payments. A restructuring of domestic debts would also significantly reduce interest costs for the following reasons. First, the fall in the level of the yield curve means that the interest cost of lengthening the maturity of previously accumulated debt—especially given the large issuance of 2-year bonds in 2002/03—will lead to substantial savings. Second, a further moderation of inflationary expectations, and more subdued long term growth, should be accompanied by a further fall and flattening of the yield curve over the coming years, leading to interest savings on newly accumulated debt. Overall, the proposed expenditure measures could save 1.1 percent of GDP.

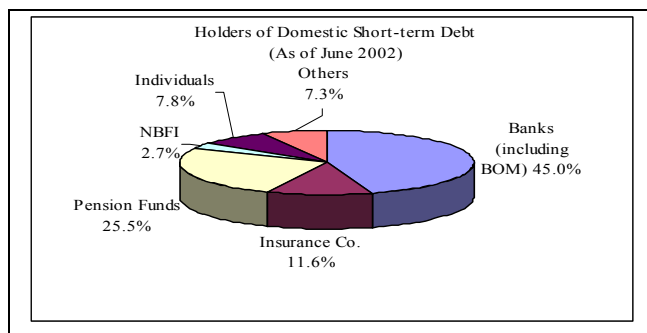
28. **The authorities were in general agreement with the proposed fiscal measures, but they acknowledged that there would be political resistance to some of them.** They welcomed the revenue proposals and indicated that they were also considering to set up an independent Revenue Authority in line with recent recommendations from an FAD technical assistance mission. As to expenditure policy, the authorities indicated that they were receiving support from the World Bank and the U.S. Treasury to develop a Medium-Term Expenditure Framework. While they agreed in principle to the targeting of subsidies, they noted that reducing these subsidies may be difficult in light of the upcoming election. Moreover, the authorities were of the view that putting in place an efficient system of direct transfers would take time and be administratively challenging. They also indicated that they were planning to postpone some capital projects that would save about MUR 500 million (0.3 percent of GDP) in 2004/05. To mitigate the effect of a bunching of maturing treasury bills in 2004/05, the authorities are in the process of implementing a strategy to restructure the debt into longer maturities.

### Box 4. Domestic Public Debt in Mauritius<sup>1</sup>

The increase in Mauritius's public debt can be attributed primarily to: (i) fiscal imbalances that emerged since the late 1990s as the government invested heavily in education and infrastructure for the new ICT sector; and (ii) the issuance of treasury bills for monetary policy purposes. The BOM only began issuing central bank bills as a monetary policy tool in July 2003.

	1998/99	1999/00	2000/01	2001/02	2002/03
<b>Long Term</b>					
Treasury Certificates	0.0	0.0	0.0	0.0	0.0
Tap Loan Stocks	0.0	0.0	0.0	0.0	0.0
Development Loan Stocks	11,340.0	11,590.0	12,710.0	11,807.8	11,408.0
Anonymous Bearer Bonds	0.0	0.0	0.0	0.0	0.0
8-Year Savings Bonds	0.0	0.0	0.0	0.0	0.0
4-Year Independence Bonds	296.4	0.0	0.0	0.0	0.0
5-Year Republic Bonds	2,078.5	2,078.5	0.0	0.0	0.0
Treasury Bearer Bonds	0.0	0.0	0.0	0.0	0.0
5-Year GOM Bonds	0.0	0.0	0.0	0.0	866.3
<b>sub total</b>	13,714.9	13,668.5	12,710.0	11,807.8	11,408.0
In percent of GDP	12.9	12.1	10.2	8.6	7.7
<b>Short Term</b>					
Treasury Bills (nominal)	24,097.4	32,188.2	41,034.9	55,607.0	74,662.2
1-Month	860.4	0.0	0.0	0.0	0.0
3-Month	3,299.0	4,018.0	1,582.9	2,051.3	911.9
6-Month	4,484.1	6,875.5	3,414.3	3,887.4	3,521.8
12-Month	6,339.0	8,153.8	16,070.0	14,807.2	14,700.0
24-Month	9,114.9	13,140.9	19,967.7	34,861.1	55,528.5
Advances from B.O.M.	3,161.5	1,089.4	0.0	0.0	0.0
Tax Reserve Certificates	0.5	0.4	0.4	0.4	0.4
<b>sub total</b>	27,259.4	33,278.0	41,035.3	55,607.4	74,662.6
In percent of GDP	25.7	29.5	32.8	40.5	50.1
<b>TOTAL</b>	40,974.3	46,946.5	53,745.3	67,415.2	86,070.6
In percent of GDP	38.6	41.7	43.0	49.1	57.8

A large part of the public debt is in short-term maturities and is largely held by banks.<sup>2</sup> This concentration of short-term debt exposes the government to interest rate and rollover risk. The persistent fiscal deficits and the weak state of debt management has resulted in interest payments rising by over 40 percent between 2001/02 and 2002/03. The authorities are burdened with a major rollover of treasury bills amounting to about MUR 40 billion (24 percent of GDP) in 2003/04, compared with MUR 50 billion (33 percent of GDP) in 2002/03.



The government is in the process of setting up a Debt Management Unit within the Ministry of Finance and is seeking to convert much of the short-term debt to longer term bonds, while smoothing future interest payments. However, unless the fiscal deficit is significantly reduced, lengthening the maturity structure would only postpone the debt problem.

	2001/02	2002/03	2003/04	2004/05
Interest payments on total government domestic debt	4,333.9	6,202.0	6,405.0	6,850.0
(In percent of current expenditure)	15.5	19.7	18.5	18.5
Interest payments on T Bills	3,108.0	5,076.6	5,177.7	6,639.8
Rollover of T Bills		49,974.3	39,865.3	29,161.0
(In percent of GDP)		33.5	24.4	16.4

1/ Excluding pension fund debt.

2/ Short-term securities are mostly held by the banks (including the BOM), while nonbank financial institutions are the major holders of longer-term bonds.

29. **To reduce contingent liabilities, the mission stressed the need to address the difficult financial condition of the STC and the CEB.** The authorities indicated that the recently implemented automatic pricing mechanism for petroleum products will prevent the STC from accumulating further losses. Prices will be adjusted on a quarterly basis in response to changes in the international price of oil. The initial adjustments on April 2, 2004, which resulted in an increase in diesel prices, are unlikely to cause a significant rise in bus fares.

30. **The CEB has been able to reduce its overdraft in the banking system from MUR 1 billion (around one percent of domestic credit) in September 2000 to MUR 300 million (about ¼ of a percent of domestic credit).** However, this situation is expected to be reversed as the CEB incurs expenditure related to its transmission and distribution networks during the rest of 2004. Additionally, the CEB has significant debts with the government that it has not been servicing and faces unfunded pension liabilities. The authorities recognize the difficult financial position of the CEB and have been implementing a strategy to corporatize its operations, including through the setting-up of a new governance structure, the possible sale of part of the government's shares, and the establishment of a utilities' regulator. The authorities, however, remain noncommittal at this stage regarding an immediate adjustment in electricity tariffs.

#### **D. Monetary and Financial Sector Policies**

31. **As mentioned above, the authorities have been pursuing an informal inflation targeting framework, and the BOM has established credibility in achieving its inflation objectives.** The monetary programs adopted by the central bank have generally been successful, and over the last seven to eight years the BOM has exceeded its publicly announced inflation target only once, and by a small margin. In addition to primary sales of treasury bills/BOM bills, the BOM has used the Lombard rate to signal the direction of monetary policy. However, transactions at the Lombard facility have become infrequent and the Lombard rate has increasingly become disconnected from other interest rates. The mission suggested that the BOM adopt short-term interest rates as its operational target, mainly through the development of an active secondary market in government securities and BOM bills. This would provide a more direct link, through the yield curve, to banks' lending behavior and the credit markets. It would also transparently indicate the intended direction of monetary policy and support the development of a more formal inflation targeting framework. The authorities responded that they were reviewing their monetary policy framework; they agreed that there was a need to target interest rates at the shorter end of the market.

32. **The BOM agreed that the current situation of excess liquidity in the banking system largely reflects the drawdown of government deposits, weak credit demand, and the cautious attitude of banks toward credit risk.** The mission argued that this excess liquidity could be a potential source of rapid money growth and inflationary pressures if credit growth was to pick up. The BOM agreed with this view and indicated that it had been attempting to absorb the excess liquidity through the issuance of BOM bills. However, given

the weak prospects for some key sectors of the economy, the BOM believes that it is unlikely that credit growth will accelerate quickly and that the risk of an increase in inflation remains low.

33. **Monetary policy faces the additional challenge of rising oil and other commodity prices and the impact that such imported inflation could have on the domestic price level.** To date, this impact has been partly mitigated by the nominal strengthening of the rupee against the U.S. dollar. Looking forward, the authorities have indicated that their main focus is to prevent a rise in the core inflation rate by keeping inflationary expectations low.

34. **The financial system in Mauritius is generally sound, but there is a need to mitigate and diversify the onshore banking sector's credit risk concentration.** Several steps have been taken to enforce limits on large exposures and related-party transactions, to subject deposit-taking nonbanks to BOM regulation and supervision, and to develop a comprehensive credit information bureau.<sup>10</sup> The authorities were urged to pass the draft laws to revise the Bank of Mauritius Act—which would strengthen the independence of the central bank—and the Banking Act—to improve supervision and regulation—by the time of the announcement of the 2004/05 budget. The guidance notes on AML/CFT that have been issued are in line with recommendations of the FSSA and cover the strengthening of banks' internal controls, customer identification procedures, and record keeping, and the identification and reporting of suspicious transactions. In addition, the authorities passed the Convention of the Suppression of the Financing of Terrorism Act 2003.

35. **Development of an efficient corporate bond market would be an important alternative for institutional investors and would contribute to the overall stability of the banking sector.** It would provide well-developed pension funds and insurance companies the option of investing in long-term Mauritian assets while spreading credit concentration in the banking sector. To encourage market development, the mission stressed that the tax rate on interest earned on corporate bonds should be harmonized with the rates on other financial instruments. The full development of this market, however, would need to be preceded by an active trading of government debts. In this regard, the mission welcomed the recent listing of government treasury bills on the Mauritian Stock Exchange.

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<sup>10</sup> The authorities also took steps to contain the potential damage to the financial system from the fraud case involving around US\$31 million at the Mauritius Commercial Bank (MCB) in February 2003. In March 2003, the BOM enlisted the services of an investigative firm and a team from the central bank supported the investigations. A report by the consultants recommended a strengthening of the internal controls of MCB, the review of the concentration of powers vested in its staff, and periodic reviews of the work of key staff members. The MCB is already implementing many of the recommendations.



### E. Exchange Rate and External Sector Policies

36. **The authorities agreed with the mission that the current managed float regime has served the country well.** The exchange rate does not appear to be misaligned, and the real effective exchange rate has remained relatively stable in the last two years. The mission commended the authorities' decision to limit intervention in the foreign exchange market to smoothing volatility in the exchange rate. BOM purchases in the foreign exchange market declined in 2003 and during the first three months of 2004 there was no intervention in the market. More generally, the mission supports the authorities' view that for Mauritius to remain competitive, the best course of action is to achieve real productivity gains, rather than rely on a depreciating exchange rate.

37. **The recovery in the tourism sector is expected to contribute to sustaining a current account surplus of 2½ percent of GDP in 2004/05.** However, as a result of the expected decline in textile exports from the EPZ and a possible slowdown in sugar exports, the current account is expected to weaken over the medium term.

38. **The external debt has been on a declining trend and remains sustainable in the medium term, even when subject to plausible shocks.** The external debt is estimated to have declined from 25½ percent of GDP in 1999/00 to 19 percent in 2003/04. Stress tests indicate that even with combined negative shocks to the non-interest current account, real GDP growth, and the GDP deflator in 2004/05 and 2005/06, the external debt would rise to 31¾ percent of GDP in 2005/06 but would fall to 27½ percent in 2007/08.

39. **Mauritius has no significant nontariff barriers, except with regard to state trading and monopoly imports of petroleum products.** The maximum tariff rate is 80 percent (applicable to more than 10 percent of the total number of imported products), and the unweighted average nominal tariff rate is 18.5 percent. No major changes to the trade system have occurred since last year and the trade restrictiveness index is 6 on a 10-point scale, indicating a moderately open economy. The mission recommended a reduction in the number of nonzero tariff bands from eight to three, and urged the adoption of a preannounced medium-term tariff reform, which should include a lowering of the maximum and average tariff rates.

40. **The mission encouraged the government to liberalize further its trade policies within COMESA and SADC agreements.** While COMESA is planning to introduce a customs union by end-2004, conflicting areas will emerge concerning countries with dual membership in COMESA and SADC. Thus, the mission urged the authorities to coordinate their trade policies with the two institutions to avoid possible conflicts.

### IV. STAFF APPRAISAL

41. **Mauritius's main strength continues to be its public institutions.** Strong governance, rule of law, a stable democratic system, and a predictable regulatory environment have served to promote investment and confidence in the economy. These characteristics

should support the needed structural transformation of the economy in the face of an increasingly competitive global environment.

42. **Growth in the past has been driven mainly by the high rate of domestic savings, with little reliance on external sources of financing.** The growth process has also been defined by capital deepening rather than increases in productivity. The staff believes that, going forward, the elimination of trade preferences will imply that foreign direct investment and improvements in productivity will be critical to achieving high rates of growth.

43. **The impending loss of trade preferences in sugar and textiles poses significant medium-term downside risks and heightens the need for rapid adjustment to the changing global environment.** While some subsectors in the textile industry are likely to grow—where Mauritian firms remain competitive—other subsectors could suffer significant output and employment losses. Against this background, the country faces the challenge of significantly reducing costs and improving competitiveness.

44. **The authorities are fully cognizant of these challenges and are taking appropriate steps to strengthen Mauritius's key sectors.** In this regard, it would be important to review the initial phase of the Sugar Sector Strategy in order to determine whether production costs have been reduced sufficiently to improve long-term viability, and to adopt any additional actions that might be warranted. The establishment of TEST to support the rehabilitation of viable textile enterprises is timely, and the proposed restructuring of corporate debts should provide firms the breathing space necessary to carry out the required reforms.

45. **One of the fundamental reasons for the decline in competitiveness in the textile sector is the persistent rise in unit labor costs.** For the restructuring of the sector to succeed, the current centralized wage setting system must be replaced by a system based on collective bargaining at the firm level. This would help ensure that there is a closer link between wage increases and productivity growth. In addition, the numerous regulations governing the conditions of employment in various sectors, which limit the ability of firms to redeploy and create jobs for low-skilled workers, should be promptly streamlined.

46. **The authorities should be commended for their efforts to diversify the economy.** Although the ICT sector is expected to grow more slowly than previously envisaged, the authorities rightfully see it not just as a pillar of medium-term growth but also as a platform that could transform the overall economy. While recognizing the importance of the leading role of the government in providing the necessary infrastructure for the sector, it will be critical to ensure that the risks are appropriately balanced between the public and private sectors. Additional efforts by the government to support growth in financial services, free port activities and tourism are also praiseworthy. However, greater opportunities for private sector participation should be provided for in the utilities, transportation, and commercial sectors. In this regard, the initiation of a public-private sector partnership framework is welcome.

**47. Mauritius faces the challenge of achieving medium-term fiscal sustainability.**

Addressing this challenge requires a strong commitment on the part of the authorities, particularly in the run up to the election. Given the downside risks facing the economy, it is important not to postpone the difficult decisions that have to be made on the budget. Slower economic growth combined with a sudden rise in real interest rates could very quickly lead to unsustainable debt dynamics unless the fiscal deficit is brought down in the next several years. In particular, there is scope for broadening the tax base and prioritizing and rephasing capital expenditures. The adjustment path to fiscal sustainability is gradual, which would ensure that fiscal policy does not become unduly contractionary in the face of a possible slowdown in economic activity.

**48. The credibility achieved by the BOM in reducing inflation is praiseworthy, especially in light of the relatively large budget deficits.**

Looking ahead, efforts are required to absorb the high levels of excess liquidity in the banking system, which poses the risk that inflationary pressures may reemerge. In addition, the monetary policy framework, in particular the use of the Lombard rate as a signaling rate, should be reviewed with a view to moving gradually toward targeting short-term interest rates, which would provide a more direct link to banks' lending behavior and credit markets.

**49. The mission welcomes the BOM's policy of allowing the exchange rate to be mainly market determined.**

Despite the appreciation of the rupee against the U.S. dollar, the current level of the real effective exchange rate appears to be broadly appropriate. The staff agrees with the authorities on the need to foster external competitiveness through real productivity gains.

**50. Staff welcomes the many steps that have been taken to strengthen the financial system.**

The authorities have responded positively to the recommendations of the FSAP carried out in 2003. Other actions should be considered to address potential vulnerabilities in the sector, such as encouraging greater participation by foreign banks in the domestic market. Further, development of an efficient corporate bond market would present an important alternative to bank financing and would contribute to the overall stability and soundness of the financial system by allowing institutional investors to diversify their portfolio and contributing to a reduction of credit concentration in the banking sector.

**51. Staff recommends that the number of tariff bands be reduced, and that a preannounced medium-term tariff reform be adopted.**

This should include a lowering of the maximum and average tariff rates. Moreover, trade policies within COMESA and SADC should be coordinated to avoid conflicts.

**52. It is proposed that the next Article IV consultation with Mauritius be held on the standard 12-month cycle.**

Table 1. Mauritius: Selected Economic and Financial Indicators, 1999/00-2003/04 1/

	1999/00	2000/01	2001/02	2002/03 Prov.	2003/04 Proj.
(Annual percentage changes, unless otherwise indicated)					
National income, prices, and employment					
Real GDP 2/	2.7	7.6	4.3	2.7	4.4
GDP deflator 2/	3.5	3.2	5.3	5.7	5.0
Domestic demand at current prices 3/ 4/	8.8	6.1	7.6	11.1	9.5
Consumer prices (period average)	5.3	4.4	6.4	5.1	3.9
Unemployment rate (in percent) 5/	7.7	8.8	9.1	9.7	10.2
External sector (in U.S. dollar terms)					
Exports, f.o.b.	-9.4	7.6	-2.8	15.7	9.4
Imports, f.o.b. 4/	3.6	-6.4	-7.0	19.9	11.3
Nominal effective exchange rate 6/	2.3	0.5	-6.2	-3.2	0.5
Real effective exchange rate 6/	5.7	2.7	-1.9	-1.0	0.8
Terms of trade	-5.1	-1.9	2.7	1.0	-0.7
Central government budget					
Revenue and grants	10.2	-3.4	11.3	19.9	12.4
<i>Of which</i> : tax revenue	13.8	-0.9	6.6	20.3	12.2
Expenditure and net lending 7/ 8/	11.9	7.3	12.5	17.8	8.9
(Contribution to changes in broad money, unless otherwise indicated) 7/					
Money and credit					
Net foreign assets	3.3	7.4	9.0	7.0	-0.3
Domestic credit	13.2	5.3	7.7	6.5	9.1
Net claims on government	3.2	-1.1	1.3	2.2	5.6
Credit to private sector	10.0	6.4	6.3	4.3	3.5
Broad money	10.9	9.9	13.0	11.7	9.6
Time deposit rate (in percent) 9/	10.8	11.4	11.5	10.5	10.3
Average prime lending rate (end of fiscal year, in percent)	11.0	11.1	10.6	9.0	7.0
(In percent of GDP at market prices)					
Central government budget					
Current balance (including grants)	0.1	-3.3	-1.9	-0.8	-0.3
Overall balance (including grants) 7/ 8/	-3.8	-5.7	-6.0	-6.2	-5.5
Domestic financing	3.4	4.5	5.3	6.1	5.5
<i>Of which</i> : banking system (net)	2.3	-0.8	1.0	1.7	4.2
External financing	-0.5	-2.9	0.8	0.1	0.0
Domestic debt of central government	41.7	43.0	49.1	57.8	58.2
External debt of central government	8.8	5.5	6.4	6.1	6.7
Gross domestic investment	26.4	23.7	21.8	23.9	23.5
Public	7.9	6.8	7.0	8.3	8.4
Private	18.5	16.9	14.8	15.6	15.1
Gross domestic savings 10/	23.5	25.5	26.0	25.1	25.2
Public	0.5	-2.9	-1.8	-0.7	-0.2
Private	23.0	28.4	27.7	25.8	25.3
External current account balance 11/	-1.6	3.4	5.4	2.6	2.6
Total external debt (including the debt of state-owned firms)	25.5	22.4	21.8	19.3	17.8
(In percent of exports of goods and nonfactor services)					
Total external debt	43.3	36.7	35.8	32.8	31.2
<i>Of which</i> : government	14.5	8.4	10.6	10.7	12.3
Total external debt service	7.9	9.8	8.4	8.2	6.0
<i>Of which</i> : interest payments	2.1	1.8	1.4	1.2	1.1
(In millions of U.S. dollars, unless otherwise indicated)					
Net international reserves of the Bank of Mauritius	688.0	789.3	1,017.0	1,438.5	1,549.3
In months of prospective imports, c.i.f. 4/ 12/	4.1	5.0	5.4	6.9	7.5
Net international reserves of the banking system	966.0	1,085.9	1,352.8	1,723.4	1,825.3
In months of prospective imports, c.i.f. 4/	5.7	6.9	7.2	8.3	8.8
Memorandum item:					
GDP at current market prices (in millions of Mauritian rupees)	112,667	125,024	137,208	148,960	163,280

Sources: Bank of Mauritius; Central Statistics Office; Ministry of Finance; and IMF staff estimates and projections.

1/ Fiscal year from July to June.

2/ Sugar crops and milling included in fiscal year harvested; otherwise, averages of calendar-year data.

3/ Excluding changes in stocks.

4/ Excluding the acquisition of aircraft and ships.

5/ Unemployment rate as of the beginning of the FY.

6/ Trade-weighted period averages (a negative sign signifies a depreciation). Figure for 2003/04 represent the percentage change from July to December 03.

7/ In 2000/01, net lending includes the repayment of US\$33 million and US\$117 million of the FRN.

8/ Changes in indicated aggregates as percent of broad money at the beginning of the period.

9/ End-of-period maximum interest rate offered by banks on time deposits with maturities of between six and twelve months.

10/ Since domestic savings are reported, savings minus investment do not equal the current account balance.

11/ Including transfers, aircraft, and ships.

12/ The reserves of the Bank of Mauritius are not pledged as collateral for short-term liabilities, nor are they sold forward.

Table 2. Mauritius: Balance of Payments, 1999/00- 2007/08 1/  
(In millions of U.S. dollars, unless otherwise indicated)

	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
				Prov.	Proj.	Proj.	Proj.	Proj.	Proj.
Current account balance	-68.7	154.3	247.8	136.1	155.6	167.6	123.5	74.4	30.5
In percent of GDP	-1.6	3.4	5.4	2.6	2.6	2.5	1.8	1.0	0.4
Trade balance	-483.9	-252.9	-205.3	-285.9	-311.1	-331.0	-417.5	-499.7	-571.4
Exports, f.o.b.	1,522.6	1,639.0	1,592.9	1,843.5	2,016.9	1,971.0	1,945.7	1,951.2	1,973.8
Percentage change	-9.4	7.6	-2.8	15.7	9.4	-2.3	-1.3	0.3	1.2
<i>Of which</i> : export processing zone (EPZ)	1,171.2	1,177.1	1,092.9	1,120.8	1,197.5	1,151.7	1,111.6	1,109.0	1,106.4
sugar	213.5	272.9	297.4	270.0	308.2	278.6	261.6	236.1	225.7
Imports, f.o.b.	-2,006.5	-1,891.9	-1,798.2	-2,129.4	-2,328.1	-2,302.1	-2,363.3	-2,450.9	-2,545.2
Percentage change	-1.9	-5.7	-5.0	18.4	9.3	-1.1	2.7	3.7	3.9
<i>Of which</i> : EPZ	-620.7	-607.9	-556.8	-559.6	-597.9	-570.1	-550.3	-543.4	-531.1
petroleum products	-177.5	-213.5	-181.7	-212.7	-240.8	-219.5	-211.7	-211.1	-215.3
aircraft and ships	0.0	-14.4	-52.3	-37.0	0.0	0.0	0.0	0.0	0.0
Services (net)	354.2	332.0	395.7	346.3	409.9	410.3	440.1	465.0	489.6
<i>Of which</i> : tourism	376.5	387.5	411.3	434.1	506.2	525.2	556.5	586.8	618.5
credit	562.2	562.8	632.8	620.8	724.4	767.9	812.1	857.2	904.9
debit	-185.8	-175.3	-221.5	-186.6	-218.2	-242.7	-255.6	-270.4	-286.4
Income (net)	-35.1	12.2	-8.2	-1.3	-25.5	-5.0	5.0	10.0	10.0
Current transfers (net)	96.0	63.0	65.6	77.0	82.3	93.4	95.9	99.1	102.4
Capital and financial account	-18.7	90.2	-12.2	108.8	-44.7	-167.6	-123.5	-74.4	-30.5
Capital account	-0.5	-1.4	-1.0	-2.0	-0.7	-1.5	-1.5	-1.5	-1.5
Financial account	-18.2	91.6	-11.2	110.8	-44.0	-166.1	-122.0	-72.9	-29.0
Direct investment	12.7	197.3	48.4	56.9	23.6	20.0	18.0	25.0	25.0
Abroad	-11.8	-4.7	-1.5	1.9	-9.1	-12.0	-14.0	-15.0	-15.0
In Mauritius	24.4	202.0	49.9	55.0	32.6	32.0	32.0	40.0	40.0
Portfolio investment 2/	-23.1	-139.0	-19.9	-21.2	-9.1	-31.7	-34.7	-27.7	-29.3
Other investment	-7.8	33.3	-39.7	75.0	-58.5	-21.6	-30.7	-31.7	-31.7
Government	-20.0	-16.6	35.6	-2.6	-1.1	16.4	3.5	3.3	3.3
Other public sector	-42.4	37.2	-51.6	-80.7	-68.7	-43.0	-39.2	-40.1	-40.1
Other 3/	54.6	12.7	-23.6	158.4	11.3	5.0	5.0	5.0	5.0
Errors and omissions 4/	172.3	-58.6	10.0	94.7	0.0	0.0	0.0	0.0	0.0
Overall balance	84.9	185.8	245.6	339.7	110.8	132.8	74.6	38.5	-7.0
Reserve assets of the Bank of Mauritius	-84.9	-185.8	-245.6	-339.7	-110.8	-132.8	-74.6	-38.5	7.0
Memorandum items:									
Current account balance, excluding aircraft and ships	-68.7	168.7	300.2	173.1	155.6	167.6	123.5	74.4	30.5
In percent of GDP	-1.6	3.7	6.6	3.4	2.6	2.5	1.8	1.0	0.4
Overall balance (in percent of GDP)	1.9	4.3	5.4	6.6	1.9	2.0	1.1	0.5	-0.1
Net international reserves of the banking system 5/	966.0	1,085.9	1,352.8	1,723.4	1,825.3	1,958.0	2,032.6	2,071.1	2,064.1
Net international reserves of the Bank of Mauritius 5/	688.0	789.3	1,017.0	1,438.5	1,549.3	1,682.0	1,756.7	1,795.1	1,788.1
In months of prospective imports, c.i.f. 6/	4.1	5.0	5.4	6.9	7.5	7.9	8.0	7.9	7.5
Total debt-service ratio (in percent of exports of goods and services)	7.9	9.8	8.4	8.2	6.0	6.3	6.0	5.8	5.5
Mauritian rupees per U.S. dollar (period average) 7/	25.51	27.59	30.09	28.99	...	...	...	...	...
Mauritian rupees per U.S. dollar (end of period) 7/	26.09	29.24	29.96	28.03	...	...	...	...	...

Sources: Bank of Mauritius; Ministry of Finance; Mauritius Sugar Syndicate; and IMF staff estimates and projections.

1/ Fiscal year from July to June.

2/ In 2000/01, portfolio investment outflows include the repayment of the balance (US\$117 million) of the floating rate note.

3/ Including movements in international reserves of commercial banks.

4/ Including valuation adjustments.

5/ End of period.

6/ Excluding the acquisition of aircraft and ships.

7/ Market rate.

Table 3. Mauritius: Summary of Government Finances, 1999/00-2004/05 1/

	1999/00	2000/01	2001/02	2002/03	2003/04 Rev. Budg. Est.	2004/05 Proj.
(in millions of Mauritian rupees)						
Total revenue and grants	23,500	22,707	25,270	30,298	34,068	35,053
Tax revenue	20,373	20,189	21,519	25,879	29,042	32,283
Nontax revenue	2,966	2,318	3,435	4,056	4,346	2,090
External grants	161	199	317	363	680	680
Total expenditure and net lending	27,810	29,846	33,432	39,533	43,064	43,444
Current expenditure	23,379	26,786	27,881	31,538	34,574	36,952
Wages and salaries	7,763	8,181	8,854	9,366	10,864	11,698
Other goods and services	2,354	2,735	2,927	3,168	3,489	3,628
Interest payments	3,856	5,527	4,541	6,390	6,611	7,162
External interest	453	401	207	189	207	312
Domestic interest	3,403	5,125	4,334	6,202	6,405	6,850
Current transfers and subsidies	9,406	10,342	11,558	12,614	13,611	14,463
Capital expenditure	3,381	3,899	5,061	7,015	7,777	5,777
Net lending 2/	167	-1,574	490	980	712	715
Overall balance after grants	-4,310	-7,139	-8,161	-9,235	-8,995	-8,391
Overall balance, excluding exceptional factors 3/	-4,810	-8,853	-9,062	-9,258	-8,424	-8,049
Financing	4,310	7,139	8,161	9,235	8,995	8,392
External (net)	-510	-3,584	1,070	87	-29	42
Disbursements	410	349	1,778	923	865	865
Amortization	-920	-3,932	-708	-836	-894	-823
Domestic	3,815	5,652	7,229	9,148	9,024	8,349
Banking system (net)	2,579	-959	1,314	2,496	6,900	2,254
Nonbank	1,236	6,611	5,915	6,803	2,124	6,095
Sale of equity in state-owned enterprises	0	7,100	0	0	0	0
Residual	1,006	-2,029	-137	0	0	0
(In percent of GDP, unless otherwise indicated)						
Total revenue and grants	20.9	18.2	18.4	20.3	20.9	19.7
<i>Of which:</i> tax revenue	18.1	16.1	15.7	17.4	17.8	18.1
<i>Of which:</i> taxes on imports	6.2	5.1	4.3	4.4	4.5	4.4
sales tax/value-added tax (VAT)	5.0	4.7	5.1	6.6	6.8	7.1
income tax	2.6	2.4	2.5	2.7	2.9	3.0
Total expenditure and net lending	24.7	23.9	24.4	26.5	26.4	24.4
Current expenditure	20.8	21.4	20.3	21.2	21.2	20.8
<i>Of which:</i> wages and salaries	6.9	6.5	6.5	6.3	6.7	6.6
interest payments	3.4	4.4	3.3	4.3	4.0	4.0
Capital expenditure	3.0	3.1	3.7	4.7	4.8	3.2
Net lending 2/	0.1	-1.3	0.4	0.7	0.4	0.4
Overall balance after grants	-3.8	-5.7	-5.9	-6.2	-5.5	-4.7
Overall balance, excluding exceptional factors 3/	-4.3	-7.1	-6.6	-6.2	-5.2	-4.5
Primary balance (overall balance, excluding interest) 4/	-0.4	-1.3	-2.6	-1.9	-1.5	-0.7
Financing	3.8	5.7	5.9	6.2	5.5	4.7
External	-0.5	-2.9	0.8	0.1	0.0	0.0
Domestic	3.4	4.5	5.3	6.1	5.5	4.7
Sale of equity in state-owned enterprises and residual	0.9	4.1	-0.1	0.0	0.0	0.0
Memorandum items:						
Central government domestic debt (in percent of GDP)	41.7	43.0	49.1	57.8	58.2	58.1
Nominal GDP (in millions of Mauritian rupees)	112,667	125,024	137,208	148,960	163,280	177,908

Sources: Ministry of Finance; Bank of Mauritius; and IMF staff estimates and projections.

1/ Budgetary central government, Government Finance Statistics basis, unless otherwise indicated; fiscal year from July to June. For 2004/05, the projection is based on the premise of acceptance of the fiscal measures proposed by the staff in Table 9.

2/ In 2000/01, and 2001/02 net lending includes the repayment of US\$33 million, US\$111 million, and US\$6 million of the international floating rate note (FRN) of US\$150 million, respectively.

3/ Exceptional factors include the repayment of the FRN on-lending equivalent to 1.4 percent of GDP in 2000/01, and 0.1 percent of GDP in 2001/02, as well as the proceeds from the sale of fixed assets equivalent to 0.4 percent of GDP in 1999/2000.

4/ Overall balance after grants, excluding interest payments.

Table 4. Mauritius: Monetary Survey, 2000-2004

	2000	2001	2002	2003	2004
	June	June	June	June	June
					Proj.
(In millions of Mauritian rupees; end of period)					
Net foreign assets	25,204	31,748	40,531	48,301	47,932
Monetary authorities	17,950	23,077	30,469	40,317	40,685
Commercial banks	7,254	8,671	10,062	7,984	7,247
Domestic credit	88,128	92,821	100,323	107,517	118,727
Claims on government (net)	18,503	17,544	18,858	21,312	28,212
Monetary authorities	2,980	2,329	-3,227	-11,285	-457
Commercial banks	15,522	15,215	22,085	32,596	28,669
Claims on private sector 1/	69,626	75,277	81,465	86,206	90,516
Broad money (M2)	88,910	97,720	110,440	123,365	135,224
Money (M1)	11,065	12,711	15,131	17,437	19,086
Quasi money	77,846	85,009	95,308	105,928	116,138
Money market instruments 2/	0	0	0	0	4,500
Other items (net)	24,421	26,849	30,414	32,453	26,936
(Annual change in millions of Mauritian rupees)					
Net foreign assets	2,648	6,544	8,783	7,770	-369
Monetary authorities	2,166	5,128	7,391	9,848	369
Commercial banks	482	1,417	1,392	-2,078	-737
Domestic credit	10,587	4,693	7,502	7,194	11,210
Claims on government	2,579	-959	1,314	2,454	6,900
Claims on private sector 1/	8,008	5,651	6,188	4,741	4,310
Broad money (M2)	8,739	8,809	12,720	12,926	11,859
Money (M1)	160	1,646	2,421	2,306	1,649
Quasi money	8,579	7,163	10,299	10,620	10,210
(Annual change in percent)					
Domestic credit	13.7	5.3	8.1	7.2	10.4
Claims on government	16.2	-5.2	7.5	13.0	32.4
Claims on private sector 1/	13.0	8.1	8.2	5.8	5.0
Broad money (M2)	10.9	9.9	13.0	11.7	9.6
Money (M1)	1.5	14.9	19.0	15.2	9.5
Quasi money	12.4	9.2	12.1	11.1	9.6
(Annual change in percent of beginning-of-period broad money)					
Net foreign assets	3.3	7.4	9.0	7.0	-0.3
Domestic credit	13.2	5.3	7.7	6.5	9.1
Claims on government (net)	3.2	-1.1	1.3	2.2	5.6
Claims on private sector 1/	10.0	6.4	6.3	4.3	3.5
Broad money (M2)	10.9	9.9	13.0	11.7	9.6

Sources: Bank of Mauritius; and Fund staff estimates.

1/ Including claims on public enterprises.

2/ The central bank bills hold by the non-banking financial institutions.

Table 5. Mauritius: Indicators of External Vulnerability, 1999/00-2003/04 1/  
(In percent of GDP, unless otherwise indicated)

	1999/00	2000/01	2001/02	2002/03 Prov.	2003/04 Proj.
<b>Financial indicators</b>					
Total public sector debt 2/	65.8	64.4	70.5	80.5	72.8
Broad money (percent change; 12-month basis)	10.9	9.9	13.0	11.7	9.6
Private sector credit (percent change; 12-month basis)	13.0	8.1	8.2	5.8	5.0
Interest rate (one-year term deposits) 3/	10.8	11.4	11.5	10.5	10.3
<b>External indicators</b>					
Exports of goods (percentage change; in U.S. dollar terms)	-9.4	7.6	-2.8	15.7	9.4
Imports of goods (percentage change; in U.S. dollar terms) 4/	3.6	-6.4	-7.0	19.9	11.3
Terms of trade (percentage change)	-5.1	-1.9	2.7	1.0	-0.7
Current account balance	-1.6	3.4	5.4	2.6	2.6
Capital and financial account balance	-0.4	2.0	-0.3	2.1	-0.8
Net international reserves of the Bank of Mauritius (in millions of U.S. dollars) 5/	688.0	789.3	1,017.0	1,438.5	1,549.3
In months of prospective imports, c.i.f. 4/	4.1	5.0	5.4	6.9	7.5
Net international reserves of the banking system (in millions of U.S. dollars)	966.0	1,085.9	1,352.8	1,723.4	1,825.3
In months of prospective imports, c.i.f. 4/	5.7	6.9	7.2	8.3	8.8
Total external debt	25.5	22.4	21.8	19.3	17.8
In percent of exports of goods and nonfactor services	43.3	36.7	35.8	32.8	31.2
Total short-term public debt on a remaining-maturity basis	5.0	3.8	4.0	2.6	2.4
In percent of exports of goods and nonfactor services	8.5	6.2	6.5	4.4	4.3
Ratio of gross reserves over short term debt	3.1	4.8	5.5	9.3	9.0
Total external debt service (in percent of exports of goods and nonfactor services)	7.9	9.8	8.4	8.2	6.0
Interest payments	2.1	1.8	1.4	1.2	1.1
Principal repayments	5.8	8.0	7.0	7.0	4.9
Exchange rate (Mauritian rupees per U.S. dollar; period average)	25.51	27.59	30.09	28.99	...
<b>Financial market indicators</b>					
Mauritius stock exchange index (SEMDEX; July 1989 = 100) 6/	407.8	387.9	353.1	481.0	599.3
Change in percent 6/	-0.5	-4.9	-9.0	36.2	24.6
Foreign currency long-term debt rating by Moody's 7/	Baa2	Baa2	Baa2	Baa2	Baa2

Sources: Mauritian authorities; and IMF staff estimates and projections.

1/ Fiscal year from July to June.

2/ the figure of 2003-04 is related to the baseline scenario adopted in the fiscal framework.

3/ End of period; maximum interest rate offered by banks on time deposits with maturities of between six and twelve months.

4/ Excluding the acquisition of aircraft and ships.

5/ The reserves of the Bank of Mauritius are not pledged as collateral for short-term liabilities, nor are they sold forward.

6/ End of period. For 2002/03, as of end-Feb. 2004.

7/ Bonds rated "Baa2" by Moody's are considered as medium-grade obligations. For 2003/04, as of March 2004.



Table 6. Mauritius: Financial Soundness Indicators for the Banking Sector, 1998-2003  
(In percent, unless otherwise indicated)

	Dec-98	Dec-99	Dec-00	Dec-01	Dec-02	Dec-03
<b>Capital Adequacy</b>						
Regulatory capital to risk-weighted assets 1/ *	11.9	13.3	12.3	13.0	13.0	14.3
Regulatory Tier I capital to risk-weighted assets 2/ *	11.8	12.6	12.5	12.7	13.7	13.8
Total (regulatory) capital to total assets	7.1	8.1	7.8	8.4	9.0	9.4
<b>Asset composition and quality</b>						
Share of loans (exposures) per risk weight (RW) category						
RW=0%	4.5	5.6	6.3	6.3	7.8	5.1
RW=20%	5.0	2.5	4.2	1.2	1.9	4.6
RW=50%	10.0	10.0	8.9	8.2	6.8	7.8
RW=100%	80.5	82.0	80.5	84.3	83.5	82.5
Total exposures/ Total assets	53.9	54.3	56.5	58.9	61.8	57.1
Sectoral distribution of loans to total loans 3/ *						
Agriculture	7.8	6.7	8.6	8.3	9.8	9.2
of which: sugar	6.7	5.8	7.7	6.5	7.9	7.2
Manufacturing	22.8	20.1	19.6	18.2	16.1	14.8
of which: export enterprise certificate holders	13.2	10.9	10.7	10.8	8.6	7.5
Traders	19.9	18.6	15.8	14.1	14.3	14.9
Personal and professional	13.1	13.3	12.3	9.5	9.1	9.8
Construction	17.7	18.7	16.9	14.2	13.7	14.2
of which: housing	12.2	12.8	11.6	8.7	8.5	1.9
Tourism / Hotels 4/ *	4.4	7.3	8.3	14.1	17.2	15.9
Other	14.4	15.3	18.5	21.6	19.8	21.2
FX loans to total loans	12.6	10.1	12.7	13.9	14.1	13.9
NPLs to gross loans - excluding accrued/unpaid interest	9.1	8.3	7.7	8.0	8.6	9.6
NPLs net of provisions to capital*	40.5	34.3	39.8	35.0	42.7	33.3
Large exposures to capital*	212.4	248.6	197.8	256.6	251.4	222.1
<b>Earnings and Profitability</b>						
ROA* (Pre-tax net income / average assets)	2.4	2.2	2.3	2.2	2.3	2.3
ROE* (Pre-tax net income / average equity)	23.9	20.7	22.1	20.6	22.0	21.4
Interest margin to gross income*	28.3	27.4	27.2	30.6	33.3	32.1
Noninterest expenses to gross income*	22.3	20.8	20.6	21.2	23.2	24.1
Expenses/revenues	10.5	10.3	9.9	10.5	10.8	10.5
Earnings/employee - in Rs 000s	1371.0	1401.0	1718.0	1752.0	1828.0	2138.0
<b>Liquidity</b>						
Liquid assets to total assets*	28.4	31.2	28.5	29.2	32.7	36.6
Liquid assets to total short-term liabilities*	63.1	73.2	67.0	60.2	65.3	71.0
Funding volatility ratio	16.4	11.6	14.1	21.1	16.4	13.9
Demand deposits / Total liabilities	6.5	6.0	6.1	10.9	10.3	10.3
FX deposits to total deposits	9.6	11.3	12.1	12.1	11.7	11.0
<b>Sensitivity to market risk</b>						
Net open positions in FX to capital*		9.2	5.0	3.2	7.5	20.8

Source: Mauritian authorities and IMF/WB staff estimates.

1/ Total of Tier 1 and Tier 2 capital, less investments in subsidiaries and associated companies.

2/ Does not reflect deductions for investments in subsidiaries and associated companies.

3/ The sectoral classification was changed in 2001. An attempt has been made to make a time-consistent series, but the numbers from 2001 onward may not refer to the exact same industries as those from before the date.

4/ Refers to hotels and hotel management certificate companies only up to 2000, entire tourism industry after that date.

\* Part of the core set of financial soundness indicators.

Table 7. Mauritius: Medium-Term Projections, 2002/03-2007/08 1/

	2002/03 Prov.	2003/04	2004/05	2005/06 Projections	2006/07	2007/08
(Annual percentage changes, unless otherwise indicated)						
National income and prices						
Real GDP 2/	2.7	4.4	4.8	3.8	4.0	4.1
GDP deflator 2/	5.7	5.0	4.0	4.0	4.0	4.0
Domestic demand at current prices 3/ 4/	11.1	9.5	9.8	8.8	9.0	8.8
Consumer prices (period average)	5.1	3.9	4.0	4.0	4.0	4.0
External sector (in U.S. dollars terms)						
Exports, f.o.b.	15.7	9.4	-2.3	-1.3	0.3	1.2
Imports, f.o.b. 4/	19.9	11.3	-1.1	2.7	3.7	3.9
Terms of trade	1.0	-0.7	-0.1	0.0	0.1	0.2
(In percent of GDP at market prices)						
Central government budget						
Revenue and grants	20.3	20.9	19.7	20.1	19.9	20.0
<i>Of which</i> : tax revenue	17.4	17.8	18.1	18.1	17.9	18.1
Expenditure and net lending	26.5	26.4	24.4	23.6	22.5	22.0
Current balance (including grants)	-0.8	-0.3	-1.1	-0.2	-0.3	-0.3
Overall balance (including grants)	-6.2	-5.5	-4.7	-3.5	-2.5	-2.0
Total public debt	80.5	72.8	71.5	69.7	67.0	65.5
Gross domestic investment	23.9	23.5	25.2	25.9	25.8	26.0
Public	8.3	8.4	5.7	5.6	4.1	3.3
Private	15.6	15.1	19.5	20.3	21.7	22.6
Gross domestic savings 5/	25.1	25.2	26.4	26.2	25.4	24.9
Public	-0.7	-0.2	-0.9	0.0	-0.1	-0.1
Private	25.8	25.3	27.2	26.2	25.5	25.0
External current account balance	2.6	2.6	2.5	1.8	1.0	0.4
(In millions of U.S. dollars, unless otherwise indicated)						
External sector						
Current account balance	136	156	168	123	74	30
Exports, f.o.b.	1,844	2,017	1,971	1,946	1,951	1,974
Imports, f.o.b.	-2,129	-2,328	-2,302	-2,363	-2,451	-2,545
Services (net)	346	410	410	440	465	490
Factor income (net)	-1	-26	-5	5	10	10
Current transfers (net)	77	82	93	96	99	102
Net international reserves of the Bank of Mauritius	1,438	1,549	1,682	1,757	1,795	1,788
In months of prospective imports, c.i.f. 4/	6.9	7.5	7.9	8.0	7.9	7.5
Memorandum item:						
GDP at current market prices (in millions of Mauritian rupees)	148,960	163,280	177,908	192,062	207,635	224,722

Sources: Bank of Mauritius; Central Statistics Office; Ministry of Finance; and IMF staff estimates and projections.

1/ Fiscal year from July to June.

2/ Sugar crops and milling included in fiscal year harvested; otherwise, averages of calendar-year data.

3/ Excluding changes in stocks.

4/ Excluding the acquisition of aircraft and ships.

5/ Since domestic savings are reported, savings minus investment do not equal the current account balance.

Table 8a. Mauritius: Public Sector Debt Sustainability Framework, 1999/00-2007/08  
(In percent of GDP, unless otherwise indicated)

Baseline scenario	Actual					Projections				
	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	
	<b>I. Baseline Medium-Term Projections</b>									
Central government debt	50.4	48.4	55.5	63.9	57.6	56.8	55.1	52.9	49.8	
Public sector debt 1/	65.8	64.4	70.5	80.5	72.8	71.5	69.7	67.0	63.9	
Overall balance after grants	-3.8	-5.7	-6.0	-6.2	-5.5	-4.7	-3.5	-2.5	-2.0	
Change in public sector debt	1.0	-1.4	6.1	9.9	-7.7	-1.3	-1.8	-2.7	-3.1	
Identified debt-creating flows (4+7+12)	0.9	-3.9	0.8	-0.6	-2.6	-0.8	-1.5	-2.4	-2.8	
Primary deficit	0.4	1.3	2.7	1.9	1.5	0.7	-0.6	-1.8	-1.2	
Revenue and grants	20.9	18.2	18.4	20.3	20.9	19.7	20.1	19.9	20.0	
Primary (noninterest) expenditure	21.3	19.5	21.2	22.2	22.3	20.4	19.6	18.2	18.8	
Automatic debt dynamics 2/	0.4	0.5	-1.9	-2.5	-4.1	-1.5	-0.9	-0.6	-1.6	
Contribution from interest rate/growth differential 3/	-0.4	-2.1	-2.4	-1.3	-3.0	-2.0	-1.2	-0.9	-1.9	
Of which contribution from real interest rate	1.2	2.4	0.1	0.5	0.2	1.2	1.3	1.6	0.6	
Of which contribution from real GDP growth	-1.6	-4.5	-2.5	-1.8	-3.2	-3.2	-2.5	-2.5	-2.5	
Contribution from exchange rate depreciation 4/	0.9	2.6	0.5	-1.2	-1.1	..	..	..	..	
Other identified debt-creating flows	0.0	-5.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	0.0	-5.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes 5/	0.1	2.5	5.3	10.5	-5.0	-0.4	-0.3	-0.3	-0.3	
Public sector debt-to-revenue ratio 1/	315.6	354.8	382.9	395.6	348.8	363.0	346.1	336.2	318.7	
<b>Gross financing need 6/</b>	7.0	10.2	9.5	9.9	7.9	6.9	5.4	4.4	3.7	
in billions of U.S. dollars	0.3	0.5	0.4	0.5	0.4	0.4	0.4	0.3	0.3	
<b>Key Macroeconomic and Fiscal Assumptions</b>										
Real GDP growth (in percent)	2.7	7.6	4.3	2.7	4.4	4.8	3.8	4.0	4.1	
Average nominal interest rate on public debt (in percent) 7/	5.6	7.5	5.6	6.6	5.5	6.0	6.1	6.7	5.2	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	2.1	4.3	0.4	0.9	0.5	2.0	2.1	2.7	1.2	
Nominal appreciation (increase in US dollar value of local currency, in percent)	-3.3	-10.8	-2.4	6.9	6.7	-2.7	-2.2	-2.2	-2.2	
Inflation rate (GDP deflator, in percent)	3.5	3.2	5.3	5.7	5.0	4.0	4.0	4.0	4.0	
Growth of real primary spending (deflated by GDP deflator, in percent)	9.1	-1.6	13.4	8.0	4.7	-4.3	-0.4	-3.6	7.9	
<b>II. Stress Tests for Public Debt Ratio</b>										
1. Real GDP growth, real interest rate, and primary balance are at historical averages in 2004/05-2007/08						72.8	71.3	70.0	68.8	67.6
2. Real interest rate is at historical average plus two standard deviations in 2004/05 and 2005/06						72.8	73.1	71.6	69.2	66.3
3. Real GDP growth is at historical average minus three standard deviations in 2004/05 and 2005/06						72.8	78.0	76.4	73.8	70.7
4. Primary balance is at historical average minus two standard deviations in 2004/05 and 2005/06						72.8	78.3	76.4	73.7	70.4
5. Combination of 2-4 using two to three standard deviation shocks						72.8	87.2	84.1	80.2	75.7
<b>Historical Statistics for Key Variables</b>										
		Standard				Average				
		Average		Deviation		2005-08				
Primary deficit		1.3		1.6		-0.7				
Real GDP growth (in percent)		4.9		1.5		4.2				
Nominal interest rate (in percent) 6/		6.2		0.7		6.0				
Real interest rate (in percent)		1.2		1.6		2.0				
Inflation rate (GDP deflator, in percent)		5.0		2.5		4.0				
Revenue to GDP ratio		19.8		1.3		20.0				

1/ Gross debt of the nonfinancial public sector (central government and parastatal entities).

2/ Derived as  $[(r - \pi(1+g) - g + \alpha\varepsilon(1+r))/(1+g+\pi+g\pi)]$  times previous period debt ratio, with  $r$  = interest rate;  $\pi$  = growth rate of GDP deflator;  $g$  = real GDP growth rate;  $\alpha$  = share of foreign-currency denominated debt; and  $\varepsilon$  = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

3/ The real interest rate contribution is derived from the denominator in footnote 2/ as  $r - \pi(1+g)$  and the real growth contribution as  $-g$ .

4/ The exchange rate contribution is derived from the numerator in footnote 2/ as  $\alpha\varepsilon(1+r)$ .

5/ For the projected period, the figures include the contribution from exchange rate depreciation

6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

Table 8b Mauritius: Public Sector Debt Sustainability Framework, 1999/00-2007/08  
(In percent of GDP, unless otherwise indicated)

	Actual					Projections				
	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	
<b>I. No Fiscal Adjustment Medium-Term Projections</b>										
Central government debt	50.4	48.4	55.5	63.9	57.6	<b>59.3</b>	<b>61.5</b>	<b>63.3</b>	<b>65.0</b>	
Public sector debt 1/	65.8	64.4	70.5	80.5	72.8	<b>73.8</b>	<b>74.8</b>	<b>75.7</b>	<b>76.4</b>	
Overall balance after grants	-3.8	-5.7	-6.0	-6.2	-5.5	-6.5	-6.5	-6.5	-6.5	
Change in public sector debt	1.0	-1.4	6.1	9.9	-7.7	1.0	1.1	0.9	0.7	
Identified debt-creating flows (4+7+12)	0.9	-3.9	0.8	-0.6	-2.6	1.4	1.4	1.2	1.4	
Primary deficit	0.4	1.3	2.7	1.9	1.5	1.9	1.7	1.7	1.7	
Revenue and grants	20.9	18.2	18.4	20.3	20.9	19.0	19.4	19.2	19.1	
Primary (noninterest) expenditure	21.3	19.5	21.2	22.2	22.3	20.9	21.2	20.9	20.8	
Automatic debt dynamics 2/	0.4	0.5	-1.9	-2.5	-4.1	-0.5	-0.3	-0.6	-0.3	
Contribution from interest rate/growth differential 3/	-0.4	-2.1	-2.4	-1.3	-3.0	-0.9	-0.7	-0.9	-0.6	
Of which contribution from real interest rate	1.2	2.4	0.1	0.5	0.2	1.8	1.9	1.9	2.3	
Of which contribution from real GDP growth	-1.6	-4.5	-2.5	-1.8	-3.2	-3.2	-2.6	-2.7	-2.8	
Contribution from exchange rate depreciation 4/	0.9	2.6	0.5	-1.2	-1.1	..	..	..	..	
Other identified debt-creating flows	0.0	-5.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	0.0	-5.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes 5/	0.1	2.5	5.3	10.5	-5.0	-0.4	-0.3	-0.3	-0.3	
Public sector debt-to-revenue ratio 1/	315.6	354.8	382.9	395.6	348.8	388.1	385.0	395.2	399.6	
<b>Gross financing need 5/</b>	7.0	10.2	9.5	9.9	7.9	8.7	8.4	8.3	0.0	
in billions of U.S. dollars	0.3	0.5	0.4	0.5	0.4	0.6	0.6	0.6	0.0	
<b>Key Macroeconomic and Fiscal Assumptions</b>										
Real GDP growth (in percent)	2.7	7.6	4.3	2.7	4.4	4.8	3.8	4.0	4.1	
Average nominal interest rate on public debt (in percent) 6/	5.6	7.5	5.6	6.6	5.5	6.9	7.0	6.8	7.4	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	2.1	4.3	0.4	0.9	0.5	3.0	3.0	2.8	2.2	
Nominal appreciation (increase in US dollar value of local currency, in percent)	-3.3	-10.8	-2.4	6.9	6.7	-2.7	-2.2	-2.2	-2.2	
Inflation rate (GDP deflator, in percent)	3.5	3.2	5.3	5.7	5.0	4.0	4.0	4.0	4.0	
Growth of real primary spending (deflated by GDP deflator, in percent)	9.1	-1.6	13.4	8.0	4.7	-2.0	5.2	2.7	0.0	
<b>II. Stress Tests for Public Debt Ratio</b>										
1. Real GDP growth, real interest rate, and primary balance are at historical averages in 2004/05-2007/08						<b>72.8</b>	<b>72.2</b>	<b>71.3</b>	<b>70.4</b>	<b>67.4</b>
2. Real interest rate is at historical average plus two standard deviations in 2004/05 and 2005/06.						<b>72.8</b>	<b>79.1</b>	<b>80.5</b>	<b>81.6</b>	<b>81.3</b>
3. Real GDP growth is at historical average minus three standard deviations in 2004/05 and 2005/06						<b>72.8</b>	<b>84.2</b>	<b>85.6</b>	<b>86.9</b>	<b>86.6</b>
4. Primary balance is at historical average minus two standard deviations in 2004/05 and 2005/06						<b>72.8</b>	<b>84.5</b>	<b>85.5</b>	<b>86.3</b>	<b>85.3</b>
5. Combination of 2-4 using two to three standard deviation shocks						<b>72.8</b>	<b>93.0</b>	<b>92.9</b>	<b>92.6</b>	<b>112.3</b>
<b>Historical Statistics for Key Variables</b>										
						Standard Deviation				Average 2004-07
Primary deficit						1.6				1.8
Real GDP growth (in percent)						1.5				4.2
Nominal interest rate (in percent) 6/						0.7				7.0
Real interest rate (in percent)						1.6				2.7
Inflation rate (GDP deflator, in percent)						2.5				4.0
Revenue to GDP ratio						1.3				19.2

1/ Gross debt of the nonfinancial public sector (central government and parastatal entities).

2/ Derived as  $[(r - \pi(1+g) - g + \alpha\varepsilon(1+\tau)] / (1+g+\pi+g\pi)$  times previous period debt ratio, with  $r$  = interest rate;  $\pi$  = growth rate of GDP deflator;  $g$  = real GDP growth rate;  $\alpha$  = share of foreign-currency denominated debt; and  $\varepsilon$  = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

3/ The real interest rate contribution is derived from the denominator in footnote 2/ as  $r - \pi(1+g)$  and the real growth contribution as  $-g$ .

4/ The exchange rate contribution is derived from the numerator in footnote 2/ as  $\alpha\varepsilon(1+\tau)$ .

5/ For the projected periods, the figures include the contribution from exchange rate depreciation.

6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

Table 9. Mauritius: Impact of Revenue and Expenditure Policy Recommendations for 2004/05

	2003/04 Proj.	2004/05 Proj.	Policy yields	2004/05 Policy Implemented
<b>Tax revenue</b>	<b>29,042</b>	<b>31,203</b>	<b>1,080</b>	<b>32,283</b>
Taxes on net income and profits	4,765	5,153	230	5,383
Individuals	2,340	2,531	230	2,761
<i>fringe benefits at market value should be included in taxable income</i>			30	30
<i>improvement in income tax administration</i>			200	200
Corporate	2,425	2,623		2,623
Other				
Taxes on property	1,460	1,579		1,579
Taxes on domestic goods & services	15,515	16,674	900	17,573
Selective excises	2,550	2,671		2,671
Alcoholic beverages	1,088	1,140		1,140
Tobacco	1,460	1,530		1,530
Other	2	2		2
Taxes on services	1,094	1,183	200	1,383
<i>Implementation of head tax on tourists</i>			200	
Taxes on use of goods	812	858		858
Value-Added Tax	11,060	11,961	700	12,661
<i>Application of VAT to some key products previously exempted or zero-rated:</i>			700	700
<i>cereal preparation</i>			55	55
<i>processed meat products</i>			55	55
<i>processed dairy products</i>			60	60
<i>processed fish products and fish preparations</i>			120	120
<i>Other processed foods</i>			310	310
<i>Electricity</i>			100	100
Taxes on international trade	7,290	7,784	-50	7,734
Import duties	7,290	7,784	-50	7,734
<i>compliance with SADC trade protocol</i>				
Other tax revenue--stamp duty	12	13	0	13
<b>Nontax revenue</b>	<b>4,346</b>	<b>1,930</b>	<b>160</b>	<b>2,090</b>
Property income	3,118	795	160	955
Rent and other	125	125	160	285
<i>revaluation of state owned land</i>				
Other nontax revenue	1,128	1,125	0	1,125
<b>Total tax and nontax revenue</b>	<b>33,388</b>	<b>33,133</b>	<b>1,240</b>	<b>34,372</b>
Foreign grants	680	680	0	680
<b>Total revenue and grants</b>	<b>34,068</b>	<b>33,813</b>	<b>1,240</b>	<b>35,052</b>
<i>(in percent of GDP)</i>	20.9	19.0	0.7	19.7
<b>Current expenditure</b>	<b>34,574.4</b>	<b>38,452.0</b>	<b>-1,500.0</b>	<b>36,952.0</b>
Expend. On goods & services	14,352.5	15,326.6		15,326.6
Interest payments	6,611.1	8,662.2	-1,500.0	7,162.2
External interest	206.6	312.2		312.2
Domestic interest	6,404.5	8,350.0	-1,500.0	6,850.0
<i>Savings from lower debt stock and debt restructuring at lower interest rates</i>				
Current transfers and subsidies	13,610.8	14,463.2		14,463.2
<b>Capital expenditure and net lending</b>	<b>8,489.2</b>	<b>6,992.4</b>	<b>-500.0</b>	<b>6,492.4</b>
<i>Postponement of capital projects</i>				
<b>Total expenditure and net lending</b>	<b>43,063.6</b>	<b>45,444.4</b>	<b>-2,000.0</b>	<b>43,444.4</b>
<i>(in percent of GDP)</i>	26.4	25.5	-1.1	24.4
<b>Overall balance after grants</b>	<b>-8,995.4</b>	<b>-11,631.6</b>	<b>3,239.5</b>	<b>-8,392</b>
<i>(in percent of GDP)</i>	-5.5	-6.5	1.8	-4.7

Table 10. Mauritius: External Debt Sustainability Framework, 1999/00-2007/08  
(In percent of GDP, unless otherwise indicated)

	Actual				Projections			Debt-stabilizing non-interest current account 7/	
	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06		2006/07
<b>1 External debt</b>	25.5	22.4	21.8	19.3	17.8	17.1	15.4	14.0	12.4
2 Change in external debt	-3.2	-3.1	-0.6	-2.5	-1.6	-0.6	-1.7	-1.5	-1.5
3 Identified external debt-creating flows (4+8+9)	0.0	-8.5	-6.7	-4.3	-3.9	-3.7	-2.8	-2.1	-1.4
4 Current account deficit, excluding interest payments	0.3	-4.5	-6.3	-3.4	-3.3	-3.3	-2.4	-1.6	-1.0
5 Deficit in balance of goods and services	2.9	-1.7	-4.2	-1.2	-1.7	-1.2	-0.3	0.5	1.0
6 Exports	59.0	61.2	60.9	58.8	56.9	50.8	49.0	47.4	46.1
7 Imports	61.9	59.5	56.8	57.6	55.2	49.6	48.6	47.9	47.1
8 Net non-debt creating capital inflows (negative)	-0.6	-4.5	-1.1	-1.1	-0.6	-0.5	-0.5	-0.5	-0.5
9 Automatic debt dynamics 1/	0.3	0.4	0.7	0.2	-0.1	0.0	0.1	0.1	0.1
10 Contribution from nominal interest rate	1.2	1.0	0.9	0.7	0.7	0.7	0.7	0.6	0.6
11 Contribution from real GDP growth	-0.7	-1.9	-1.0	-0.5	-0.7	-0.8	-0.6	-0.6	-0.5
12 Contribution from price and exchange rate changes 2/	-0.2	1.2	0.8	...	...	...	...	...	...
13 Residual, incl. change in gross foreign assets (2-3) 3/	-3.2	5.4	6.1	1.7	2.4	3.1	1.2	0.6	-0.1
External debt-to-exports ratio (in percent)	43.3	36.7	35.8	32.8	31.2	33.7	31.5	29.5	27.0
<b>Gross external financing need (in millions of US dollars) 4/</b> in percent of GDP	54.3	-104.4	-201.2	-168.0	-106.5	-161.7	-104.7	-60.4	-20.9
	1.2	-2.3	-4.4	-3.3	-1.8	-2.4	-1.5	-0.8	-0.3
<b>Key Macroeconomic Assumptions</b>									
Real GDP growth (in percent)	2.7	7.6	4.3	2.7	4.4	4.8	3.8	4.0	4.1
GDP deflator in US dollars (change in percent)	0.8	-4.6	-3.5	9.7	10.4	7.7	1.5	1.8	1.8
Nominal interest rate (in percent)	4.4	4.2	3.9	3.8	4.3	4.8	4.2	4.4	4.5
Growth of exports (US dollar terms, in percent)	-1.6	6.4	0.2	8.7	11.5	0.8	1.5	2.4	2.9
Growth of imports (US dollar terms, in percent)	-1.7	-1.5	-3.9	14.4	10.5	1.4	3.2	4.1	4.2
Current account balance, excluding interest payments	-0.3	4.5	6.3	3.4	3.3	3.3	2.4	1.6	1.0
Net non-debt creating capital inflows	0.6	4.5	1.1	1.1	0.6	0.5	0.5	0.5	0.5
<b>A. Alternative Scenarios</b>									
A1. Key variables are at their historical averages in 2004/05-2007/08 5/									
A2. Country-specific shock in 2004, with reduction in GDP growth (relative to baseline) of one standard deviation 6/									
A3. Selected variables are consistent with market forecast in 2004/05-2007/08									
<b>B. Bound Tests</b>									
B1. Nominal interest rate is at historical average plus two standard deviations in 2004/05 and 2005/06									
B2. Real GDP growth is at historical average minus two standard deviations in 2004/05 and 2005/06									
B3. Change in US dollar GDP deflator is at historical average minus two standard deviations in 2004/05 and 2005/06									
B4. Non-interest current account is at historical average minus two standard deviations in 2004/05 and 2005/06									
B5. Combination of 2-5 using one standard deviation shocks									
B6. One time 30 percent nominal depreciation in 2004/05									
<b>II. Stress Tests for External Debt Ratio</b>									
Debt-stabilizing non-interest current account 6/	20.7	20.5	19.7	18.1	18.1	17.1	15.4	14.0	12.4
	17.1	15.4	14.0	12.4	12.4	17.1	15.4	14.0	12.4
	17.3	15.9	14.4	12.9	12.9	17.3	15.9	14.4	12.9
	17.6	16.3	14.8	13.3	13.3	17.6	16.3	14.8	13.3
	21.8	23.8	22.4	20.6	20.6	21.8	23.8	22.4	20.6
	25.5	31.3	29.6	27.9	27.9	25.5	31.3	29.6	27.9
	26.0	31.7	29.7	27.6	27.6	26.0	31.7	29.7	27.6
	26.9	25.6	24.2	22.3	22.3	26.9	25.6	24.2	22.3

1/ Derived as  $[r - \rho(1+g) + \alpha d(1+r)](1+g+p+g)$  times previous period debt stock, with  $r$  = nominal effective interest rate on external debt;  $\rho$  = change in domestic GDP deflator in US dollar terms,

$g$  = real GDP growth rate,  $e$  = nominal appreciation (increase in dollar value of domestic currency), and  $a$  = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as  $1-p(1+g) + \alpha d(1+r)(1+g+p+g)$  times previous period debt stock,  $p$  increases with an appreciating domestic currency ( $e > 0$ ) and rising inflation (based on GDP deflator).

3/ For projection, line includes price and exchange rate changes.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth, nominal interest rate, dollar deflator growth, and both non-interest current account and non-debt inflows in percent of GDP.

6/ The implied change in other key variables under this scenario is discussed in the text.

7/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and both non-interest current account and non-debt inflows in percent of GDP) remain at their level of the last projection year.

### Mauritius: Public and External Debt Sustainability

*This analysis shows that under the baseline projections (the reform scenario), the debt ratio will decline and fiscal sustainability (indicated by falling or stable debt ratios) is achieved in the medium term. In this case, the debt ratios are robust enough to withstand a series of plausible shocks. However, a combination of large shocks could lead to an increase in the debt/GDP ratio, which could become unsustainable if the authorities fail to reduce the fiscal deficit over the medium term. External debt has been on a declining trend and remains sustainable in the medium term, even when subject to plausible shocks.*

1. **Under the staff's baseline projections where the overall deficit is reduced to 2 percent of GDP by 2007/08, Mauritius' public sector debt ratio declines over the medium term (Table 8a).** The debt ratio is projected to decline from about 73 percent to 64 percent of GDP.
2. **The public sector debt remains largely sustainable under the standard sensitivity tests.** Under the first sensitivity test, which sets real GDP growth, the primary deficit, and real interest rates at historical averages,<sup>1</sup> the debt/GDP ratio declines to about 68 percent by 2007/08. Under several other sets of sensitivity tests, which assume independent temporary shocks to key parameters, Mauritius's public sector debt declines over the medium term, albeit at slower rates.
  - A temporary rise in the real interest rate by itself would not derail public debt dynamics significantly, and the debt/GDP ratio would broadly follow the same path as in the baseline scenario.
  - Under both the real GDP shock and the primary deficit shock, the public debt would rise temporarily to about 78 percent, and then decline to 70-71 percent of GDP by 2007/08.
  - **The combination of large shocks could possibly lead to a significant rise in public debt.** Unlikely shocks of two standard deviations in real interest rates and primary balance, and three standard deviations in real growth would cause public debt to jump to 87 percent of GDP, but this would decline subsequently, albeit remaining at around 76 percent by the end of the period.
  - **In the absence of fiscal adjustment over the medium term, debt dynamics would become unsustainable (Table 8b).** In the no fiscal adjustment scenario, the fiscal deficit would rise to 6.5 percent of GDP in 2004/05 and remain at that level during the period. This would be associated with unfavorable debt dynamics, as the debt ratio would increase to about 76½ percent of GDP, and become increasingly vulnerable to various shocks.

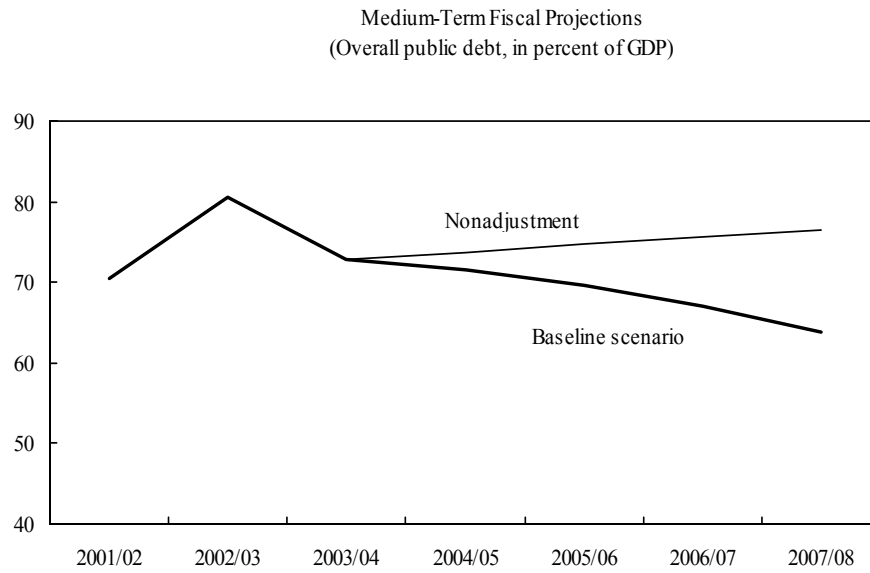
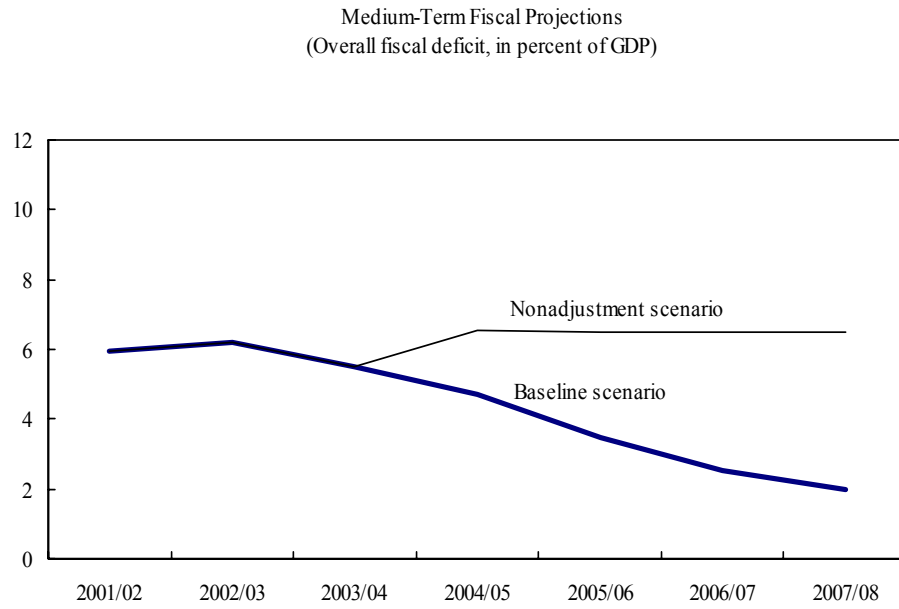
<sup>1</sup> The historical averages of the past ten years for real GDP growth and primary deficits are 4.9 and 1.3 percent of GDP, respectively, and 1.2 percent for the real interest rate over the past 7 years.

3. **External debt has been on a decreasing trend since 1997/98 and is expected to remain subdued in the medium term.** The external debt/GDP ratio declined from 31.5 percent in 1997/98 to 19.3 percent in 2002/03. In the baseline scenario, the external debt/GDP ratio is expected to decline further to 12.4 percent in 2007/08. Gross external financing needs will remain negative mainly due to the positive non-interest current account.

4. **The most important factor affecting the external debt/GDP ratio is the non-interest current account.** The external debt/GDP ratio could rise to 31.3 percent in 2005/06 and then decline to 27.9 percent in 2007/08 in the most extreme scenario where the non-interest current account is at the historical average minus two standard deviations in 2004/05 and in 2005/06. Figure 8 shows that in this case, the gross external financing needs would increase dramatically in 2004/05 and in 2005/06 before falling back to near balance in the following years. When several shocks are combined (one standard deviation decrease from historical average of GDP growth, GDP deflator, and non-interest current account) in 2004/05 and 2005/06, the external debt/GDP ratio could rise to 31.7 percent in 2005/06 and then decline to 27.6 percent in 2007/08, leading to positive gross external financing needs.

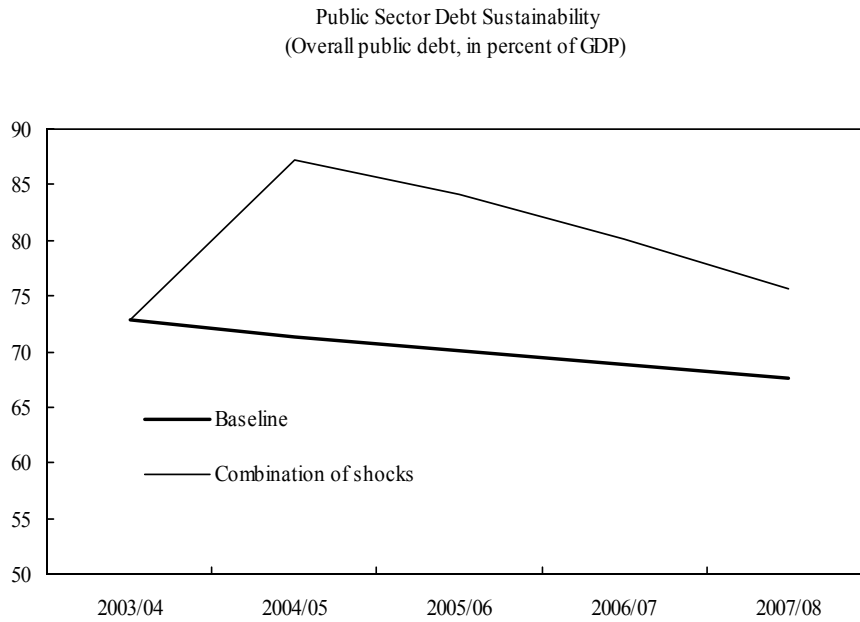
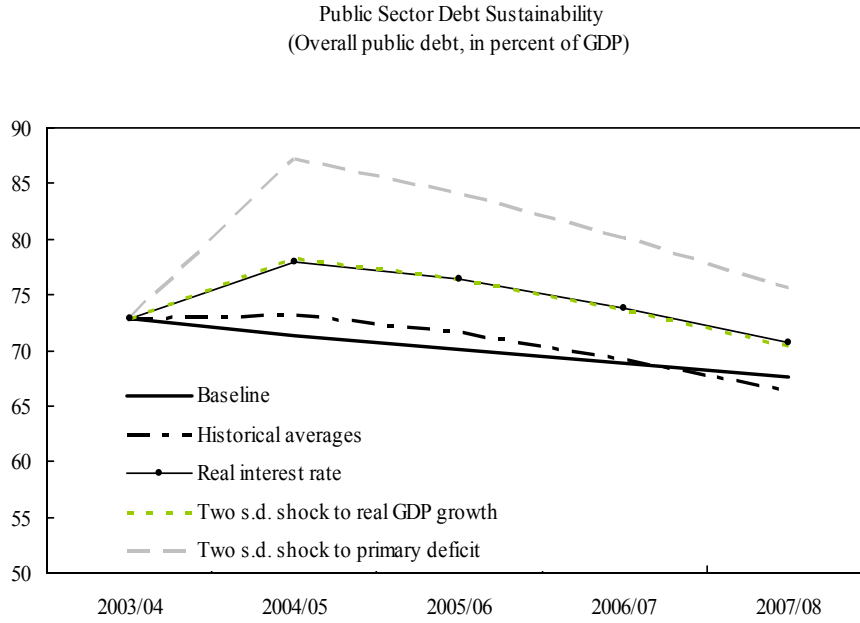


Figure 6. Mauritius: Medium-Term Fiscal Projections, 2001/02-2007/08



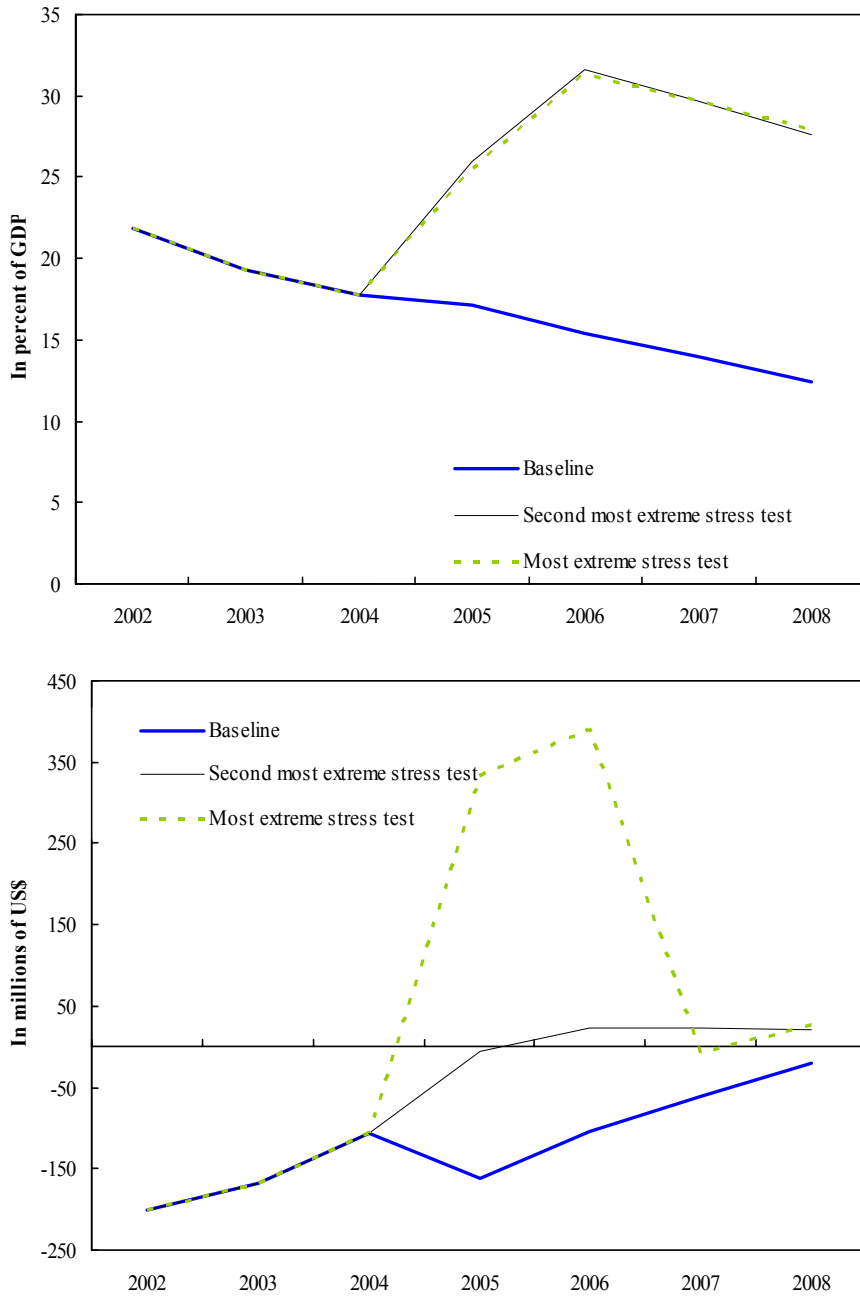
Source: Mauritian authorities; and Fund staff estimates and projections.

Figure 7. Mauritius: Public Sector Debt Sustainability, 2003/04-2007/08



Source: Mauritian authorities; and Fund staff estimates and projections.

Figure 8. Mauritius: External Debt Ratio and Gross External Financing Need, 2002-08



Source: IMF staff calculations.

**Mauritius: Relations with the Fund**  
(As of March 31, 2004)

**I. Membership Status**

Joined on September 23, 1968; Article VIII.

**II. General Resources Account**

	SDR Millions	Percent of Quota
Quota	101.60	100.00
Fund holdings of currency	79.72	78.47
Reserve position in Fund	21.88	21.53

**III. SDR Department**

	SDR Millions	Percent of Allocation
Net cumulative allocation	15.74	100.00
Holdings	17.30	109.90

**IV. Outstanding Purchases and Loans**

None.

**V. Latest Financial Arrangements**

Type	Approval Date	Expiration Date	Amount Approved (SDR million)	Amount Drawn (SDR million)
Stand-By	3/1/85	8/31/86	49.00	49.00
Stand-By	5/18/83	8/17/84	49.50	49.50
Stand-By	12/21/81	12/20/82	30.00	30.00

**VI. Projected Obligations to Fund**

None.

**VII. Implementation of HIPC Initiative**

Not applicable.

**VIII. Safeguards Assessments**

Not applicable.

**IX. Exchange Rate Arrangement**

The currency of Mauritius is the Mauritian rupee, and the exchange rate regime is a managed float with no preannounced path for the exchange rate. The exchange rate is currently determined in the interbank foreign exchange market. The exchange arrangement is free from

multiple currency practices and restrictions on the making of payments and transfers for current international transactions. Mauritius also maintains a liberal capital account. On April 26, 2004, the US\$1 was equivalent to MUR 27.05.

#### **X. Article IV Consultation**

Mauritius is on the standard 12-month cycle. The last Article IV consultation discussions were held during March 3- 18, 2003. The staff report (IMF Country Report No. 03/319, 10/14/03) was considered by the Executive Board on June 30, 2003. A Financial System Stability Assessment was completed by a joint IMF/World Bank team on June 5, 2003.

#### **XI. Technical Assistance (1998–2003)**

FAD advisor on introduction of a value-added tax system, October 1997–June 1999.

MFD mission on monetary operations, banking supervision, and payment system structures, January–February 1998.

MFD missions on bank supervision: the first of three in April–June 1998; the second in September–December 1998; and the third in February–April 1999.

MFD mission on monitoring of the financial system under Article IV surveillance and on monetary operations, January 1999.

STA mission on quarterly national accounts, February–March 1999.

MFD mission on monetary operations, May 1999.

MFD missions on bank supervision: the first of three in June–August 1999; the second in October–December 1999; and the third in February–March 2000.

MFD missions on monetary operations: the first of two in August–September 1999; and the second in November 1999.

MFD general advisor to the Governor of the Bank of Mauritius, February 2000–February 2002.

STA mission on quarterly balance of payments statistics, March 2000.

STA mission on quarterly national accounts and General Data Dissemination System (GDSDS), June 2000.

MFD missions on bank supervision: the first of three in August 2000; the second in November–December 2000; and the third in February–March 2001.

MFD/LEG joint mission on the revision of the Bank of Mauritius Act and the Banking Act, March–April 2001.

FAD mission on tax reform, May 2001.

MFD missions on bank supervision during 2001: the first of three in May–June 2001; the second in September 2001; and the third in November–December 2001.

STA mission on the Coordinated Portfolio Investment Survey 2001, May 2001.

STA mission to prepare a Report on the Observance of Standards and Codes (ROSC) for data compilation and dissemination, July 2001.

STA mission on government finance statistics, January 2002.

STA mission on monetary and financial statistics, March–April 2002.

MFD missions on general central banking during 2002: the first of three in February–April 2002; the second in June 2002; and the third in October–November 2002.

MFD missions on bank supervision during 2002: the first of four in February-March 2002; the second in May-June 2002; and the third in September-October 2002; and the fourth in November-December 2002.

MFD missions on bank supervision during 2003: February 2003, May/June 2003, September/October 2003, and November/December 2003.

MFD missions on bank supervision during 2004: February/March 2004.

Joint MFD/World Bank mission on anti-money laundering and combating the financing of terrorism, February-March 2003.

FAD mission on revenue administration and tax policy, February 2004.

**Resident Representative:** None.

## **Mauritius: Relations with the World Bank Group** (As of April 2004)

### **The Bank Group strategy and lending operations**

1. Mauritius has been a member of the World Bank since its independence in 1968. Mauritius is a development success story. In 1968, the country was poor, with a nominal per capita income of about US\$260. Today, nominal income per capita is US\$4,020 (Atlas method). The country graduated from IDA, the part of the World Bank Group that provides credits and grants to the poorest of the developing countries, in FY1975, and the last IDA credit was made in July 1974. In the 1980s, the World Bank supported macroeconomic and sectoral policy reforms through quick-disbursing loans. After the success of the structural adjustment effort, the country turned to more traditional project lending.
2. Given Mauritius's strong track record in economic management, the World Bank approved a Country Assistance Strategy (CAS) on May 7, 2002, which shifts from traditional project support to analytical and advisory services coupled with program support. The CAS supports the government's five-year *Economic Agenda for the New Millennium (NEA)*, with advice and direct budget assistance, around the three objectives of: (i) increasing Mauritius's competitiveness; (ii) bringing about deeper social development and social cohesion; and (iii) preserving and protecting Mauritius's fragile environment.
3. To better meet the needs of the government, the World Bank approved a Public Expenditure Reform Loan (US\$40 million) in 2002 to support the government's *Economic Agenda* through its first budget. The PERL was disbursed fully on June 25, 2002, and closed on September 30, 2003. The PERL directly supported the government's reform agenda, based on actions taken through 2001/02. Specifically, it supported education reform, poverty reduction, and expenditure allocations on the island of Rodrigues, environment and transport reforms, and economic management.
3. Under the CAS, analytical and advisory services are provided in a variety of forms, ranging from just-in-time advice to formal reports. The Bank recently carried out a Country Procurement Assessment Review, a Public Expenditure Review to assess the sustainability of the NEA, and a Transport Action Plan. Under the previous CAS, the Bank prepared a report on modernization of the pension system. It is also supporting work on budgetary management and will be undertaking an Investment Climate Assessment.
4. The World Bank currently has two active projects totaling US\$14 million in the financial services and environment sewage and sanitation sectors, of which US\$5.9 million was disbursed as of April 2004.
5. In 2003, the International Finance Corporation (IFC), the Bank Group's private sector lending arm, began an advisory mandate for structuring private participation in the Water and

Sewer utility. IFC's main focus for future activity is to support the deepening of the financial market, undertake advisory work, and make investments in private infrastructure. IFC has committed no new investments since 1996; the portfolio has steadily decreased as investments have been repaid and/or exited. IFC is seeking projects with Mauritian sponsors investing elsewhere in Africa.

6. Mauritian investors have benefited substantially in recent years from guarantees from the Multilateral Investment Guarantee Agency (MIGA) for their investments in continental Africa, with total gross exposure currently at US\$116.3 million, and net exposure at US\$105.3 million, for projects in Burundi, Mozambique, and Nigeria. MIGA currently has active interest from Mauritian investors for projects in Afghanistan, Madagascar, and Tanzania. Total coverage for these projects in the power and oil and gas sectors, is expected to be about \$150 million. In FY03, MIGA provided \$911,000 in guarantees for Mauritius Telecom, covering its investment in Burundi against the risks of war and civil disturbance, transfer restriction, and expropriation. MIGA also maintains on-line investment promotion services, which feature investment opportunities and the related legal and regulatory environment in Mauritius.

7. Mauritians have participated in World Bank Institute regional activities that were held elsewhere or by video-conference. A program on Strengthening Parliament in FY02 drew 12 participants. Responding to a Mauritian Government request in June 2003, the Bank has been discussing the possibility of developing a customized knowledge sharing program coordinated by WBI on issues related to Information and Communication Technology and competitiveness.

World Bank Portfolio in Mauritius  
(In millions of U.S. dollars, unless otherwise indicated)

	Approval Date	Effective Date	Closing Date	Net Commitment	Undisbursed Amount
Environment, Sewerage, and Sanitation	2/12/98	2/3/99	6/30/05	12.4	6.8
Financial Sector Supervisory Authority	12/4/01	4/10/02	9/30/04	1.8	1.6
Total				14.2	8.4

**IMF-World Bank collaboration in specific areas**

8. Overall, the IMF and World Bank staff maintain a close collaborative relationship in supporting sound budgetary and fiscal management. The World Bank is supporting the



government's Medium-Term Expenditure Framework, has prepared a Public Expenditure Review, and has provided just-in-time advice on a Budget Framework Paper to lead the 2004/05 budget cycle, which feeds into the IMF work on budgetary management and macroeconomic policy. Cooperation is also taking place on financial sector reforms and trade and labor market issues (the World Bank completed a Trade Mauritius Membership in SADC Note in FY04 and will undertake a labor market review).

#### **Areas in which the World Bank leads**

9. Areas in which the World Bank takes the lead are related to specific sector advice in the areas such as the environment, sewage and sanitation, education and training, social welfare, pensions, transport sector, MTEF, health, insurance, procurement, restructuring the EPZ sector, and privatization, as well as through a number of analytical studies as described above, including an ongoing Investment Climate Assessment.

#### **Areas in which the IMF leads**

10. Areas where the Fund takes the lead role relate to policy advice and reforms with respect to (i) overall economic policy advice and targets for macroeconomic targets; (ii) tax policy and administration; (iii) budgetary accounting; (iv) treasury procedures; (v) public sector wage policy; and (vi) monetary management and exchange rate policy. The Bank team actively participates in discussions between the Fund and the government in these areas, however, especially with respect to the setting of overall macroeconomic targets.

Questions may be referred to Mr. Willem Van Eeghen (email: [mvaneeghen@worldbank.org](mailto:mvaneeghen@worldbank.org)).

### **Mauritius: Statistical Issues**

The quality and timeliness of Mauritius's reporting of core minimum data, as well as of other economic and financial statistics to the IMF are, in general, satisfactory. Efforts are under way to improve the frequency and quality of fiscal data, particularly regarding their consistency with monetary sector data. The authorities already publish economic data on Mauritius, including a *Monthly Bulletin* published by the Bank of Mauritius and a number of statistics reports published by the Central Statistics Office (CSO), which are accessible via the Internet. Mauritius started participating in the IMF's General Data Dissemination System (GDSS) in September 2000. The authorities have shown interest in subscribing to the Special Data Dissemination Standard (SDDS), but improvements in the periodicity and timeliness of several data series are required before subscription can take place.

#### **Real sector**

Mauritius's annual national accounts are based on the concepts and definitions recommended by the *System of National Accounts 1993*. National accounts data are prepared by the CSO on a calendar-year basis and cover all transactions categories except financial transactions. In general, GDP by the production approach is compiled by using the ratios of the 1997 Census of Economic Activities (CEA). However, for enterprises not covered by the CEA (agriculture, fishing and forestry) the technical ratios may have been presumed unchanged for more than twenty years. Annual surveys rely on enterprise accounts that do not reflect calendar years and underreport output. Most government operations and external transactions other than goods are recorded on a cash basis rather than on an accrual basis. GDP estimates by expenditure are not derived independently, as household final consumption expenditure is determined as a residual. Although the five-yearly Household Budget Survey generates an independent estimate, this estimate is considerably lower than the one resulting from the commodity flow approach. GDP volume change is published as real growth rates over the previous year. Following IMF technical assistance in 1999 and 2000, the CSO started to compile national accounts on a quarterly basis for past years. However, the CSO has not yet compiled quarterly national accounts for the current year, and improvements are still needed regarding the timeliness and quality of domestic production indicators and foreign trade statistics.

The consumer price index is regularly rebased as consumption patterns and relative prices change. As from July 2002, a new series of the consumer price index has been introduced (July 2001-June 2002=100), with weights derived from the 2001/02 Household Budget Survey that followed the COICOP to classify goods and services. Producer price indices of agriculture and manufacturing, input costs of construction, wage rate, and employment have been developed but are not reported to the IMF for publication in *International Financial Statistics (IFS)*.

### **Government finance**

Mauritius continues to be a regular and timely reporter of fiscal data for surveillance, including quarterly data and annual projections. The July 2001 mission to prepare the data Report on the Observance of Standards and Codes (ROSC) highlighted the need for statistical improvements in the fiscal data, especially to reduce duplication in data collection, publish quarterly central government data, and improve the timeliness of consolidated government data. The data for surveillance purposes would be enhanced significantly if it would contain information on the overall public accounts, in particular off-budget accounts and nonfinancial public sector corporations. Follow-up technical assistance was provided in January 2002 to assist the authorities with the compilation of nonfinancial public sector data. The authorities also reported 2002 general government data for publication in the *Government Finance Statistics Yearbook (GFSY)*. While the authorities produce quarterly *GFS* data, they do not report these for publication in *IFS*.

### **Monetary accounts**

The authorities report money and banking statistics on a timely and regular basis. In March 2002, the IMF provided technical assistance to implement the *Monetary and Financial Statistics Manual (MFSM)*. The BOM successfully implemented the compilation procedures for the new Depository Corporations Survey (DCS) as recommended in the *MFSM* and compiled data in this framework for the period beginning in August 2001. However, the monetary survey is still used for monetary policy purposes (in the Monetary Targeting Framework) and for reporting to the Fund. There is no specific timeframe for switching to the DCS and discontinuing the compilation of the monetary survey.

### **Balance of payments**

Mauritius provides quarterly balance of payments and international investment position data to the Statistics Department on the basis of the classification system of the *Balance of Payments Manual* (5<sup>th</sup> edition). The data in the financial account of the balance of payments and in the international investment position statement, particularly those on direct investment and portfolio investment, have limited coverage. To address these gaps a 2001 data ROSC mission recommended the establishment of a survey of enterprises, banks, and other financial institutions, both onshore and offshore, to obtain data on claims on, and liabilities to, nonresidents. Follow-up action by the authorities is due.

Mauritius: Core Statistical Indicators  
(As of May 25, 2004)

	Exchange Rates	International Reserves	Central Bank Balance Sheet	Reserve/ Base Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Government Balance	External Public Debt	GDP/ GNP
Date of latest observation	01/31/04	01/31/04	03/04	03/04	03/04	03/04	04/04	12/03	2001/02	12/02	12/02	2003
Date received	02/05/04	02/05/04	05/13/04	05/13/04	05/13/04	05/13/04	05/04	05/04	03/03	03/03	03/03	05/04
Frequency of data	M	M	M	M	M	M	M	Q	A	Q	A	A
Frequency of reporting	M	M	M	M	M	M	M	Q	A	Q	A	A
Frequency of publication	M	M	M	M	M	M	M	A	A	A	A	A
Source of update	A	A	A	A	A	A	A	N	A	A	A	N
Mode of reporting	C	C	C	C	C	C	C	E	V	V	V	V
Confidentiality	C	C	C	C	C	C	C	C	R	R	C	C

Notes: Frequency of data: M=monthly; Q=quarterly; A=annually.  
 Frequency of reporting and publication: D=daily; M=monthly; Q=quarterly; A=annually.  
 Source of update: A=direct reporting by central bank, Ministry of Finance, or other official agency; N=official publication or press release.  
 Mode of reporting: C=cable or facsimile; M=mail; E=electronic (e-mail or Internet); V=staff visits.  
 Confidentiality: C=unrestricted use; R = restricted use.

## Mauritius: Millennium Development Goals 1/

	1990	1995	2001	2002	2015 Target 2/
<b>General Social Indicators</b>					
Population (millions)	1.1	1.1	1.2	1.2	...
Adult literacy rate (percent of people of ages 15 and over)	79.8	82.3	84.8	85.3	...
Total fertility rate (births for women)	2.3	2.1	2.0	2.0	...
Life expectancy at birth	69.6	70.3	72.1	72.5	...
<b>Goal 1. Eradicate extreme poverty and hunger</b>					
Target: Halve between 1990 and 2015, the proportion of people whose income is less than one dollar a day and who suffer from hunger.					
1. Prevalence of child malnutrition (percent of children under 5)	...	14.9	...	...	...
2. Population below minimum level of dietary energy consumption (in percent)	6.0	...	5.0	...	3.0
<b>Goal 2. Achieve universal primary education</b>					
Target: Ensure that, by 2015, children everywhere will be able to complete a full course of primary schooling.					
3. Net primary enrollment ratio (percent of relevant age group)	94.9	96.2	94.7	...	100.0
4. Percentage of cohort reaching grade 5 (in percent)	98.4	98.8	...	...	100.0
5. Youth literacy rate (in percent of ages 15-24)	91.1	92.6	94.0	94.2	100.0
<b>Goal 3. Promote gender equality</b>					
Targets: Eliminate gender disparity in primary and secondary education, preferably by 2005, and to all levels of education no later than 2015					
6. Ratio of girls to boys in primary and secondary education (in percent)	98.0	99.0	97.1	...	100.0
7. Ratio of young literate females to males (percent of ages 15-24)	99.9	100.5	101.1	101.2	...
8. Share of women employed in the nonagricultural sector (in percent)	...	...	...	...	...
9. Proportion of seats held by women in national parliament (in percent)	7.0	8.0	6.0	6.0	...
<b>Goal 4. Reduce child mortality</b>					
Target: Reduce by two-thirds, between 1990 and 2015, the under-five mortality rate					
10. Under-five mortality rate (per 1000)	25.0	23.6	19.0	18.2	8.3
11. Infant mortality rate (per 1000 live births)	21.0	19.6	17.0	15.0	...
12. Immunization, measles (percent of children under 12 months)	76.0	89.0	90.0	...	...
<b>Goal 5. Improve maternal health</b>					
Target: Reduce by three-fourths, between 1990 and 2015, the maternal mortality ratio.					
13. Maternal mortality ratio (modeled estimate per 100,000 live births)	...	45.0	...	...	...
14. Births attended by skilled health staff (percent of total)	...	97.0	98.5	...	...
<b>Goal 6. Combat HIV/AIDS, malaria and other diseases</b>					
Target: have halted by 2015, and begun to reverse, the spread of HIV/AIDS.					
Have halted by 2015, and begun to reverse, the incidence of malaria and other major diseases.					
15. Prevalence of HIV, female (percent of ages 15-24)	...	...	...	0.0	...
16. Contraceptive prevalence rate (percent of women of ages 15-49)	75.0	...	...	...	...
17. Number of children orphaned by HIV/AIDS	...	...	...	...	...
18. Incidence of tuberculosis (per 1,000 people)	...	...	69.2	...	...
19. Tuberculosis cases detected under DOTS (in percent)	...	42.0	32.0	...	...
<b>Goal 7. Ensure environmental sustainability</b>					
Targets: Integrate the principles of sustainable development into country policies and programs and reverse the loss of environmental resources. Halve by 2015 the proportion of people without sustainable access to safe drinking water. By 2020, to have achieved a significant improvement in the lives of at least 100 million dwellers.					
20. Forest area (percent of total land area)	8.4	...	7.9	...	...
21. Nationally protected areas (percent of total land area)	...	4.9	7.7	7.8	...
22. GDP per unit of energy use (PPP in US\$ per Kg. oil equivalent)	...	...	...	...	...
23. CO2 emissions (metric tons per capita)	1.1	1.3	2.1	...	...
24. Access to an improved water source (percent of population)	100.0	...	100.0	...	...
25. Access to improved sanitation (percent of population)	100.0	...	99.0	...	...
<b>Goal 8. Develop a Global Partnership for Development</b>					
Targets: Develop further an open rule-based, predictable, nondiscriminatory trading and financial system.					
Address the special needs of the least-developed countries and landlocked countries and small island developing states.					
Deal comprehensively with the debt problems of developing countries through national and international measures in order to make debt sustainable in the long term. In cooperation with developing countries, develop and implement strategies for decent and productive work for youth. In cooperation with the private sector, make available the benefits of new technologies, especially information and communications.					
26. Youth unemployment rate (percent of total labor force of ages 15-24)	5.3	23.8	...	...	...
27. Fixed line and mobile telephones (per 1,000 people)	54.5	142.5	509.1	...	...
28. Personal computers (per 1,000 people)	3.8	32.1	109.1	...	...

Source: World Development Indicators database, April 2002.

1/ Includes only indicators for which data is available for any given year.

2/ Targets are indicated quantitatively wherever it is possible, but specifics are described in the goals sections.

**Statement by the IMF Staff Representative**  
**July 21, 2004**

This statement provides additional information that has become available since the issuance of the staff report. The information does not alter the thrust of the staff appraisal.

1. On June 11, 2004, the Deputy Prime Minister and Minister of Finance submitted to the legislature the budget for 2004/05. The budget assumes real economic growth of 5½ percent for the fiscal year, largely on account of a more optimistic forecast for the financial services, tourism and export processing zone sectors than contained in the staff report, and inflation of 4 percent, which is in line with staff projections. The overall fiscal deficit is budgeted at 5 percent of GDP, compared with 4.7 percent recommended by the staff. The higher deficit is mainly due to larger capital outlays.
2. The budget contains a tax package that includes part of the measures recommended in the staff report, as well as other measures. The main difference with the measures proposed by staff are in the income tax, where the staff report had assumed no significant changes. In addition, the authorities did not implement the proposed measures to reduce VAT exemptions and the list of zero-rated commodities. The yield from the package is nonetheless expected to be about 1 percent of GDP, slightly higher than that arising from the proposals discussed in the staff report, mainly owing to reforms in corporate taxes and increases in some excises. The package proposes broad income tax reforms, including a redistribution of the tax burden from low to high income earners and an increase in the contribution of the corporate sector, thus broadening the tax base. Specifically, the number of brackets for the personal income tax will be increased from two to four, with the rate on the highest bracket being raised from 25 to 30 percent and that on the lowest bracket being lowered from 15 to 10 percent. The special allowances for investment to encourage firms to modernize their plants have been reduced, and an Alternative Minimum Tax will be imposed on corporations that distribute dividends. Moreover, the threshold requiring professionals and the self-employed to register with the tax department and submit returns has been lowered. The budget also proposes higher excise duties, a reduction of customs duties on selected items, a higher ceiling for the allowance on interest income, a new tax on tourism (to take the form of an arrivals fee incorporated in the airline ticket), and improvements in tax administration.
3. The government also announced its intention to improve the debt maturity profile. To do this, the Loans Act has been amended to allow for the issuance of a wider range of long-term debt instruments.



INTERNATIONAL MONETARY FUND

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August 25, 2004

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## **IMF Concludes 2004 Article IV Consultation with Mauritius**

On July 21, 2004, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Mauritius.<sup>1</sup>

### **Background**

Real GDP growth is expected to rebound to around 4½ percent in 2003/04, following a disappointing 2¾ percent in 2002/03 (July-June). This largely reflects the recovery of tourism and sugar production, the latter due to favorable weather, and continued strong construction and transportation activity. However, high domestic production costs and increasing competition have continued to affect adversely the Export Processing Zone (EPZ) sector, which registered negative growth for the second consecutive year. The unemployment rate rose to 10.2 percent in 2003 from 9.7 percent in 2002.

The overall fiscal deficit in 2003/04 is estimated to be in line with the target of 5.5 percent of GDP, a reduction from 6.2 percent in 2002/03. This improvement reflects primarily higher tax and nontax revenue. The estimated overall balance of 30 nonfinancial public sector corporations shifted to a surplus of 0.9 percent in 2002/03 from a deficit of 0.6 percent of GDP in 2001/02. The Central Electricity Board (CEB) continues to face financial difficulties. The financial position of the State Trading Corporation (STC) is expected to improve following

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<sup>1</sup> Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. This PIN summarizes the views of the Executive Board as expressed during the July 21, 2004 Executive Board discussion based on the staff report.

the introduction in early April 2004 of an automatic mechanism for adjusting the prices of petroleum products.

There is a danger that public debt could become unsustainable as a result of continuing central government fiscal deficits. The public debt, which was around 66 percent of GDP in 1999/00, rose to about 80 percent in 2002/03, and is projected at 73 percent of GDP by end-June 2004.

The Bank of Mauritius (BOM) has established credibility in achieving its inflation objective. Average annual inflation fell to around 4 percent in 2003, from 6.4 percent in 2002, reflecting in part slower growth in credit to the private sector. The outlook is for a further moderate fall in inflation over the near term, as demand pressures remain subdued. Given lower inflation expectations, the BOM lowered its Lombard rate in five steps by a total of 200 basis points, to 9½ percent in late January 2004. However, given the weaknesses in key sectors of the economy, banks have been cautious in advancing credit, which has led to a situation of excess liquidity in the banking system. The financial system in Mauritius is generally sound. The government has also taken a number of actions to strengthen its Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) framework.

The overall balance of payments surplus is projected to decline from 6½ percent of GDP in 2002/03 to below 2 percent in 2003/04. The current account is projected to remain in surplus with the recovery of the tourism sector offsetting a widening in the trade deficit. The capital and financial account is projected to register a small deficit of 0.8 percent of GDP in 2003/04 compared with a surplus in 2002/03. FDI flows are expected to weaken in 2003/04, however, portfolio investment inflows (primarily from U.S. and U.K. mutual funds) should register strong growth as a result of high interest rate differentials.

### **Executive Board Assessment**

Directors noted Mauritius' impressive social and economic achievements during the last twenty-five years, in particular the strong GDP growth, high level of domestic savings, and improving living standards. These achievements have been underpinned by the strength of public institutions, good governance, respect for the rule of law, a stable democratic system, and a transparent regulatory environment—elements that will continue to serve the country well as it confronts future economic challenges. Nevertheless, Directors expressed concern about the high and growing level of unemployment, especially among the unskilled, the uncertain medium-term outlook for a number of key economic sectors, and the large stock of domestic public debt.

Directors considered that, to safeguard Mauritius's past achievements, prepare for a more competitive global environment, and strengthen medium-term fiscal sustainability, the authorities should focus in the period ahead on implementing structural adjustments and reforms, especially in the sugar and textile sectors and the labor market, and on reducing persistent budget deficits. It would be important to press ahead in these areas while the economy is still performing well, and the public debt is manageable.



Directors welcomed the reduction in the fiscal deficit achieved during 2003/04 and the fiscal efforts announced in the 2004/05 Budget Speech. At the same time, they urged the authorities to take further measures to reduce the deficit, with a view to returning the domestic public debt to a sustainable path and stabilizing the debt-to-GDP ratio over the medium term.

They recommended, on the revenue side, a broadening of the income tax base and the extension of the VAT to additional items. On the spending side, they saw scope for more carefully prioritizing government expenditures, stretching out non-critical capital projects, and targeting the now-generalized subsidies for rice and flour to only the disadvantaged groups. The need to maintain fiscal discipline in the period leading to the general elections was underscored. Given the importance of improving the maturity structure of the debt, Directors considered that the creation of a debt management unit in the Ministry of Finance would be a step in the right direction.

Directors commended the authorities for their success in reducing inflation. Looking ahead, they urged the central bank to monitor closely the excess liquidity in the banking system to guard against a rapid expansion of credit to the private sector and increased inflation. Directors encouraged the Bank of Mauritius to review the effectiveness of its monetary policy instruments, in particular the signaling role of the Lombard rate. Directors noted that the current level of the real effective exchange rate appears to be broadly in line with macroeconomic fundamentals. They welcomed the central bank's policy of allowing the exchange rate to respond to market forces, and supported the central bank's view that external competitiveness should be fostered through real productivity gains.

Directors considered that the Mauritian financial system is well developed, sound, and profitable. They welcomed the authorities' positive response to the recommendations of the Financial Sector Assessment Program carried out in 2003. Directors noted that the development of an efficient corporate bond market would allow institutional investors to diversify their portfolios and help reduce credit concentration, and could strengthen the overall stability and soundness of the financial system. Directors welcomed the issuance of guidance notes to banks on anti-money laundering and countering the financing of terrorism, and the passage of the Convention on the Suppression of the Financing of Terrorism Act 2003.

Looking beyond the macroeconomic policy challenges to structural adjustments, Directors were encouraged by the steps being taken by the government to address the impending loss of trade preferences in the sugar and textile sectors, which risks a contraction of these sectors. They welcomed the planned review of the Sugar Sector Strategy, and urged the authorities to take further actions to strengthen the sector's competitiveness. Directors also welcomed the establishment of the Textile Emergency Support Team to assist in the rehabilitation and restructuring of those textile enterprises judged to be viable.

Directors called for a closer link between wage increases and productivity growth to facilitate the restructuring of the textile sector, stimulate job creation, and improve competitiveness. In particular, they urged the authorities to take steps to make the wage bargaining system more flexible and streamline labor regulations to stem the rise in unit labor costs. Directors welcomed the comprehensive measures that have been taken to improve access to the

education system and strengthen the curriculum at all levels, which will help to alleviate the skills mismatch in the economy and raise employment over the medium term.

Directors commended the authorities for their efforts to diversify the economy and create new job opportunities by developing the financial services, tourism, and information and communications technology sectors. While the government must continue to play a leading role in providing infrastructure to support economic growth, Directors considered that greater opportunities could be provided for private sector participation in infrastructure development, in particular in the public utilities, transportation, and commercial areas. In this connection, they welcomed efforts to facilitate public-private sector partnerships in infrastructure investments, and also urged the authorities to take due note of the potential costs and risks of such arrangements.

Directors welcomed the authorities' commitment to trade liberalization and supported the reduction of custom duties in the 2004/05 budget. At the same time, they urged the authorities to announce a medium-term tariff reform program, including a lowering of the maximum and average tariff rates.

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**Mauritius: Selected Economic Indicators 1/**

	1999/00	2000/01	2001/02	2002/03 Prov.	2003/04 Proj.
	(Annual percentage change)				
<b>Domestic economy</b>					
Real GDP	2.7	7.6	4.3	2.7	4.4
Consumer prices (period averages)	5.3	4.4	6.4	5.1	3.9
Unemployment	7.7	8.8	9.1	9.7	10.2
	(In millions of U.S. dollars, unless otherwise indicated)				
<b>External economy</b>					
Exports, f.o.b	1,522.6	1,639.0	1,592.9	1,843.5	2,016.9
Imports, f.o.b.	-2,006.5	-1,891.9	-1,798.2	-2,129.4	-2,328.1
Current account balance	-68.7	154.3	247.8	136.1	155.6
(in percent of GDP)	-1.6	3.4	5.4	2.6	2.6
Capital and financial account balance	-18.7	90.2	-12.2	-108.8	-44.7
Net international reserves of the Bank of Mauritius (end of period)	688.0	789.3	1,017.0	1,438.5	1,549.3
(in months of prospective imports, c.i.f.) 2/	4.1	5.0	5.4	6.9	7.5
Debt service (in percent of exports of goods and nonfactor services)	7.9	9.8	8.4	8.2	6.0
Change in real effective exchange rate (in percent) 3/	5.7	2.7	-1.9	-1.0	...
	(In percent of GDP, unless otherwise indicated) 2/				
<b>Financial variables</b>					
Total public debt	65.8	64.4	70.5	80.5	72.8
Total revenues and grants	20.9	18.2	18.4	20.3	20.9
Total expenditures and net lending	24.7	23.9	24.4	26.5	26.4
Central government fiscal balance 4/	-3.8	-5.7	-5.9	-6.2	-5.5
Primary fiscal balance 4/ 5/	-0.4	-1.3	-2.6	-1.9	-1.5
Change in broad money (in percent)	10.9	9.9	13.0	11.7	9.6
Interest rate (in percent) 6/	11.0	11.1	10.6	9.0	7.0

Sources: Mauritian authorities; and IMF staff estimates and projections.

1/ Fiscal year from July to June.

2/ Excluding the acquisition of aircraft and ships.

3/ Trade-weighted period averages; data for 2002/03 are for July-Feb. 2003. A negative sign signifies a depreciation.

4/ Including grants.

5/ Overall central government fiscal balance, excluding interest payments.

6/ Average prime lending rate (end of fiscal year, in percent).

**Statement by Damian Ondo Mañe, Executive Director for Mauritius**  
**July 21, 2004**

1. I would like to express the appreciation of my Mauritian authorities to the staff for the constructive and comprehensive discussions they had during the 2004 Article IV consultation. My authorities are in broad agreement with the staff's analysis as well as with their assessment regarding the main challenges facing the economy. In addressing these challenges, my authorities have benefited well from the staff's advice as well as from excellent and timely technical assistance from the Fund, for which they are thankful. As the Staff Report and the excellent Selected Issues Paper indicate, the Mauritian authorities in close cooperation with the private sector have already started implementing wide ranging reforms to adapt the country to the new environment. These reforms are bearing fruits, but will require sustained efforts over the long term. My Mauritian authorities are committed to implement the necessary reforms to ensure that the economy maintains a strong and sustainable growth path, over the medium to long term.

**Recent Developments**

2. The Mauritian economy rebounded in 2003/04, with real GDP growth estimated at 4.5 percent, following growth of about 2.7 percent in 2002/03. Per capita GDP is now estimated at about US \$4,000. This improved performance results from the recovery in the sugar and tourism sectors, as well as stronger activity in the construction and transportation sectors. However, the Export Processing Zone (EPZ), which consists mainly of textile and garments industries and which has been the locomotive of the economy for several decades, has experienced its second consecutive year of negative growth, reflecting higher production costs and increased competition.

3. In the fiscal sector, the deficit for 2003/04 is expected to be 5.6 percent of GDP compared to 6.2 percent in 2002/03. The lack of a more pronounced improvement in the deficit ratio is explained by shortfall in government revenue, and lower than projected growth. The overall balance of the nonfinancial public enterprises turned into a surplus, but the domestic public debt increased.

4. Monetary policy remained prudent, with the central bank pursuing successfully its informal inflation targeting framework. Inflation remained low and under control and fell to below 4 percent in 2003/04. The lower inflationary expectations as well as lower demand for private sector credit enabled a further decline in domestic interest rates. The Mauritian rupee strengthened against the U.S. dollar, and helped to mitigate somewhat the rising oil and commodity prices, and their impact on domestic inflation.

5. The external current account remained in surplus, and the level of international reserves remained comfortable and represents an import cover of about 8 months. The gross domestic savings and investment rates have remained high at about 25 and 23 percent of GDP, respectively.

6. On the labor market, the economy created more than 14,000 jobs in 2003/04, but the unemployment rate increased to 10.5 percent. The Mauritian stock market continued to register important gains, increasing by over 35 percent, in the year ending June 2004. Overall, the Mauritian economy performed well, with private sector confidence remaining strong.

### **Policies for 2004/05 and Medium-Term Prospects and Policies**

7. Although the economy is faced with a number of challenges, the reforms underway and the policies envisaged should help to maintain real GDP growth at about 4 percent per annum. Inflation is expected to remain under control. The fiscal deficit is projected to decline, with the external current account balance remaining in surplus.

8. The authorities agree with the staff that the three immediate challenges are:

- reducing the fiscal deficit;
- adapting the economy to the impending loss of trade preferences in sugar and textiles; and
- carrying out structural reforms, including lessening labor market rigidities.

The authorities are cognizant of the constraints that an increasing public debt will have on policies, and intend to take steps to reduce it.

### **Fiscal Policy**

9. It is my Mauritian authorities' intention to reduce the fiscal deficit gradually over the medium term, and to reverse the trend in the debt-to-GDP ratio. The authorities agree with the staff that this is required to ensure fiscal sustainability and macroeconomic stability. For 2004/05, the deficit is projected at 5 percent of GDP, on the basis of additional revenue and expenditure measures, a prioritization of capital outlays, and the lengthening of the maturity structure of the domestic debt. As I noted last year, the high level of capital expenditure has been the main cause of the increase in the deficit. For 2004/05, the projected fiscal deficit will be almost equivalent to the level of capital expenditure, so that borrowing for the most part will be to finance capital expenditure and not to meet recurrent expenditure.

10. Over the medium term, as the government completes its program of capital spending in the area of education and information technology, which presently accounts for the largest block of capital spending, total outlays should come down, and thus contribute to a lowering of the deficit. Moreover, to strengthen budgetary management, the authorities are in the process of creating a Revenue Authority in line with FAD recommendations. They are also working closely with bilateral and multilateral partners to develop a Medium-Term Expenditure Framework. The new system has already been implemented in the areas of Education and Training. It will be gradually introduced in all ministries. The MTEF should allow the government to be more focused on objectives it wants to achieve, on results and performance. On the issue of reducing subsidies, the authorities agree with the staff that this would contribute to lower government expenditure, but it is an issue that is politically very sensitive, and will require continued consultation with all social partners. The authorities are

of the view that this is one of the issues that will require a broad consensus. Broadening the tax base is another issue that is being considered, and the authorities have taken steps in this direction in the present Budget. These include the increase in the number of income tax brackets from two to four, changes in the corporate income tax, including the Alternative Minimum Tax, and the registration of professionals and other self-employed persons,.

### **Monetary and Financial Policies**

11. The Bank of Mauritius (BOM) has been quite successful in the pursuit of its informal inflation targeting framework. As a result inflation has been brought down significantly over the past years, and has enabled a lowering of interest rates. However, as the Lombard rate, which the Bank of Mauritius has been using to signal the direction of monetary policy, has become less effective, it is planning to review its monetary framework, with a view to adopting short term interest rates as its operational target. In this regard, it is considering developing an active secondary market in government securities and Bank of Mauritius bills.

12. On the issue of excess liquidity in the banking system, the central bank does not think that, in the present circumstances, the excess liquidity poses any risk of a surge in inflation. Nevertheless, it is following developments carefully, and is attempting to absorb it through the issuance of BOM bills.

13. The financial system of Mauritius remains sound. The few areas of weaknesses, in particular in the offshore financial sector, that had been identified in last year's FSAP report, are being addressed. The authorities agree with the staff that the financial market should be deepened with the development of an efficient corporate bond market which would contribute to the stability and soundness of the financial system. However, as the excellent study on "Developing a Corporate Bond Market in Mauritius" in the Selected Issues paper makes it clear, the development of such a market requires a number of preconditions to which the authorities are giving their attention.

### **Structural Reforms**

14. As mentioned in previous Board discussions on Mauritius, the authorities have put in place a broad strategy to deal with the challenges facing the economy. Most of the measures needed are of a structural nature and will require fundamental changes in the way that the economy has operated up to now. My Mauritian authorities' approach has been one of close cooperation with the private sector, and broad consultation with stakeholders. This approach has been helpful in developing the strategy and the broad consensus needed to implement the deep-seated changes that are needed and that are not only economic, but involve social and cultural changes as well.

15. As regards **the sugar sector**, a strategy has been put in place to restructure the industry and to improve its competitiveness, but these changes will require some time to be effective. Already the measures taken have resulted in the closure of several mills and the loss of almost 8,000 jobs in the sugar industry. The strategy also includes measures aimed at diversifying sugar-related activities, such as the production of electricity from the by-products of sugar, as well as the production of ethanol and rum. The Government will start

soon consultation with stakeholders on the Mid-Term Review of the Sugar Sector Strategic Plan to assess the progress made, and to decide on what further steps or changes are needed.

16. Steps are also being taken to encourage the development of the **non-sugar agricultural sector**, through, among others the leasing of agricultural land to small planters, and the improvement of the land irrigation system. Under the Non-Sugar Sector Strategic Plan, farmers are being encouraged and assisted to produce high-value added products with export potential. They are receiving assistance from the newly created National Biotechnology Institute in deciding what to produce. At the same time a Certification Body is being set up to help farmers meet the sanitary certification and standards required by importers, especially in the Euro area.

17. The authorities are also working closely with **the textile and garments sector** to help in its restructuring through technical advice and development finance. Already this sector has lost 10,000 jobs, and the relocation of many textile factories could cause the loss of an additional 20,000 jobs. Working closely with the private sector, the Government has set up a Textile Emergency Support Team (TEST) which is helping viable enterprises to restructure. This is being done through the provision of corporate diagnosis services as well as financial resources from the National Equity Fund and the Development Bank of Mauritius for capitalization and modernization of the enterprises. Improving productivity in the sector is an important objective of the restructuring process. Retraining of displaced workers is also being undertaken.

18. As regards the other sectors, **the tourism sector remains buoyant**, and the construction of a number of new upper-scale hotels by the private sector is envisaged for the next few years. Training facilities for workers in this industry is being expanded. In **the Information and Communications Technology (ICT)** sector, the infrastructure has been almost completed, and more than 50 companies, accounting for the creation of over 2,000 jobs have started operation. It is expected that over 4,000 new jobs will be created by the end of the year. Although the outlook for this sector appears less favorable than a year ago, the authorities remain confident that it will become an important pillar of the economy in the next few years.

19. In addition to the sectoral policies being implemented, as described above, the authorities are also focusing their attention on **the labor market** and further private sector development. On the labor market, the increase in the unemployment rate is due to several factors which include the ongoing restructuring and contraction of the two major sectors of sugar and textiles, the skills mismatch and the rigidities in the labor market.

20. The contraction of the sugar and textiles sectors which have been major generators of employment has been a strong factor in the high level of unemployment. It has not been easy for workers who have been for most of their life employed in one industry to be trained and to find employment in other sectors. Most of the time the new jobs do not exist. Nevertheless, the government is helping with different programs of retraining. As regards the mismatch of skills, the significant investment in education should help to address this issue over the medium term. But for the more immediate future and in order to meet the needs of the market, the authorities have launched a national program for training of 5,000 high school

graduates in skills related to the needs of the ICT sector. Attention is also being given to the training of those who have not completed high school education and who are having the most difficult time finding a job. Special training programs in a number of crafts and professions are being provided. The program is starting with some 3,000 trainees this year.

21. Investment is also being made in developing **a culture of entrepreneurship** in Mauritius. This will include a program of support to entrepreneurs, as well as a Young Entrepreneur Scheme to help up to 100 qualified young entrepreneurs each year to start new business ventures.

22. The authorities view the unemployment problem as one that will require time to solve. They are confident that the measures they are taking will not only help to diversify the economy and create new employment opportunities, but they are also ensuring that these new sectors will be able to get the type of workers that they need, thus helping the economy to grow. The authorities also agree with the staff that these measures need to be complemented by a reform of the various labor market institutions. It is a process that will take time, but discussions with the trade unions have already started on ways to reduce rigidities in the market. The authorities view this cooperative approach as essential to maintain social peace, and are confident that progress will be made in this area.

23. **In conclusion**, I would like to say that my Mauritian authorities are fully cognizant of the challenges the economy faces, and are taking steps to address them. They are confident that their gradual approach and the strategies that they have put in place will help the country to maintain a high and sustainable growth path over the medium to long term.