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Mauritius: 2012 Article IV Consultation—Staff Report; 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 2012 Article IV consultation with Mauritius, the following documents have been released and are included in this package:

- The staff report for the 2012 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on January 25, 2012, 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 February 29, 2012. 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 Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its March 14, 2012 discussion of the staff report that concluded the Article IV consultation.
- A statement by the Executive Director for Mauritius.

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MAURITIUS

STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION

February 29, 2012

KEY ISSUES

Outlook and risks: The outlook for growth and inflation is broadly positive, although growth is likely to slow somewhat to below 4 percent. The external environment, particularly the export dependence on Europe is the largest risk for the outlook.

Fiscal policy and public debt sustainability: The cyclical component of Mauritius' fiscal balance is projected to be small. A less expansionary fiscal stance than currently projected by staff would contribute to building policy buffers and reducing relatively high debt levels. In the event of a deterioration in the external environment, automatic stabilizers should be allowed to work and limited fiscal stimulus could also be considered, particularly to help employment change and mitigate social costs. Fiscal adjustment should focus on public enterprises and better targeting of social protection.

Monetary and exchange rate policies: The monetary policy stance is appropriate, but developments in inflation and excess liquidity need to be followed closely. The recent decline in year-on-year and core inflation point to lesser inflationary pressures for 2012. Staff estimates that at end-2011 the real exchange rate was broadly in line with fundamentals, but there is a need to reduce the current account deficit over time. The flexible exchange rate continues to play a useful role as a potential shock absorber; exchange rate interventions should be used primarily to limit excess volatility. Net international reserves appear fully adequate, but not excessive.

Inclusive Growth: The poor have benefitted from economic growth, but less than richer groups in recent years. The social protection system could be better targeted to ensure that growth is inclusive. Revenue policies appear to be moderately progressive.

Financial sector: Stress-tests indicate that the Mauritian banking system is well-capitalized and resilient against many shocks. Supervisory coordination between the Bank of Mauritius and the Financial Services Commission (FSC) should be enhanced further to ensure that there are neither supervisory loopholes nor supervisory overlaps.

Approved By
Saul Lizondo and Vivek Arora

Discussions took place in Port Louis from January 11–25, 2012. The staff team comprised Mr. Petri (head), Mr. Culiuc, Mr. David, and Ms. Svirydzenka (all AFR). Mr. Ismael (OED) participated in the policy discussions. Mr. Parry (FAD) prepared an appendix on green taxes.

CONTENTS

INTRODUCTION 4

RECENT DEVELOPMENTS 4

OUTLOOK AND RISKS 7

POLICY THEME 1. MACROECONOMIC POLICIES FOR 2012 7

A. Fiscal Policy 9
B. Monetary and Exchange Rate Policies 10
C. Reserve Adequacy 13

POLICY THEME 2. LONGER-TERM CHALLENGES 14

A. Medium-Term Debt Sustainability 14
B. Inclusive Growth in Mauritius 15
C. Financial Sector Issues 17
D. Structural Reforms and Statistical Issues 19

STAFF APPRAISAL 20

TABLES

1. Selected Economic and Financial Indicators, 2009–17 22
2. Summary of Central Government Finances, 2009–14 23
3. Central Government Integrated Balance Sheet 24
4. Balance of Payments, 2008–14 25
5. Depository Corporations Survey, 2008–12 26
6. Financial Soundness Indicators for the Banking Sector, December 2006–June 2011 27

FIGURES

1. Macroeconomic Developments, 2004–11 ___ 6
2. Macroeconomic Projections Through 2017 ___ 8
3. Inflation and Interest Rates ___ 10
4. Actual and Equilibrium Exchange Rates, 2004–16 ___ 12
5. Reserve Adequacy as Measured by IMF Multidimensional Metric, 2000–11 ___ 13
6. Growth Incidence Curve, 2001–06/07 ___ 16

APPENDIXES

I. Exchange Rate and External Balance Assessment ___ 28
II. Reserve Adequacy Assessment ___ 31
III. Debt Sustainability Analysis ___ 34
IV. Green Taxes and Ethanol Policies ___ 42
V. Inclusive Growth ___ 43
VI. State-Owned Enterprises: Financial Monitoring and Reform ___ 47
VII. Stress-Testing the Banking System ___ 49
VIII. Tourism Sector Competitiveness ___ 54

INTRODUCTION

1. **To cushion the economy against the impact of the 2008/2009 global crisis, the Mauritian authorities responded with two comprehensive fiscal stimulus packages starting in 2009/2010.** Monetary and exchange rate policies were also supportive for most of the period. The economy responded well to the policy packages and showed signs of recovery in 2010 and 2011.

2. **The 2011 Article IV consultation concluded that the authorities' prompt response to the crisis was appropriate**, but that going forward a less expansionary fiscal stance was warranted to rebuild fiscal buffers and that the central bank should closely monitor inflationary pressures. The authorities broadly adhered to staff's recommendations, with 2011 showing a decline in the fiscal deficit and monetary policies responding to inflation and economic growth developments. Going forward, policy recommendations stress continuing to build fiscal buffers and maintaining price stability in the context of a potentially deteriorating external environment.

RECENT DEVELOPMENTS

3. **The Mauritian economy has continued its recovery despite a somewhat adverse external environment.** Real GDP growth is estimated again at around 4 percent in 2011, driven mostly by growth in textiles, ICT, financial services, and real estate (Figure 1). Inflationary pressures increased in the first half of the year (year-on-year inflation rate rose to 6.6 percent in June) mainly due to higher import prices and one-time increases in administered prices. There was a further jump to 7 percent in November 2011 due to one-time increases in alcohol and tobacco excises. By December inflationary pressures moderated with year-on-year inflation falling to 4.9 percent (and remaining at that level in January 2012), as the base effects became absorbed.

4. **The fiscal stance in 2011 improved compared to 2010, and was significantly less expansionary than planned.** The overall deficit narrowed from 3.0 percent of GDP in 2010 to 2.4 percent of GDP.[1] Also, the cyclically-adjusted primary deficit excluding grants decreased somewhat to essentially zero. A small shortfall in total revenues and grants was more than offset by savings on current expense and a net accumulation of resources in special funds. Compensation of employees

[1] The numbers consolidate the operations of the earmarked special funds outside the budget. The central government budget deficit concept used by the authorities shows a small increase due to transfers from the budget to the special funds accounts.

was lower than projected partly because of the postponing of local elections to 2012 and delays in filling vacancies in the civil service. However, transfers were higher than in 2011 particularly to the special funds (2 percent of GDP), although most were not spent in 2011. The deficit was over 2 percentage points of GDP lower than expected at the time of the last Article IV consultation mainly because of lower capital expenditures and net savings in the special funds. Public sector debt declined moderately to 56 percent of GDP at end 2011.

5. **Monetary policy was tightened during the year in response to inflationary developments.** To address excess liquidity that built up in the system, the Bank of Mauritius (BOM) increased cash reserve requirements from 6 to 7 percent in February and issued Bank of Mauritius Bills and Notes. It also increased the repo rate by 50 basis points in March and by 25 basis points in June to address inflationary developments. The BOM lowered the repo rate by 10 basis points in December in response to the worsening growth outlook. Private sector credit growth—estimated at close to 13 percent for 2011—remained adequate, and similar to 2010. The authorities continued to intervene in the foreign exchange market to smooth excessive exchange rate volatility. In the second half of the year, the BOM also intervened to limit the real appreciation of the rupee with most of the interventions sterilized. As a result of its liquidity management, the BOM is expected to have recorded a loss for 2011.

6. **The banking sector is robust, and the system has proved resilient.** Banks have remained liquid and well-capitalized with 14.1 percent of Regulatory Tier I capital to risk-weighted assets as of June 2011. Non-performing loans (NPL) decreased from 2.8 percent of gross loans at end-2010 to 2.6 percent by June 2011. Banks have remained profitable with 21.5 percent return on equity, despite relatively low leverage ratios. In March 2011, the BOM started publishing overall CAMEL ratings for individual banks; one of the first central banks in Sub-Saharan Africa (SSA) to do so. This should contribute to increased transparency about the state of the banking system.

7. **Despite strong export growth, a rebound in world commodity prices led to a widening of the current account deficit, but international reserves increased.** Exports increased some 16 percent (in dollar terms), with strong growth across all major tradable industries. Tourism receipts grew strongly as well, but a marked decrease in fourth quarter arrivals from key EU markets points to a difficult year ahead. On balance, the 17 percent increase in imports and a reduction in net transfers widened the current account deficit to some 10 percent of GDP. The deficit was more than covered with portfolio inflows and official loan disbursements. International reserves increased in nominal terms, but reserve cover in terms of imports of goods and services slipped to 4.4 months.

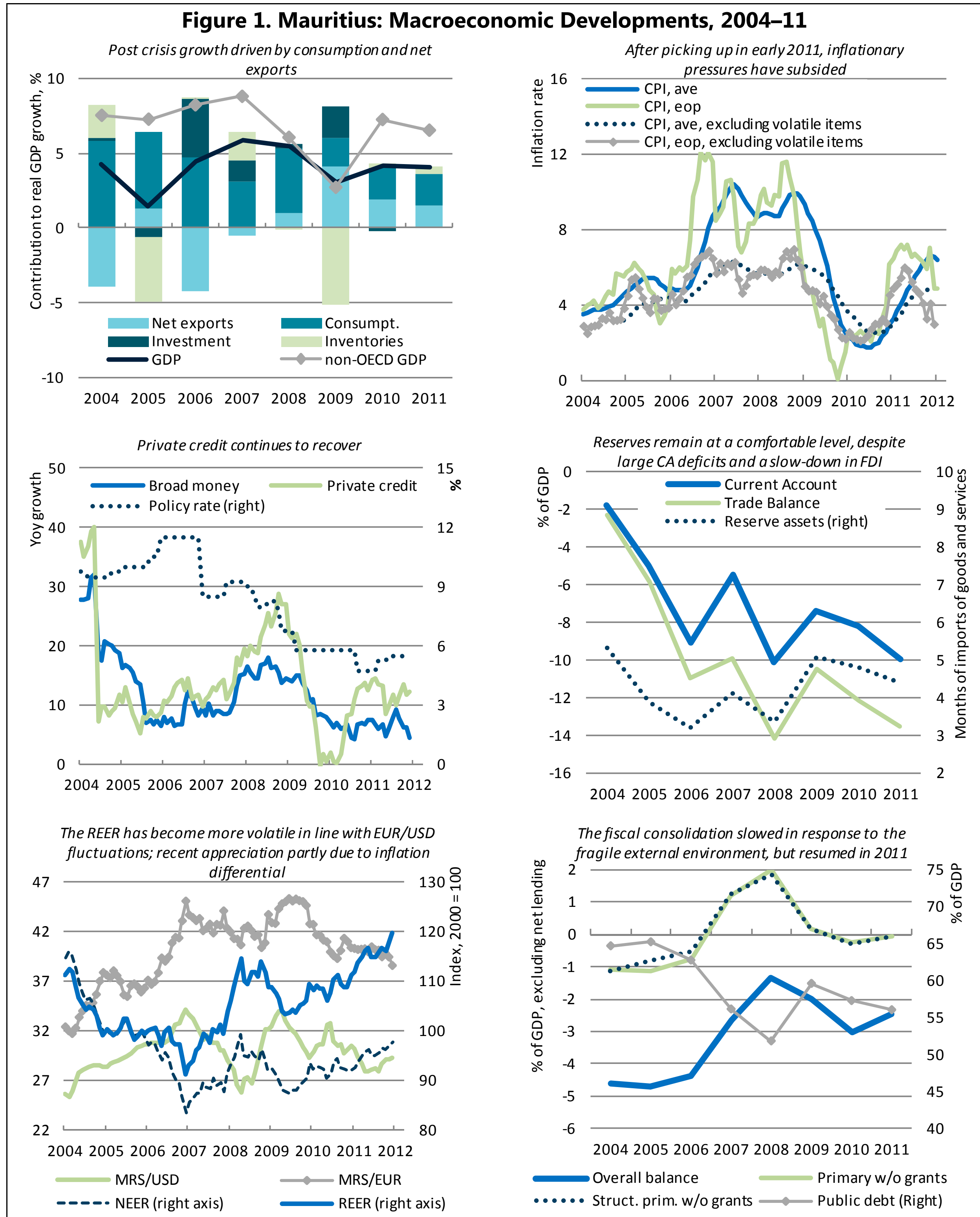


Figure 1. Mauritius: Macroeconomic Developments, 2004–11

Sources: Mauritian authorities; and IMF staff estimates.

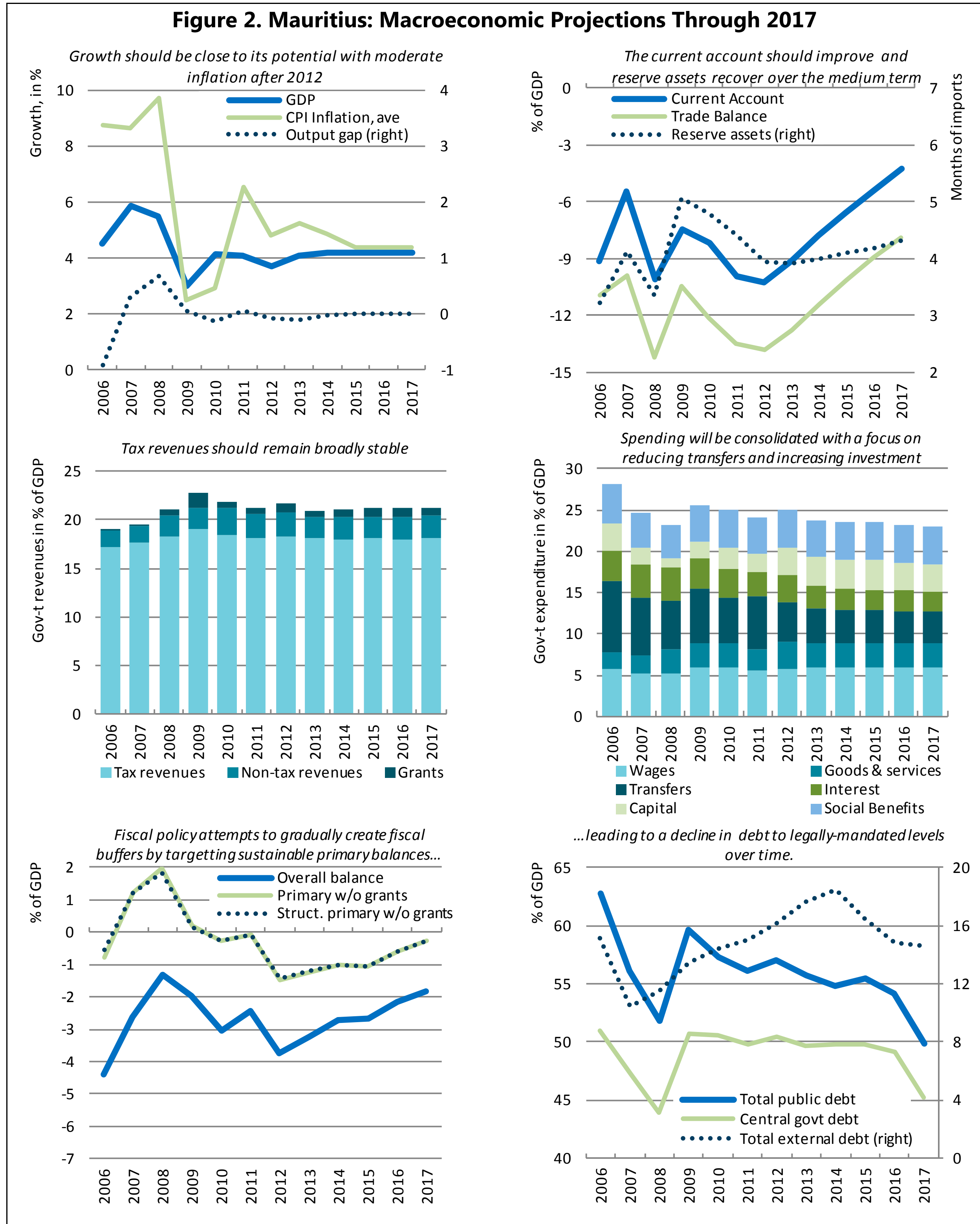
OUTLOOK AND RISKS

8. **The outlook for 2012 is broadly positive but uncertainties have grown.** Growth should moderate given the adverse external environment (Figure 2). Staff projects that real GDP growth in 2012 will decline moderately to 3¾ percent and will be driven mostly by growth in consumption and investment, which will accelerate relative to 2011. The main downside risks stem from a heavy dependency on the global economy, especially Europe. Potential spillovers to Mauritius from subdued partner country growth could materialize through reduced tourism, trade, and foreign direct investment (FDI) flows. Other international financial flows could become an additional source of vulnerability if large short-term capital flows linked in large part to the Global Business Corporations (GBCs) prove to be more volatile than in the past. In the event of adverse external shocks, staff's view is that the main fiscal policy response should be to let automatic stabilizers work. Some limited fiscal stimulus measures could also be considered. With the appropriate policy response, the Mauritian economy would remain broadly resilient to a recession in advanced economies, even though the negative effects on the domestic economy would be significant. The authorities have already done a considerable amount of contingency planning for a possible downturn, and the 2012 budget provides contingency funds for such an event.

9. **Longer-term challenges include sustaining reform efforts, improving the targeting of social benefits, improving the cost-effectiveness of public sector delivery, and enhancing overall productivity through investments in physical and human capital.** However, these challenges appear manageable in view of Mauritius' well-established track record as an economic reformer, with a dynamic private sector, reasonable economic fundamentals, and robust institutions.

POLICY THEME 1. MACROECONOMIC POLICIES FOR 2012

Discussions centered on the fiscal stance for 2012 given the uncertainty of the external outlook and the need for consolidation to strengthen public debt dynamics. Also, the role of monetary policy and liquidity management in stabilizing inflation and supporting growth was discussed in conjunction with exchange rate policy and reserve management given the real appreciation of the rupee and ensuing concerns regarding the competitiveness of the export sector.



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

A. Fiscal Policy

10. The 2012 budget reflects the authorities' objectives of increasing the economy's resilience to shocks. On the revenue side, changes included the abolition of a tax on capital gains and certain property taxes, deemed to have negatively affected the real estate sector without generating significant revenue. These measures were partly compensated by an increase in excise duties (notably on alcohol and cigarettes), which should maintain the overall tax revenue broadly stable as a percentage of GDP. Current expense in 2012 is projected to decrease as a percent of GDP due to lower transfers and subsidies. The 2012 budget envisages a strong increase in public investment spending to 4 percent of GDP, which appears ambitious given the capacity constraints that limited capital budget execution in 2010 and 2011. There is also a plan to spend 1½ percent of GDP out of special funds, with a large share of these expenditures linked to investment projects or of a contingent nature. While staff agreed with the authorities' revenue projections, it projected that capital projects and spending from special funds would be lower than budgeted. Thus, staff projects a more moderate fiscal expansion, with the overall budget deficit (including the special funds) increasing from 2.4 percent of GDP in 2011 to 3.7 percent of GDP in 2012 (compared to 5.3 percent of GDP under the budget). In fact, staff's projections are in line with historical budget implementation as the fiscal outturns for the past two years have been less expansionary than initially envisaged under the relevant budget documents.

11. Staff recommended a less expansionary fiscal stance than projected for 2012. The cyclical component of Mauritius' fiscal balance is projected to be small, reflecting small estimates of the output gap. Thus, the mission argued that there was little need for expansionary fiscal policy for cyclical considerations, particularly given the fact that fiscal multipliers are likely to be small in an open economy with a flexible exchange rate regime. As a consequence, the mission argued for a less expansionary fiscal stance than currently projected by staff in order to build policy buffers and ensure favorable debt dynamics, given that current debt levels are still relatively high for an emerging economy.

12. Authorities' responded that infrastructure investments are needed to remove bottlenecks and that external shocks impose a constraint on fiscal consolidation. They explained that most of the planned expansion is related to capital spending to address infrastructure constraints on growth, which should yield benefits for future growth. They also noted that over the last two years, fiscal policy has been less expansionary than anticipated. Moreover, the 2012 budget includes contingent expenditures financed mostly by the special funds to support businesses through loan guarantees,

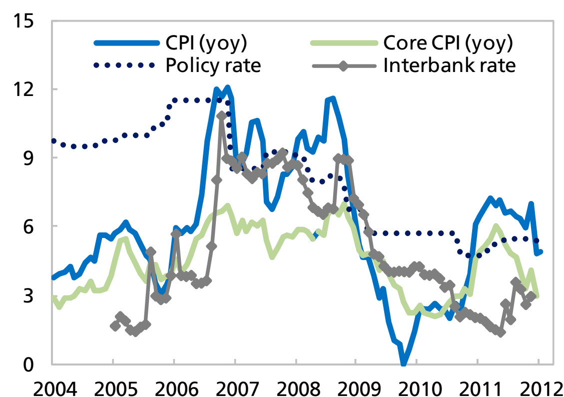
factoring, and leasing schemes in the event of adverse shocks, which are likely to materialize at least partly in 2012.

13. Staff acknowledged that in the event of a deterioration in the external environment, a looser fiscal stance could become appropriate. The authorities have been proactive in considering policy options for a more significant downturn in the world economy and its impact on Mauritius. It was agreed that automatic stabilizers should be allowed to work. In addition, the measures applied during the 2008/09 crisis and further developed in the 2012 budget should be fully implemented. Finally, some fiscal stimulus to support social programs, protect employment, and accelerate capital spending could also be considered.

B. Monetary and Exchange Rate Policies

14. The monetary policy stance is broadly appropriate, but developments in inflation and excess liquidity need to be followed closely. The decline in year-on-year inflation in December and developments in core inflation measures point to a moderation in inflationary pressures for 2012. Private sector credit demand is likely to decelerate because of reduced risk appetite. The current repo rate of 5.4 percent is slightly positive in real terms given a year-on-year inflation projection of 4.9 percent (Figure 3). The current policy rate appears appropriate given the weak external environment, but the MPC needs to be vigilant against possible inflationary pressures and adjust its policy stance in light of future developments regarding inflation but also domestic growth. The BOM actively withdrew excess liquidity in the banking system during 2011, but there is room to further reduce the remaining excess liquidity—attributable in part to strong FDI inflows—to align the market-driven interbank rate with the BOM's policy rate more closely. This will ensure a better working of the monetary transmission mechanism by ensuring that market rates move with policy rates.

Figure 3. Mauritius: Inflation and Interest Rates



Source: Bank of Mauritius

15. The authorities broadly agreed with the mission's view on monetary policy. They believed that the recent track record for balancing price stability and economic development has been good. However, they

explained that the cost of removing excess liquidity from the banking system was reducing the BOM's profitability significantly, which was difficult to explain to the general public.

16. The current monetary policy framework of "hybrid inflation targeting" remains well-suited for the needs of the Mauritian economy and can be developed further. The MPC has been operating with an implicit inflation target of about 5 percent. Staff argued that a formal inflation target might help to anchor inflationary expectations. This would also be in line with the legal framework, which specifies that a target be announced in consultation with the Ministry of Finance. The adoption of a range around the target would still allow the BOM sufficient policy flexibility to fulfill its price stability and economic development mandate while increasing its accountability. Staff recommended that BOM's macro-forecasting and analytical capability be strengthened further before shifting to a more formal inflation targeting framework. In particular, active use of structural models will allow the BOM to undertake scenario analysis of the macroeconomic effects of monetary and exchange rate policy. Also, there may be a need to strengthen price and external sector statistics further and to develop higher frequency real variables.

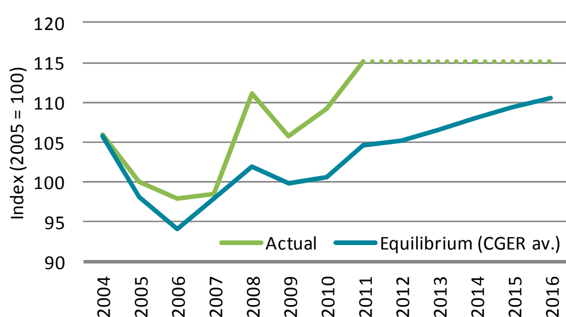
17. The authorities agreed on the desirability to move to inflation targeting over the medium-term, after improving the policy framework. Given Mauritius' status as a small island economy, certain components of the CPI index (imported goods, administered prices) are quite volatile, thus requiring an appropriate measure of core inflation to underpin the formal target. They acknowledged the value of Fund technical assistance in enhancing the modeling capacity of the BOM, which they intend to strengthen further.

18. The real value of the Mauritian rupee has followed a U-shaped path over the last decade. The rupee depreciated steadily some 25 percent from peak (2001) to trough (end-2006). During the crisis years of 2008–09 the depreciation of the Euro and the British Pound has pushed up the value of the rupee. Mauritius rebounded relatively quickly from the world economic crisis, with increased financial flows translating into a steady nominal appreciation in 2010–11. During 2011, the real effective exchange rate (REER) is estimated to have appreciated by 5 percent despite some interventions by the BOM.

19. Staff estimates that the REER is broadly in line with fundamentals. The analysis indicates an overvaluation of the rupee, which is within the margin of error of the methodologies. It is estimated at 5 percent relative to medium-term fundamentals as the current account deficit is projected to gradually narrow over time (Figure 4 and Appendix I). These findings are based on the

application of the three CGER-based approaches: macroeconomic balances, external sustainability, and equilibrium real exchange rate. This result is essentially the same as for the last Article IV assessment.

Figure 4. Actual and Equilibrium Exchange Rates, 2004–16



Source: IMF staff estimates.

20. Staff emphasized that the analysis suggested a need to reduce the current account deficit over time. This adjustment would be facilitated by medium-term fiscal consolidation, which is one of the authorities' priorities and required by the public debt law. Staff noted that the flexible exchange rate system has served Mauritius well and that interventions in foreign exchange markets should be used primarily to limit exchange rate fluctuations in a relatively narrow market. Moreover, improved competitiveness through structural reforms would also help reduce the current account deficit. Current projections suggest that the current account would improve over time with an adequate policy-mix consisting of improvements in external competiveness and sustained fiscal adjustment.

21. The authorities are concerned about the impact of a real exchange rate appreciation on export competitiveness. The export sectors are a large engine of job creation, particularly tourism and textiles, which are also price sensitive and operating on low margins. The authorities also wondered whether their position vis-à-vis other competitors had deteriorated given the recent appreciation of the REER, the deterioration in Mauritius' terms of trade, and lesser reserve accumulation (see section on reserve adequacy below). At the same time, the authorities recognized that sterilized interventions to moderate any real exchange rate overvaluation have quasi-fiscal costs given the important interest rate spread between reserve assets and sterilization instruments. In addition, such efforts might complicate inflation stabilization objectives. Moreover, they were not certain whether intervention would have much impact on the real exchange rate, which in their view is mostly determined by market fundamentals.

22. Staff highlighted that the estimate of overvaluation by itself is not significant enough to warrant considering active exchange rate management. The mission underscored that the exchange rate is only one mechanism for reducing external imbalances, and not necessarily the most obvious one in the case of a floating exchange rate regime. Staff recommended that the authorities monitor real exchange rate developments in relation with its fundamentals going forward. Further real appreciation not warranted by

fundamentals might be resisted through sterilized interventions, but such policies should also be supported by fiscal adjustment and productivity increasing reforms to facilitate external adjustment.

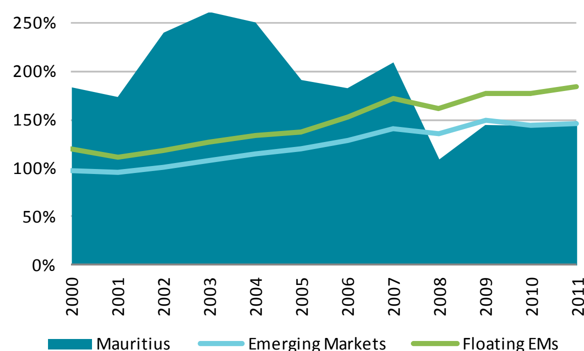
C. Reserve Adequacy

23. Net international reserves appear fully adequate, but not excessive. Mauritius' reserves are comfortable when measured against two traditional metrics (Appendix II). Import cover at four months is above the commonly-used benchmark of three months and short-term debt cover around 500 percent compares well against the benchmark of 100 percent. The authorities were interested in knowing whether they could manage "excess" reserves more actively. The mission established that a new multidimensional metric introduced in IMF (2011) is also met (Figure 5).[2] At around 140 percent, reserves are at the upper margin of the suggested range of 100–150 percent, and firmly in the middle of the distribution among emerging markets. However, reserves have just kept up with financial deepening and are hovering only slightly above the 20 percent of M2, a benchmark intended to capture the risk of capital flight and the potential need for bank support in/after a crisis. Moreover, staff projects moderate declines in reserve adequacy over the medium term.

[2] For floating regime countries, the measure sums 30 percent of short term debt on remaining maturity basis, 10 percent of other portfolio liabilities, 5 percent of M2 and 5 percent of exports of goods and services.

24. The mission argued that the current reserve cushion is warranted for several reasons. These include: (i) increased external risks stemming from Europe; (ii) likely under-reporting in external sector statistics of short-term debt and volatile exports, which would tend to over-estimate reserve adequacy; and (iii) Mauritius' emerging status as international financial center. Risks are likely to decline over the medium term, which might justify lower reserves going forward. Moreover, there is likely some scope to increase the yield potential on a part of BOM's reserves.

Figure 5. Mauritius: Reserves Adequacy as Measured by IMF Multidimensional Metric, 2000–11



Source: IMF staff estimates.

25. The authorities concurred with the analysis regarding reserve adequacy. They expressed interest in obtaining technical assistance to enhance reserve management

capacity. They are looking forward to exploring these issues further with the forthcoming IMF technical assistance mission on asset/liability management and a medium-term debt strategy.

POLICY THEME 2. LONGER-TERM CHALLENGES

The discussions centered on the appropriate medium-term fiscal policies to control public debt including through improvements in the public enterprise sector; on inclusive growth and the strengthening of the social safety net; on the results of stress testing exercise for the banking system; and on productivity-enhancing structural reforms.

A. Medium-Term Debt Sustainability

26. Results of the Debt Sustainability Analysis indicate that the debt outlook for Mauritius is broadly positive, but more could be done to reduce vulnerabilities. Both total public debt and external debt are on sustainable trajectories and the results of stress tests indicate that debt dynamics are resilient to several shocks (see Appendix III). These conclusions are based on the current macroeconomic framework discussed with the authorities, which assumes that some fiscal consolidation will take place over the medium-term. Staff recommended that the authorities target slightly more ambitious fiscal adjustment objectives, which would reduce vulnerabilities more quickly and provide larger assurances of meeting the legally-mandated debt target of 50 percent of GDP by 2018. The bulk of fiscal consolidation efforts are likely to fall on current expense, especially transfers to state-owned enterprises (SOEs) and improvements in targeting of social benefits.

27. The role of taxes in fiscal adjustment is limited. Given the government's focus on a stable tax regime with low rates, significant increases in the tax-to-GDP ratio over time are unlikely. The tax system is already relatively broad based and the main focus of tax reforms should be on administrative simplification and removing some of the few remaining exemptions (for example on motor vehicle excises). Mauritius is a pioneer in the development of green taxes, but more can be done (see Appendix IV), not least regarding reducing road congestion. Staff recommended progressively introducing congestion charges. The planned introduction of a subsidy for ethanol production, which reflects the positive externality of using ethanol, is a welcome initiative and more efficient than a quantitative requirement.

28. The macroeconomic impact of SOEs is large and there is scope for significant savings. In 2010 revenue for 15 large

enterprises (for which data is available) amounted to 15 percent of GDP and investment expense was 8.5 percent of GDP. Transfers to SOEs from the budget amounted to 2.7 percent of GDP in 2010, which suggests that SOEs do not charge full cost-recovery prices for their services. Raising tariffs to full cost recovery would represent an important potential for savings and fiscal adjustment. The authorities are developing a financial monitoring framework aimed at promoting improvements in efficiency and minimizing the need for central government transfers. The indicators chosen by authorities are broadly appropriate (Appendix VI), but the system could increase the focus on variables measuring risks and contingent liabilities.

29. Staff recommended that Government financial support to public enterprises should be curtailed. The government's program to strengthen the financial performance of SOEs is welcome. Staff also suggested reviewing the public policy purpose of each SOE and developing clear financial and service performance objectives. In particular, tariff structures and pricing policies will need to be revised to ensure long-term financial sustainability of these firms.

B. Inclusive Growth in Mauritius

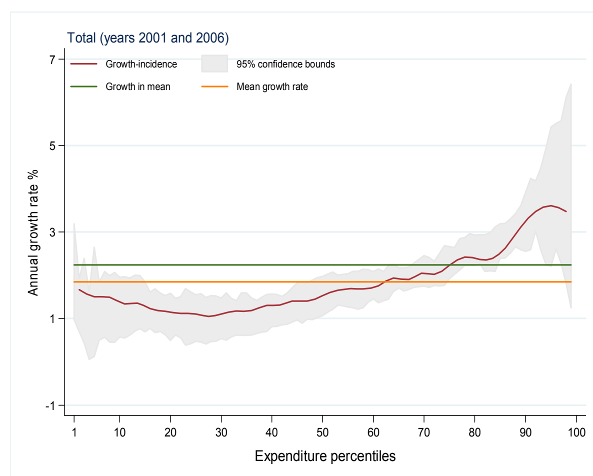
30. The poor have benefitted from economic growth, but less than richer income groups. Mauritius has performed well in terms of securing relatively high growth rates without large adverse consequences for inequality over the last two decades and has a relatively low Gini-coefficient compared to emerging markets and advanced countries (Appendix V). However, during the period from 2001 to 2006/07, which is covered by the last available household survey, richer segments of the population have experienced faster growth rates in expenditure than the average, whereas poorer groups of the population had below average growth in expenditure (Figure 6). This points to a more uneven distribution of the benefits of economic growth, possibly linked to fundamental structural changes in the Mauritian economy, as some traditional sectors (agriculture, textile manufacturing) have declined and the service sector has played an increasing role as an engine of growth (particularly financial services). Differences in human capital accumulation, evidenced by disparities in educational outcomes, are also likely to be an important factor in explaining these trends.

31. The authorities agreed with much of the analysis, but argued that some measures might have improved since 2007. Some social assistance programs were streamlined since, and the authorities have worked with the World Bank on better targeting. They also wondered whether the developments might be part of a global trend,

which might require further comparative research.

Figure 6. Mauritius: Growth Incidence Curve, 2001–06/07

Growth in Real Household Expenditure per Capita



Source: HBS surveys and IMF staff estimates. Annual growth in real household expenditure per capita by expenditure percentile is depicted. The horizontal lines describe growth in average expenditure across surveys (growth in mean) and the average growth rate across percentiles (mean growth rate).

32. The current social protection system is costly, but not well-targeted. In 2011, social insurance payments exceeded 4 percent of GDP, including over 1.3 percent of GDP for the basic retirement pension scheme (Appendix V). However, almost 40 percent of the basic retirement pension benefits go to the richest 20 percent of the population. Only about 24 percent of direct and indirect beneficiaries of social protection programs are poor. The poor receive only about 13 percent of total social protection payments. Estimates from the latest household survey indicate that the two richest quintiles of the population (top 40 percent) receive close to 58 percent of all social protection benefits and the richest 20 percent receive about 37 percent of all benefits. Thus, there is substantial scope for savings to be made.

33. Moreover, government-subsidized prices for rice, flour, cooking gas and transportation tend to be regressive. Subsidies administered by the State Trading Corporation (STC) on LPG, rice and wheat are significant (½ percent of GDP in 2011). The richest 20 percent of the population typically receive a multiple of the subsidies that go to the poorest 20 percent, particularly for LPG, where the subsidy also partly undoes the government's environmental agenda.

34. The authorities have elaborated a strategy to reform the social protection system. A review of social protection programs undertaken by the authorities in 2010 concluded that social assistance programs are fragmented, leading to diseconomies of scale, and that these programs generally do not help beneficiaries transition from welfare to work. Monitoring and evaluation of these programs is also considered to be weak, which impairs the ability of policy makers to determine whether programs are cost effective.

35. Staff recommended that the authorities intensify their efforts to improve the targeting of social protection expenditures. Important steps include the completion of the Social Registry of Mauritius

(an information system that would provide comprehensive data on existing and potential program clients) and replacing existing programs with a new absolute poverty benefit based on objective targeting criteria, as suggested by the Social Protection Review. The use of conditional cash-transfer schemes could also foster human capital accumulation and help to address skills mismatches in the labor market in the longer term. Staff believes that a reform of the pension system, albeit difficult from a political economy perspective, could also yield positive results in terms of income distribution and sustainability of the system. Savings from better targeting could be deployed more effectively in the pro-poor sectors of primary and secondary education and health, where they would also partially benefit the non-poor, and contribute to human capital accumulation.

36. **The authorities agreed that targeting could be improved, but pointed out that political economy considerations were important.** Some of the relatively inefficient programs (basic retirement pension and subsidies) have a long history in Mauritius and are backed by considerable societal consensus. They explained that it would take further communication efforts to prepare the ground for such reforms in order to avoid adverse reactions. They welcomed the involvement of the World Bank in designing appropriate targeting mechanisms.

37. **The tax system appears to be moderately progressive overall.** An analysis based on data from the 2006/07 household survey indicates that the VAT is not regressive in Mauritius, a concern often expressed with respect to consumption taxes. Furthermore, the evidence indicates that personal income taxes were progressive, as richer segments of the population bear a disproportionate share of the tax burden (Appendix V). Nevertheless, unlike countries such as New Zealand and the United States, the personal income tax (PIT) only has a limited impact as an instrument for redistribution given its small economic importance (tax revenue derived from PIT amounted to 1.5 percent of GDP in 2010).

C. Financial Sector Issues

38. **Staff undertook a stress testing exercise for the Mauritian banking system based on bank-level data.** The exercise used several toolkits, and focused on banking system vulnerabilities to credit risk, interest and exchange rate risk, liquidity risk and concentration risk (Appendix VII). It assessed the resilience of the banking system to extreme events by (i) assessing the drop in capital adequacy ratios following plausible shocks; and (ii) estimating breaking points – the size of the adverse shocks that would reduce the adequacy ratios below acceptable thresholds.

39. Stress-tests indicate that the Mauritian banking system is well-capitalized and resilient against many shocks. Banks' profitability and comfortable capitalization provide important cushions against a range of shocks to their credit portfolios. Direct exchange rate, liquidity, and interest rate risks appear to be low, while concentration of lending remains an important source of risk. Medium and small banks are more vulnerable to shocks given their relatively higher exposure to the domestic economy in their loan book. Simulations suggest that the banking system would be resilient to a significant decrease in GDP growth following a slowdown Europe, with regulatory capital adequacy ratios remaining above 8 percent. Staff cautioned that there might be a residual risk to the banking system from the activities of the GBCs, which are significant. The direct link to the banking system through the deposit of the float of GBC activities appears to be low risk with maturities and currencies well matched. The domestic activities of GBCs are quite limited and their international investments appear mostly equity like with little risk of contagion. However, the availability of data on the other activities of GBCs could be improved in the future to provide greater transparency.

40. Authorities welcomed the stress testing exercise and pointed to possible areas for further refinement. They emphasized the complementarities between the analysis undertaken by Fund staff and exercises that are regularly performed by the BOM in the context of the semi-annual financial stability report, which focuses mostly on credit risk. Authorities also believe that it would be desirable to extend stress testing to the insurance and corporate sectors given the interconnectedness of banks, non-bank financial institutions and large private sector firms. These extensions will require considerable data collection efforts. They plan to improve the data availability for non-bank financial institutions, where the BOM cooperates with the Financial Services Commission (FSC).

41. Supervisory coordination between the BOM and the FSC should be enhanced further to ensure that there are neither supervisory loopholes nor supervisory overlaps. The decision on a possible merger of the two agencies needs further study to weigh potential benefits of supervisory unification against potential costs, particularly regarding integration, specialization, and institutional cultures. IMF technical assistance might be useful in this area. Loopholes have been identified with regard to AML/CFT supervision of non-financial businesses and professions, some of them essential to GBCs' operations. Due to the importance of GBCs' activities for the financial sector, this creates a risk, which is currently being addressed by the authorities with IMF technical assistance support

42. An important outstanding recommendation from the 2007 FSAP is the creation of a deposit insurance scheme (DIS). The BOM has already advanced in its preparations for the adoption of a DIS and Mauritius is now a member of the Committee of Deposit Insurance Schemes. Some important decisions still need to be made, including whether the DIS is intended to foster financial sector stability or to primarily protect small depositors. Fund technical assistance could be helpful in this respect.

D. Structural Reforms and Statistical Issues

43. Mauritius has a strong record of implementing structural reforms, but more can be done. The country has been consistently ranked as the top performer in terms of governance in sub-Saharan African. Nevertheless, Mauritius' overall country ranking in the Doing Business indicators fell from 21st in 2011 to 23rd in 2012, a sign that it needs to continue to implement its reform strategy. Further improving the business environment and the facilitation of permits should help attract FDI and increase growth prospects. Insufficient skills, particularly for the less educated workers, are an important impediment to improvements in competitiveness. Reform of the basic educational system is required to address the unequal distribution of educational outcomes. Also, mechanisms need to be put in place to support the access of poorer segments of the population to tertiary education.

44. Important infrastructure bottlenecks should be addressed. Inefficiencies in water provision impose high costs on society and reflect years of mismanagement. The government's efforts to work with Singapore to develop a water strategy are welcome. The strategy might usefully be reviewed by the World Bank, and should be implemented swiftly. There is an urgent need to increase water tariffs to full cost-recovery level including the cost of maintaining and expanding the distribution system. The reliability of the electricity supply may soon become an issue without further investment. Road congestion imposes costs on society and reduces the attractiveness of Mauritius as a place for investment. Although the capacity of the transportation system needs improvement, road congestion will continue, unless motorists are charged for their impact on adding to congestion.

45. Staff recommended reallocating spending and leveraging private sector involvement given the limited available fiscal space for additional public investment. Reduced transfers to SOEs and better targeting of social protection expenses could create substantial resources for additional investments. In addition, public-private-partnerships (PPPs) could generate further financial resources for infrastructure

projects with positive impact on growth, provided that they are well managed. The authorities agreed on the usefulness of PPPs and intend to strengthen their implementation capacity in this respect. They stressed that the reallocating of spending would be a medium-term endeavor.

46. Authorities continue to pursue their efforts to strengthen Mauritius' statistical capacity. The statistical framework has been reinforced to adhere to the Special Data Dissemination Standard (SDDS), and Mauritius subscribed to the SDDS in February 2012. The 2010 balance of payments statistics have been updated with results from the second survey of resident Global Business Companies (GBC1s), but important statistical and aggregation issues remain to be solved in subsequent rounds. The next survey may be extended to cover non-resident GBC2s.

STAFF APPRAISAL

47. The outlook for 2012 is broadly positive, but downside risks have increased. At around 3¾ percent, growth is expected to slow somewhat compared to 2011. Inflation is expected to be around 5 percent, similar to the level observed in 2011. However, as a small open economy, Mauritius is vulnerable to the external environment.

48. Staff recommended a somewhat less expansionary fiscal stance than projected by staff for 2012 to build policy buffers and accelerate debt reduction in the medium term. In the absence of further external shocks, staff projections point to a negligible output gap; consequently there is no need for expansionary fiscal policies for countercyclical reasons. Staff considers that both total public debt and external debt are on sustainable trajectories provided that the planned fiscal consolidation takes place over the medium-term. In addition, some further fiscal efforts should be undertaken to further reduce debt vulnerabilities and to ensure that legally-mandated debt targets are met comfortably.

49. Should economic growth slow significantly due to global developments, it would be appropriate to let automatic stabilizers work. The policy response would also include the instruments developed in response to the 2008/09 financial crisis and enhanced in the 2012 budget, which help firms restructure and workers find new employment. Strengthening the social safety net through better targeting would also be desirable. The contingency plans developed by the authorities for such eventualities are welcome.

50. The monetary policy stance is broadly appropriate and the financial sector appears sound. The current repo rate is slightly positive in real terms, which seems adequate given the weak external environment and limited domestic demand pressures. Staff believes that the BOM should continue to

pursue its efforts to remove excess liquidity in the banking system even if it has a negative impact on the central bank's profitability. The adoption of a formal inflation target could help to anchor inflationary expectations. Stress-tests indicate that the Mauritian banking system is well-capitalized and resilient against several types of shocks.

51. The floating exchange rate regime continues to serve the country well, particularly by allowing the exchange rate to be a shock absorber. In this context, exchange rate interventions should be used primarily to limit volatility. Staff estimates that the real exchange rate is broadly in line with medium-term fundamentals, but there is a need to reduce external imbalances over time. Further fiscal consolidation based on savings from the public enterprise and social protection sectors, and combined with structural reforms to enhance competitiveness should contribute towards external adjustment over the medium-term.

52. SOEs needs better pricing and governance policies. SOEs consume considerable fiscal resources that would be better used to build human and physical infrastructure. Full-cost recovery pricing and better service delivery standards should apply to all SOEs. This would help reduce bottlenecks to growth and improve the investment climate. Better SOE governance would also help improve performance.

53. Reform of the social protection system could contribute to secure more inclusive growth. Mauritius was able to achieve relatively high growth rates without large adverse consequences for inequality over the last two decades, but recent data point to a more uneven distribution of the benefits of growth. Following an extensive reform in the mid-2000s, the tax system appears to be moderately progressive and relatively efficient. Better targeting of the relatively large social protection expenses as well as a revision of subsidies to certain products could yield positive results both for income distribution and fiscal consolidation.

54. Staff recommends that the next Article IV consultation be held on the standard 12-month cycle.

Table 1. Mauritius: Selected Economic and Financial Indicators, 2009–2017

	2009	2010	2011		2012		2013	2014	2015	2016	2017
		Prel.	Last SR	Est.	Last SR	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
	(Annual percent change, unless otherwise indicated)										
National income, prices and employment											
Real GDP	3.0	4.1	4.1	4.1	4.2	3.7	4.1	4.2	4.2	4.2	4.2
Real GDP per capita	2.5	3.7	3.5	3.5	3.6	3.1	3.5	3.6	3.6	3.7	3.7
GDP per capita (in U.S. dollars)	6,919	7,582	7,990	8,385	8,471	8,403	8,789	9,158	9,649	10,184	10,807
GDP deflator	-0.2	1.8	5.0	4.3	4.4	3.9	5.9	4.4	4.4	4.4	4.4
Consumer prices (period average)	2.5	2.9	7.4	6.5	4.6	4.8	5.3	4.9	4.4	4.4	4.4
Consumer prices (end of period)	1.5	6.1	5.8	4.9	4.4	5.0	5.5	4.4	4.4	4.4	4.4
Unemployment rate (percent)	7.3	7.8	…	7.8	…	…	…	…	…	…	…
External sector											
Exports of goods and services, f.o.b.	-15.6	18.9	12.5	15.5	6.6	3.0	6.1	6.0	6.2	6.5	6.7
Of which: tourism receipts	-23.5	15.9	10.4	13.5	11.2	2.9	10.3	9.2	9.0	9.1	9.1
Imports of goods and services, f.o.b.	-19.3	20.5	18.8	17.1	4.2	3.0	4.3	3.7	4.1	4.5	5.0
Nominal effective exchange rate (annual averages)	-5.8	3.2	...	3.1	...	...	...	...	...	...	...
Real effective exchange rate (annual averages)	-4.6	3.2	...	5.7	...	...	...	...	...	...	...
Terms of trade	7.8	-5.5	...	-4.9	...	...	...	...	...	...	...
	(Annual change in percent of beginning of period M2)										
Money and credit											
Net foreign assets	17.4	20.2	10.3	-7.7	...	16.9	...	...	...	...	...
Domestic credit	1.8	10.3	16.1	8.6	...	10.0	...	...	...	...	...
Net claims on government	1.1	1.0	2.5	-1.4	...	1.5	...	...	...	...	...
Credit to private sector[1]	0.4	10.1	13.6	10.7	...	8.2	...	...	...	...	...
Broad money (end of period, annual percentage change)	8.1	7.6	9.3	4.6	...	12.3	...	...	...	...	...
Income velocity of broad money	1.0	0.9	0.9	1.0	...	0.9	...	...	...	...	...
Interest rate (weighted average TBs, primary auctions)	4.4	3.9	...	4.6	...	...	...	...	...	...	...
	(Percent of GDP, unless otherwise indicated)										
Central government finances											
Overall consolidated balance (including grants)[2]	-2.0	-3.0	-4.8	-2.4	-4.5	-3.7	-3.2	-2.7	-2.7	-2.2	-1.8
Primary balance (including grants)[2]	1.8	0.4	-1.3	0.6	-1.0	-0.5	-0.6	-0.1	-0.2	0.3	0.6
Revenues and grants	22.8	21.9	21.5	21.2	21.0	21.8	20.9	21.1	21.2	21.2	21.3
Expenditure, excl. net lending	24.8	24.9	26.2	23.7	25.5	25.5	24.1	23.8	23.9	23.3	23.1
Domestic debt of central government	44.7	43.1	42.5	41.2	41.6	40.5	38.1	36.8	37.0	37.0	34.0
External debt of central government	6.0	7.4	8.9	8.5	10.5	10.0	11.6	12.9	12.7	12.2	11.2
Investment and saving											
Gross domestic investment	26.4	24.9	26.2	24.4	26.6	24.8	25.3	25.7	26.1	26.6	27.0
Public	6.6	6.1	7.6	6.4	7.7	7.4	7.7	7.8	8.3	8.2	7.6
Private	19.8	18.8	18.6	18.0	18.9	17.5	17.5	17.9	17.9	18.3	19.4
Gross national savings	13.8	15.6	14.2	14.7	15.7	14.8	16.4	18.1	19.8	21.4	23.0
Public	-0.8	-0.5	-0.7	-0.7	-0.5	0.2	0.5	1.1	1.3	1.4	1.5
Private	14.6	16.1	14.9	15.5	16.2	14.7	15.8	17.1	18.5	20.1	21.5
External sector											
Balance of goods and services	-10.5	-12.1	-15.7	-13.5	-13.5	-13.8	-12.7	-11.4	-10.1	-8.9	-7.9
Exports of goods and services, f.o.b.	47.1	50.9	52.9	52.8	53.6	53.9	54.4	55.0	55.1	55.3	55.4
Imports of goods and services, f.o.b.	-57.6	-63.0	-68.6	-66.3	-67.1	-67.7	-67.2	-66.4	-65.2	-64.3	-63.2
Current account balance	-7.4	-8.2	-11.8	-9.9	-9.9	-10.2	-9.1	-7.8	-6.6	-5.4	-4.3
Overall balance	4.3	2.1	-0.9	1.3	0.1	-2.4	0.2	0.5	0.8	0.6	1.0
Total external debt[3]	12.7	14.4	13.5	15.0	15.2	16.1	17.7	18.4	16.5	14.8	14.6
Net international reserves (millions of U.S. dollars)	2,150	2,448	2,253	2,636	2,265	2,420	2,512	2,660	2,852	3,035	3,289
Months of imports of goods and services, f.o.b.	5.1	4.8	3.8	4.4	3.7	3.9	3.9	4.0	4.1	4.2	4.3
Memorandum items:											
GDP at current market prices (billions of Mauritian rupees)	282.0	299.1	327.4	324.8	356.6	350.0	385.9	419.6	456.3	496.5	540.2
GDP at current market prices (millions of U.S. dollars)	8,824	9,714	10,299	10,809	…	...	...	...	...	...	...
Public sector debt (percent of GDP)	59.6	57.3	58.8	56.1	59.7	57.0	55.7	54.8	55.5	54.2	49.8
Foreign currency long-term debt rating (Moody's)	Baa2	Baa2	…	Baa2	…	…	…	…	…	…	…

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

[1] Excludes credit to state-owned enterprises.

[2] *GFSM 2001* concept of net lending/net borrowing, includes special and other extrabudgetary funds.

[3] Reported debt only, excluding private sector short-term debt.

Table 2. Mauritius: Summary of Central Government Finances, 2009–2014 [1]
(Percent of GDP; unless otherwise indicated)

	2009	2010	2011		2012			2013	2014
	Actual	Actual	Last SR	Est.	Last SR	Budget	Proj.	Proj.	Proj.
Total revenue and grants (1)	22.8	21.9	21.5	21.2	21.0	21.5	21.8	20.9	21.1
Domestic revenue	21.2	21.2	20.6	20.6	20.0	20.5	20.8	20.2	20.2
Tax revenue	19.1	18.5	18.2	18.2	16.5	18.1	18.3	18.1	18.0
Income tax - Individuals	1.5	1.5	1.5	1.5	1.5	1.6	1.6	1.6	1.6
Income tax - Corporations	3.7	2.8	2.5	2.6	2.5	2.5	2.5	2.5	2.5
Value added tax (VAT)	6.9	7.1	7.0	7.0	6.9	6.9	7.0	7.0	7.0
Excise duties, incl. "Maurice Ile Durable" levy	3.1	3.1	3.3	3.5	3.2	3.5	3.6	3.3	3.1
Customs	0.6	0.5	0.5	0.5	0.4	0.4	0.4	0.4	0.4
Other taxes	3.3	3.5	3.5	3.1	2.0	3.2	3.2	3.3	3.4
Social contributions	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Nontax revenue	1.8	2.4	2.0	2.0	1.5	2.1	2.2	1.8	2.0
Grants	1.6	0.7	0.9	0.7	1.1	1.0	1.0	0.6	0.9
Total expense (current spending) (2)	23.6	22.4	22.2	22.0	21.6	21.3	21.6	20.4	20.1
Expense on goods and services	8.8	9.0	9.4	8.2	8.6	8.6	9.0	8.9	8.9
Compensation of employees	6.0	5.9	5.9	5.6	5.6	5.5	5.7	5.9	5.9
Use of goods and services	2.8	3.1	3.5	2.6	3.0	3.0	3.3	3.0	3.1
Interest payments	3.8	3.4	3.4	3.1	3.6	3.2	3.3	2.7	2.6
Domestic interest	3.6	3.3	…	2.9	…	3.0	3.0	2.4	2.3
External interest	0.1	0.1	…	0.2	…	0.2	0.2	0.2	0.3
Transfers and subsidies	6.6	5.5	4.4	6.3	4.6	4.7	4.8	4.2	4.0
Subsidies	0.3	0.3	0.4	0.4	0.3	0.4	0.4	0.3	0.3
Grants and transfers	6.3	5.2	4.0	5.9	4.3	4.4	4.5	3.9	3.7
Social benefits	4.5	4.5	4.4	4.4	4.3	4.4	4.5	4.5	4.6
Contingencies	0.0	0.0	0.5	0.0	0.5	0.4	0.0	0.0	0.0
Gross operating balance ((3)=(1)-(2))	-0.8	-0.5	-0.7	-0.7	-0.5	0.2	0.2	0.5	1.1
Net acquisition of non-financial assets (capital spending)	2.7	2.7	3.5	2.6	2.7	4.0	3.0	3.1	3.2
Net lending / borrowing (central governm. budget balance) [2]	-3.6	-3.2	-4.2	-3.4	-4.1	-3.8	-2.8	-2.6	-2.1
Net lending / borrowing (special funds) [3]	1.6	0.2	-0.6	0.9	-0.4	-1.5	-0.9	-0.7	-0.6
Inflows to special funds (contribution from government)	2.0	1.0	…	2.0	…	0.5	0.5	0.1	0.0
Outflows from special funds (expense)	-0.4	-0.9	…	-1.1	…	-2.0	-1.4	-0.7	-0.6
Net lending / borrowing (consolidated balance)	-2.0	-3.0	-4.8	-2.4	-4.5	-5.3	-3.7	-3.2	-2.7
Transactions in financial assets/liabilities	0.3	-0.1	1.0	0.8	0.8	0.6	0.6	0.6	1.4
Net acquisition of financial assets	0.3	0.0	1.2	0.9	1.0	0.8	0.8	0.8	1.7
Of which: net lending	0.0	0.0	1.2	0.7	1.0	0.9	0.9	0.9	1.6
Adjustment for difference in cash and accrual (net)	0.0	-0.2	-0.2	-0.1	-0.2	-0.2	-0.2	-0.2	-0.3
Borrowing requirements (financing)	3.7	2.9	5.8	3.2	5.3	5.9	4.3	3.9	4.1
Domestic	3.0	1.0	3.7	1.6	3.0	3.8	2.2	1.3	1.8
Banks	1.0	1.0	…	-0.5	…	2.5	1.5	0.7	0.9
Nonbanks	2.0	0.1	…	2.1	…	1.3	0.8	0.7	0.9
Foreign	1.8	1.9	2.1	1.7	2.3	2.0	2.1	2.5	2.2
Disbursements	2.1	2.1	2.4	1.9	2.6	2.3	2.3	2.8	2.8
Amortization	-0.3	-0.3	-0.3	-0.2	-0.3	-0.3	-0.3	-0.3	-0.5
Memorandum items:									
Government debt	50.7	50.5	51.4	49.8	52.1	…	50.5	49.7	49.8
Public sector debt	59.6	57.3	58.8	56.1	59.7	…	57.0	55.7	54.8
GDP at current market prices (in billions of rupees)	282.0	299.1	327.4	324.8	356.6	357.7	350.0	385.9	419.6
Expenditure, including special funds outflows	26.8	26.0	…	25.7	…	27.3	26.0	24.2	23.8
Primary balance (incl. grants; excl. net lending) [3]	1.8	0.4	-1.3	0.6	-1.0	-2.1	-0.5	-0.6	-0.1
Primary balance (excl. grants; excl. net lending) [3]	0.2	-0.3	-2.2	-0.1	-2.0	-3.1	-1.5	-1.2	-1.0
Structural primary balance (excl. grants)	0.2	-0.3	-2.2	-0.1	-1.9	…	-1.4	-1.2	-1.0

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

[1] *GFSM 2001* presentation.

[2] Corresponds to the authorities' budget presentation.

[3] Includes the following special and other extra-budgetary funds: Maurice Ile Durable Fund; Human Resource, Knowledge and Arts Development Fund; Food Security Fund; Local Infrastructure Fund; and Social Housing Development Fund; National Resillience Fund (named Business Growth Fund prior to 2012); and Road Decongestion Program Fund.

Table 3. Mauritius: Central Government Integrated Balance Sheet
(Percent of GDP)

	2009	2010		
	Closing/ opening balance	Transactions	Other economic flows	Closing balance
Net worth	104.2	-0.3	-13.0	90.8
Nonfinancial assets	161.7	2.7	-10.8	153.7
Of which: fixed assets	42.5	2.6	-4.0	41.1
Of which: land	118.8	0.0	-6.7	112.1
Net financial worth	-57.5	-3.0	-2.2	-62.8
Financial assets	13.0	-0.8	-1.1	11.2
Currency and deposits	1.7	-0.6	0.0	1.0
Equity and investment fund shares	6.7	0.0	-0.9	5.8
Loans (includes loans to parastatals)	2.3	0.0	-0.1	2.2
Other accounts receivable (arrears of revenue)	2.4	-0.2	0.0	2.2
Liabilities	70.5	2.3	1.2	74.0
Domestic				
Currency and deposits [1]	3.1	-0.6	0.0	2.4
Securities and loans [2]	45.9	1.0	-2.7	44.3
Insurance, pensions, and standardized guarantee schemes	15.4	0.0	4.3	19.7
Foreign				
Securities and loans [2]	6.2	1.9	-0.4	7.6
Memorandum items:				
GDP at current market prices (billions of rupees)	282.0	299.1		
Liabilities/assets ratio	0.4			0.4
Liabilities/financial assets ratio	5.4			6.6

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

[1] Includes special funds.

[2] Includes interest payable on debt.

Table 4. Mauritius: Balance of Payments, 2008−2014

	2008	2009	2010	2011		2012		2013	2014
			Prel.	Last SR	Est.	Last SR	Proj.	Proj.	Proj.
	(Millions of U.S. dollars, unless otherwise indicated)								
Current account balance	-971	-654	-793	-1,191	-1,071	-1,058	-1,113	-1,044	-938
Trade balance	-1,989	-1,550	-1,894	-2,459	-2,419	-2,503	-2,494	-2,585	-2,631
Exports of goods, f.o.b.	2,389	1,929	2,259	2,459	2,612	2,621	2,664	2,782	2,906
Imports of goods, f.o.b.	-4,378	-3,479	-4,154	-4,918	-5,032	-5,124	-5,158	-5,367	-5,537
Services (net)	621	627	714	847	963	1,022	994	1,124	1,258
Of which: tourism	997	763	884	937	1,004	1,076	1,033	1,139	1,244
Income (net)	172	53	205	316	209	336	207	235	254
Current transfers (net)	225	216	183	106	177	87	180	182	181
Capital and financial accounts	903	752	841	1,103	1,177	1,069	849	1,063	996
Capital account	-1	-2	-5	-6	-5	-6	-5	-6	-6
Financial account	905	754	845	1,108	1,182	1,075	855	1,068	1002
Direct investment (net)	331	220	301	373	235	399	237	327	369
Abroad	-52	-37	-129	-130	-85	-134	-51	-77	-115
In Mauritius	383	257	430	503	320	534	288	403	484
Portfolio investment (net)	-171	-57	-186	-63	135	-77	-10	0	-33
Other investment (net)	745	591	730	798	812	752	628	741	665
Of which: SDR allocation	…	127	…	…	…	…	…	…	…
Of which: government (net)	49	155	177	215	171	256	187	291	269
Errors and omissions	231	281	152	0	30	0	0	0	0
Overall balance	163	379	201	-88	137	11	-264	19	58
Change in official reserves (- = increase)	-163	-379	-201	88	-137	-11	264	-19	-58
	(Percent of GDP, unless otherwise indicated)								
Memorandum items:									
Balance of goods and services	-14.2	-10.5	-12.1	-15.7	-13.5	-13.5	-13.8	-12.7	-11.4
Exports of goods and services, f.o.b.	51.1	47.1	50.9	52.9	52.8	53.6	53.9	54.4	55.0
Imports of goods and services, f.o.b.	-65.3	-57.6	-63.0	-68.6	-66.3	-67.1	-67.7	-67.2	-66.4
Foreign direct investment	3.4	2.5	3.1	5.0	2.2	5.0	2.2	2.8	3.1
Current account balance	-10.1	-7.4	-8.2	-11.8	-9.9	-9.9	-10.2	-9.1	-7.8
Overall balance	1.7	4.3	2.1	-0.9	1.3	0.1	-2.4	0.2	0.5
Errors and omissions	2.4	3.2	1.6	0.0	0.3	0.0	0.0	0.0	0.0
Net international reserves, BOM, (mill. of U.S. dollars)	1,760	2,150	2,448	2,253	2,636	2,265	2,420	2,512	2,660
In months of imports of goods and services, f.o.b.	3.4	5.1	4.8	3.8	4.4	3.7	3.9	3.9	4.0
As ratio to external short term debt[1]	5.9	7.7	8.8	32.7	8.5	30.0	8.4	7.5	8.2
Percent of broad money	18.3	23.2	23.6	18.0	23.7	...	20.7	21.7	21.0
Gross reserves, BOM, (mil. of U.S. dollars)	1,785	2,304	2,601	2,407	2,790	2,418	2,573	2,665	2,813
GDP (millions of U.S. dollars)	9,641	8,824	9,714	10,135	10,809	...	10,898	11,468	12,022
Total external debt	13.4	12.7	14.4	13.5	15.0	15.2	16.1	17.7	18.4
Total debt service ratio (% of goods & services exports)	3.5	3.1	4.4	3.2	4.0	2.8	3.8	3.5	4.0
Mauritian rupees per U.S. dollar (period average)	28.5	32.0	30.8	...	30.0	...	...	...	...
Mauritian rupees per U.S. dollar (end of period)	31.8	30.3	30.4	...	29.7	...	...	...	...

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

[1] The 2011 foreign asset and liability survey has resulted in significant upward revisions in the stock of short term debt, thus leading to a sharp reduction in the ratio compared to previous projections.

Table 5. Mauritius: Depository Corporations Survey, 2008–2012

	2008	2009	2010	2011		2012
				Last SR	Est.	Proj.
			(Millions of rupees, end of period)			
Net foreign assets	285,016	332,684	392,515	424,734	367,800	424,200
Net domestic assets	-10,702	-36,204	-73,391	-75,901	-33,895	-49,116
Domestic credit	296,098	301,170	331,747	366,952	359,314	392,585
Claims on government (net)	46,967	49,849	52,735	60,578	48,180	53,293
Monetary authorities	-3,797	-10,289	-4,188	-4,174	-2,085	-2,069
Commercial banks	50,764	60,137	56,923	64,752	50,265	55,362
Claims on local government and SOEs	10,222	11,351	9,136	…	7,075	7,715
Claims on private sector	238,909	239,971	269,875	…	304,059	331,576
Other financial liabilities [1]	-207,939	-237,986	-296,803	-324,433	-279,049	-313,463
Other items (net)	-98,861	-99,388	-108,335	-118,420	-114,160	-128,238
Broad money (M2)	274,314	296,480	319,124	348,832	333,905	375,084
Money (M1)	75,820	88,151	91,119	103,555	96,683	108,667
Quasi-money	198,494	208,329	228,005	245,277	237,222	266,417
Reserve money	30,641	35,934	46,914	60,286	51,370	65,993
			(Annual change, millions of rupees)			
Net foreign assets	19,414	47,668	59,831	32,715	-24,715	56,400
Domestic credit	53,908	5,072	30,577	51,359	27,567	33,271
Claims on government	1,443	2,882	2,887	7,843	-4,555	5,113
Claims on local government and SOEs	2,946	1,128	-2,214	43,516	-2,061	640
Claims on private sector	49,519	1,062	29,904	43,516	34,183	27,518
Broad money (M2)	34,995	22,167	22,644	29,708	14,781	41,179
Money (M1)	11,390	12,332	2,968	12,436	5,564	11,984
Quasi money	23,605	9,835	19,676	17,272	9,217	29,195
Reserve money	2,561	5,293	10,980	13,373	4,457	14,623
			(Annual percent change)			
Net foreign assets	7.3	16.7	18.0	…	-6.3	15.3
Domestic credit	22.3	1.7	10.2	16.3	8.3	9.3
Claims on government	3.2	6.1	5.8	14.9	-8.6	10.6
Claims on local government and SOEs	40.5	11.0	-19.5	16.6	-22.6	9.1
Claims on private sector	26.1	0.4	12.5	16.6	12.7	9.1
Broad money (M2)	14.6	8.1	7.6	9.3	4.6	12.3
Money (M1)	17.7	16.3	3.4	13.6	6.1	12.4
Quasi-money	13.5	5.0	9.4	7.6	4.0	12.3
Reserve money	9.1	17.3	30.6	28.5	9.5	28.5
			(Percentage change of beginning of year of broad money)			
Net foreign assets	8.1	17.4	20.2	10.3	-7.7	16.9
Domestic credit	22.5	1.8	10.3	16.1	8.6	10.0
Claims on government (net)	0.6	1.1	1.0	2.5	-1.4	1.5
Claims on local government and SOEs	1.2	0.4	-0.7	13.6	-0.6	0.2
Claims on private sector	20.7	0.4	10.1	13.6	10.7	8.2
Memorandum Items:						
Domestic credit (in percent of GDP)	107.9	106.8	110.9	112.1	110.6	112.2
Claims on private sector (in percent of GDP)	84.8	82.8	87.9	93.6	93.6	94.7
Money multiplier	9.0	8.3	6.8	5.8	6.5	5.7
Velocity	1.0	1.0	0.9	0.9	1.0	0.9

Sources: Bank of Mauritius; and IMF staff estimates. SOEs is the acronym for State-Owned Enterprises.

[1] The major component of other financial liabilities consists of restricted deposits, which largely include deposits of the offshore nonfinancial corporations (so-called Global Business Companies, GBCs). GBCs are resident corporations licensed to conduct business exclusively with nonresidents and only in foreign currencies.

Table 6. Mauritius: Financial Soundness Indicators for the Banking Sector, December 2006–June 2011
(End of period, in percent, unless otherwise indicated)

	2006	2007	2008	2009	2010 Sep.	2010 Dec.	2011 Mar.	2011 Jun.
Capital adequacy								
Regulatory capital to risk-weighted assets [1]	15.8	13.3	15.3	15.4	15.9	15.8	17.2	16.3
Regulatory Tier I capital to risk-weighted assets	13.7	11.5	13.7	13.3	13.6	13.6	15.0	14.1
Total (regulatory) capital to total assets	7.3	6.0	7.3	7.7	7.0	7.3	7.5	7.3
Asset composition and quality								
Share of loans (exposures) per risk-weight (RW) category								
RW = 0%	12.8	9.1	9.0	20.6	18.6	21.6	16.4	17.2
RW = 20%	1.3	3.9	3.3	24.9	23.8	19.5	21.6	21.7
RW = 35%	…	…	…	3.2	3.1	3.0	3.3	3.2
RW = 50%	6.0	5.7	5.2	8.4	8.1	8.8	11.2	10.7
RW = 75%	…	…	…	3.7	3.6	3.6	3.6	3.7
RW = 100%	79.8	81.1	82.3	38.3	41.8	42.5	42.8	42.3
RW = 150%	…	…	…	0.9	1.0	1.0	1.1	1.2
Total exposures/total assets	40.1	44.8	54.9	45.9	45.5	46.7	49.7	49.1
Sectoral distribution of loans to total loans								
Agriculture	5.7	6.0	6.1	6.3	6.6	6.3	6.0	5.8
of which: sugar	*5.0*	*4.8*	*5.0*	*5.2*	*5.7*	*5.5*	*5.2*	*4.9*
Manufacturing	11.2	10.2	9.4	8.7	7.5	7.8	7.4	7.6
of which: EPZ	4.8	4.7	4.0	3.2	2.6	2.6	2.3	2.4
Traders	14.9	13.5	11.7	10.1	10.7	10.5	10.5	10.6
Personal and professional	9.5	9.7	8.6	9.0	9.0	8.8	9.0	8.9
Construction	15.4	16.4	18.7	19.7	20.3	20.2	20.8	20.9
of which: housing	*12.0*	10.9	12.4	11.6	12.1	*14.3*	*14.6*	*14.5*
Tourism/hotels	13.2	13.6	15.4	*16.2*	*17.4*	17.6	17.4	17.7
Other	30.1	30.6	45.6	30.0	28.5	28.8	28.9	28.5
Foreign currency loans to total loans	50.7	56.3	65.5	59.1	61.0	61.5	60.6	61.6
NPLs to gross loans - excluding accrued/unpaid interest	3.0	2.5	2.0	3.3	2.5	2.8	2.8	2.6
NPLs net of provisions to capital	7.0	9.1	8.2	13.4	8.6	9.1	8.2	9.6
Large exposures to capital [2]	380.0	493.2	394.2	216.9	217.0	222.5	197.4	228.2
Earnings and Profitability								
ROA (Pre-tax net income/average assets)	1.7	1.9	1.7	1.6	1.2	1.4	1.4	1.6
ROE (Pre-tax net income/average equity)	22.4	26.4	24.3	21.0	16.7	20.0	19.3	21.5
Interest margin to gross income	31.2	27.6	29.7	68.9	70.5	67.1	70.0	65.4
Noninterest expenses to gross income	16.4	15	17.2	39.2	43.0	38.9	39.3	36.7
Liquidity								
Liquid assets to total assets [3]	52.8	47.7	27.7	27.9	23.6	23.4	19.8	21.2
Liquid assets to total short-term liabilities [3]	118.8	104.2	31.9	34.4	31.2	31.9	28.1	29.9
Demand deposits/total liabilities	15.4	18.4	19.4	23.9	27.4	25.6	26.9	25.3
FX deposits to total deposits	68.0	67.6	66.0	64.1	64.3	64.0	62.2	65.1
Sensitivity to market risk								
Net open positions in FX to capital [3]	6.4	3.2	3.8	5.3	4.6	7.0	2.6	2.0

Source: Mauritian authorities.

[1] Total of Tier I and Tier 2 less investments in subsidiaries and associates.

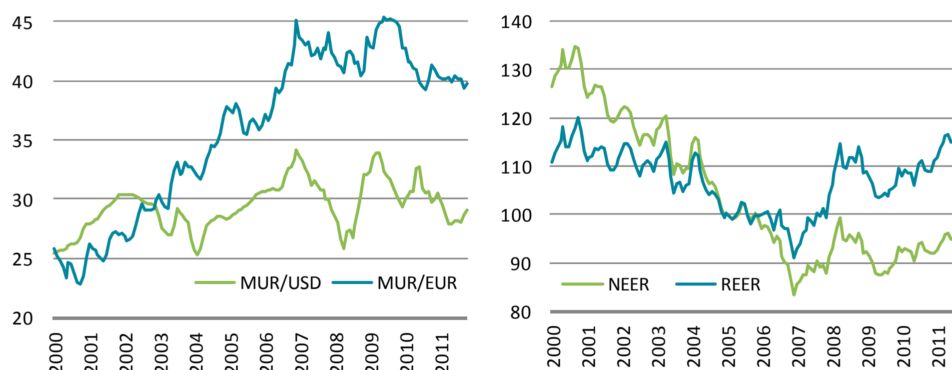
[2] Large exposures refer to one or more credit exposures to the same individual or group that exceed 15 per cent of a bank's capital base. The current aggregate large exposures ratio is well below the prudential limit of 800 per cent as set in the Bank of Mauritius *Guideline on Credit Concentration Risk* from December 2011.

[3] Ratio has been revised according to the FSI manual from 2008.

APPENDIX I. EXCHANGE RATE AND EXTERNAL BALANCE ASSESSMENT

The real value of the Mauritian rupee has followed a U-shaped path over the last decade. The currency depreciated some 25 percent from peak (2001) to trough (end-2006). During the 2008/09 crisis, the depreciation of the Euro and the British Pound pushed up the rupee's real value. With the relatively quick rebound from the world economic crisis, FDI and other investment flows returned to pre-crisis levels in 2010–11, which translated into a slight real appreciation over that period.

Figure I.1. Mauritius: Bilateral and Effective Exchange Rates, 2000–11

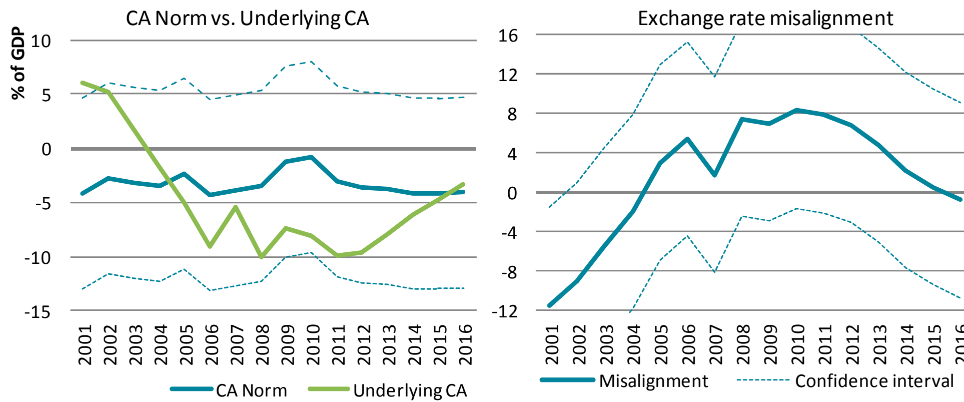


The rupee was broadly in line with fundamentals. The empirical strategy follows Vitek's "Exchange Rate Assessment Toolkit" (2012), based on the application of three CGER approaches: macroeconomic balance (MB), external sustainability (ES) and equilibrium real exchange rate (ERER). All approaches point to a small overvaluation at end-2011, but the estimates taken together are still statistically indistinguishable from a zero misalignment and the misalignment declines over time.

The macroeconomic balance (MB) approach is a two-stage method. First, the equilibrium "current account norm" (CA norm) is estimated based on a Generalized Method of Moments (GMM) regression using a dataset covering 184 economies and spanning 1973–2010. The CA norm is compared to the "underlying CA", which adjusts current account projections for one-off operations and real exchange movements. Second, using the country-specific elasticity of the current account with respect to the real exchange rate (0.88 estimated in IMF WP/08/212), the misalignment is computed as the real exchange rate adjustment required to close the external gap.

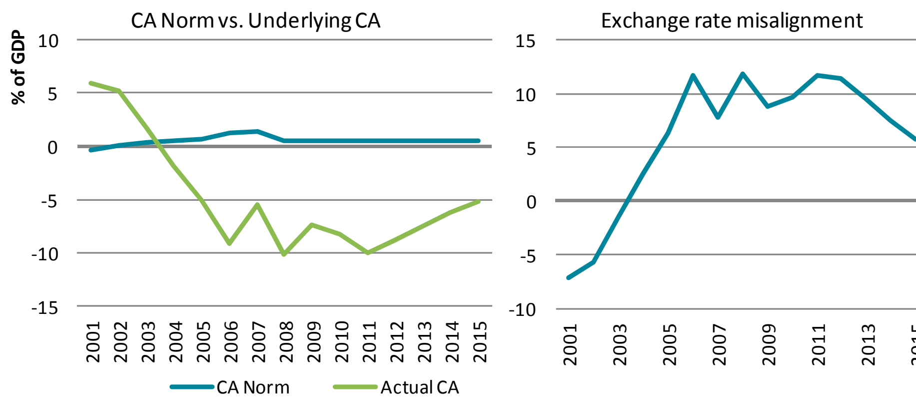
The MB approach shows that the underlying current account deficit has been greater than its equilibrium level since 2005 (Figure I.2). In 2011, the implied overvaluation decreased slightly from 2010 to below 8 percent. Zero deviation is within the 95 percent confidence interval, and thus the MB approach does not provide strong evidence of overvaluation in 2011. The balance of payments projections imply that the overvaluation is expected to continue shrinking in the medium term.

Figure I.2. MB Approach: Norm vs. Underlying Current Account and Implied Real Effective Exchange Rate Misalignment



The external sustainability (ES) approach also estimates the misalignment as the adjustment required to close the external gap. However, unlike the MB approach, ES defines the CA norm as the current account balance that would keep Mauritius' net foreign assets constant as a share of GDP. Despite differences in methodology, results for the ES approach (Figure I.3) are similar to those derived from the MB approach: the exchange rate was overvalued by some 12 percent in 2011, but the misalignment is projected to diminish over the medium term.

Figure I.3. ES Approach: Norm vs. Underlying Current Account and Implied Real Effective Exchange Rate Misalignment



The ES approach misalignment estimates should be interpreted cautiously. As discussed in IMF WP/08/212 and WP/10/148, the liability side of Global Business Corporations' (GBCs) activities is likely underestimated in external statistics, which biases upwards the NFA estimate for Mauritius.[1] This results in overestimating the CA Norm and, consequently, the REER overvaluation. Confidence intervals cannot be estimated using the ES approach because it is based on an accounting identity.

The reduced-form equilibrium real exchange rate (ERER) approach uses fitted values from a panel regression to compute the equilibrium real exchange rate. The difference with the actual REER

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[1] GBCs offer investors tax planning vehicles based on double-taxation treaties between Mauritius and third countries.

constitutes the misalignment. Results, presented in Figure I.4, broadly corroborate those obtained by the other two methods: the overvaluation, currently at 12 percent, is projected to decrease over the medium term. The overvaluation is statistically significant at the 5 percent level in 2011 in the ERER approach.

Figure I.4. Equilibrium Real Effective Rate (ERER) Approach and Implied Misalignment

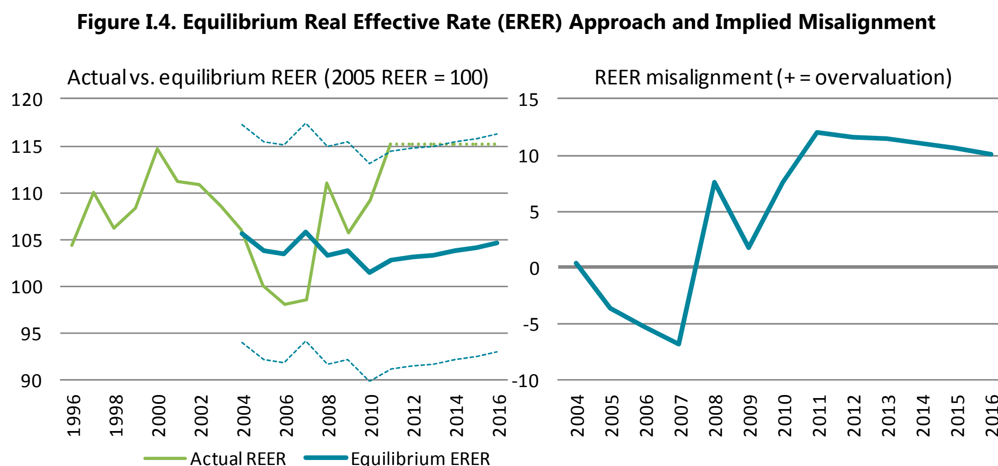
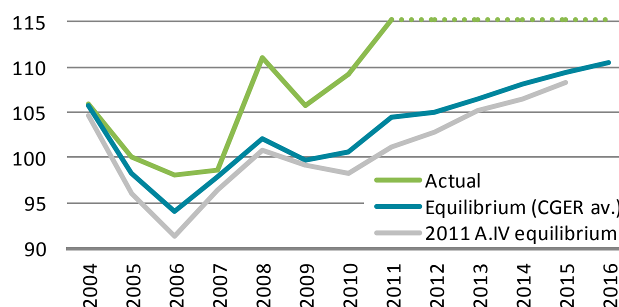


Table I.1 summarizes the current and medium-term exchange rate misalignment computed under the three methodologies, while Figure I.5 compares the average equilibrium real exchange rate computed under the three methodologies with the REER forecasted under the random walk hypothesis. The results from the current analysis are essentially unchanged from last year's Article IV consultation.

Table I.1. Real Effective Exchange Rate Misalignment Results

	2010 (2011 A.IV)	2010 (revised)	2011	2016
MB	12.3	8.3	7.8	-0.8
EREER	8.3	7.6	12.3	10.5
ES	12.4	9.7	11.7	4.4
Average	11.0	8.5	10.6	4.7

Figure I.5. Equilibrium Exchange Rate: Average for Three CGER Methodologies



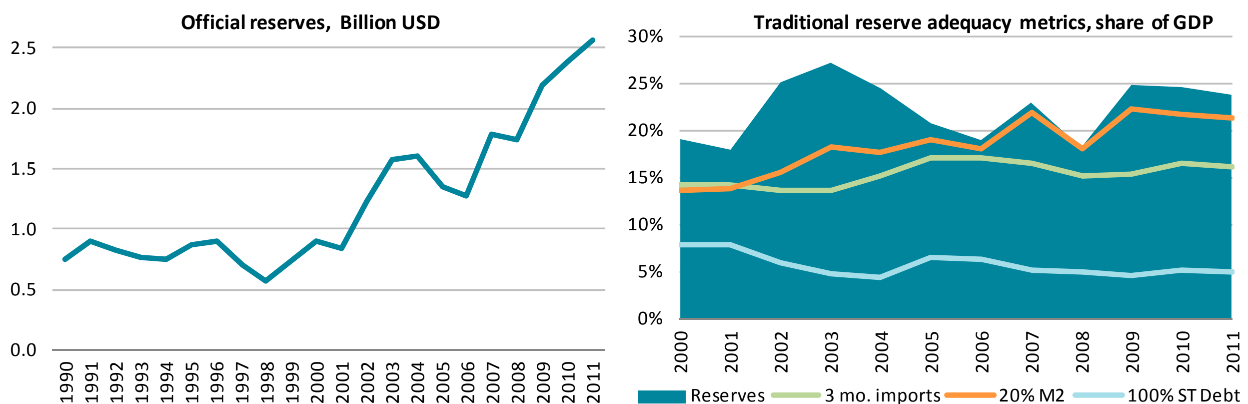
The analysis does not provide support for active exchange rate management. There might be some scope to resist further appreciation that does not reflect fundamentals, although this might not be fully effective and would carry important sterilization costs. Moreover, the exchange rate is only one of the instruments available to close the external balance gap, and not necessarily the most obvious for a country with a floating exchange rate regime. Sustained fiscal adjustment can also contribute to reduction of external imbalances and reduce overall vulnerabilities (and is required by law). Reforms to increase productivity and reduce trade restrictions appreciate the equilibrium real exchange rate and thus reduce potential overvaluation.

APPENDIX II. RESERVE ADEQUACY ASSESSMENT[1]

Net international reserves held by the Bank of Mauritius appear fully adequate to face the current volatile global environment.

In nominal terms, net international reserves have nearly doubled since 2006, reaching USD 2.5 billion at end-2011 (Figure II.1). This rapid accumulation, plus the fact that at above 4 months of imports, reserves exceeded the 3 months threshold, has prompted policy discussions about the excessiveness of reserves and the merits of committing part of them to a sovereign wealth fund. This appendix analyzes international reserve adequacy for Mauritius using both traditional and new metrics.

Figure II.1. Mauritius: International Reserves in Nominal Terms and Compared to Standard Adequacy Metrics



While reserve accumulation may appear impressive in nominal terms, it has been broadly in line with the growth of the economy, the deepening of its financial sector and increased trade openness (Figure II.1). Over the last 6 years, reserves have been closely tracking another commonly-used benchmark—20 percent of M2, thus just keeping pace with rapid financial deepening. At some 500 percent of short term debt on a remaining maturity basis, reserves appeared particularly comfortable with respect to the Guidotti-Greenspan rule of 100 percent. It should be noted however that available statistics likely underestimate the stock of private short term debt.[2]

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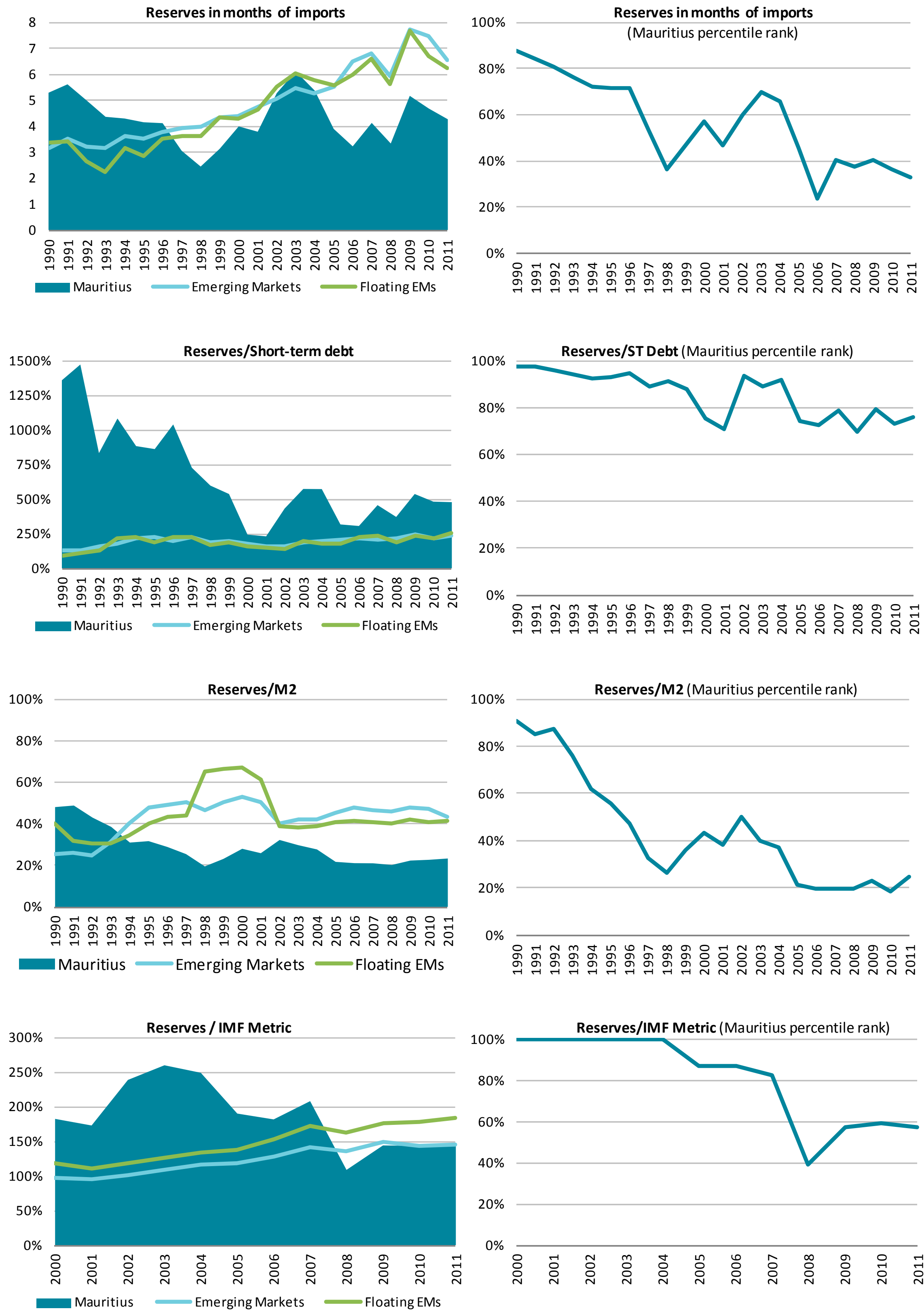
[1] Prepared by Alexander Culiuc.

[2] The 2011 foreign asset and liability survey has already resulted in significant upward revisions in the stock of short term debt. However, future statistical surveys there are likely to uncover more short-term private liabilities.

Figure II.2. Mauritius: International Reserves Against Various Adequacy Metrics, and Compared to 80 Emerging Markets.



Mauritius has been accumulating reserves at a slower pace than comparator countries. As shown in Figure II.2, emerging markets have increased reserve import cover to an average of over 6 months of goods and services. Mauritius' relative drop over time is not driven by outliers. As shown in the right column graphs of Figure II.2, the country's percentile ranking among the 80 emerging markets included in the analysis has been on a decline across all three traditional metrics, albeit from high levels.

Mauritius' reserves are adequate when measured against the new multi-dimensional IMF (2011) metric.[3] A main drawback of traditional metrics is that each of them only measures the country's exposure to one type of risk: current account shocks (import cover); sudden stops (short-term debt cover); and capital flight (M2 cover). Moreover, the actual thresholds (e.g. 3 months of imports) are relatively arbitrary rules of thumb. The study of external market pressure episodes conducted as part of IMF's recent research on reserve adequacy shows that these risks often materialize simultaneously. The event study also allowed constructing relative weights for each of these risks and the corresponding reserve cover needed to face them. In the case of countries with a floating regime, reserves should cover the sum of: 30 percent short term debt on remaining maturity basis, 10 percent of other portfolio liabilities, 5 percent of M2, and 5 percent of exports of goods and services. An adequacy index of 100 percent means that reserves exactly equal the sum of these four components. At end-2011, the metric for Mauritius constituted 143 percent, which is at the upper end of the suggested adequacy range (100 to 150 percent). Again, Mauritius has been slipping in relative terms among the 80 emerging markets for which the metric was computed, and is currently in the middle quintile (bottom graphs in Figure II.2).

Staff considers it appropriate for Mauritius to continue targeting the upper end of the suggested reserve adequacy range, as measured by the IMF metric. In addition to facing standard economic risks, the country is also exposed to the risk of costly cyclones and floods. Given the increasing role of Mauritius as an international financial center, M2 is an increasingly less representative measure of the size of the financial sector and associated risks. Finally, in the short run, an additional safety margin is needed to factor in increased uncertainty stemming from Mauritius' high exposure to the European market. Staff therefore sees little scope in devoting any of BOM's reserves to a potential sovereign wealth fund. However, staff welcomes BOM's ongoing efforts to increase the yield potential on the upper tranches of reserves, including through diversifying the currencies in which reserve instruments are denominated.

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[3] IMF (2011) "Assessing Reserve Adequacy". http://www.imf.org/external/np/pp/eng/2011/021411b.pdf

APPENDIX III. MAURITIUS: DEBT SUSTAINABILITY ANALYSIS (DSA) USING THE DEBT SUSTAINABILITY FRAMEWORK FOR MARKET ACCESS COUNTRIES[1]

Recent Debt Developments

Public debt has stabilized over the last two years, albeit at a relatively high level of close to 60 percent of GDP, highlighting the need for fiscal consolidation over the medium term. After reaching a peak of close to 75 percent in 2003, the ratio of public debt to GDP had been on a declining trend mainly due to strong economic growth and sound fiscal policy. Nevertheless, a series of stimulus measures to counter the effects of the global financial crisis has pushed up public debt to close to 60 percent of GDP by the end of 2009, thus approaching the legally-mandated ceiling defined in the 2008 Public Debt Management Act (PDMA).[2] Although the comprehensive policy packages are considered to have been broadly effective in facilitating economic recovery in 2010–11 and bringing the debt ratio to 56 percent of GDP by end-2011, the Mauritian authorities are cognizant of the need for fiscal consolidation over the medium-term.

The central government relies mostly on domestic debt for its borrowing needs, whereas in relative terms, state-owned firms have relied more heavily on external debt. As of end-December 2011, domestic debt represented some 80 percent of total central government debt, a small decline with respect to the average share for the period 2003–09 (90 percent), as the government pursued a strategy of seeking long-term financing from multilateral and bilateral creditors under favorable conditions (below market terms). Over 20 percent of domestic central government debt is classified as short-term (by original maturity). The debt of State-Owned Enterprises (SOEs) is estimated to account for 11 percent of total public debt as of end-2011. External debt amounted to over 40 percent of total SOE debt in 2011, a decline with respect to the historical average of over 50 percent for the period 2003–09.

The authorities are currently elaborating a new debt management strategy. The strategy attempts to meet the borrowing needs of the government in a manner that avoids market

[1] Prepared by Antonio David (AFR).

[2] The limits are 60 percent of GDP until 2017 and 50 percent of GDP after 2018. The 2011 Article IV consultation (SM/11/60) included discussions on the appropriateness of the debt ceiling rule contained in the PDMA in supporting fiscal sustainability.

disruption; to minimize the cost of the debt portfolio within an acceptable level of risk; and to support the development of a well-functioning market for government securities. Among other objectives, the strategy envisages lengthening the maturity profile of government debt (partly by increasing the share of external debt in the total portfolio), increase the issuance of long-term domestic debt instruments, and increase liquidity in the domestic market for government securities by increasing the number of benchmark instruments.

Baseline Assumptions underlying the DSA

The results of this debt sustainability analysis are based on a number of important assumptions, notably regarding fiscal consolidation, sound monetary policy and sustained economic growth over the medium term. GDP growth is expected to increase gradually to 4.2 percent by 2014 driven by increased infrastructure investment and productivity improvements. Inflation should remain moderate due to credible implementation of monetary policy by the Bank of Mauritius. Furthermore, the macroeconomic framework used for this exercise assumes that the government will resume fiscal consolidation after 2012, with the primary deficit (including grants) declining by 1 percentage point of GDP between 2012 and 2017. A reduction in transfers and subsidies and better enforcement of financial discipline for public enterprises is expected to contribute to deficit reduction.

The current account deficit is expected to gradually narrow reaching close to 4 percent of GDP by 2017. The trade balance should improve over the projection period as import growth decelerates from current high levels (imports are estimated to have grown by 17 percent in dollar terms in 2011), while export growth continues to be robust at around 6 percent on average. After a marked slow-down in 2011 and 2012, financial flows including FDI are expected to recover contributing to an accumulation of international reserves over the medium-term.

The baseline macroeconomic framework is subject to downside risks. Given the strong links between Mauritius and advanced economies in Europe, the macroeconomic outlook remains vulnerable to the volatile external environment. FDI flows, tourism receipts and exports of manufactured goods to European trading partners are particularly important transmission channels for external shocks.

Public Debt Sustainability

The results of the debt sustainability analysis indicate that public debt is sustainable over the medium-term (Table III.1 and Figure III.1). Despite the small fiscal expansion expected in the context of the 2012 budget, public debt should gradually decline over the projection period, as fiscal

consolidation takes place. Nevertheless, more ambitious consolidation efforts might be required to reach the 50 percent debt-to-GDP target mandated by the Public Debt Management Act (PDMA) before 2018. In fact, public debt is projected to peak at 57 percent of GDP in 2012 before falling to close to 50 percent by 2017, the end of the projection period.

Public debt dynamics are resilient to several stress tests (Figure III.1). The results of standardized sensitivity tests do not fundamentally alter the broadly positive outlook for public debt previously discussed. In most cases, the public debt-to-GDP ratio does not approach 60 percent by the end of the projection period under the different shocks considered,[3] except for the scenario including an increase in contingent liabilities, which would cause the debt-to-GDP ratio to exceed 65 percent in 2013 before falling back to 59 percent by 2017. The external debt outlook is somewhat vulnerable to a large devaluation, which would push up the debt-to-GDP ratio by 7 percentage points to 57 percent in 2017 (Figure III.1).

External Debt Sustainability

External debt dynamics are sustainable in the baseline scenario (Table III.2 and Figure III.2). Excluding short-term private sector liabilities, external debt is estimated at 15 percent of GDP at the end of 2011, down from 20 percent in 2002. Gross bank external liabilities surpassed 100 percent of GDP at the end of December 2011. They are not included in external debt figures, as bank foreign assets are almost twice as large,[4] and as in many international financial centers, it would be misleading to include gross bank liabilities in the external debt measure.[5] External debt is projected to increase over the medium term reaching 18 percent of GDP by 2013, as authorities take advantage of partially concessional long-term financing from multilateral and bilateral sources.

Stress tests indicate that the external debt trajectory is particularly vulnerable to shocks to the non-interest current account and large exchange rate depreciations. Sensitivity analysis suggests that Mauritius' external debt is resilient to interest rate and growth shocks, but a 30 percent real depreciation would push up the external debt-to-GDP ratio to around 23 percent in 2017. A current

[3] Sensitivity tests include shocks to the interest rate, to growth, to the primary balance, a combination of shocks, as well as shocks to contingent liabilities and a 30 percent exchange rate depreciation.

[4] Bank investments of the GBC float—that is, money from foreign investors meant to be transferred to third countries but held for a short period by GBCs in bank deposits—are included. Excluding these GBC counterpart investments would still result in a positive bank net foreign asset position.

[5] See *Debt Sustainability Analysis for Market Access Countries Guidance Note* (July 5, 2005), available at http://www-intranet.imf.org/departments/SPR/Debt/Pages/DSAMarketAccess.aspx.

account deficit that is 3 percentage points of GDP larger than projected in the baseline would likely put the country on an unsustainable path, as the debt-to-GDP ratio would shoot up to 27 percent by 2017. Thus, moderating the non-interest part of the external current account balance is key to maintaining external debt sustainability.

Conclusion

Overall, the DSA results indicate that the debt outlook for Mauritius is broadly positive. Both total public debt and external debt are on sustainable trajectories in the baseline, and the results of stress tests indicate that debt dynamics are resilient to several shocks. Nevertheless, the external debt outlook is particularly vulnerable to a shock to the non-interest current account, which may lead to unsustainable trajectories. In addition, total public sector debt could be significantly affected by shocks to contingent liabilities. It is important to note that the simulated debt trajectories are based on the assumption that structural reforms will be implemented to sustain growth rates and that some fiscal consolidation will take place over the medium-term.

Table III.1. Mauritius: Public Sector Debt Sustainability Framework, 2007-2017
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	**Debt-stabilizing primary balance 9/**
Baseline: Public sector debt 1/	56.2	51.9	59.6	57.3	56.1	**57.0**	**55.7**	**54.8**	**55.5**	**54.2**	**49.8**	**-1.5**
o/w foreign-currency denominated	9.3	13.4	12.7	14.4	15.0	16.1	17.7	18.4	16.5	14.8	14.6	
Change in public sector debt	-6.6	-4.3	7.8	-2.3	-1.2	0.9	-1.3	-1.0	0.7	-1.3	-4.4	
Identified debt-creating flows (4+7+12)	-7.9	-3.8	0.0	-0.3	-2.4	-0.3	-2.1	-1.8	-1.7	-2.3	-2.6	
Primary deficit	-1.4	-2.6	-1.8	-0.4	-0.6	0.5	0.6	0.1	0.2	-0.3	-0.6	
Revenue and grants	19.5	21.0	22.8	21.9	21.2	21.8	20.9	21.1	21.2	21.2	21.3	
Primary (noninterest) expenditure	18.2	18.5	21.0	21.5	20.6	22.3	21.5	21.3	21.4	20.9	20.7	
Automatic debt dynamics 2/	-6.5	-1.3	1.8	0.1	-1.8	-0.8	-2.6	-1.9	-1.9	-2.1	-2.0	
Contribution from interest rate/growth differential 3/	-3.9	-2.3	2.4	0.0	-1.5	-0.8	-2.6	-1.9	-1.9	-2.1	-2.0	
Of which contribution from real interest rate	-0.6	0.4	3.9	2.4	0.7	1.1	-0.5	0.2	0.2	0.1	0.1	
Of which contribution from real GDP growth	-3.2	-2.8	-1.5	-2.3	-2.2	-1.9	-2.1	-2.2	-2.1	-2.1	-2.1	
Contribution from exchange rate depreciation 4/	-2.6	1.1	-0.6	0.0	-0.3	...	...	...	...	...	...	
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0	0.0	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	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	0.0	0.0	
Residual, including asset changes (2-3) 5/	1.3	-0.5	7.8	-2.0	1.2	1.2	0.8	0.8	2.5	1.0	-1.8	
Public sector debt-to-revenue ratio 1/	287.6	246.5	261.5	261.7	264.1	261.7	266.6	259.2	261.9	256.0	234.2	
Gross financing need 6/	27.8	20.2	13.6	18.3	14.8	15.8	14.3	10.3	9.6	8.6	7.4	
in billions of U.S. dollars	2.2	2.0	1.2	1.8	1.6	1.7	1.6	1.2	1.2	1.2	1.1	
Scenario with key variables at their historical averages 7/						**57.0**	**56.2**	**55.5**	**56.4**	**55.9**	**52.6**	**-1.0**
Scenario with no policy change (constant primary balance) in 2012-2017						**57.0**	**55.7**	**55.1**	**56.1**	**55.5**	**52.2**	**-1.6**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (in percent)	5.9	5.5	3.0	4.1	4.1	3.7	4.1	4.2	4.2	4.2	4.2	
Average nominal interest rate on public debt (in percent) 8/	7.3	7.8	7.5	6.1	5.8	6.3	5.1	5.0	4.9	4.8	4.9	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	-0.7	1.2	7.7	4.3	1.5	2.3	-0.8	0.6	0.5	0.4	0.4	
Nominal appreciation (increase in US dollar value of local currency, in percent)	21.7	-11.1	4.8	-0.3	2.3	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	8.0	6.5	-0.2	1.8	4.3	3.9	5.9	4.4	4.4	4.4	4.4	
Growth of real primary spending (deflated by GDP deflator, in percent)	-2.1	7.3	17.1	6.6	-0.1	12.0	0.4	3.2	4.8	1.8	3.0	
Primary deficit	-1.4	-2.6	-1.8	-0.4	-0.6	0.5	0.6	0.1	0.2	-0.3	-0.6	

1/ Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.

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; π = growth rate of GDP deflator; g = real GDP growth rate; α = share of foreign-currency denominated debt; and ε = 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 $\alpha\varepsilon(1+r)$.

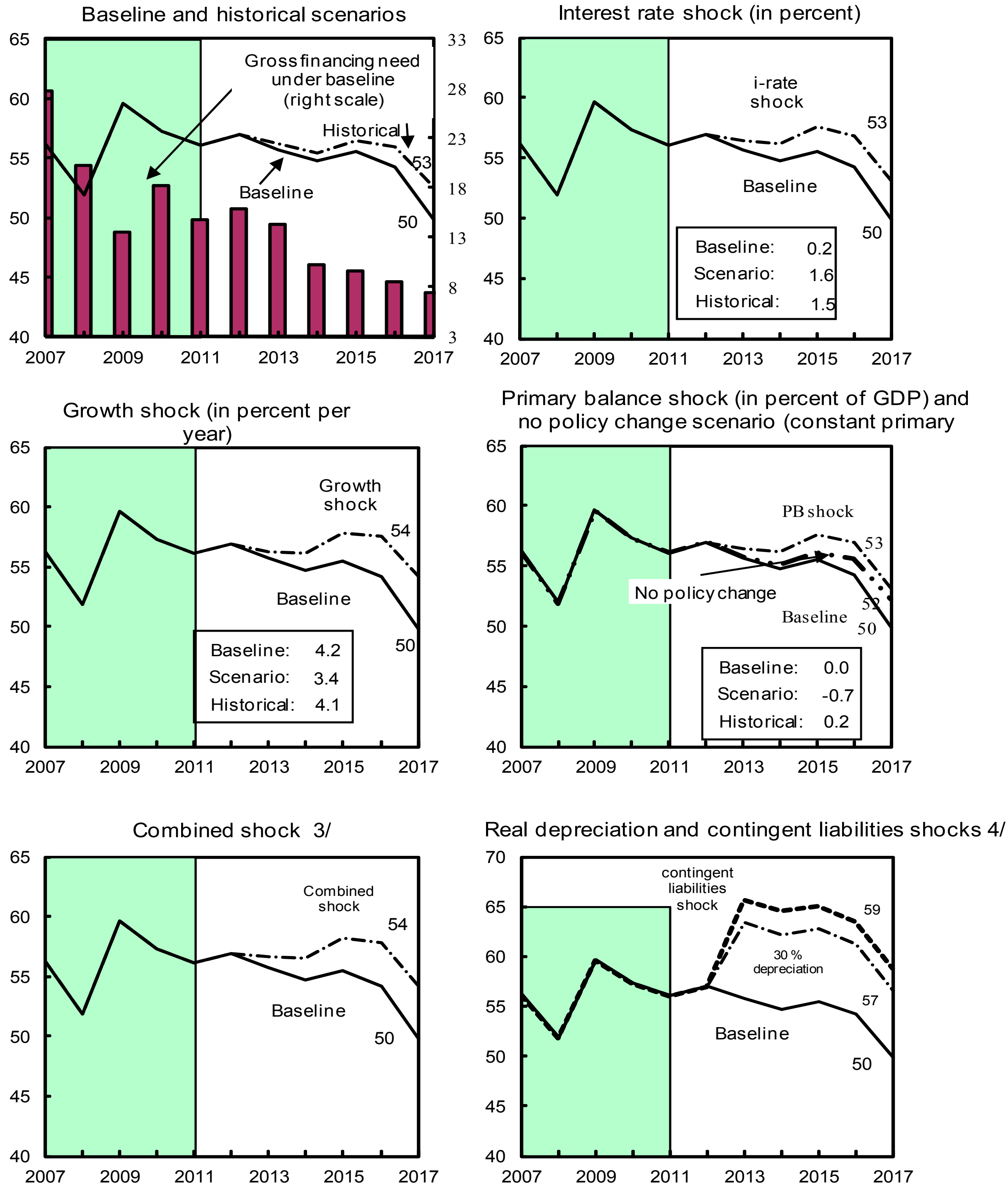
5/ For projections, this line includes exchange rate changes.

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.

7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.

8/ Derived as nominal interest expenditure divided by previous period debt stock.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.



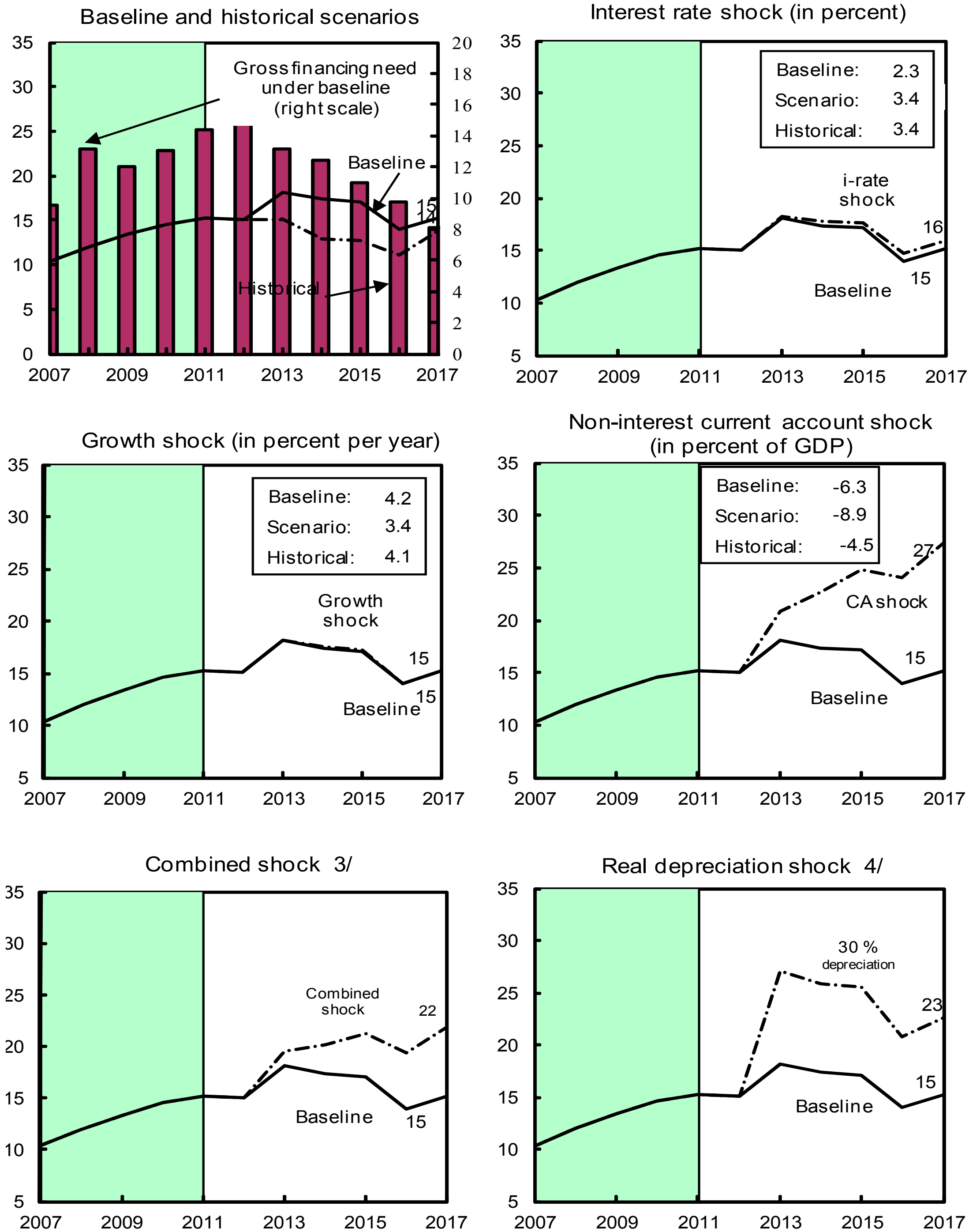
Sources: International Monetary Fund, country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.
4/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2010, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Table III.2. Mauritius: External Debt Sustainability Framework, 2007-2017
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	**Debt-stabilizing non-interest current account 6/**
Baseline: External debt	10.3	12.0	13.4	14.6	15.2	**15.0**	**18.1**	**17.4**	**17.1**	**14.0**	**15.2**	**-3.0**
Change in external debt	-5.2	1.6	1.4	1.2	0.6	-0.2	3.1	-0.8	-0.3	-3.1	1.2	
Identified external debt-creating flows (4+8+9)	-1.1	6.4	6.7	5.7	5.0	7.6	5.7	4.3	3.0	2.0	1.3	
Current account deficit, excluding interest payments	5.0	9.8	7.2	8.0	9.7	9.9	8.8	7.4	6.2	5.0	3.9	
Deficit in balance of goods and services	9.9	14.2	10.5	12.1	13.5	13.8	12.7	11.4	10.1	8.9	7.9	
Exports	56.7	51.1	47.1	50.9	52.8	53.9	54.4	55.0	55.1	55.3	55.4	
Imports	66.6	65.3	57.6	63.0	66.3	67.7	67.2	66.4	65.2	64.3	63.2	
Net non-debt creating capital inflows (negative)	-4.4	-1.7	-1.8	-1.2	-3.4	-2.1	-2.9	-2.8	-2.9	-2.7	-2.4	
Automatic debt dynamics 1/	-1.7	-1.7	1.3	-1.0	-1.2	-0.3	-0.2	-0.3	-0.3	-0.4	-0.2	
Contribution from nominal interest rate	0.4	0.3	0.2	0.2	0.2	0.3	0.3	0.4	0.4	0.3	0.3	
Contribution from real GDP growth	-0.8	-0.5	-0.4	-0.5	-0.5	-0.6	-0.6	-0.7	-0.7	-0.7	-0.6	
Contribution from price and exchange rate changes 2/	-1.3	-1.5	1.5	-0.7	-0.9	...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	-4.1	-4.8	-5.3	-4.5	-4.4	-7.7	-2.5	-5.0	-3.3	-5.2	-0.1	
External debt-to-exports ratio (in percent)	18.2	23.4	28.4	28.7	28.7	27.8	33.3	31.6	31.1	25.3	27.4	
Gross external financing need (in billions of US dollars) 4/	0.7	1.3	1.1	1.3	1.6	1.6	1.5	1.5	1.4	1.3	1.2	
in percent of GDP	9.6	13.1	12.0	13.1	14.4	14.8	13.2	12.4	10.9	9.7	8.1	
Scenario with key variables at their historical averages 5/						**15.0**	**15.1**	**12.9**	**12.8**	**11.1**	**13.9**	**-2.1**
Key Macroeconomic Assumptions Underlying Baseline												
Real GDP growth (in percent)	5.9	5.5	3.0	4.1	4.1	3.7	4.1	4.2	4.2	4.2	4.2	
GDP deflator in US dollars (change in percent)	9.3	17.3	-11.2	5.7	6.9	-2.8	1.1	0.6	1.7	1.8	2.4	
Nominal external interest rate (in percent)	3.1	3.6	1.8	1.6	1.8	2.0	2.4	2.3	2.3	2.0	2.4	
Growth of exports (US dollar terms, in percent)	10.3	11.4	-15.6	18.9	15.5	3.0	6.1	6.0	6.2	6.5	6.7	
Growth of imports (US dollar terms, in percent)	9.5	21.2	-19.3	20.5	17.1	3.0	4.3	3.7	4.1	4.5	5.0	
Current account balance, excluding interest payments	-5.0	-9.8	-7.2	-8.0	-9.7	-9.9	-8.8	-7.4	-6.2	-5.0	-3.9	
Net non-debt creating capital inflows	4.4	1.7	1.8	1.2	3.4	2.1	2.9	2.8	2.9	2.7	2.4	

1/ Derived as $[r - g - \rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock, with r = nominal effective interest rate on external debt; ρ = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate,
ε = nominal appreciation (increase in dollar value of domestic currency), and α = share of domestic-currency denominated debt in total external debt.
2/ The contribution from price and exchange rate changes is defined as $[-\rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock. ρ increases with an appreciating domestic currency ($\varepsilon > 0$) and rising inflation (based on GDP deflator).
3/ For projection, line includes the impact of 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/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels
of the last projection year.

Figure III.2. Mauritius: External Debt Sustainability: Bound Tests 1/ 2/
(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2012.

APPENDIX IV. GREEN TAXES AND ETHANOL POLICIES[1]

Mauritius is a pioneer in the development of green taxes. The authorities view taxes as the best policy instrument for reflecting environmental damages in the costs of energy and vehicle use and for promoting a variety of changes in household and firm behavior to reduce these damages. The excise on carbon-based fuels under the *Maurice Ile Durable* Initiative comes close to an ideal CO2 tax.

The amendment to the Excise Act in July 2011 to allow for the imposition of a CO2 levy or the granting of a rebate on the excise duty payable on motor cars has merit, but could be improved. The levy or rebate system depends on the CO2 emissions of the vehicle (new and second-hand motor cars) and was designed to be revenue neutral.[2] Staff considers that levy/rebate scheme has merit, but it would be desirable to remove the graduated tax/subsidy rates, as the value of reducing CO2 by an additional ton should be the same across all possible uses. For example, currently the reward for incrementally reducing CO2 per km is much higher for high-tax vehicles than for other vehicles.

Designing Policies to Promote the Use of Ethanol

The appropriate subsidy per liter of ethanol should reflect the value of environmental benefits. To the extent that ethanol production from sugar cane (for blending with motor fuels) generates less carbon emissions and pollution than gasoline, it should be taxed at a lower rate, or equivalently, receive a tax refund or subsidy. The Mauritian authorities intend to follow this approach and currently, an ethanol subsidy (Rs 2 per liter or US $0.27 per gallon) is being proposed based on a careful assessment of lifecycle emissions from ethanol production compared with emissions from combusting gasoline. With pollution benefits appropriately rewarded, the market should supply the economically efficient amount of ethanol. If future sugar prices are high, or oil prices are low, ethanol supply will likely be minimal or zero, as production would not be commercially viable. However, ethanol could be economic to produce under several alternative future price scenarios that appear realistic at the moment.

There is no obvious economic rationale for supplementing the ethanol subsidy with a quantitative ethanol mandate. Even though mandates are common in other countries, a mandate could, in fact, be counterproductive, if it forces ethanol into the market when it would otherwise not be economic to produce (despite its environmental benefits, which should be addressed through the subsidy).

In principle, if there are additional market impediments, this may warrant more initial policy support, but this seems less plausible. Whether there are such impediments is not entirely clear (for example, one possible impediment, the inability of early ethanol producers to capture spillover benefits accruing from their 'learning-by-doing' to later producers should not be a large problem, given that the number of potential ethanol producers is very limited). Moreover, even if additional support might be justified, setting a higher initial subsidy would be better than forcing ethanol production through a mandate, regardless of whether future production makes economic sense.

[1] Prepared by Ian Parry (FAD).

[2] The motor vehicle buyer pays an additional amount as a CO2 levy (penalty) per gram of CO2 emission per km above a threshold. On the other hand, the buyer receives a rebate calculated on the basis of gram of CO2 emission per km if the CO2 emission standard of the motor car is below the CO2 threshold.

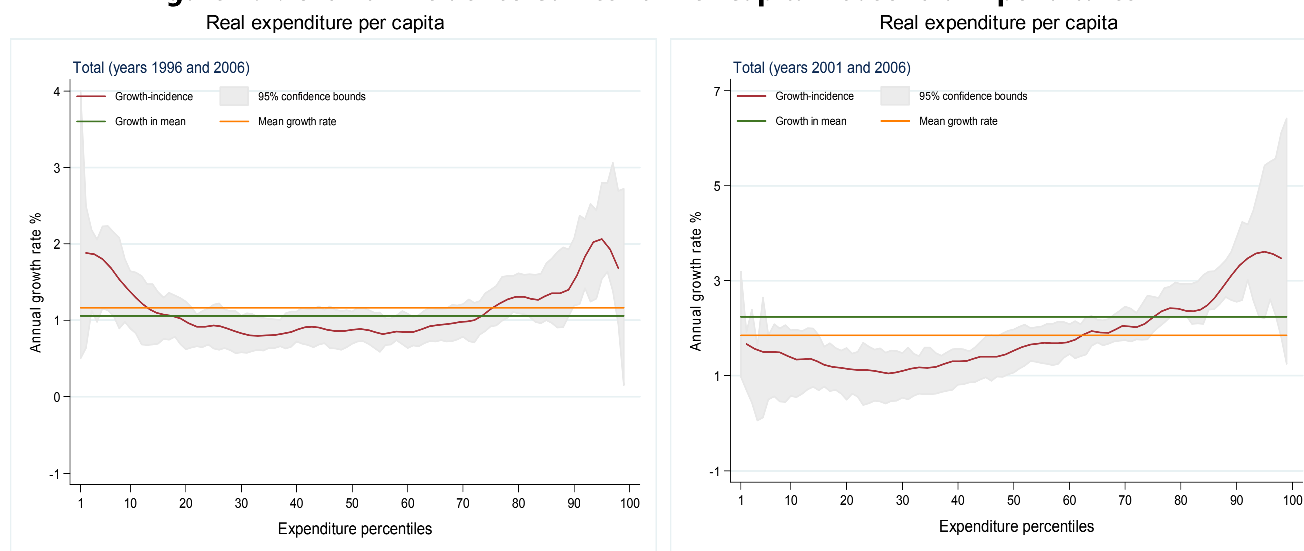
APPENDIX V. INCLUSIVE GROWTH[1]

Poverty and inequality in Mauritius are relatively low. Extreme poverty, measured by the proportion of the population living below $1.25 a day in PPP terms was below 1 percent in 2006/07. By international standards, inequality in Mauritius with a Gini coefficient of 38.8 is not high. Egalitarian societies such as Sweden and Canada have Gini coefficients between 25 and 35, whereas most countries have coefficients around 40 (United States, China, and Russia). Between 1996 and 2007, Mauritius experienced strong per capita GDP growth, averaging 3.7 percent. Based on data from three household budget surveys (HBS), we review how inclusive growth in 1996-2007 has been and analyze the distributional incidence of social protection expenditures. We also discuss the redistributive impact of the tax structure.

Inclusive Growth Measured by Growth Incidence Curves

All income groups experienced positive real growth in household expenditure per capita between the three surveys, but the poor gained less more recently. Growth incidence curves examine the interaction between growth, poverty and inequality. As depicted in Figure V.1, for the whole period from 1996/1997 to 2006/2007, both the poorest percentiles and the richest percentiles grew well above the mean. However, from 2001/2002 to 2006/2007, richer groups' expenditures grew faster, pointing to a more unequal distribution of the benefits of growth in recent years.

Figure V.1. Growth Incidence Curves for Per Capita Household Expenditures



Source: HBS Surveys; and IMF Staff estimates

Mauritius performed well compared to African countries analyzed in the latest AFR Regional Outlook. Even though mean growth in real expenditure per capita was stronger in some countries (not surprising given lower levels of development), in several instances poorer households saw slower growth or even negative growth in expenditure per capita.

Structural changes in the Mauritian economy might be an important factor in explaining recent trends in inequality. During the years of the last survey (2006 and 2007) unemployment rates were

[1] Prepared by Antonio David (AFR).

relatively high in Mauritius (around 9 percent). The loss of trade preferences in textile, the decline in some traditional sectors (agriculture, textile manufacturing) might have reduced demand for lower-skilled workers, whereas the expansion of the financial service and health sectors might have increased demand and wages for higher-skilled groups. This could reflect a global trend related to globalization and technological progress that are likely to have increased return on human capital and greater inequality between skilled and unskilled workers—something that might persist going forward. The educational system has been unable to accompany these structural changes and inequality in educational outcomes is still relatively high leading to significant problems of skill mismatches.[2]

Social Protection System

The Mauritian social protection system needs to improve to ensure that the poor benefit more from economic development. Social protection expenditures at close to 4.5 percent of GDP in 2010 are relatively high. Non-contributory and non-targeted pensions account for 1.3 percent of GDP. Only about 50 percent of direct and indirect beneficiaries of Social Aid (the main means-tested social assistance program) live below the poverty line. Old age pension benefits overwhelming go to non-poor households (only 22 percent of recipients of old age pensions are poor). Furthermore, 39 percent of the basic retirement pension benefits go to the richest 20 percent (Table V.1). The two richest quintiles of the population receive close to 58 percent of all social protection benefits, and the richest 20 percent alone receive 37 percent. Eliminating transfers to the richest 40 percent of the population could save significant sums, which could be deployed more effectively in the pro-poor sectors of primary and secondary education and health.

Table V.1. Distribution of Benefits (in percent by quintile)

	Q1	Q2	Q3	Q4	Q5
All social protection	13.7	12.7	15.9	21.2	36.5
All social insurance	13.0	12.5	15.9	21.5	37.1
Old Age Pension	12.1	11.6	15.8	21.8	38.7
Social Aid	40.6	22.6	15.5	8.3	13.0

Sources: IMF staff estimates; and 2006/07 HBS survey. Benefits' incidence is the transfer amount received by the group as a percent of total transfers received by the population. Aggregated transfer amounts are estimated using household size-weighted expansion factors.

Structure of Tax Revenue and Incidence of Taxes

Major tax reforms after 2006 aimed at broadening the tax base and increasing tax progressivity. Measures included the introduction of a single 15 percent rate for VAT, corporate and personal income tax (the latter with an increase in the exemption threshold). Taxes on consumption are the most important sources of tax revenue (Table V.2) with VAT and excise duties accounting for more than half of total tax revenue. Corporate income taxes are some 15 percent on tax revenue, whereas personal income tax is about 8 percent of tax revenue.

[2] World Bank (2010) "Mauritius Enhancing and Sustaining Competitiveness" Report No: 53322-MU, World Bank, December, Washington, DC.

Table V.2. Composition of Tax Revenues in Mauritius

	2007	2008	2009	2010
	(in percent of total tax revenue)			
Income Tax on Individuals	6.7	7.5	8.0	8.1
Corporate Income Tax	13.4	16.5	19.2	15.3
Property Taxes	7.9	6.4	4.1	4.3
VAT	39.6	37.5	36.2	38.2
Excise and Gambling Taxes	21.2	19.9	19.5	21.0
Customs Duty	5.6	4.1	2.9	2.8
Other	5.6	8.2	10.1	10.3
	(in percent of GDP)			
Total	17.6	18.2	19.1	18.5
of which: Income Tax on Individuals	1.2	1.4	1.5	1.5
of which: Corporate Income Tax	2.4	3.0	3.7	2.8
of which: VAT	7.0	6.8	6.9	7.1
of which: Excise and Gambling	3.7	3.6	3.7	3.9
of which: Customs Duty	1.0	0.8	0.6	0.5

Source: Mauritian authorities and IMF staff estimates.

Personal income taxes are relatively progressive but their redistributive potential is limited. The concentration index[3] for income tax payments is very high, indicating that richer segments of the population bear a disproportionate share of the tax burden (Table V.3). The Kakwani index—the difference between the Gini for pre-tax income and the concentration index for taxes—is the highest among the comparator countries considered, confirming that personal income taxes are relatively progressive. Nevertheless, the Kakwani index does not take into account the redistributive potential of the tax. The Reynolds-Smolensky (RS) index addresses this shortcoming by measuring the difference between the Gini coefficients for pre-tax and post-tax income.[4] It suggests that income taxes have a negligible income distribution capacity in Mauritius, because of their relatively small share in total taxes. The RS index for Mauritius is close to zero, comparable to Costa Rica and Panama, whereas redistribution through taxation is much stronger in New Zealand and the United States.

VAT does not seem to be regressive in Mauritius. The early literature on the incidence of the VAT suggested that it was regressive, although some recent studies on VAT incidence in developing countries conclude that it might be less regressive than previously thought. A study by Statistics Mauritius based on the latest household survey estimates that the average share of VAT payments for poor households relative to total household expenditure was 5.8 percent compared to 8.7 percent for the richest households (7.2 percent for all households). Furthermore, the poor accounted for 2.8 percent of VAT payments, whereas the richest 10 percent accounted for 26.7 percent of all VAT payments.

[3] The concentration index is the area below the concentration curve for a given tax. The concentration curve plots cumulative shares of tax payments with respect to the quantile distribution of pre-tax income.

[4] Note that the Gini coefficients in the Table differ from the overall Gini discussed at the beginning of the appendix because the welfare measure used for the analysis in the table is household income per adult equivalent, excluding government transfers. We define gross income as the sum of income from employment, income from self-employment, net rent income, and any other income from property. The measure of income net of income taxes simply subtracts from the gross income measure deductions related to PAYE and income tax on income from self-employment.

Table V.3. Redistributive Impact of Income Taxes in Mauritius and Comparator Countries

	Concentration Index	Kakwani Index	Gini for pre-Tax Income	Gini for post-Tax income	RS Index
Mauritius (2006/07)	89.2	42.8	46.4	45.9	0.5
Colombia (2003)	89.4	35.7	53.7	51.3	2.4
Costa Rica (2000)	48.1	3.0	45.1	44.8	0.3
New Zealand (2006/07)	47.9	8.8	39.1	36.3	2.8
Panama (2003)	73.9	20.1	53.8	53.4	0.4
US (Federal, 2004)	75.5	31.7	43.8	39.8	4

Sources: Creedy et al. (2008) Equity and Efficiency Measures of Tax-Transfer Systems: Some Evidence for New Zealand" New Zealand Treasury WP/08/04; Cubero and Hollard (2010) "Equity and Fiscal Policy: The Income Distribution Effects of Taxation and Social Spending in Central America" IMF WP/10/112; and IMF staff estimates.

Conclusions and Policy Implications

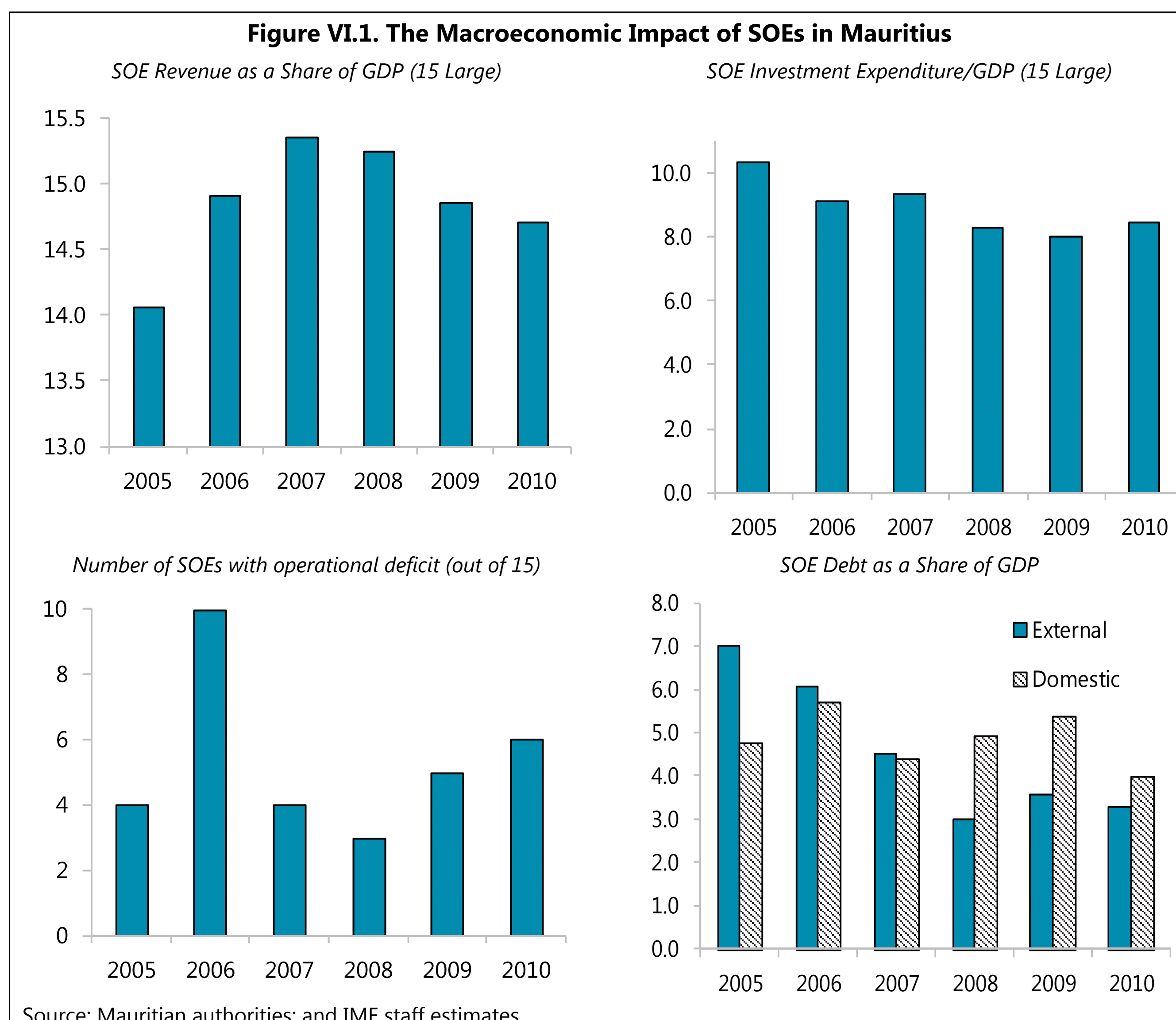
Mauritius achieved high economic growth with positive results for poverty, but better targeting of social benefits is needed. The extensive, but largely untargeted social protection system needs reforms to ensure that resources are spent in the most cost-effective way. The authorities should improve the targeting of social protection by completing the Social Registry of Mauritius (an information system that provides comprehensive data on existing and potential program clients). Conditional cash-transfer schemes could help foster human capital accumulation and address skills mismatches in the labor market. Redesigning the eligibility criteria for the basic retirement pension could have a positive redistributive impact over time. Reform of the basic educational system is required to address the unequal distribution of educational outcomes and mechanisms need to be put in place to support the access of poorer segments of the population to tertiary education.

The tax system does not appear to be regressive, but offers limited scope for redistribution. Personal income taxes are relatively progressive, although they are too small to have much of an impact. Preliminary evidence suggests that the VAT is not regressive, but more analysis would be useful given its economic importance. In general the tax system is relatively efficient, and expenditures offer better tools for addressing income inequality.

APPENDIX VI. STATE-OWNED ENTERPRISES: FINANCIAL MONITORING AND REFORM[1]

State-Owned Enterprises (SOEs) are of considerable macroeconomic importance in Mauritius. The revenue of 15 large SOEs (for which data was available) was 15 percent of GDP in 2010 (Figure VI.1). Investment expenditure for these firms was 8.5 percent of GDP, but considered insufficient and probably inefficient. This appendix discusses the options for integrating SOEs into the macrofiscal analysis and describes the authorities' recent efforts at reforming the sector to improve service delivery and statistics.

Figure VI.1. The Macroeconomic Impact of SOEs in Mauritius



Source: Mauritian authorities; and IMF staff estimates.

[1] Prepared by Antonio David (AFR).

Integrating SOEs into the fiscal statistics for the overall public sector would allow for a better evaluation of the macrofiscal stance. Six out of 15 large SOEs had an operational deficit in 2010, the highest number since 2006; and government transfers to SOEs are estimated to amount to 2.7 percent of GDP in 2010. This suggests that having consolidated public sector statistics (general government, central bank, and SOEs) would help assess the true macro-fiscal stance and provide a better view of the public sector's net worth.[2] Moreover, it would provide a better description of the public sector's expenditure priorities.

Inadequate pricing policies negatively impact SOE financial sustainability and public sector investment. For example, despite recent increases in water tariffs, below full cost recovery pricing in water has led to years' of underinvestment in public infrastructure and severe service delivery problems. The government has paired with Singapore to develop a strategy for the water sector, which might benefit from World Bank review. Other sectors might also be reviewed to ensure that all (i) SOEs fulfill a public service objective that cannot be provided by the private sector; (ii) pricing reflects full cost recovery (including externalities, if any); (iii) service delivery standards are well-specified and verifiable; and (iv) management is well-qualified and accountable. Following these objectives should allow to significantly decrease transfers to SOEs, while increasing investment.

The Mauritian authorities are enhancing the monitoring of SOEs to increase their operational efficiency and mitigate fiscal risks. The Parastatal Information Management System (PIMS) is currently being implemented on a pilot basis and contains financial and non-financial indicators. The PIMS collects information on assets management; corporate governance; financial management, human resource management, and strategic management. The indicators chosen seem broadly appropriate but the system would benefit from obtaining information on risks to which SOEs are exposed (including contingent liabilities, exposures to liquidity risk, roll-over risk, interest rate risk and currency mismatches). These indicators would permit to better assess the risk that a specific SOE poses to public finances.

The exclusion criteria to discount SOE debt with low risks from the public debt ceiling calculations are broadly appropriate. The assessment questionnaire covers (i) managerial independence, including pricing and employment policy; (ii) transparent and stable relations with government; (iii) governance structure; (iv) sustainable finances; and (v) other risks. Overall, this framework is compatible with the IMF Staff Guidance Note on Debt Limits in Fund-Supported Programs (2009). But coverage of information on off-balance sheet liabilities (foreign exchange hedging and other derivative contracts), on currency mismatches, on the cost of debt, and on pricing policies could be improved. It might also be desirable to increase the focus on risks to debt sustainability to the detriment of purely corporate governance issues.

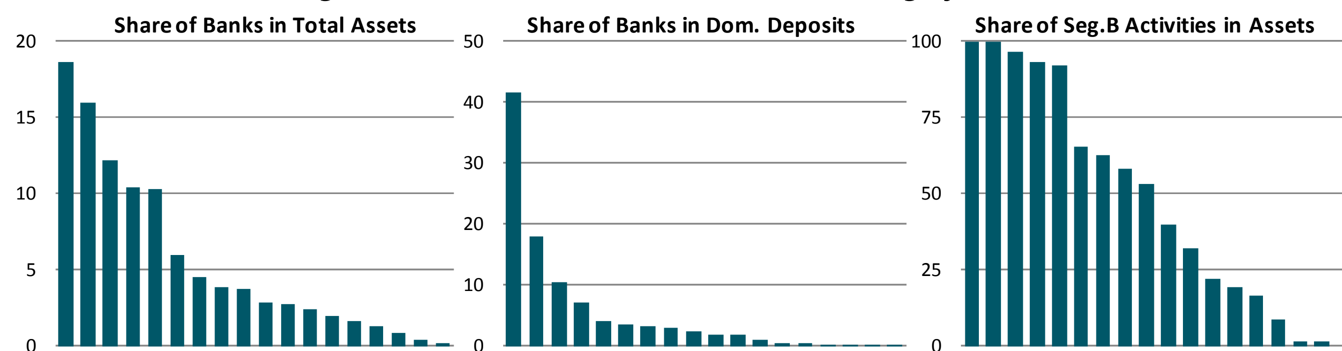
[2] In 2010, total SOE debt was 7 percent of GDP or 12.5 percent of total public debt. After 2005, SOE debt fell as a share of GDP, and its composition has tilted towards domestic debt, which reached 55 percent in 2010.

APPENDIX VII. STRESS-TESTING THE BANKING SYSTEM[1]

Stress tests based on June 2011 data indicate that the level of capitalization appears sufficient to withstand sizeable macroeconomic shocks; the concentration of loans on single borrowers remains a major vulnerability; the direct exchange rate and interest rate risks on banks' capitalization are likely to be limited; and liquidity conditions appear adequate. Exposure to Europe is limited and funding is diverse and stable. The activities of the GBCs appear to carry low risk for the banking system with maturities and currencies well-matched, but further research in this area would be useful when more data become available.

Since the 2007 FSAP update, the Mauritian banking system retained its key features. The number of banks operating in the market increased from 19 in 2007 to 20 at end-2011. The sector is fairly concentrated, with three largest banks accounting for 60 percent of domestic deposits and five largest banks controlling 70 percent of the system's assets. Stress tests are conducted for 18 banks, since two smaller banks that are funded primarily through equity and including their results would skew the aggregate capital adequacy ratios (CAR).[2] For the purposes of reporting stress test results, we sub-divided banks into four types: (1) three large banks serving both domestic and non-resident market; (2) three large banks serving primarily non-resident market; (3) five medium to small banks serving mostly non-residents; and (4) seven medium to small banks serving the domestic market.

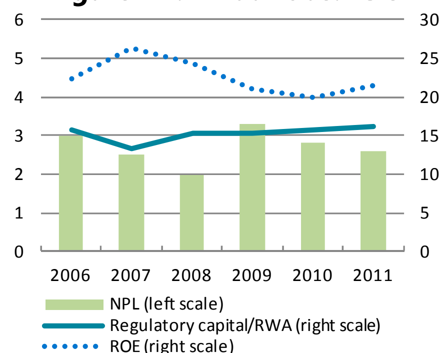
Figure VII.1 Mauritius: Structure of the Banking System



Source: BOM.

Financial soundness indicators (FSIs) suggest that: (i) capitalization is adequate (CAR > regulatory minimum of 10 percent); (ii) credit quality appears to be good (low non-performing loan (NPL) ratio); (iii) profitability is comfortable with good return on equity (ROE); and (iv) liquidity is adequate and net open positions in foreign exchange are low (Figure VII.2).

Figure VII.2 Mauritius: FSIs



Source: BOM.

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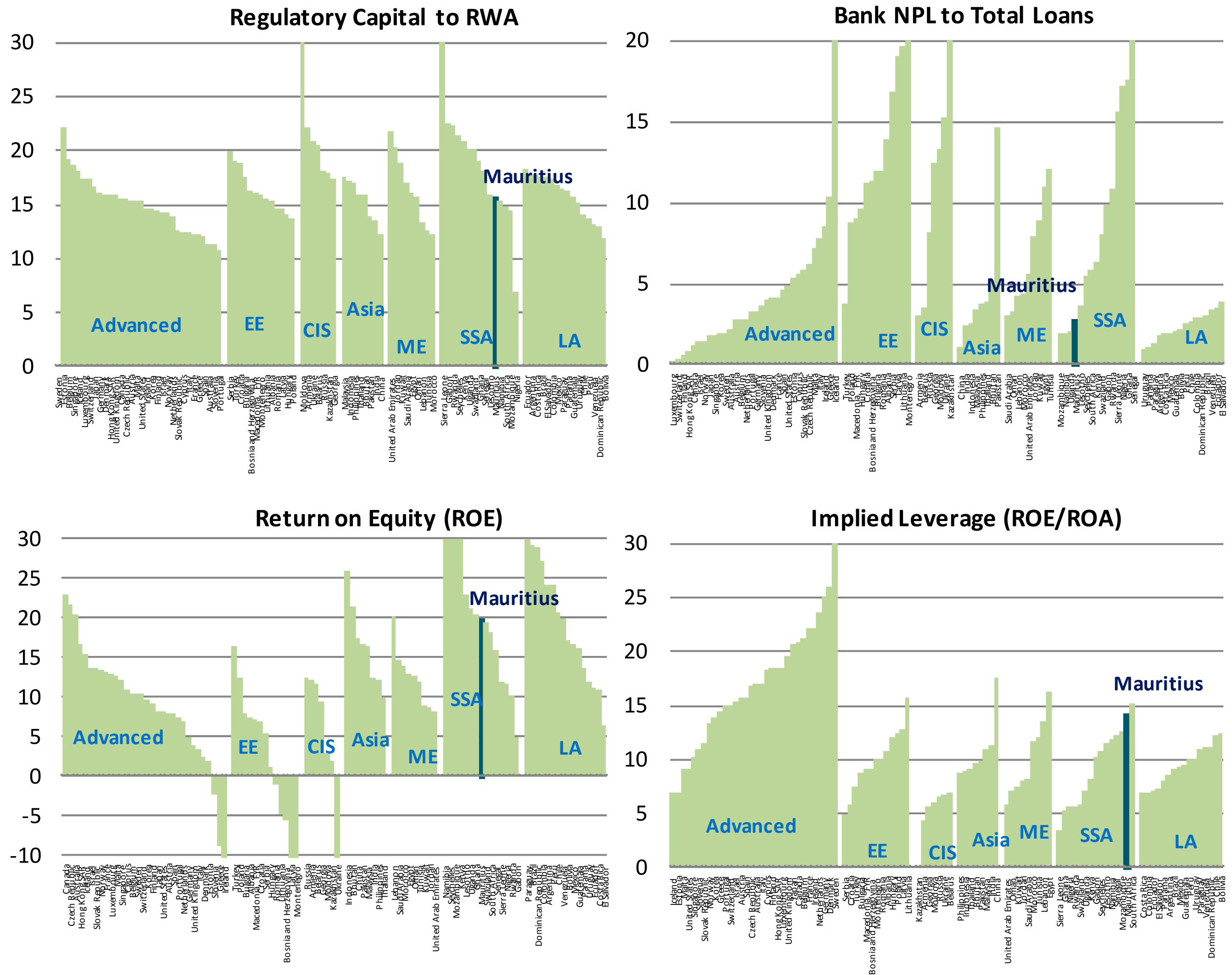
[1] Prepared by Katsiaryna Svirydzenka.

[2] Stress tests apply Cihak (IMF WP/07/59) methodology, estimating the impact of credit, concentration, exchange rate, interest rate, and liquidity shocks. The stress tests assume uniform shocks. New NPLs stemming from shocks are assumed to be in proportion to existing loans, fully provisioned and reduce regulatory capital in due proportion, without considering the profit cushion, which would make the effect of shocks more benign.

Cross-country comparisons shown in Figure VII.3 indicate that (i) regulatory capital as a percentage of risk-weighted assets (RWA) is in the intermediate range when compared to other countries; (ii) non-performing loans are relatively low, but comparable to and somewhat higher than in financial centers (Luxembourg, Switzerland, Hong Kong, Singapore); (iii) returns on equity are high when compared to advanced countries, but average compared to other SSA countries, some of which might feature both higher risks and less competition; and (iv) the implied leverage ratio is lower than in advanced countries and comparable to financial centers, but higher than average when compared to SSA and emerging markets.[3]

Figure VII.3 Mauritius: FSIs – Cross-Country Comparison, end-2010 (or latest available)



Source: IMF Financial Soundness Indicators.

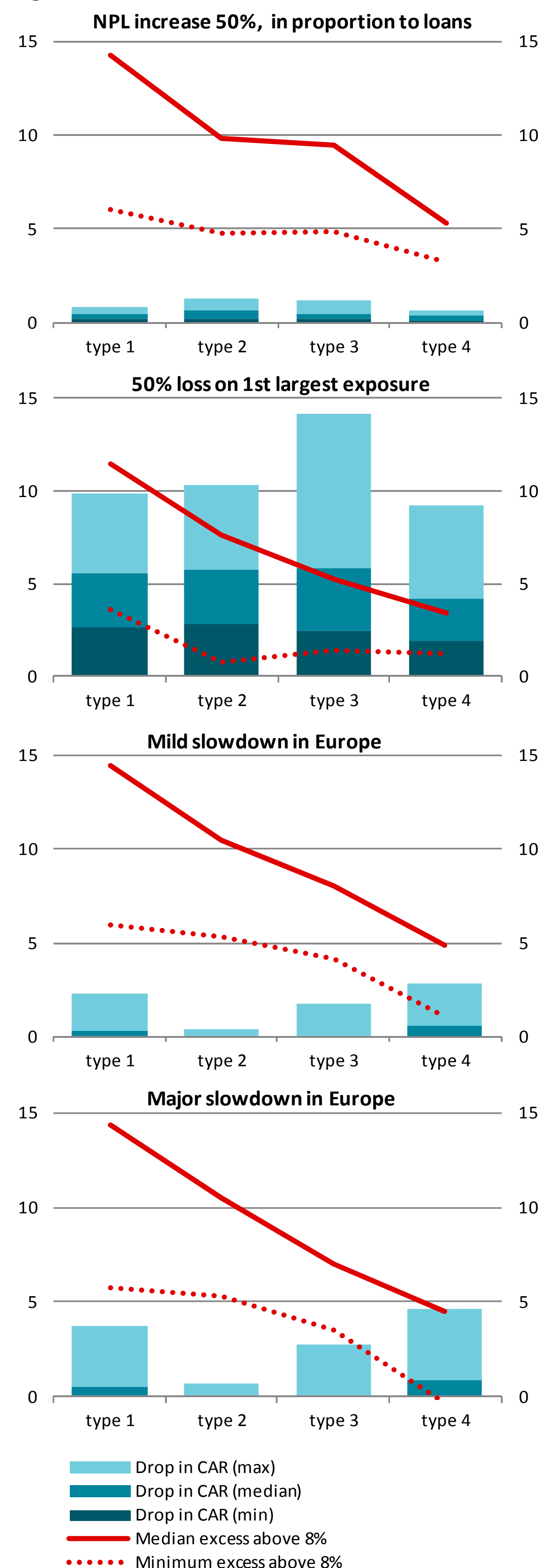
[3] Data definitions follow, to the extent possible, the methodology of the Financial Soundness Indicators Compilation Guide. Due to differences in consolidation methods, national accounting, taxation, and supervisory regimes, data are not strictly comparable across countries. Also, the implied leverage ratio is not equal to the actual leverage ratio.

System-wide, capitalization is not very vulnerable to credit risk shocks. A fifty percent increase in NPLs, when allocated in proportion to existing loans, does not lead to major drops in CARs (Figure VII.4, Panel 1). The maximum decrease in the CARs is about 1 percentage point for a type 3 bank, but the median drop is well below 1 percent. Also, the median excess of the CARs over the Basel II requirement of 8 percent is comfortable between 15 and 5 percent, and even the minimum for all banks at around 3 percentage points seems reasonable.

Concentration of exposures remains a risk for banks. A 50 percent default on the largest borrower would bring CARs below the domestic regulatory requirement for some type 2, 3, and 4 banks, but all would remain above the Basel II requirement (Figure VII.4, Panel 2). Here the median drop in CARs is around 3 percentage points and the maximum almost 10 percentage points, indicating that some banks have relatively concentrated loan portfolios, and could benefit from further diversification.

The banking system appears resilient to external growth shocks, but smaller banks are more vulnerable. Two alternative scenarios were considered: (1) a mild slowdown in Europe with a policy response, leading to a one percentage point drop in real GDP growth in Mauritius in 2012 compared to the baseline; (2) a larger slowdown in Europe without a policy response. The elasticity of the NPL ratio to GDP growth uses a rule of thumb value of -0.38 compared to -0.5 during the 2008/09 crisis. The shocks have a larger affect on smaller banks and those banks with larger exposure to domestic economy. Only one smaller bank falls marginally below the domestic CAR requirement in the mild slowdown scenario (Figure VII.4, Panel 3). In the severe downturn scenario, one smaller bank would see its CAR fall slightly below Basel II requirements (Figure VII.4, Panel 4). This indicates that the Mauritian banking system is relatively well prepared for external shocks although there is a need to monitor the exposure of some banks in the case of severe shocks.

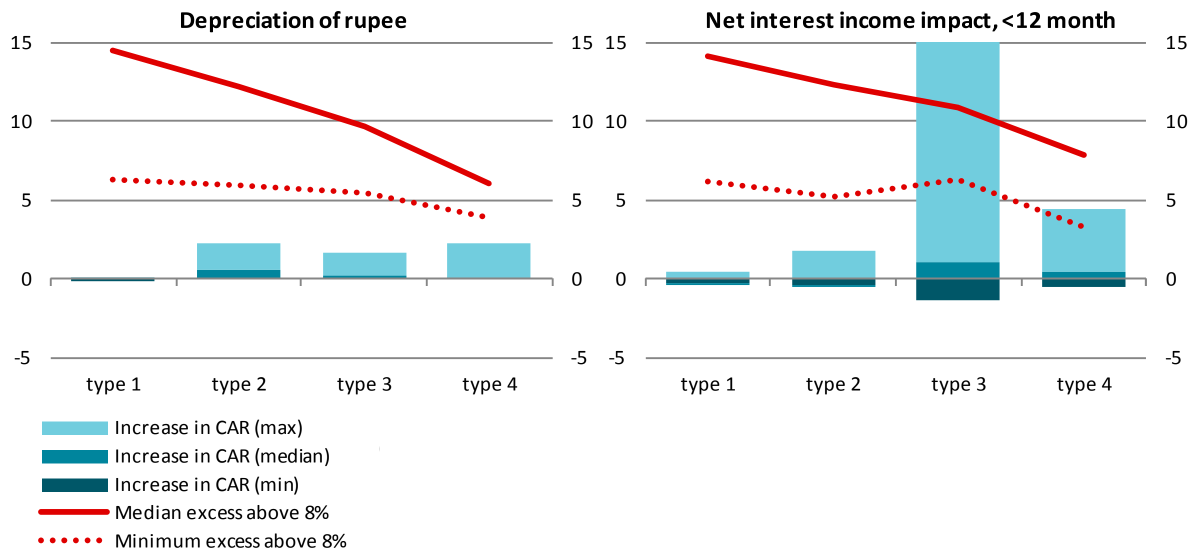
Figure VII.4. Credit Risk Stress Test Results



Source: Staff estimates.

Shocks on net foreign exchange positions and interest rate shocks suggest limited impact on bank capitalization. Most banks have small net-long foreign exchange exposures, which means that they gain from a rupee depreciation (Figure VII.5, Panel 1). The shock applied the most severe depreciation against major currencies over the last 10 years. In the worst and median case, there is essentially no impact on the CAR, but some banks gain moderately. A 300 basis point decrease in the policy interest rate has a limited impact on most banks' capital positions because of moderate gaps between assets and liabilities with short-term maturity (Figure VII.5, Panel 2). One bank would gain significantly because short-term liabilities are greater than short-term assets (the bank would pay significantly less on deposits and loose only a moderate amount of interest on short-term assets).

Figure VII.5 Market Risk Stress Test Results



Source: Staff estimates.

International exposure analysis: On a net basis, the banking system is intermediating funds from the domestic economy into Asia with a small net claim on Europe (Figure VII.1 and Table VII.1). Since Mauritius has a net claim on Europe, the impact from an economic slowdown in Europe might be limited. The largest net exposure is to Asia, which reflects intermediation of funds to India in particular.

Figure VII.6. Cross-border Net Exposures

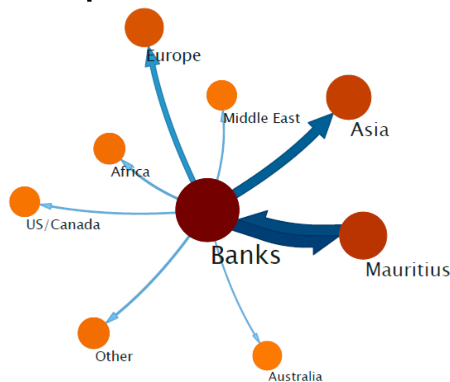


Table VII.1. Breakdown of Bank's Balance Sheet, June 2011

(In billion rupees)

	Liabilities to	Claims on	Net claims	% GDP
Africa	18.8	27.1	8.2	2.6
Asia	27.5	287.0	259.5	83.2
Australia	0.5	2.3	1.8	0.6
Europe	123.3	141.1	17.8	5.7
Mauritius	670.6	364.6	-306.0	-98.1
Middle East	1.7	11.7	9.9	3.2
US/Canada	13.4	14.1	0.7	0.2
Other	14.1	27.1	13.0	4.2

GBCs and residents fund non-residents and foreign banks on a net basis. The largest sources of funds for the banks are GBCs and domestic residents, which contribute about 170 percent of GDP to banks (Figures VII.7-8 and Table VII.2). Banks use the funds mainly to finance non-residents, the domestic economy (residents), and foreign banks. The maturity profile of assets and liabilities is considered to be well matched, although some further study would be beneficial (see below).

Figure VII.7. Claims on Sectors of Economy

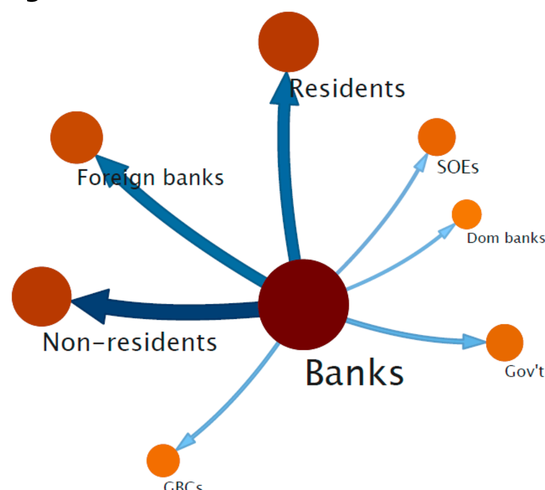


Figure VII.8. Liabilities to Sectors of Economy

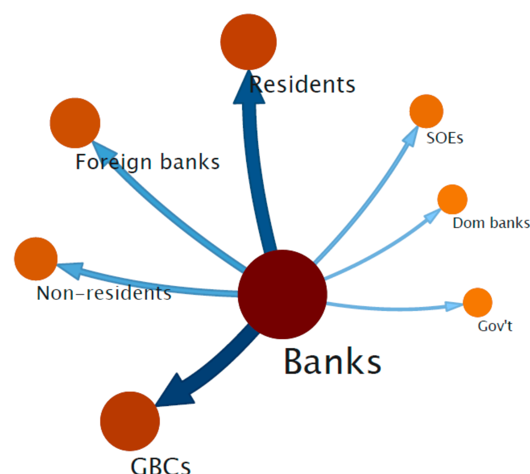


Table VII.2. Mauritius: Breakdown of Banks' Balance Sheet, June 2011

(In billion rupees)

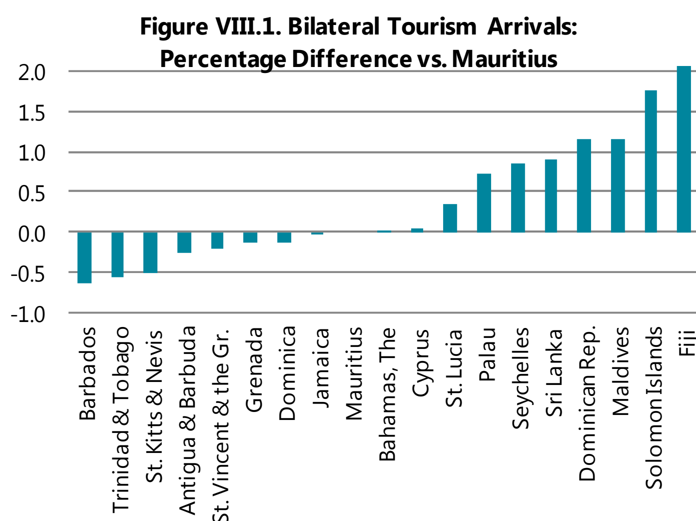
	Liabilities to	Claims on	Net claims	% GDP
Residents	241.8	208.1	-33.7	-10.8
SOEs	28.0	8.0	-20.0	-6.4
Gov't	3.4	51.5	48.1	15.4
Dom banks	3.8	3.8	0.0	0.0
GBCs	288.2	22.1	-266.1	-85.3
Non-residents	79.0	297.2	218.2	70.0
Foreign banks	95.0	199.7	104.7	33.6
Interbank	8.8	8.8	0.0	0.0

Areas of further investigation and analysis regarding stress testing should include (i) better understanding of the transmission of real, exchange rate, and interest rate shocks into NPLs; and (ii) monitoring of the cross-border and cross-sector exposures. In particular, better information on the international activities of GBCs would be useful in determining the potential risk to the banking system. GBCs intermediate foreign investments into other countries (mainly India) of a primarily equity type, which appears to be low risk. The float of funds that is held in Mauritius before being sent to their final destination is deposited with domestic banks. The banks mostly place these deposits with other banks abroad matching the maturity and currency profile of the funds involved, which should carry very limited risk. The authorities consider the risks from GBCs to be low and are working on improving the information available from GBCs to undertake better analysis of the potential risks.

APPENDIX VIII. TOURISM SECTOR COMPETITIVENESS[1]

At over 8 percent of GDP, tourism is Mauritius' major export industry, as well as a potential channel through which external shocks affect the domestic economy. Staff is currently undertaking research concerning tourism competitiveness and vulnerabilities stemming from the sector. The study uses a new panel dataset of the universe of bilateral tourism flows for 1999–2009, covering over 180 countries (underlying data from UNWTO), and applies a gravity model used in empirical international trade research since the 1960s. This appendix summarizes selected preliminary results that the mission shared with the authorities.

Assessing competitiveness of tourism destinations is complicated by the fact that tourism flows to each destination is subject to multiple objective factors, known in the traditional international trade literature as trade frictions. Some of these cannot be influenced by policies (at least not in a useful time frame), such as common borders, distances to main markets, bilateral cultural and historical ties. Accounting for and eliminating these effects allows for constructing a ranking of countries' tourism competitiveness.[2] As shown in Figure VIII.1, Mauritius is doing on par with major destinations in the Caribbean (The Bahamas and Jamaica), but is slightly behind regional competitors – Maldives and Seychelles. Preliminary results also show that Mauritius is doing slightly worse than predicted by the model, which, if correct, would allow some scope for increasing tourism arrivals through appropriate policies (e.g. further market diversification) over time.



The tourism industry represents an important channel through which Mauritius is exposed to the risks emanating from Europe. To quantify the impact of this slowdown, one requires estimates of the elasticity of tourism—as measured by arrivals, visitor-nights and receipts—to GDP in tourist-originating countries. Using first differences regressions, staff estimates the elasticity of tourist-arrivals at around 0.54, and the elasticity of the average tourist stay at 0.45. Mauritius is therefore likely to see tourism demand drop one for one if GDP growth in main markets (France, UK) turns negative. Preliminary results also indicate that tourists are price sensitive, as each percent of real appreciation is associated with a 0.5 percent shorter stay.

[1] Prepared by Alexander Culiuc.

[2] The computed competitiveness index is the value of the country dummy in a fixed effects regression with bilateral arrivals as explanatory variable and regressors including: GDPs of both countries, their population, areas, distances, price levels, geographical characteristics, common culture and history (language, colonial relationship, etc.).

INTERNATIONAL MONETARY FUND

MAURITIUS

STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

February 29, 2012

Prepared By The African Department

Approved by Saul Lizondo and Vivek Arora.

CONTENTS

APPENDIX I. RELATIONS WITH THE FUND 2

APPENDIX II. THE JMAP BANK-FUND MATRIX (2012) 6

APPENDIX III. RELATIONS WITH THE AFRICAN DEVELOPMENT BANK GROUP 9

APPENDIX IV. STATISTICAL ISSUES 11

APPENDIX I. RELATIONS WITH THE FUND

(As of January 31, 2012)

I. Membership Status: Joined: September 23, 1968; Article VIII

II. General Resources Account:	**SDR Million**	**%Quota**
Quota	101.60	100.00
Fund holdings of currency (Exchange Rate)	70.07	68.96
Reserve Tranche Position	31.54	31.05

III. SDR Department:	**SDR Million**	**%Allocation**
Net cumulative allocation	96.81	100.00
Holdings	99.91	103.21

IV. Outstanding Purchases and Loans: None

V. Latest Financial Arrangements:

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-By	Mar 01, 1985	Aug 31, 1986	49.00	49.00
Stand-By	May 18, 1983	Aug 17, 1984	49.50	49.50

VI. Projected Payments to Fund [1/]

(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2012	2013	2014	2015	2016
Principal					
Charges/Interest	0.00	0.00	0.00	0.00	0.00
Total	0.00	0.00	0.00	0.00	0.00

[1/] When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

VII. Implementation of HIPC Initiative: Not Applicable

VIII. Implementation of Multilateral Debt Relief Initiative (MDRI): Not Applicable

IX. Implementation of Post-Catastrophe Debt Relief (PCDR): Not Applicable

X. Exchange Rate Arrangement

Starting in July 1, 2010, Mauritius intervened occasionally in the foreign exchange market to smooth excess volatility and the de facto exchange rate arrangement was reclassified from free floating to floating. Mauritius has accepted the obligations of Article VIII, Section 2, 3, and 4. It maintains an exchange system free of multiple currency practices and of restrictions on the making of payments and transfers for current international transactions. Mauritius also maintains a liberal capital account. On February 13, 2012, US$1 was equivalent to MUR 28.94.

XI. Article IV Consultation

Mauritius is on the standard 12-month cycle. The last Article IV consultation staff report (Country Report No. 11/96, May, 2011) was completed by the Executive Board on April 14, 2011. A Financial System Stability Assessment update was completed by a joint IMF–World Bank team on April 20, 2007.

XII. Technical Assistance (2004–2012)

FAD mission on revenue administration and tax policy, February 2004.
MFD mission on banking supervision and legislation, October 2004.
MFD mission on banking supervision during 2005: the first mission in January 2005, and the second in March-April 2005.
FAD mission on revenue administration and tax policy, January 2005.
MFD mission on financial sector policy and strategy, January 2006.
FAD mission on fiscal adjustment strategy and Poverty and Social Impact Analysis (PSIA), February-March 2006.
MFD mission on financial sector policy and strategy, July 2006.
MFD mission on banking supervision/monetary operations/monetary policy, October 2006.
STA mission on multisector statistics, November 2006.
MCM mission on financial sector policy and strategy, January 2007.
MCM primary mission on Financial Sector Assessment Program (FSAP), February 2007.
FAD mission on Public Financial Management (PFM) and Medium-Term Expenditure Framework (MTEF), March 2007.
MCM mission on financial sector policy and strategy, March-April 2007.
STA mission on balance of payments statistics, March 2007.
MCM mission on foreign exchange markets, August 2007.
STA balance of payments module mission, October 2007.
STA mission on Phase II SDSS balance of payments statistics, October-November 2007.
STA Report on the Observance of Standards and Codes (ROSC) mission, November-December 2007.
FAD mission on Public Financial Management (PFM): Implementing Program-Based Budgeting: Next Steps, February 2008.
STA mission on national accounts statistics, February 2008.
STA mission on Phase II SDSS Government Finance Statistics, March 2008.
MCM mission on Central Bank-FSAP follow-up, March 2008 (2 missions).
STA mission on Phase II SDSS Multisector Statistics, March-April 2008.
STA mission on monetary and financial statistics, April 2008.
STA mission on balance of payments statistics, May 2009.
FAD mission on refining program budgeting and performance management, September 2009
STA mission on national accounts statistics, November 2009
STA mission on national accounts statistics, April 2010
STA mission on balance of payments statistics, July 2010
MCM mission on anti-money laundering (AML), August 2010
MCM mission on macroeconomic modeling, August/September 2010
FAD mission on refining program budgeting and performance management, September 2010
STA mission on international investment position, October 2010
FAD mission on PEFA, November 2010
STA mission on government finance statistics, January 2011
FAD mission on revenue administration, June 2011
LEG mission on AML/CFT, July 2011

STA mission on balance of payment statistics, September 2011
STA/DFID mission on external sector statistics, October 2011
MCM mission on macroeconomic modeling and forecasting, October 2011
MCM mission on technical assistance needs assessment, October 2011
LEG mission on AML/CFT, February 2012

Resident Representative: None.

APPENDIX II. THE JMAP BANK-FUND MATRIX (2012)

(As of February 9, 2012)

The IMF and World Bank Mauritius teams met on February 9 to discuss a Joint Managerial Action Plan (JMAP). The team from the World Bank comprised Mr. Muñoz (senior country economist) and from the IMF, Messrs. Petri, Culiuc, David and Ms. Svirydzenka (all AFR).

The IMF's work program entails continued engagement through the Article IV consultation process as well as technical assistance in: public financial management provided through the Fiscal Affairs Department (FAD) and AFRITAC South (AFS); financial sector stability and government debt and asset management through the Monetary and Capital Markets Department (MCM), and enhancements to macroeconomic statistics with the support of the Statistics Department (STA).

The World Bank's work program entails continuing work on infrastructure, competitiveness, public sector reform, social sectors and social protection. The 2007-2013 World Bank Country Partnership Strategy for Mauritius aims at helping the Government to deal with (i) short-term trade shocks and (ii) the transition to a more competitive and diversified economy, while minimizing negative social impacts along the transition. On-going and planned Bank assistance to Mauritius is:

- The Mauritius Infrastructure Project signed in December 2009 seeks to support the government investment program in transport, water and electricity. Additional support in infrastructure is envisaged through fee for services and a new infrastructure project under discussion.

- The IFC has focused its interventions on three key sectors: infrastructure, tourism and financial services. Its activities have been targeted at: supporting the mobilization of foreign direct investment to these sectors; introducing climate change mitigation and cleaner production standards and best practices; improving access to finance for SMEs; and promoting South-South transactions.

- The Bank is expected to approve in March 2012 two new two year Development Policy Loans of $20 million and US$15 million each per year. The Public Sector Performance DPL aims to support improvement in the performance of the public sector in Mauritius by assisting the government to implement reforms within the following three pillars: (i) strengthening services that support and empower the most vulnerable; (ii) streamlining trade regulation and processes; and (iii) improving human resource management in the civil service and monitoring of SOE performance. The Private Sector Competitiveness DPL aims to support competitiveness and enterprise development in three areas: (i) improving competitiveness and growth of enterprises; (ii) improving access to finance; and (iii) promoting ICT and e-Gov for enhancing competitiveness and transparency.

- In line with the DPL agenda, a civil service policy note will be delivered in FY12, to take stock of the challenges in the sector and support the authorities in the design and implementation of the on-going civil service reform.

- The Bank has initiated dialogue with the government to prepare a Public Expenditure Review report in FY13 to gain efficiency and effectiveness of the public sector; taking stock and propose areas of improvement in public enterprises and parastatals; benchmarking service delivery with peer countries and analyzing the redistributive impact of public services delivered.

- The Bank envisages a series of policy notes to identify opportunities in air space cooperation, tourism, ports and fisheries between Indian Ocean Countries.

The JMAP Bank-Fund Matrix (2012)

Title	Products	Provisional timing of mission	Expected delivery date
A. Mutual Information on Relevant Work Programs			
The World Bank work program in the next 12 months	Private Sector Competitiveness DPL	Not foreseen	March 2012
	Public Sector Performance DPL	Not foreseen	March 2012
	Civil Service Reform Policy Note	March 2012	April 2012
	Mauritius Infrastructure Project II	February 2012	FY13
	Public Expenditure Review	March 2012	FY13
	ROSC IAIS	Not foreseen	February 2012
	ROSC Corporate Governance	April 2012	March 2012
	Policy notes on Indian Ocean Countries	Not foreseen	FY13
A. Mutual Information on Relevant Work Programs			
The IMF work program in the next 12 months	2012 Article IV consultation	January 2012	Board meeting in March 2012
	TA on conglomeration risks, the regulatory structure, deposit insurance, bank resolution regime, and competition in the banking sector (MCM)	Second Quarter of 2012	
	TA on government debt and asset management (MCM)	Third Quarter of 2012	
B. Requests for Work Program inputs			
Bank request to Fund	Macroeconomic framework		February 2012
	Assessment Letter		February 2012
Fund request to Bank	Background sector information to complement Article IV report.		February 2012
C. Agreement on Joint Products and Missions			
Joint products			

APPENDIX III. RELATIONS WITH THE AFRICAN DEVELOPMENT BANK GROUP

(As of February 13, 2012)

The African Development Bank (AfDB)'s 2009-2013 Country Strategy Paper (CSP) for Mauritius provides the framework for its partnership with the country. The CSP has two pillars (i) reducing bottlenecks to competitiveness and trade and (ii) Enhancing public sector efficiency and social service delivery. The Bank's assistance to Mauritius combines lending and non-lending activities. Within the first pillar, the lending program currently focuses on infrastructure development particularly transport, ports and energy. The lending program within the second pillar focuses on an operation supporting water and sanitation services. The largest on-going lending operation is a policy-based lending in form of direct budget support that supports both pillar I and II. About US$200 million has been disbursed. A review of the operation will be conducted in March, 2012. The Bank is also providing MIC grants to support policy reforms, capacity building and studies in specific areas within the framework of the two strategic pillars. These include support to public debt management, public sector investment program, preparation of the sewerage master plan, review of outline planning, statistical capacity building and preparation of sector strategies for health, gender and ICT to improve the Performance based budgeting (PBB). In line with its Regional Integration Strategy for Southern African, the Bank is supporting the country's vision of becoming a regional center of excellence. In this area the Bank is working with the IOC in partnership with the EU, COMESA and SADC to support the recently launched Regional Multi-Disciplinary Centre of Excellence. The Bank is also collaborating with the Commonwealth Secretariat in supporting Capacity Building for Public Debt Management. Past collaboration with the World Bank (and other partners) has included the following sectors: water, sewerage, and sanitation (the Plaines Wilhems Sewerage Project) and transport (Southeastern Highway). The Bank collaborates very closely with other development partners including the World Bank, EU, AFD and UNDP in supporting structural reforms through its policy based lending. The CSP Mid Term Review Report of 2011 envisages continued collaboration on the policy based lending, MIC Grants and studies.

Table 1. Operations Summary as of February 13, 2012

Operations since: 1975
Total number of operations 37:
26 projects, 3 policy-based operations; 3 studies; 5 lines of credit.

Source of financing	Commitments net (UA million)	Percentage share	Disbursed amount (UA million)	Percentage disbursed[1]
ADB	766.25	98.28	217.10	27.85
ADF[2]	4.97	0.64	0.86	0.11
NTF[3]	8.40	1.08	3.30	0.42
MIC grant	2.37	0.30	0.31	0.04
Total	779.62	100.00	221.26	28.38

Source: African Development Bank

Questions may be referred to Carlos Mollinedo (email: C.MOLLINEDO@AFDB.ORG)

[1] Percentage of commitments net relative to each respective source of financing.
[2] African Development Fund.
[3] Nigeria Trust Fund.

APPENDIX IV. STATISTICAL ISSUES

<table>
<tr><td colspan="2">MAURITIUS—STATISTICAL ISSUES APPENDIX
As of February 10, 2012</td></tr>
<tr><td colspan="2">I. Assessment of Data Adequacy for Surveillance</td></tr>
<tr><td colspan="2">General: Data provision is adequate for surveillance. However, balance of payments (BOP) and international investment position (IIP) statistics could be further improved. The authorities are aware of this situation and are continuing work in this regard.</td></tr>
<tr><td colspan="2">Balance of Payments and International Investment Position Statistics: Coverage and accuracy of BOP and IIP statistics have diminished as a consequence of the growth of global business license holders. The authorities are in the process of reinforcing the statistical framework. Already, there were significant improvements in reducing the errors and omissions category in the BOP statistics.</td></tr>
<tr><td colspan="2">II. Data Standards and Quality</td></tr>
<tr><td>Participant in the GDDS since September 2000, Mauritius subscribed to Special Data Dissemination Standard (SDDS) on February 28, 2012. Mauritius is the second Sub-Saharan African country to subscribe to the SDDS.</td><td>A data ROSC report was published in August 2008.</td></tr>
</table>

Mauritius: Table of Common Indicators Required for Surveillance

February 10, 2012

	Date of latest observation	Date received	Frequency of data[7]	Frequency of reporting[7]	Frequency of publication[7]	Memo Items:	
						Data Quality-Methodological soundness [8]	Data Quality-Accuracy and reliability[9]
Exchange Rates	February 2012	02/2012	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	December 2011	02/2012	M	M	M		
Reserve/Base Money	December 2011	02/2012	M	M	M	O, LO, LO, LO	O, O, O, O, LO
Broad Money	December 2011	02/2012	M	M	M		
Central Bank Balance Sheet	December 2011	02/2012	M	M	M		
Consolidated Balance Sheet of the Banking System	December 2011	02/2012	M	M	M		
Interest Rates[2]	December 2011	02/2012	M	M	M		
Consumer Price Index	January 2012	02/2012	M	M	M	O, LO, O, O	O, O, O, O, O
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	Q4/2011	02/2012	Q	Q	Q	LO, O, O, O	LO, O, O, O, NO
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	Q4/2011	02/2012	Q	Q	Q		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Q4/2011	02/2012	Q	Q	Q		

Mauritius: Table of Common Indicators Required for Surveillance

February 10, 2012 (concluded)

	Date of latest observation	Date received	Frequency of data[7]	Frequency of reporting[7]	Frequency of publication[7]	Memo Items:	
						Data Quality-Methodological soundness [8]	Data Quality-Accuracy and reliability[9]
Exports and Imports of Goods and Services	Q3/2011	02/2012	Q	Q	Q		
External Current Account Balance	Q3/2011	02/2012	Q	Q	Q	O, LO, LO, LO	LNO, LNO, LO, LO, NO
GDP/GNP	Q3/2011	02/2012	Q	A	A	O, LO, O, LO	LO, O, LNO, LO, O
Gross External Debt	Q4/2011	02/2012	Q	Q	Q		
International Investment Position[6]	Q4/2011	02/2012	Q	Q	Q		

[1] Any reserve assets that are pledged of otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.

[2] Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes, and bonds.

[3] Foreign, domestic bank, and domestic nonbank financing.

[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

[5] Including currency and maturity composition.

[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.

[7] Daily (D); Weekly (W); Monthly (M); Quarterly (Q); Annually (A); Irregular (I); Not Available (NA).

[8] Reflects the assessment provided in the data ROSC published in August, 2008, and based on the findings of the mission that took place during November 29–December 7, 2007 for the dataset corresponding to the variables in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO).

[9] Same as footnote 8, except referring to international standards concerning source data, assessment and validation of source data, statistical techniques, assessment and validation of intermediate data and statistical outputs, and revision studies.

INTERNATIONAL MONETARY FUND

Public Information Notice

EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 12/27
FOR IMMEDIATE RELEASE
March 19, 2012

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2012 Article IV Consultation with Mauritius

On March 14, 2012, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Mauritius.[1]

Background

The Mauritian economy continued its recovery in 2011, but growth momentum has slowed down in face of an adverse external environment. Real GDP growth is estimated to remain at around 4 percent, driven mostly by growth in textiles, ICT, financial services, and real estate. Inflationary pressures increased substantially in the first half of the year (the year-on-year inflation rate tripled to 6.6 percent in June) mainly on account of import prices and one-time increases in administered prices. There was a further jump to 7 percent in November 2011 due to one-time increases in alcohol and tobacco excises. By December, inflationary pressures moderated with year-on-year inflation falling to 4.9 percent as the base effects became absorbed. The fiscal stance was broadly unchanged compared to 2010, but less expansionary than expected. The overall deficit is estimated to have narrowed to 2.4 percent of GDP. The structural primary deficit excluding grants decreased from 0.3 percent of GDP in 2010 to 0.1 percent. A small shortfall in total revenues and grants was more than offset by the fact that capital expenditures were almost 1 percentage point of GDP lower than anticipated. While total expense remained close to projected levels, contrary to what was anticipated there was a net

[1] 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. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

accumulation of resources in extra budgetary funds of almost 1 percent of GDP. Expense on goods and services and compensation of employees was lower than projected partly because of the postponing of local elections to 2012 and delays in filling vacancies in the civil service, whereas expense on grants and transfers was almost 2 percentage points of GDP higher than anticipated, because of larger capital grants and transfers to the special funds. Public sector debt declined to 56 percent of GDP.

Monetary policy was tightened with the key repo rate increased cumulatively by 65 basis points in response to inflationary developments. To address excess liquidity that built up in the system, the Bank of Mauritius (BOM) increased cash reserve requirements from 6 to 7 percent in February and issued Bank of Mauritius Bills and Notes with maturities of up to four years. It also increased the repo rate by 50 basis points in March and by 25 basis points in June, before lowering it by 10 basis points in December to address inflationary and economic developments. Private sector credit growth estimated at 13 percent for 2011 remained adequate, and similar to 2010. The authorities continued to intervene in the foreign exchange market to smooth excess volatility. Later in the year, the BOM also intervened to limit the appreciation of the rupee with most of the interventions sterilized. As a result of its liquidity management, the BOM's profitability was reduced in 2011.

The banking sector remains robust, and the system has proved resilient. Banks have remained liquid and well-capitalized, with 14.1 percent of Regulatory Tier I capital to risk-weighted assets in June. Non-performing loans (NPL) decreased from 2.8 percent of gross loans at end-2010 to 2.6 percent by June 2011. Banks have remained profitable with 21.5 percent return on equity, despite relatively low leverage ratios. In June 2011, the BOM started publishing CAMEL rating of domestic banks. This is a welcome development, as it is one of the first central banks in Sub-Saharan Africa (SSA) to do so. This should contribute to increase transparency about the state of the banking system. Despite strong export growth, a rebound in world commodity prices led to a widening of the current account deficit, but international reserves increased. Exports increased some 16 percent (in dollar terms), with strong growth registered across all major tradable industries. Tourism receipts grew some 12 percent as well, but a marked decrease in fourth quarter arrivals from key EU markets point to a difficult year ahead. On balance, the 17 percent increase in imports and a reduction in net transfers widened the current account deficit to some 10 percent of GDP. The deficit was more than covered with portfolio inflows and official loan disbursements. International reserves increased in nominal terms, but reserve cover in terms of imports of goods and services slipped to 4.4 months.

Over the past two decades, wide-ranging structural reforms, supported by prudent policies, have established Mauritius as a top regional performer. Mauritius' national statistical capacity is being strengthened in line with its needs as an emerging economy. In line with these efforts, Mauritius subscribed to the Special Data Dissemination Standard (SDDS) in February 2012.

Executive Board Assessment

Executive Directors agreed with the thrust of the staff appraisal. They commended the authorities' skillful policy response to the global crisis, which has enabled a strong economic recovery and contained inflationary pressures. The growth outlook for 2012 is broadly positive, although external risks have increased. The key priorities going forward are to sustain fiscal

consolidation, reduce external imbalances, enhance competitiveness and public sector service delivery, and foster inclusive growth.

Directors acknowledged the need for higher public investment to remove infrastructure bottlenecks. At the same time, most Directors saw merit in a slightly less expansionary fiscal stance than projected for 2012, in view of the need to build policy buffers. In case of a significant slowdown in growth, contingent measures in the budget can be used and automatic stabilizers should be allowed to operate.

Directors agreed that fiscal consolidation needs to be sustained to reduce debt vulnerabilities and achieve Mauritius' debt reduction targets. They emphasized the need to reform the social protection system and public enterprises. They supported efforts to rationalize subsidies and better target social benefits, and to develop a financial monitoring framework to minimize transfers to state owned enterprises, implement full cost recovery, and enhance governance.

Directors welcomed the authorities' efforts to ensure price stability, underpinned by an appropriate monetary policy stance. They supported continuing efforts to remove excess liquidity in the system. Directors welcomed future plans to adopt formal inflation targeting, which could help anchor inflation expectations, and supported ongoing initiatives to strengthen capacity within the central bank.

Directors noted the staff's assessment that the real exchange rate is broadly in line with fundamentals. They agreed that the floating regime has served the economy well, and that exchange rate interventions should be limited to smoothing volatility. They noted that an adequate reserve cushion together with a stronger fiscal position and improved competitiveness are important to reduce external imbalances and safeguard against shocks.

Directors noted that the banking system is well capitalized and resilient to shocks. They welcomed efforts to increase transparency and plans to strengthen supervisory coordination, enhance the stress testing framework, and improve data availability in the financial sector.

Directors called for continued efforts to secure more inclusive and diversified growth. In addition to social protection and state owned enterprise reform, this will require investments in human and physical infrastructure, as well as further improvements in the business environment.

Directors commended Mauritius' subscription to the Special Data Dissemination Standard (SDDS) in February 2012.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Mauritius: Selected Economic and Financial Indicators, 2009–2017

	2009	2010	2011		2012		2013	2014	2015	2016	2017
		Prel.	Last SR	Est.	Last SR	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
National income, prices and employment											
Real GDP	3.0	4.1	4.1	4.1	4.2	3.7	4.1	4.2	4.2	4.2	4.2
Real GDP per capita	2.5	3.7	3.5	3.5	3.6	3.1	3.5	3.6	3.6	3.7	3.7
GDP per capita (in U.S. dollars)	6,919	7,582	7,990	8,385	8,471	8,403	8,789	9,158	9,649	10,184	10,807
GDP deflator	-0.2	1.8	5.0	4.3	4.4	3.9	5.9	4.4	4.4	4.4	4.4
Consumer prices (period average)	2.5	2.9	7.4	6.5	4.6	4.8	5.3	4.9	4.4	4.4	4.4
Consumer prices (end of period)	1.5	6.1	5.8	4.9	4.4	5.0	5.5	4.4	4.4	4.4	4.4
Unemployment rate (percent)	7.3	7.8	…	7.8	…	...	...	...	...	...	...
External sector											
Exports of goods and services, f.o.b.	-15.6	18.9	12.5	15.5	6.6	3.0	6.1	6.0	6.2	6.5	6.7
Of which: tourism receipts	-23.5	15.9	10.4	13.5	11.2	2.9	10.3	9.2	9.0	9.1	9.1
Imports of goods and services, f.o.b.	-19.3	20.5	18.8	17.1	4.2	3.0	4.3	3.7	4.1	4.5	5.0
Nominal effective exchange rate (annual averages)	-5.8	3.2	...	3.1	...	...	...	...	...	...	...
Real effective exchange rate (annual averages)	-4.6	3.2	...	5.7	...	...	...	...	...	...	...
Terms of trade	7.8	-5.5	...	-4.9	...	...	...	...	...	...	...
			(Annual change in percent of beginning of period M2)								
Money and credit											
Net foreign assets	17.4	20.2	10.3	-7.7	...	16.9	...	...	...	...	...
Domestic credit	1.8	10.3	16.1	8.6	...	10.0	...	...	...	...	...
Net claims on government	1.1	1.0	2.5	-1.4	...	1.5	...	...	...	...	...
Credit to private sector[1]	0.4	10.1	13.6	10.7	...	8.2	...	...	...	...	...
Broad money (end of period, annual percentage change)	8.1	7.6	9.3	4.6	...	12.3	...	...	...	...	...
Income velocity of broad money	1.0	0.9	0.9	1.0	...	0.9	...	...	...	...	...
Interest rate (weighted average TBs, primary auctions)	4.4	3.9	...	4.6	...	...	...	...	...	...	...
			(Percent of GDP, unless otherwise indicated)								
Central government finances											
Overall consolidated balance (including grants)[2]	-2.0	-3.0	-4.8	-2.4	-4.5	-3.7	-3.2	-2.7	-2.7	-2.2	-1.8
Primary balance (including grants)[2]	1.8	0.4	-1.3	0.6	-1.0	-0.5	-0.6	-0.1	-0.2	0.3	0.6
Revenues and grants	22.8	21.9	21.5	21.2	21.0	21.8	20.9	21.1	21.2	21.2	21.3
Expenditure, excl. net lending	24.8	24.9	26.2	23.7	25.5	25.5	24.1	23.8	23.9	23.3	23.1
Domestic debt of central government	44.7	43.1	42.5	41.2	41.6	40.5	38.1	36.8	37.0	37.0	34.0
External debt of central government	6.0	7.4	8.9	8.5	10.5	10.0	11.6	12.9	12.7	12.2	11.2
Investment and saving											
Gross domestic investment	26.4	24.9	26.2	24.4	26.6	24.8	25.3	25.7	26.1	26.6	27.0
Public	6.6	6.1	7.6	6.4	7.7	7.4	7.7	7.8	8.3	8.2	7.6
Private	19.8	18.8	18.6	18.0	18.9	17.5	17.5	17.9	17.9	18.3	19.4
Gross national savings	13.8	15.6	14.2	14.7	15.7	14.8	16.4	18.1	19.8	21.4	23.0
Public	-0.8	-0.5	-0.7	-0.7	-0.5	0.2	0.5	1.1	1.3	1.4	1.5
Private	14.6	16.1	14.9	15.5	16.2	14.7	15.8	17.1	18.5	20.1	21.5
External sector											
Balance of goods and services	-10.5	-12.1	-15.7	-13.5	-13.5	-13.8	-12.7	-11.4	-10.1	-8.9	-7.9
Exports of goods and services, f.o.b.	47.1	50.9	52.9	52.8	53.6	53.9	54.4	55.0	55.1	55.3	55.4
Imports of goods and services, f.o.b.	-57.6	-63.0	-68.6	-66.3	-67.1	-67.7	-67.2	-66.4	-65.2	-64.3	-63.2
Current account balance	-7.4	-8.2	-11.8	-9.9	-9.9	-10.2	-9.1	-7.8	-6.6	-5.4	-4.3
Overall balance	4.3	2.1	-0.9	1.3	0.1	-2.4	0.2	0.5	0.8	0.6	1.0
Total external debt[3]	12.7	14.4	13.5	15.0	15.2	16.1	17.7	18.4	16.5	14.8	14.6
Net international reserves (millions of U.S. dollars)	2,150	2,448	2,253	2,636	2,265	2,420	2,512	2,660	2,852	3,035	3,289
Months of imports of goods and services, f.o.b.	5.1	4.8	3.8	4.4	3.7	3.9	3.9	4.0	4.1	4.2	4.3
Memorandum items:											
GDP at current market prices (billions of Mauritian rupees)	282.0	299.1	327.4	324.8	356.6	350.0	385.9	419.6	456.3	496.5	540.2
GDP at current market prices (millions of U.S. dollars)	8,824	9,714	10,299	10,809	…	...	...	...	...	...	...
Public sector debt (percent of GDP)	59.6	57.3	58.8	56.1	59.7	57.0	55.7	54.8	55.5	54.2	49.8
Foreign currency long-term debt rating (Moody's)	Baa2	Baa2	…	Baa2	…	…	…	…	…	…	…

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

[1] Excludes credit to state-owned enterprises.

[2] *GFSM 2001* concept of net lending/net borrowing, includes special and other extrabudgetary funds.

[3] Reported debt only, excluding private sector short-term debt.

Statement by Mr. Kossi Assimaidou, Executive Director for Mauritius
March 14, 2012

My Mauritian authorities thank staff for the constructive and fruitful discussions held in Port-Louis in the context of the 2012 Article IV Consultation. The focus of the discussions was on the economic challenges facing the country given the global uncertainties, and the policies to be implemented to ensure continuous, sustainable and inclusive growth. In this regard, my authorities highly appreciated the presentations made to senior officials by staff on the topics that are included in the Appendix to the main staff paper, and which address critical issues of interests to the country.

I. Recent Economic Developments and Outlook

The Mauritian economy performed well in 2011, with real GDP growing at 4.1 percent, helped by strong growth in textiles, the information technology (IT) sector, tourism, financial services and construction. This performance is also explained by the prudent macroeconomic policy put in place since the global financial crisis of 2008/09, and the continuous structural reforms being implemented in the different sectors of the economy. Consumer price inflation, after increasing in the middle of the year due to higher import prices and one-time increases in administered prices moderated to 4.9 percent by the end of the year. The unemployment rate stood at 7.9 percent at end-2011, same as in 2010.

Growth is expected to moderate in 2012 due to the adverse external environment. While the authorities welcome the projection by staff of real growth at 3.7 percent, they are concerned about external developments, in particular in the euro zone, the most important trade partner of Mauritius, as regards trade, tourism and foreign direct investment. If the external situation is as projected, the authorities are confident that the policies in place will help to maintain a healthy level of growth. However, should the difficult external situation worsens or lasts longer, the impact on the Mauritian economy would be significantly worse, and in this respect, the authorities have already prepared contingent macroeconomic policies, which are included in the 2012 budget.

Fiscal policy in 2011 was less expansionary than envisaged in the Budget, as capital expenditure was less than budgeted. Expenditure on goods and services and compensation of employees were also lower. As a result, the fiscal deficit narrowed to 2.4 percent of GDP. For 2012, fiscal policy is geared towards improving the economy's resilience to external shocks. The 2012 Budget emphasizes higher public investment spending, in particular, to address infrastructure constraints. However, the authorities will remain mindful of the deficit, and the objective of reducing the debt ratio which has been brought down to 57 percent of GDP, of which about 80 percent is domestic debt. If the global situation worsens, the authorities intend to allow fiscal stabilizers to work, and to reinforce the targeted programs to protect the poor and help firms restructure. Increased spending on infrastructure, including from special funds, is also envisaged under such circumstances.

Monetary policy was tightened in 2011 to address inflationary pressures. The key repo rate was increased cumulatively by 65 basis points and the cash reserve requirement

was also increased from 6 to 7 percent. Private sector credit growth remained at 13.5 percent, the same as 2010. The Mauritian rupee appreciated during the year, mainly due to strong capital inflows and despite some interventions by the Bank of Mauritius (BOM). For 2012, monetary policy will remain focused on maintaining domestic price stability. In the implementation of its monetary policy, the BOM has relied on a "hybrid inflation targeting" framework which has been appropriate in the context of the Mauritian economy. However, the authorities agree with staff on the desirability to move, over the medium term, to a more formal inflation targeting framework, but before doing so, they are of the view that they should further strengthen their macro-forecasting and analytical capabilities, as well as price and external sector statistics. As regards the exchange rate, any further real appreciation not in line with fundamentals will be viewed with concern, in view of its adverse impact on competitiveness, and may warrant some exchange rate intervention. However, the authorities are of the view that presently the overvaluation in itself is not significant enough to warrant active exchange rate management. They prefer to let the rate be determined by the market, with limited intervention to smooth out fluctuations.

The banking sector remains healthy. It is liquid and well-capitalized. Its Regulatory Tier I capital to risk-weighted-assets remains well above Basel II and the proposed Basel III requirements. Banks have remained profitable, and non-performing loans are low. The stress tests performed by staff confirm the robustness of the sector and its resiliency to shocks. In March, 2011 the Bank of Mauritius started publishing the CAMEL ratings of local banks. Moreover, the BOM has made good progress in preparing the adoption of a deposit insurance scheme, as recommended by the 2007 FSAP. Enhancing the coordination of supervision between the BOM and the Financial Services Commission (FSC), which is in charge of regulating the non-bank financial sector, will continue to be pursued. Already a protocol of understanding has been signed between the two to reinforce the framework for exchanging information.

The external current account deficit widened to 10 percent of GDP in 2011. Although exports increased significantly, imports also increased due to higher costs, especially food and energy, and imports related to investment in infrastructure. FDI remained strong at about 3 percent of GDP, and there were loan disbursements to the government on previously approved projects. As a result, the overall balance registered a surplus of 1.2 percent of GDP.

II. Medium-term Challenges and Policies

The section in the staff report entitled "Long-term Challenges" and the appendices describe well the policies that have been implemented and those envisaged to ensure long-term sustainable growth. My authorities are in broad agreement with the analyses and policy recommendations of staff. I will therefore highlight some of the most important features and provide additional information for clarity and completeness.

Maintaining sustainable inclusive growth in the context of macroeconomic stability remains the primary objective of the authorities. The projection, based on policies being implemented and envisaged, is for per capita income to grow and reach about US $12,000 by 2020. Achieving a fair and equitable distribution of income in the context of

high economic growth remains an important objective of the authorities. In this regard, it is worth noting that extreme poverty is quite low, as less than 1 percent of the population lives on US $1.25 per day. At the same time, as the economy has developed, the tax system has become more progressive and social protection has also increased. Nevertheless, groups that are less poor seem to have benefitted more from economic growth. This is due to a number of factors as staff's studies show, as well as the fact that some of the subsidies and social benefits are given to the whole population. Nevertheless, the authorities very much appreciate staff's studies and recommendations and intend to use them to improve the targeting of social protection expenditures. Already, steps have been taken along the lines recommended by staff. The Social Register of Mauritius project is now being implemented which will enable further targeting of some social assistance programs, namely the social housing and day care centers programs which were announced in the last Budget. A proxy means test will be undertaken for all beneficiaries of these programs, and this will also apply to all beneficiaries of Social Aid gradually improving the targeting process.

As regards fiscal policy, it is the intention of the authorities to continue fiscal stabilization efforts. My authorities will implement policies that should bring the debt ratio to 50 percent of GDP by 2018, as is legally-mandated. The authorities' efforts will focus mainly on curtailing current expenditure, in particular, transfers to public enterprises and better targeting of social benefits. In this regard, the authorities are strengthening the monitoring of public enterprises to increase their operational efficiency and minimize government transfers. It is worth noting that presently, there are no current transfers to parastatals from the budget and capital transfers are in the form of advances at the cost of capital to government plus a small premium.

As regards taxation, Mauritius is playing a leading role in the development of green taxes, which are aimed at taxing CO2 emissions and encouraging ethanol production. This is being done through a system of subsidy/taxation of cars and ethanol as explained in Appendix IV of the staff report. Under the system in place for CO2 emissions, a levy is payable if the CO2 emission exceeds a certain threshold, and a rebate is granted if it is below the threshold. Regarding ethanol, it is to be noted that the tax system that is being developed will target the related externality and will not make use of a quantitative ethanol mandate. The ratio of the mix of ethanol to gasoline will be market determined.

The Mauritian authorities will pursue steadfastly the comprehensive structural reform plan that is needed to address the structural bottlenecks and to create a competitive environment conducive to the further development of the private sector. Important measures are being taken, namely:

- On the transportation system, the road network is being expanded, and other modes of transportation are being studied to reduce road congestion. In this regard, a light rail system on a PPP model is being studied with assistance from Singapore. The Government also is planning to award, in July, a PPP contract for the road decongestion program which will introduce toll roads.
- Water supply has become a serious problem, and the authorities are working closely with experts from Singapore to develop a water strategy. This strategy is considering, among others, how to involve the private sector in operating an integrated water sector. Already, early this year water tariff was significantly increased.

- The electricity company, which is profitable, is not expanding its own production but is relying on private suppliers for both expansion of its base load and renewable energy (a tender for wind power has just been awarded). It should also be noted that already about16 percent of electricity is being produced by the sugar factories through the use of “bagasse”, a by-product of sugar cane, and the electricity is fed into the national grid.
- Air Mauritius, the national airline, has already started the process of looking for a strategic partner.
- The statistical framework is being continuously strengthened, and since February of this year Mauritius has started to subscribe to the SDDS.

Overall, the Mauritian economy continues to perform well, and vulnerabilities are being addressed. The authorities remain committed to their reform agenda and will pursue their efforts that should help to take Mauritius to the next stage of development.