THE MAURITIUS CHAMBER OF COMMERCE AND INDUSTRY

MCCI ECONOMIC OUTLOOK

2018

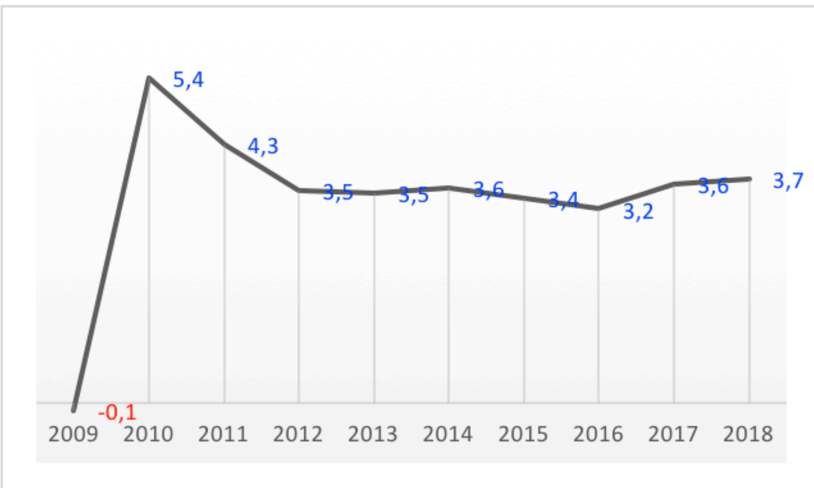
Novembre 2017

I. THE INTERNATIONAL CONTEXT

The global economy is strengthening

According to the IMF, the cyclical turnaround in the global economy observed in 2017 is expected to continue in 2018.

Figure 1: Real Global GDP growth



Source : IMF

The global economy is in a favourable economic phase. Growth is high, inflation low, and interest rates are stable and exceptionally low.

Yet, just one and a half years ago only, growth was

And yet, only a year and a half ago, growth was shaken by turbulence. The economic uncertainty with the Brexit, the different geopolitical tensions and the political situation in the United States made people fear the worst.

But, in the end, global growth has remained resilient in 2016 and should accelerate by 2017 indicating that shocks are now part of the global context and compel economic agents to adapt.

The recent period of uncertainty meant that economic agents have integrated the rule of unpredictability into the new economic configuration.

Thus, the macroeconomic scenario favoured by the IMF is that global growth should evolve at a much more sustained pace in 2017 as compared to 2016.

Indeed, the real GDP growth rate is expected to be 3.6 percent in 2017 compared to the rate of 3.2 percent reached in 2016.

The global acceleration is explained, on the one hand, for emerging countries by the coming out of recession of Brazil and Russia and on the other hand, by the progressive strengthening of the euro zone expansion.

IMF experts have noticed, in 2017, a noteworthy improvement in investment, commerce and industrial production. These elements compined with an upsurge in confidence of entrepreneurs and consumers have favoured this recovery.

Improvement of global outlook in 2018

The current phase of global growth is sufficiently shared to continue in 2018. For the first time since 2007, growth will be stable or accelerating in all countries.

The IMF predicts another improvement in global growth in 2018 with a growth in Real GDP of 3.7 percent.

Nevertheless, the absence of inflation indicates that the potential has not been attained. Though the benchmark outlook is better, inflation remains low, which indicates that the potential has not been attained.

Emerging economies will continue to record higher levels of economic growth than the global average. On average, the growth rate of real GDP is expected to be 4.8 percent for 2018, up from 4.6 percent in 2017.

The increase in domestic demand in China and the sustained recovery in the main emerging countries will support growth in 2018.

In this cyclical phase, growth in advanced economies should be of 2 percent in 2018 after a slightly higher growth of 2.1 percent in 2017.

Domestic demand and production should continue to increase in 2018.

In the United States, private sector investment will continue to grow, partly due to a recovery in the energy sector. In the euro area and Japan, stronger private consumption, investment and external demand will continue to drive overall growth.

Recovery in global trade

In their latest publication, the World Trade Organisation (WTO) forecasts a real increase in world trade for 2017 after a bleak year in 2016.

The estimate of growth in the volume of world trade in 2017 is 3.6 percent, a marked improvement over the small increase of 1.3 percent recorded in 2016.

The stronger growth forecast in 2017 is based on the recovery of trade flows in Asia and imports in North America, which had slowed in 2016.

Higher GDP growth, particularly in China and the United State, has boosted imports, thus boosting trade - demand is transmitted through regional supply chains.

The sustained growth in 2017 should not be maintained in 2018, given the prospects for tightening monetary policies. The institution expects 3.2 percent growth in trade in 2018.

A global unemployment rate of 5.8 percent in 2018

The level of economic growth is still too low to trigger a real dynamism in the labour market and thus significantly reducing the unemployment rate at the global level.

According to the International Labour Organization (ILO) , there are 201 million people unemployed worldwide in 2017, a rate of 5.8 percent, up slightly from the rate of 5.7 percent in

2016. For 2018, the overall unemployment rate will remain unchanged.

And a controlled inflation rate

One of the main paradoxes of the current period is that central banks have never so much used extraordinary and expansionary monetary policy.

Yet, inflation remains moderate, indicating that there are still unexploited capacities.

The inflation rate in 2018, according to the IMF, should be 3.3 percent, up 0.2 percentage points from the 3.1 percent rate achieved in 2017

The inflation rate in 2018, according to the IMF, should be 3.3 percent, an increase of 0.2 percentage points as compared to the 3.1 percent achieved in 2017.

Stable long-term prospects

The global economy is evolving in a dynamic but uncertain environment. It is in a situation in which there are many sources of shock and uncertainty.

These various shocks, sometimes favourable, sometimes unfavourable, necessarily affect the trajectory of recovery and growth of economies.

However, these elements should not jeopardize the pattern of global economic growth.

The latest macroeconomic forecasts suggest that growth in global GDP will remain on a balanced path in the coming years.

Our baseline scenario is a stabilization of global real GDP growth at around 3.7 percent per year by 2020.

II. EVOLUTION OF DETERMINANT VARIABLES

The year 2017 is considered, at the global level, as a cyclical turning point with improved economic performances.

For 2018, this trend is expected to continue.

At the local level, after the low point reached in 2015, we entered an upward phase of our economic cycle in 2016.

This is reflected in particular through the recovery in investment.

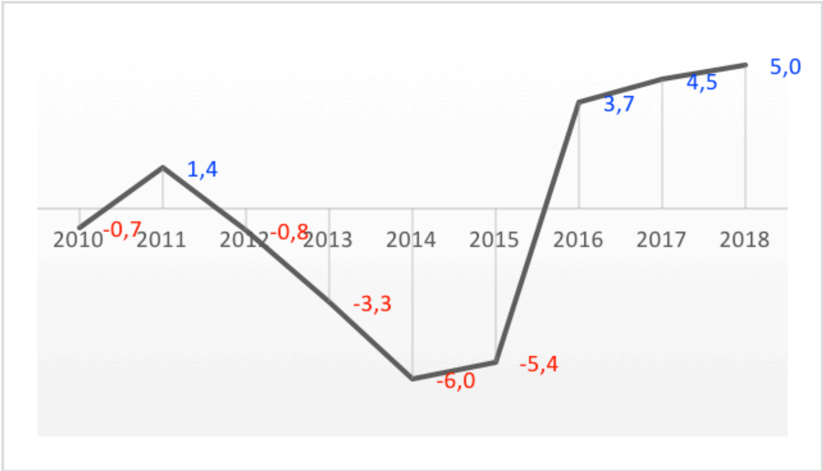
Investment, essential element of economic dynamism

Investment is the most important lever for sustainable growth and development. It is essential to strengthen productive capacities, transform the structure of the economy and create jobs.

After a period of contraction between 2012 and 2015 (a cumulative decline of about 15 percent of investment) we had a recovery in investment in 2016 with a growth rate of 3.7 percent.

This recovery in investment accelerated in 2017 with an expected rate of 4.5 percent.

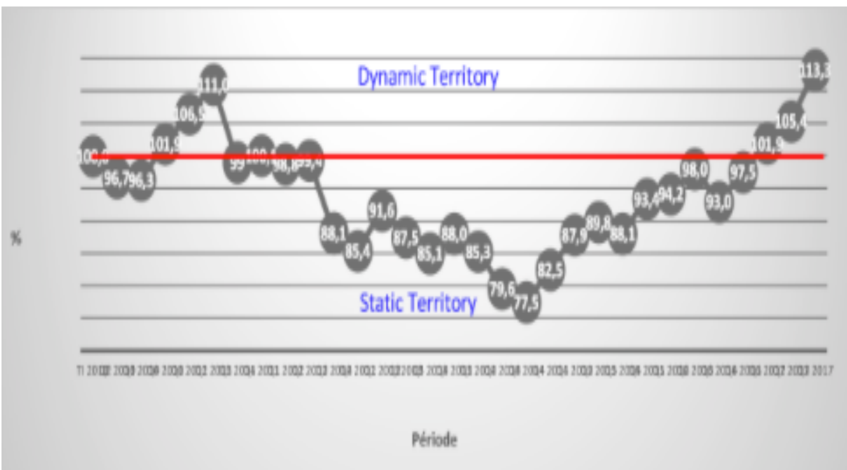
Figure 2 : Investment growth rate



For 2018, the indicators are favourable

On the one hand, the morale of entrepreneurs is at its highest and is well established in dynamic territory, as reported by the synthetic indicator of the business climate. This is one of the most important factors influencing private investment, indicating a further rise in private investment.

Figure 3 : The Business confidence indicator for enterprises



And on the other hand, at the public sector level, public investment spending should increase with the launch of several projects in 2018, especially the Metro Express.

Taking these factors into account, we, at the MCCI, expect an average of 5.0 percent growth in overall investment in 2018

Consumption, the engine of economic growth

Consumption is the essential foundation for economic growth in Mauritius. According to our econometric modelling, the regression coefficient on consumption growth in real terms is 0.56 in our economic growth.

This implies that a 1 percentage point increase in consumption would increase the economic growth rate by 0.56 percentage points, all other things being equal.

However, the Great Depression of 2009 had a strong impact on consumption in Mauritius, leading to a sharp deceleration in the growth rate of consumption.

Indeed, according to available data, the rate has decreased from around 5 percent on average over the pre-crisis period, to 2.7 percent, on average, in the post-crisis period.

We must take into account a fundamental aspect that influences the level of global consumption. It is the psychological element. There are numerous empirical studies that show that, in times of crisis, consumers who are driven by a fear factor, develop a negative anticipation of the future and consequently limit their consumption.

For 2017, after eight years, we have seen an improvement in the real growth rate of consumption.

Indeed, the rate has once again exceeded the 3 percent mark to reach 3.1 percent, implying an improvement in consumer expectations.

This improvement is expected to continue and intensify in 2018.

Policy makers have decided to implement a policy of targeted demand recovery that would move from a sub-optimal balance, low demand, unemployment and under-utilization of capital leading to negative expectations, a more adequate balance , stronger demand, confidence level and investment up and positive expectations.

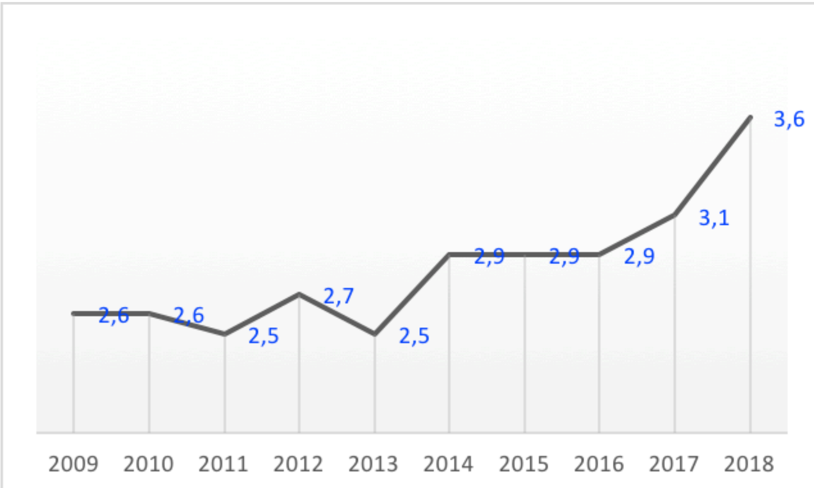
For 2017, after a period of eight years, we have noticed an improvement in the real growth of consumption.

In fact, the rate has broken the 3 percent mark to reach 3.1 percent, thus showing an improvement in the anticipation of consumers.

This improvement should continue and intensify in 2018.

Policy makers have decided to implement a targeted demand stimulating policy which would allow the country to move from a sub-optimal equilibrium, low demand, unemployment and under-utilization of capital leading to negative expectations towards a more adequate equilibrium level , stronger demand, confidence level and investment and positive expectations.

Figure 4 : Consumption growth and economic growth between 2009 and 2017



Through certain measures, in particular the allocation provided to vulnerable employees, the minimum wage, and the fiscal easing measures (raising the income tax exemption thresholds) for individuals, the public authority aims to boost economic activity through a boost in demand.

According to our estimates, some Rs. 3 Billion will be injected in the economy.

Taking these factors into account, we project, at the MCCI, a real growth rate of 3.6 percent of consumption in 2018.

The level of exports

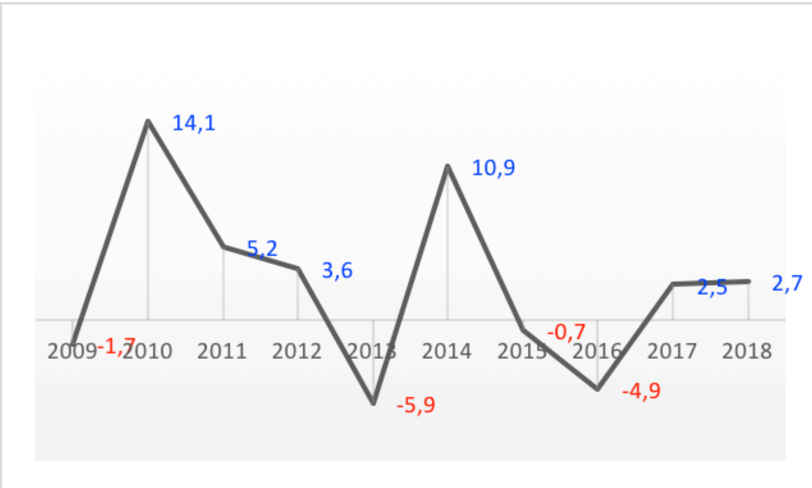
The level of our exports of goods and services has seen high fluctuations recently. We notice that there has been high increses of 14.1 percent in 2010 and 10.9 percent in 2014 as well as high decreases of -5.9 percent in 2013 and -4.9 percent in 2016.

This shows the effects of the global environment.

After two difficult years in 2015 and 2016, the level of exports of goods and services has improved in 2017.

In fact, after negative growth rates, -0,7 percent in 2015 and –4,9 percent in 2016, growth rate should be of 2.5 percent in 2017.

Figure 5 : Growth rate of exports of goods and services and economic growth between 2009 and 2017



For 2018, given the improvement in global demand which will have a positive effect on global trade flows, we estimate a growth rate of 2.7 percent in exports of goods and services.

III. FORECAST OF MAIN ECONOMIC INDICATORS

The moderate business cycle phase has closed in 2016. This is evidenced by the evolution of investment, especially private investment.

After a period of contraction between 2012 and 2015, we had a recovery in investment, global and private, in 2016 and this improvement should continue in 2017 and 2018.

Growth has accelerated as from the second half of 2016 at an annual rate slightly above 4 percent.

This cyclical recovery of the Mauritian economy continued in 2017 and we favour a macroeconomic scenario where the real GDP growth rate would be 4 percent, up 0.2 points from 2016.

A growth rate of 4.4 percent in 2018

For 2018, taking in consideration the evolution of the different variables mentioned above, the econometric model of the MCCI forecasts that the Mauritian economy should see an improvement of the real GDP of 4.4 percent, ceteris paribus.

Figure 6 : Real growth of GDP in Mauritius, 2009 to 2017

A potential growth rate of 4.1 percent

In order to be able to qualify and calibrate this recovery, it is advisable to carry out a cyclical diagnosis. Thus, we must evaluate the potential of our economy.

Macroeconomic analysis has evolved and is increasingly referring to the notion of potential growth.

This notion is frequently understood as the rate of GDP growth that could not be exceeded. This interpretation is wrong.

Potential GDP is the maximum achievable output using its full capacity, but without generating imbalances in the goods and labor markets.

Both conditions are important, but different.

The first condition refers to the macroeconomic production function and the second refers to the notion of the general equilibrium of the economy.

The measure of the output gap is central to measuring our potential.

This indicator measures the gap between actual GDP and its potential level, reflecting the position of the economy in the cycle.

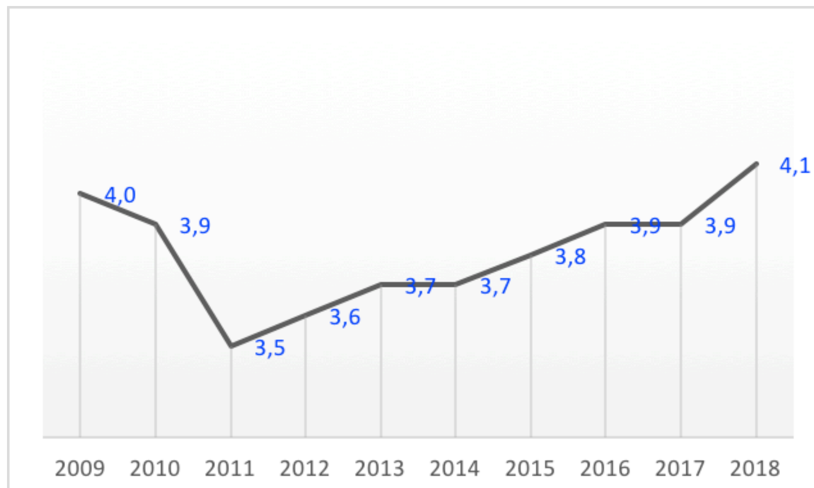
The output gap measures the distance that temporarily separates an economy from its reference level. It is positive if there are pressures on the productive apparatus, or negative if the factors of production are underutilized.

Estimating these differences in GDP ultimately allows the calculation of potential GDP by extracting the trend component of a macroeconomic series by smoothing GDP growth.

Thus, for 2018 we will have a positive output gap and a potential growth rate of 4.1 percent.

This implies that the negative output gap has been eliminated and that the actual growth rate will be higher than the potential rate, implying that our economy is regaining its momentum.

Figure 7 : Potential growth rate



A reasonable level of inflation

A positive output gap implies tensions in the goods and services market.

Inflation is the thermometer of economic activity. When it is too high, it indicates a state of overheating, where the actual growth is well above its potential.

We must, then, proceed to a restrictive policy accompanied by measures to improve our supply.

In the opposite case, where it is too weak, this clearly indicates an imbalance, where the actual growth is below its potential.

We must then proceed with an expansionary policy with measures to support consumption.

The output gap is a theoretically relevant indicator of the risks of short-run inflation in the economy.

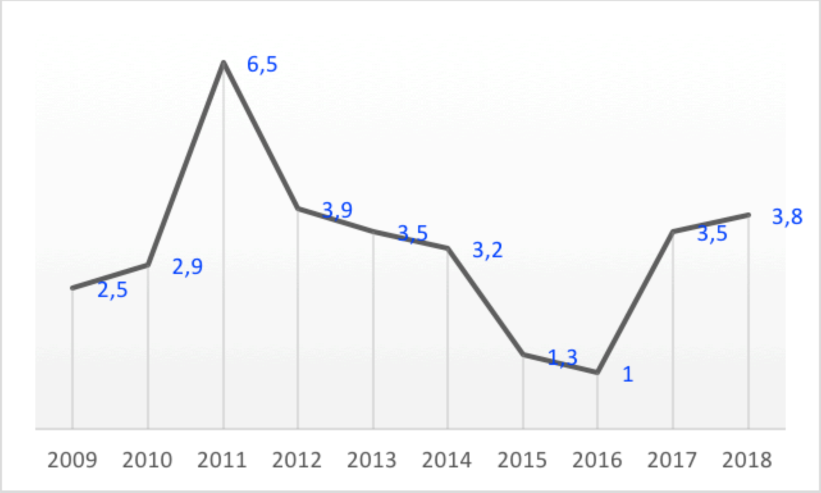
Indeed, any gap in GDP at its potential level is, by definition, a sign of an imbalance in the labour market or the goods market, resulting in disinflationary pressures if it is negative or inflationary pressures if it is positive. This link is net empirically.

Our estimates give us a positive output gap for 2017 and 2018 implying a rise in the inflation rate.

Thus, for 2018 we estimate that the inflation rate would be 3.8 percent after the rate of 3.5 percent achieved in 2017.

These rates are at a reasonable level for an emerging country

Figure 8 : Inflation rate, 2006 – 2017



Decreasing unemployment

The slack period, starting in 2009, resulted in a steady rise in unemployment in Mauritius to a rate of 8 percent in 2013.

Part of this increase is the result of partly, a change in the cyclical unemployment rate linked to the inadequacy of economic growth, and, partly, of a rise in structural unemployment. Authors DeLong and Summers empirically demonstrate that the structural unemployment rate is likely to increase during a low cycle period. The unemployed see their skills deteriorate, so their productivity and hence their employability are reduced.

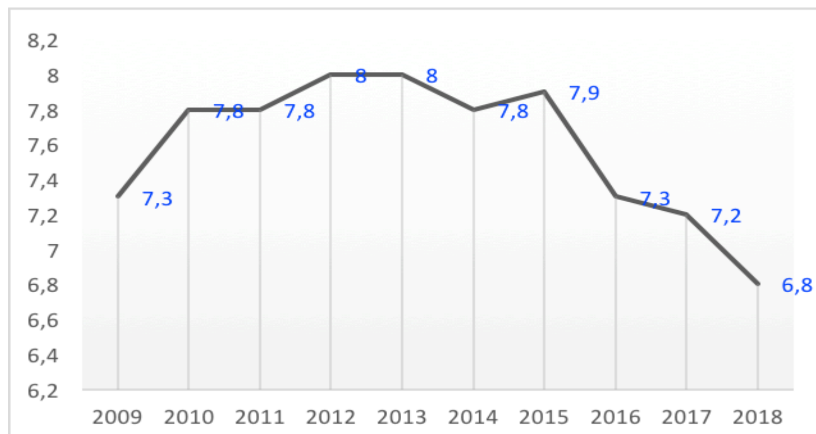
For unemployment to decline, there needs to be strong economic growth that exceeds the growth of the labor force and labor productivity. From 2016, we have seen, with the economic recovery and the stabilization of the active population, a significant inflection of the unemployment rate.

Thus, the unemployment rate fell by 0.5 points between 2015 and 2016 to reach 7.3 percent.

Given the increase in the economic growth and continued public policy to sustain employment and training, we estimate that the downward tendency should continue. The unemployment rate in Mauritius should fall to 7 percent in 2017 and 6.8 percent in 2018. As a reminder, since 1994, the unemployment rate has never gone below the 7 percent level.

We are now approaching the natural rate of unemployment; which corresponds to the long run unemployment rate of the economy, at 5 percent. We should start to reflect on the intensification of the opening of borders to foreign talents and skills.

Figure 9 : Effective growth and unemployment rate, 2006 - 2017



IV. ECONOMIC ANALYSIS

In its latest publication on the outlook for the global economy, the IMF says that the global economy should continue to consolidate in 2017 and 2018 after the sharp recovery seen since the second half of 2016.

In 2018, global growth will be on the rise by 0.5 percentage points compared to 2016, at 3.7 percent, the highest level of growth since the start of the Eurozone debt crisis.

The IMF expects growth to pick up in 2018, and the recovery will be much broader than any other recovery over the last decade.

Indeed, taking as basis GDP at purchasing power parity, the experts of this institution estimate that three quarter of the countries in the world should benefit from this acceleration of growth.

Financial conditions should remain favourable, with little turbulence in the future, even if the Federal Reserve continues to normalize its monetary policy.
These positive developments in the economic outlook provide good reasons to be more confident.

However, we must ensure sustainability and inclusivity with a longer-term vision, and thus implement the structural adjustments needed to increase resilience, productivity and investment.

Recent economic developments provide a global context for action to achieve inclusive and sustainable growth.

For the IMF, it is urgent and essential to continue to invest in human capital at all stages of the life cycle, to increase the share of labor income, contrary to the general trend of recent decades.

Improved education, training and retraining can both facilitate labor market adjustment, increase productivity and boost production.

In Mauritius, we will have in 2018 an improvement in the economic outlook.

Our estimates give us a real GDP growth rate of 4.4 percent.

The unemployment rate is expected to fall to 6.8 percent, the lowest rate since 1994, and inflation will be kept at a reasonable level for an emerging country, at 3.8 percent.

The recovery in economic activity is real. The turnaround took place in mid-2016 and the moderate business cycle phase that started in 2009 closed in 2016. This is evidenced by the positive evolution of investment, especially private investment.

Indeed, after a period of contraction between 2012 and 2015, we again had a recovery in investment, both total investment and private investment, in 2016 with positive growth rates of 3.7 percent and 6.1 percent respectively. . This positive investment trend is expected to continue in 2017 and 2018.

The Mauritian economy is creating jobs, which in turn generates consumption. Domestic demand is well oriented.

The surge in demand, a positive international economic environment and an accomodative monetary policy, combined with tax reforms to encourage the emergence of new sectors of activity and the improvement of the business environment, which is demonstrated by the prodigious recovery of our country in the ranking of the "Ease Of Doing Business" are very favorable signals for economic activity.

These are the factors that explain the improved prospects of the Mauritian economy.

At the same time, the utilization rate of production capacity is at its maximum.

We will enter a phase where the proportion of companies facing supply difficulties will increase while that of companies reporting only demand difficulties will decrease.

The cyclical upturn is generally identified by sustained increases in the synthetic business confidence index, which translates into a positive lag between the effective growth rate and the potential growth rate.

In other words, the end of a slack period results in a spontaneous rhythm of actual growth being greater than the potential.

As a result, growth in demand is returning, thus adjusting upward the price level in the short term, and consequently profitability and self-financing capacities.

In the medium term, rising demand and improving financial conditions will encourage entrepreneurs to enhance their supply, which will result in increased investment and hiring of workers. This, in turn, will boost demand and, as a result, create a virtuous circle.

Ten years after the Great Depression, we are back in favorable territory. Whilst remaining risk-averse, we must continue with this expansionary economic policy and aim to improve our potential growth.