MCCI ECONOMIC HIGHLIGHTS

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THE HIKE IN US INTEREST RATES AND ITS IMPACT ON MAURITIUS

THE MAURITIUS CHAMBER OF COMMERCE AND INDUSTRY

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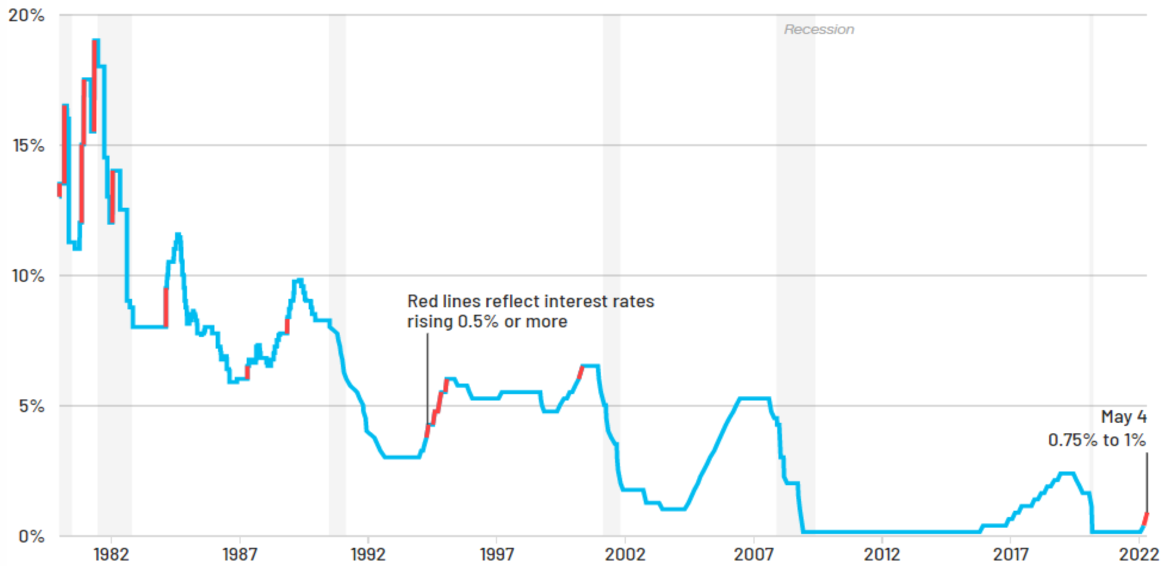
1. The 0.5% Interest Rate Hike

The Federal Reserve Bank has announced, on 04 May 2022, a 0.5% interest rate hike in more than two decades, in a bid to curb soaring inflation rates. Inflation in the United States has been continuously rising and further rate hikes are also expected in the coming months. Fed Chair, Mr. Jerome Powell emphasised that more half-point interest rate hikes will be "on the table at the next couple of meetings". The Bank also announced plans to reduce its $9 trillion (€8.5 trillion) balance sheet to deal with rapidly rising prices — in other words it intends to start selling off government bonds and other assets it previously purchased in a bid to spur inflation and growth, and drive up returns on these investments.

Central banks in several countries are tightening borrowing costs in an effort to cushion businesses and consumers from inflation. There are however real concerns that such moves could hamper economic growth and even push major economies into recession. Prices are seen rising at a time when many countries, still reeling from the pandemic, are facing added pressures from supply chain disruptions caused by the Russia-Ukraine war. Whilst the European Central Bank (ECB) has not given any signals as to whether they intend to raise rates, the Reserve Bank of India, the Reserve Bank of Australia and the Bank of England have also hiked their rates.



Source: Refinitiv
Graphic: Tal Yellin, CNN

2. Implications Of the Rate Hike on the Global Economy

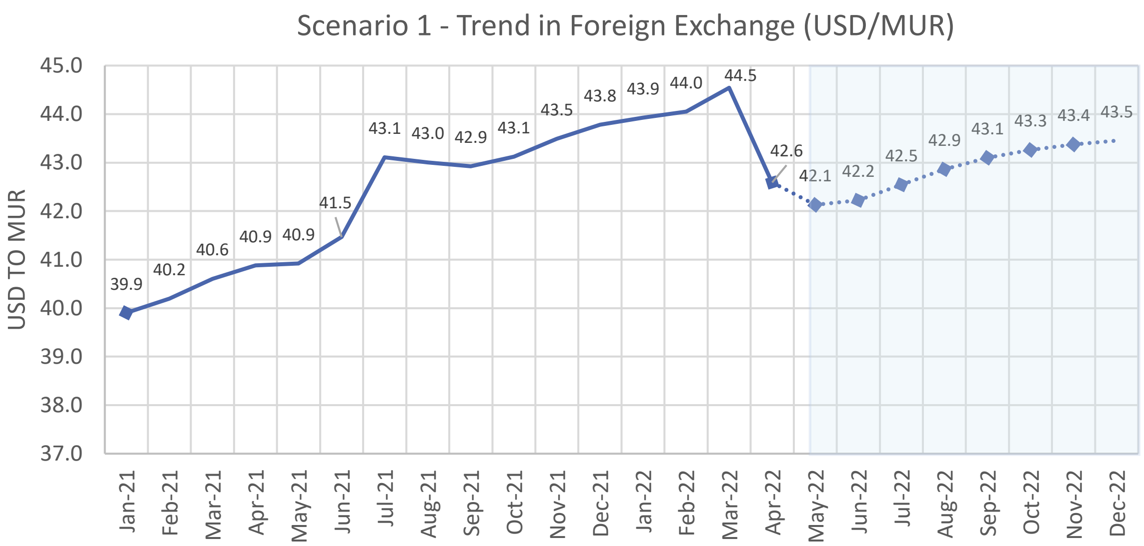
The interest rate hike is aimed at gradually slowing down consumer demand and decrease pressure on prices. However, it is to be noted that the Federal Reserve's decision to push up interest rates represents a substantial leap in borrowing costs for developing economies straight after they have borrowed billions to address COVID-19 pandemic, triggering a trend of capital outflows.

Policymakers generally tend to go about their decisions and actions slower than the economy, meaning that there will inevitably be a lag between inflationary movements and the response of policymakers. Indeed, such is the situation when inflation is surging as well as when it is at its zenith.

Inflation and repo rates have the inclination to gravitate in the same direction. Elevated interest rates render borrowing more expensive and dissuade consumers and businesses from making major acquisitions. Hence, as a result, the money supply for acquiring assets is subject to higher risk is constrained. A high repo rate inverts the wealth effect causing banks to become more prudent in their lending.

3. Implications Of the Rate Hike on the Mauritian Economy

There is a plethora of reasons why Mauritius is likely to be significantly affected by the US interest rate hike from 0.75% to 1% effective as of March 2022.



Source: Bank of Mauritius and MCCI forecast

In March 2022, the Mauritian exchange rate registered its feeblest position since 2004, depreciating by almost 60% (from MUR 27.9 in 2004 to MUR 44.5 in March 2022). Considering the impact of the USD on the Mauritian rupee and economies around the world, further depreciations are certainly on the cards. The depreciation of the Mauritian rupee is also anticipated to have a significant influence on the spending behaviour of the population.

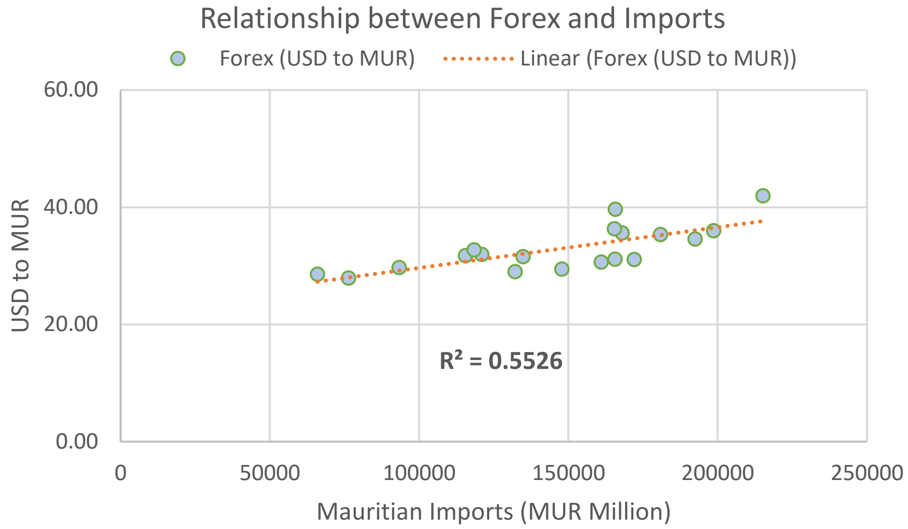
Mauritian policymakers are bound to intervene promptly and adjust their policies to reflect these changes, due to the potential risks of incurring uncertainty and going into a period of recession.

On this front, the Monetary Policy Committee (MPC) of the Bank of Mauritius recently (March 2022) decided to raise its interest rate for the first time in over a decade, from 1.85% to 2% in a bid to maintain its restrictive stance against inflationary pressures. Monetary stretching risks inflicting an economic blow to the Mauritian economy by slowing down growth, thereby potentially dragging an increase in unemployment coupled with cornering borrowers as well as investors.

Against this backdrop, the Mauritius Chamber of Commerce and Industry (MCCI) prognosticated a depreciation of 2% (from April 2022 to December 2022) of the Mauritian currency, encountered to some extent which can eventually be cushioned provided that the necessary measures and policies are implemented as appropriate (Scenario 1 Chart).

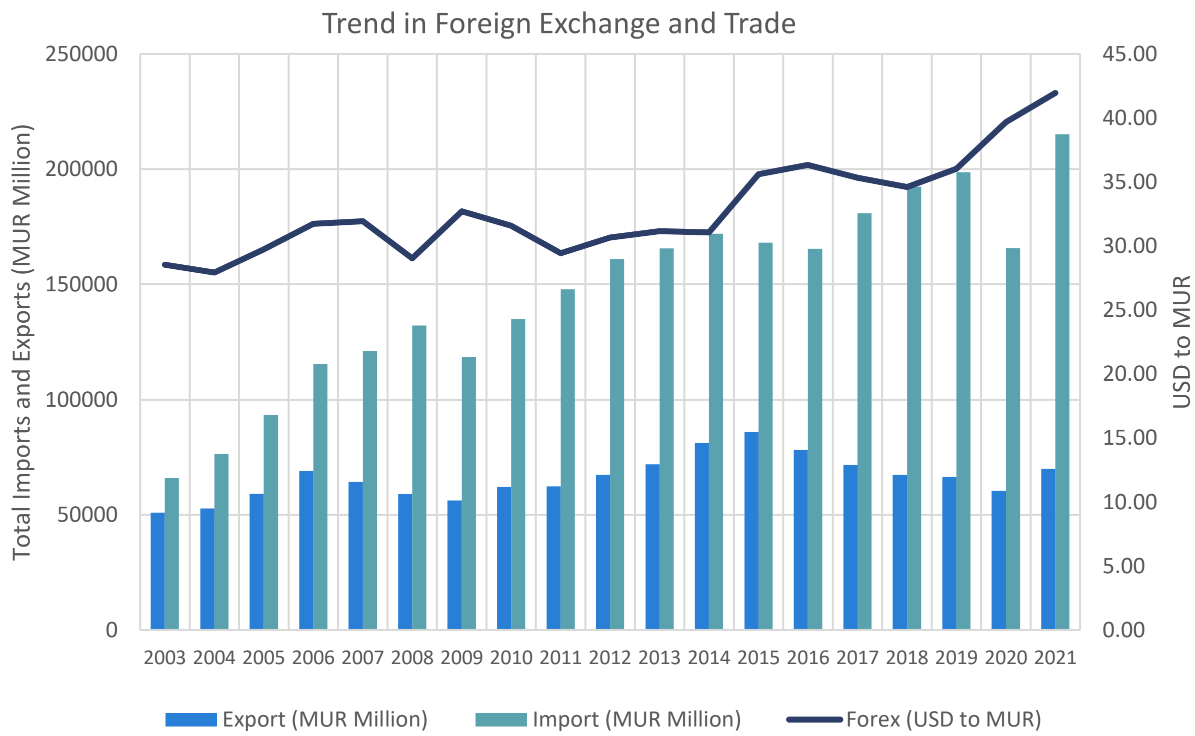
4. Implications On Trade

Mauritian imports and exports are strongly influenced by the volatility of the US dollar, as evidenced in the charts below. Moreover, foreign exchange rate poses a considerable economic and market risk for the island's business community. As Mauritius is highly dependent on imports, a direct correlation of 0.7 (R^2=0.55) can be observed between imports and the depreciation of the Mauritian currency. Faced with scant resources in Mauritius, all imports are becoming more costly hence the island is left with no other alternative but to maintain imports as it strives to sustain the population' s consumption needs.



Source: Bank of Mauritius and Statistics Mauritius

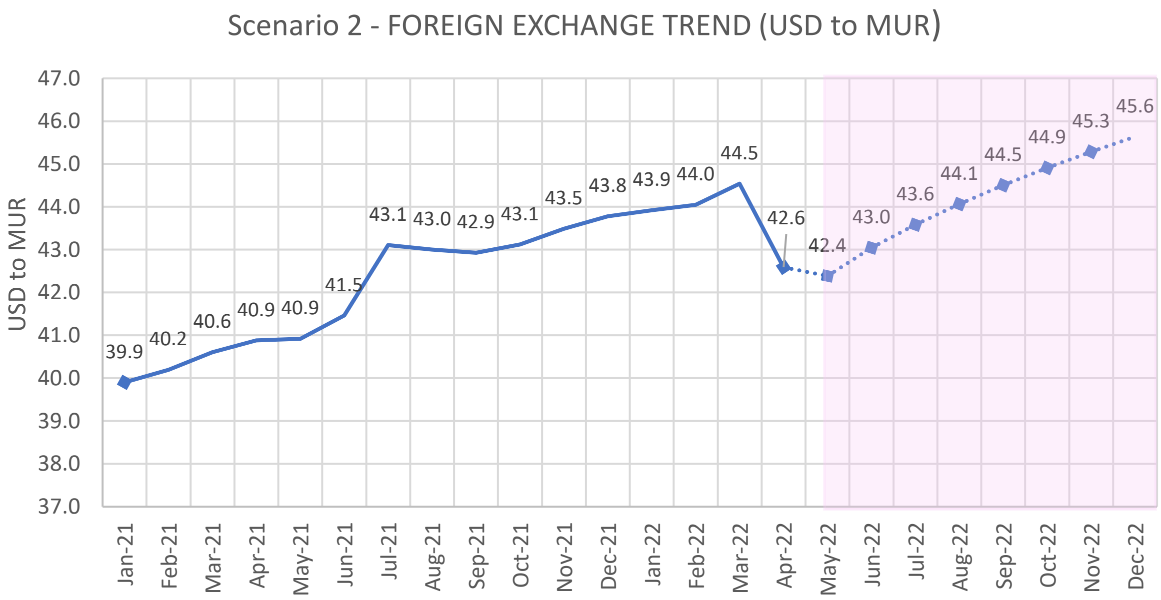
In 2005 and 2006, exports climbed from 12% to 17% and imports zoomed up from 22% to 24%. In addition, the Mauritian rupee depreciated by 6% from 2020 to 2021, thereby pushing up the cost of imports. As a result, the percentage growth of imports climbed around 30% and exports by 16%.



Source: Bank of Mauritius and Statistics Mauritius

As Mauritius relies extensively on imports, any further depreciation would shrink the purchasing power of both firms and household consumers, and adversely impinge on their overall ease of importing major commodities. Moreover, the strengthening of the US Dollar and the ongoing upward trend in crude oil prices across the globe are burdening the prevailing market sentiment. For petroleum products, foodstuffs and other commodities for which imports do not recede under a weak exchange rate, a depreciation of the Mauritian rupee will further inflate the cost of imports in Mauritius whereby driving up the cost of doing business. Moreover, given that the US dollar cost of petroleum and basic commodities are already sky-high, any subsequent surge could cause the Mauritian fiscal deficit to increase.

The situation is a matter of particular concern at a period when logjams in the supply chain and the Russo-Ukrainian crisis have already halted the flow of agricultural commodities such as sunflower oil and among other commodities, and consequently triggered soaring food prices in Mauritius. Thence, domestic inflation is fuelled by imported inflation resulting from hike in prices of other products around the world.



Source: Bank of Mauritius and MCCI forecast

In addition, the danger of imported inflation now exists since the Mauritian currency is expected to be subject to further depreciation of 8% by December 2022 (from April 2022) as forecast by the MCCI (Scenario 2), as the Financial Times reported in May that the US interest rates will undergo through more hikes of similar magnitudes. Such a situation is hardly ever considered to be particularly benign, especially as inflation and low foreign currency reserves threaten to undermine not only the economic growth in Mauritius but ultimately the island's export competitiveness as well owing to the fact that the majority of raw materials are imported.

5. Concluding Remarks

Interest rate has an economic and financial knock-on impact on all sectors. There is no distinction between sectors or industries that need to expand or be promoted and industries that are phased out due to them being inherently less productive or economically efficient. Additionally, if interest rates are pushed up too often and raised up far too high, the result might be that productive and efficient industries are pressured or even driven out of business alongside those that are less productive. Thus, a further increase in inflation coupled with a severe depreciation of the Mauritian currency cannot be expected to bring good tidings to the economy. It is anticipated that rising price pressures and monetary tightening by the US Federal Reserve will see the Central Bank maintain a hawkish stance in 2022 & 2023. The next meeting of the MPC is scheduled for June 2022.

6. Sources

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