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Economic Update

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MCB GROUP

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RECENT INTERNATIONAL DEVELOPMENTS

Global growth performance

The COVID-19 pandemic has continued to spread around the world during the past months. As of date, over 1.1 million lives have tragically been lost, with the number of positive cases having climbed above 40 million. The pandemic has exposed the global economy to an unprecedented situation and has led to an unimaginable hit on societies and families, with the deep wounds being put into light by the significant reduction in work hours and the potential ramifications on global poverty levels. Yet, there are some reasons to be hopeful as the world is gradually adapting to living with the uncertainty triggered by the virus while testing is ramping up and vaccine trials are progressing fast. According to the latest World Economic Outlook of the IMF, the global economy is coming back from the depths of its collapse in the first half of this year, backed by the easing of confinement measures, the re-opening of businesses and the prompt deployment of massive policy support across countries, without which the bleak numbers underlying the global recession would have been a lot worse. As such, the Fund continues to project a deep recession this year, with global growth forecast to stand at -4.4% in 2020, an improvement of 0.8 percentage points compared to its June projections. This revision owes to a slightly less severe hit to activity than previously expected in the second quarter as well as signs of a stronger recovery in the third quarter, offset partly by downgrades in some emerging and developing economies. A sharper-than-expected pickup in output took place in China during the second quarter, with activity returning to pre-pandemic levels, fueled by strong infrastructure investment. Moreover, latest data released by the authorities indicate that the Chinese economy gathered further pace during the third quarter of the year with GDP growing at 4.9%. Such dynamics have, in turn, supported a recovery in international trade patterns. Elsewhere, the US and the euro area both contracted at a historic pace during the second quarter, but the magnitude of the declines were less dramatic than foreseen, thereby contributing to an upward revision in the forecasted growth rate in the advanced economy group this year. That said, the pandemic continued to exert a substantial toll on some other large emerging market and developing economies, with India suffering its steepest contraction on record as the strict lockdown restrictions dented both consumer and business spending. Across sub-Saharan Africa (SSA), South Africa suffered a fall of about 17% in output in year-on-year terms in the second quarter of the year, with the economy now stuck in recession for the longest time since 1992, while economic activity in Nigeria dropped by some 6% in the second quarter, compared to the same period last year. Overall, activity in SSA is projected to contract by some 3% this year – the region's lowest growth performance on record.

For 2021, global growth is projected to rebound by 5.2%, a little lower than envisaged in the June outlook of the Fund, reflecting the less steep downturn being forecast in 2020 and the expected maintenance of social distancing measures which are expected to subsequently fade over as vaccine coverage expands and therapies improve. That said, except for China, where output is expected to exceed 2019 levels this year, output in both advanced economies and emerging market and developing economies are projected to remain below 2019 levels even next year, contributing to unemployment figures remaining elevated. Beyond 2021, the Fund expects global growth to slow to about 3.5% into the medium term. The cumulative loss in output relative to the pre-pandemic projected path is set to grow from USD 11 trillion over 2020-21 to USD 28 trillion over 2020-25, representing a severe setback to the improvement in average living standards.

While the global economy is gradually coming back from the fall observed in the first half of the year, the ascent will likely be long, uneven, and uncertain. Moreover, the risk of worse growth outcomes than projected remains significant. If the outbreak of the virus recurs – as it is currently the case in some countries – and progress on treatments and vaccines is slower than anticipated, or countries' access to them remains unequal, economic activity could be lower than expected, with renewed social distancing and tighter lockdowns. Considering the severity of the recession and the possible withdrawal of emergency support in some countries, rising bankruptcies could compound job and income losses. Deteriorating financial sentiment could trigger a sudden stop in new lending (or failure to roll over existing debt) to vulnerable economies. Moreover, cross-border spillovers from weaker external demand could amplify the impact of country-specific shocks, while geopolitical tensions could again flare up, with potential impact on oil prices.

Financial and market indicators

On another note, financial market conditions have eased further in recent months on the back of unprecedented policy actions deployed by authorities worldwide. The rebound in asset prices and the improvement in global financial conditions have benefited not only advanced economies, but also emerging markets. That said, as stressed in the latest IMF Global Financial Stability Report, a disconnect persists between financial markets – where there have been rising stock market valuations (despite the recent repricing) – and the weak economic activity and uncertain outlook. On the currency front, the US dollar lost some grounds vis-à-vis currencies of other advanced economies lately, reflecting notably the large rate cuts and other support measures deployed by the Federal Reserve – including dollar swap lines with other central banks – as well as the uncertainties being triggered by the upcoming Presidential election. Regarding commodity markets, gold prices have experienced a record rally during the past months, with prices surpassing USD 2,000 per troy oz in August for the first time in history, as investors piled into safe-haven assets in the wake of the pandemic, the weakening US dollar and low inflation expectations. As for oil prices, after stabilising at around USD 40-45 per barrel since early June on the back of the lifting of COVID-19 restrictions worldwide and the reining in of production by OPEC+ members, Brent crude prices moderated in October following the hike in cases along with uncertainties ahead of the US election. Overall, after averaging USD 61.39 in 2019, oil prices – inferred from the average of prices of Brent, Dubai Fateh, and West Texas Intermediate crude oil – are projected by the IMF to stand at USD 41.69 in 2020 and USD 46.70 in 2021, representing an upgrade from the Fund's June forecasts of USD 36.18 for 2020 and USD 37.54 for 2021.

UPDATED FORECASTS FOR MAURITIUS

Main economic indicators

	Unit	2017	2018	2019[1]	2020[2]	2021[3]
Real sector						
GVA at basic prices	Rs bn	403	422	438	387	431
GDP at market prices	Rs bn	457	481	498	440	489
GVA growth (at basic prices)	%	3.6	3.6	3.2	-14.1	7.6
GDP growth (at market prices)	%	3.8	3.8	3.0	-14.3	7.5
Gross Domestic Saving	% GDP	10.0	8.9	8.8	6.7	8.8
Gross Fixed Capital Formation	% GDP	17.4	18.8	19.6	18.0	18.8
Private sector investment	% GDP	13.3	14.2	14.3	12.7	13.5
Public sector investment	% GDP	4.1	4.5	5.3	5.3	5.2
Headline inflation	Dec, %	3.7	3.2	0.5	2.7	2.6
Fiscal sector						
Budget balance	FY, % GDP	-3.5	-3.2	-3.2	-13.6	0.0
Public sector debt	Dec, % GDP	63.5	64.9	65.5	76.9 *	74.9 *
External sector						
Balance of visible trade	Rs bn	-100.2	-112.1	-120.1	-116.2	-119.7
Current account balance	% GDP	-4.3	-5.8	-5.5	-15.6	-11.7
Overall balance of payments	% GDP	6.2	3.5	6.6	-5.6	-1.8
Memorandum item:						
Per capita GDP	*USD*	*10,407*	*11,124*	*11,056*	*8,853*	*9,691*

(1) Revised estimates (2) MCB revised forecasts (3) MCB updated projections

**Based on the new definition as provided for in the amended Public Debt Management Act i.e. public sector gross debt minus cash and cash equivalent and equity investment held by Government and public sector bodies in private entities. This figure is not strictly comparable to debt figures for previous years which are in gross terms.*

Sources: Statistics Mauritius, Ministry of Finance, Economic Planning & Development, Bank of Mauritius and MCB staff estimates

Economic growth

Revised forecasts for 2020

As expected, the Mauritian economy would witness a significant downturn this year in the wake of the nationwide lockdown and the significant difficulties confronting economic sectors amidst little visibility on the operating landscape. This mirrors trends being observed on the global scale, with 167 countries expected to experience a negative growth in 2020 as per the IMF, out of which 32 countries would register a contraction of more than 10%. In fact, as per our latest baseline projections, real GDP growth would contract by 14.1% this year when measured at basic prices and by 14.3% when computed at market prices. This represents a further downgrade from our previous forecasted contraction of around 11% issued in the previous edition of MCB Focus which had, itself, been subsequently revised downwards in the light of the highly dynamic nature of the operating landscape to some 13% for internal use, for instance, in our portfolio assessment exercises. Our updated prognoses, which are broadly in line with the magnitude of the slump being foreseen by the IMF, reflects our anticipation of a slower recovery path in the second half of the year amidst the effects of the prolonged closure of the country's international borders before the reopening thereof, in a staggered way, as from October 1. Against this backdrop, we have downgraded our already bleak outlook for the tourism sector, after factoring in the year-on-year drop in arrivals and earnings observed in the wake of the pandemic and weaker prospects for the coming months. We now expect value added in the sector to contract by some 75% in real terms this year. The acute downturn in the tourism and hospitality sector would, by virtue of the latter's direct and indirect spillover ramifications in the economy, trigger a more pronounced slowdown than previously expected in a wide range of economic sectors, including transport services, agriculture and wholesale and retail trade activities as well as administrative and support services, with particular consequences on SMEs across affected sectors. Activity in other sectors would also, to varying degrees, continue to bear the brunt of the challenging operating environment. Particularly, we expect a deep contraction in export-oriented manufacturing activities with value added in the textile sector contracting by an important margin this year in spite of a relative pickup being expected in the second half of the year. For its part, the seafood segment would post a restrained outcome in view of market access difficulties and supply disruptions following the outbreak of the virus, while the sugar sector would be impacted by a lower production level relative to last year despite benefiting from a higher price. Elsewhere, the decline in nationwide economic activities coupled with volatility on financial markets and dampened investment prospects would impact the performance of the financial and business services industry, although a slightly positive expansion is envisaged on the back of the sound buffers that banking operators have accumulated over the years. As for operators involved in the global business segment, they would remain subject to the uncertainties stemming from the inclusion of Mauritius on the EU list of High

Risk Third Countries, which became effective as from October 1. On a positive note, the ICT sector should sustain a positive expansion this year, supported by the continued activities by telecommunication and media operators during the lockdown period and the higher recourse to teleworking services and leveraging of technological platforms. As regards construction activities, while a pickup is foreseen in the second half relative to the first semester of the year on account of the implementation of large-scale public infrastructure projects, a large contraction remains on the cards for this year, after making allowance for the lockdown and the toll linked to economic uncertainties on private sector investment.

Indeed, private sector investment is expected to post a notable decline this year, with the indicator's ratio to GDP falling from 14.3% in 2019 to 12.7% in 2020. For its part, the share of public sector investment to GDP would be sustained at 5.3% this year. Overall, the country's Gross Fixed Capital Formation ratio is projected to decline by some 160 basis points, relative to last year, to stand at 18.0% this year. Furthermore, household consumption would contract this year in line with the fall in nationwide economic activities and in disposable income as well as the drag from the lockdown. Also, net exports of goods and services are anticipated to worsen markedly this year on the back, principally, of subdued demand for our goods and the sharp decline in tourism, despite the fall in volume of imports and the fillip from lower international oil prices.

Updated projections for 2021

For 2021, the performance and orientations of the Mauritian economy would continue to be subject to notable uncertainties with regard particularly to: (i) when the sanitary and economic crisis will subside globally and how long it will take to deploy effective vaccines to contain the spread of the virus; and (ii) the effectiveness of monetary and fiscal support measures put in place by the authorities locally, including the financial assistance extended by the Mauritius Investment Corporation to domestic systemic economic operators and the Government wage assistance schemes. In fact, real GDP growth is projected to pick up to 7.6% when measured at basic prices and 7.5% when computed at market prices, in line with the forecast of the Bank of Mauritius. That said, this would essentially reflect a technical rebound from the low base spawned by the sharp contraction in value added this year. Our forecasted growth for next year implies that activity levels would remain well below the pre-pandemic position, at around 92% of 2019 levels in real terms. Also, the quality of the projected growth deserves scrutiny to the extent that it would hinge on the intrinsic ability of the country to exhibit adequate resilience to and recuperate from the current storm, alongside sustaining a strong growth momentum that safeguards existing employment in affected sectors while creating new job opportunities over years ahead.

In effect, though support measures are being provided by the authorities, some key economic sectors continue to face up to key challenges. As a case in point, the hospitality sector, which has been a key contributor to the country's growth rate over the years, would not be out of the woods next year, with only a slow-moving pickup being envisaged after making allowance for: (i) subdued prospects for the recovery in international tourist travel, with the United Nations World Tourism Organization having, lately, stressed that the return to 2019 levels in terms of global passenger travel would take 2½ to 4 years; (ii) travelers' fear of catching the virus weighing on passenger numbers in the absence of a vaccine along with the maintenance of sanitary measures, including quarantine periods upon arrival; (iii) persisting disruptions to air routes owing to financial difficulties facing aviation companies; (iv) dampened purchasing power of tourists amidst economic difficulties; and (v) shift in preferences of travelers towards short haul destinations, as opposed to long haul destinations. As for the financial services sector, it would, next year, remain in the limelight, as the authorities face the challenge of getting the jurisdiction removed from the list of 'jurisdictions under increased monitoring' as per the Financial Action Task Force (FATF) listing and, as a result, from the EU list of High Risk Third Countries (i.e. those with deemed strategic deficiencies in their AML/CFT regimes). Encouragingly, the authorities have demonstrated their high-level political commitment to remove Mauritius from those lists and preserve the competitive positioning of the country's International Financial Centre, with key steps taken towards the implementation of the five remaining recommendations under the FATF Action Plan, including the passing of the Anti-Money Laundering and Combatting the Financing of Terrorism (Miscellaneous Provisions) Act 2020, the set-up of a high-level committee for overseeing the implementation of the FATF Action Plan and the undertaking of discussions with the Africa/Middle East Joint Group of the FATF. As matters stand, the authorities hope to get Mauritius removed from the FATF list and subsequently, from the European Commission list by mid next year, with the latter institution having confirmed that no top up requirements will be applied for the delisting of Mauritius.

Risks to the outlook

Bearing in mind the exceptionally unsteady and uncertain operating context, it is essential to remain cautious in our appraisal of the baseline growth projections that are formulated for the Mauritian economy. Overall, the risks to the domestic real GDP growth outlook for next year are, as mentioned previously, tilted on the downside. In fact, our macroeconomic forecasts will be recalibrated over time in light of enhanced visibility regarding key dynamics and forces impacting the international and domestic operating landscapes.

Upside risk to our outlook

As it stands, there is, albeit with a low probability of occurrence, some upside potential to our baseline growth performance for next year. This would result, principally, from a quicker-than-anticipated healing of global economic conditions – notably across our key markets – stemming from an earlier-than-expected discovery and widespread distribution of an effective treatment or vaccine that assists in curbing the contagion of the COVID-19 virus worldwide. This would, in turn, help in restoring business and consumer confidence, with positive ramifications on the country's external trade in goods and services, including notably a stronger recovery in the tourism sector than projected in our baseline scenario. Additionally, economic growth could end up being higher than projected in our base case in the event that a higher-than-envisioned growth is observed in nationwide investment, spurred by an implementation rate of public infrastructure projects which overshoots historical trends and a greater-than-expected pickup in private investment backed by improvements in business sentiment and further inroads achieved in respect of the business facilitation framework.

Downside risk to our outlook

Regarding the downside risks which are characterised by a low to moderate probability of materialisation, they notably relate to: (i) a further worsening in global economic conditions associated with a resurgence in COVID-19 cases across countries and a delay in the discovery of an effective vaccine to curb its transmission, with ripple effects on the country's trade in goods and services as well as on private sector investment prospects; (ii) higher volatility on international financial markets impacting capital and financial flows and inducing further pressures on the rupee and thus input costs; and (iii) delays in the implementation of public sector ventures. Additionally, growth could also be pinned down by the ramifications of a potential hike in oil prices amidst heightened geopolitical tensions as well as the spillover effects of a longer-than-envisaged presence of Mauritius on the FATF and EU lists notably on the global business segment. Furthermore, albeit having a low probability of occurrence as it stands, the reintroduction of restrictions in the event of the detection of new positive local cases in Mauritius may potentially derail the projected recovery. Also, a potential further deterioration of fiscal metrics could impact the country's credit rating, with possible spillover effects on the financial sector and on the country's endeavours to tap into global financial markets.

Other indicators

Headline inflation

Inflationary pressures have remained broadly contained lately, with headline inflation stabilising at 1.8% in the three months to August before picking up marginally to stand at 1.9% as at September 2020. In fact, in spite of facing up to the rise in prices of sugar-sweetened products and other goods and services, recent inflation trends largely reflect: (i) lower international commodity prices and weaker global economic activity; and (ii) subdued domestic demand, the downward adjustment in the prices of vegetables and the cut in mortgage interest rates locally. In the months ahead, inflation is expected to pursue a progressive uptrend after making allowance for the low statistical base, but is still expected to stay moderate at around 2.7% as at December 2020 on the back of the soft international commodity prices and subdued economic conditions. Such factors are anticipated to uphold the tempered evolution of consumer prices over the coming year, although the evolution of the external value of the currency and international commodity prices would continue to warrant attention. Overall, headline inflation is, barring exceptional events, forecast to stand at around 2.6% as at December 2021.

Labour market

The difficult economic context, tempered business confidence levels and sluggish capital formation in the wake of the pandemic have exacerbated the challenges on the labour market front, in spite of support measures put in place by the authorities. This can be gauged by the findings of the first round of the Rapid Continuous Multi-Purpose Household Survey (RCMPHS) undertaken by the World Bank Group and Statistics Mauritius (WBG-SM) to monitor the socio-economic effects of COVID-19 on the lives of Mauritian households. However, it is worth noting that the figures derived from the RCMPHS are not strictly comparable with historical labour statistics. For instance, the afore-mentioned survey is limited in coverage and extent, with a more restrictive definition of sub-categories and population used (RCMPHS based on individuals aged 16 to 64 and not in full-time education) compared with the usual Continuous Multi-Purpose Household Survey (based on the Mauritian population aged 16 years and above) on which labour statistics are computed by Statistics Mauritius. The national activity rate inferred from the survey has, as expected, dropped sharply during the lockdown period, reflecting the marked drop in employment – with 70% of the decline accounted for by the informal sector – and the rise in the proportion of people outside the labour force. That said, since the resumption of economic activities, the participation rate, based on the revised WBG-SM methodology is estimated to have rebounded, albeit remaining slightly below pre-pandemic level.

Beyond looking at the headline nationwide unemployment figure which is, itself, expected to deteriorate this year, the extent and seriousness of labour market difficulties can be gauged more holistically by considering the marked increase expected in the level of labour underutilisation – representing the sum of unemployed, skills-related and time-related underemployed and those in the potential labour force – in the wake of the pandemic. Indeed, labour underutilisation, which stood at an already high level of 158,000 in 2019 as per the Continuous Multi-Purpose Household Survey (i.e. close to 27% of the labour force) is anticipated to rise amidst: (i) the rise in unemployment particularly in SMEs and self-employed; (ii) the increase in number of people employed in large establishments most likely to opt for flexible working arrangements with shorter working hours with less pay; and (iii) the deterioration in labour utilisation from a skills-related standpoint for both existing and new entrants. Addressing the country's enduring labour market inadequacies – both qualitatively and quantitatively – would remain a key challenge moving forward and calls for key reforms to boost labour input in the economy. This can be achieved by, *inter alia*, improving labour utilisation and labour participation, with particular focus on women and youth, alongside pursuing the well-calibrated openness to foreign talents and expertise in strategically-targeted segments such as high-skilled human capital and Africa-focused entrepreneurs.

Public finance

Nearly all countries in the world have, amidst the crisis, been confronted by the same combination: higher spending to notably protect the health of people and support social safety nets and lower revenue in the wake of the marked decline in economic activities triggered by containment measures to fight the spread of the virus. Mauritius is no exception. Indeed, relative to the corresponding period of last year, total expenditure (including net acquisition of non-financial assets) rose by 53% during the period March – July 2020 to reach Rs 81.2 billion, with noticeable increases in grants and subsidies amidst the provision of wage assistance schemes as well as social benefits. On the other hand, total tax revenue registered a sharp decline during the period under review, mainly explained by a notable fall in taxes on goods and services and, to a lesser extent, a drop in taxes on income and profits. Overall, the budget deficit rose to Rs 43.9 billion during the period March – July 2020 when compared to Rs 5.1 billion during the same period of last year. Along the same lines, public sector debt has pursued its sharp upturn. The indicator rose to 69.1% of GDP as at June 2020 after netting out cash and cash equivalent and equity investment held by Government and public sector bodies in private entities as provided for in the amended Public Debt Management Act. In gross terms, public sector debt was estimated at 81.7% of GDP in June. Besides, while the authorities expect the overall budget to be balanced in FY 2020/21 on account of the exceptional contribution of Rs 60 billion from the Bank of Mauritius to meet recurrent and capital expenditures, fiscal metrics are, moving forward, likely to remain pressurised by the ramifications of the pandemic, along with the provision of support measures to those involved in the tourism sector in particular. As such, a key priority as the pandemic subsides, would be to underpin the economic recovery with an eye on cost effectiveness and foster credible medium-term reform plans towards ensuring fiscal sustainability.

External position

On the external front, persistently elevated imbalances continue to warrant attention in view of the challenging global economic conditions and dampened market access in the wake of the pandemic, while currency dynamics are also weighing in the balance. For the first semester of 2020, while the balance of trade deficit improved in absolute terms, reflecting a higher decline in the value of imports relative to the drop in exports of goods, the current account deficit deteriorated markedly to attain an estimated 10.4% of GDP compared to 3.6% in the corresponding period of last year. This significant increase mainly stems from a noticeable decline in services – with an unprecedented deficit in the second quarter – notably driven by the sharp drop in tourism earnings as well as a lower surplus in the primary income account. Reflecting the worsening in the current account deficit and a drop in capital and financial flows in spite of positive net errors and omissions, the balance of payments recorded a deficit estimated at Rs 9.8 billion during the first semester of the year compared to a surplus of Rs 26.6 billion posted during the same period of 2019.

For 2020, the balance of trade deficit is predicted to attain around Rs 116 billion. Next year, the indicator is set to deteriorate to reach just under Rs 120 billion on account of (i) a subdued evolution in exports to our main markets; and (ii) a rise in the import bill linked due to the purchase of machinery and transport equipment and relatively higher anticipated oil prices. Overall, the current account deficit is, as per our baseline scenario, anticipated to stand at around 15.6% of GDP in 2020 after factoring in very low tourism receipts in the second half of the year, before improving marginally to 11.7% in 2021 assuming a relative pickup in activities. All in all, the Balance of Payments would, after making allowance for the anticipated drop in the capital and financial flows, stand in a significant deficit position this year in spite of factoring in inflows linked to official borrowing, such as the loans in excess of USD 500 million received from Agence Française de Développement and African Development Bank, thus putting pressure on country's international reserves, though a narrowing in the deficit is foreseen next year.

J. Gilbert Gnany
Chief Strategy Officer

October 21, 2020

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