Occasional paper **No: 74**

# MCB Focus

## Economic Update

October 2018

MCB GROUP

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## THE GLOBAL ECONOMY

Kofi Annan, former Secretary-General of the United Nations, once said, *"Change is a process which has to be managed".* This catchphrase is valid for describing the current state of the global economy, as it appears to be morphing into a new reality. Basically, while the steady global expansion underway since the mid-2016 continues, world growth has plateaued in the first half of the year, with the expansion becoming less synchronised across countries. Against this backdrop, the IMF has, in its latest World Economic Outlook, notched down its global growth forecasts for this year and next by 0.2 percentage point in each case, relative to its prognoses released in its July update. This represents the first growth downgrade in over two years. The Fund now expects world growth to remain unchanged from last year, at 3.7% in both 2018 and 2019. In particular, the downward revision has been triggered by the ramifications of widespread trade tensions – notably between the US and China – on the pace of global investment, manufacturing and trade, which had, thus far, played a key role in underpinning the global recovery. Concomitantly, the Fund's revised baseline scenario evokes a weaker outlook for a number of advanced economies and for some key emerging market and developing economies, on the back of country-specific factors, tighter financing conditions, geopolitical tensions and higher oil import bills. Moreover, the balance of risks to the global outlook has now shifted to the downside, both in the short term and beyond. Indeed, while the potential for upside surprises has receded, there are now darker clouds on the horizon that could lead to lower-than-projected global outturns, stemming notably from threats of:

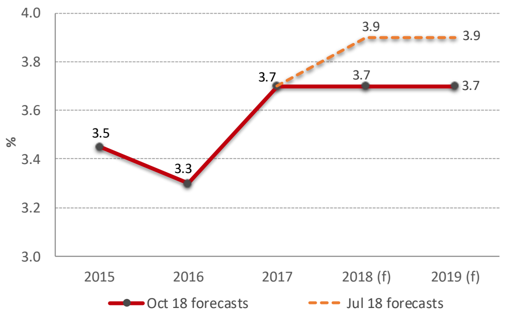
- An intensification of trade tensions and the associated further rise in policy uncertainty, impacting business and financial market sentiment, and triggering financial market volatility and a more pronounced slowdown in trade and investment;
- Sudden tightening of financial conditions on the back of a sharper-than-expected rise in US interest rates, which would accelerate capital flight from emerging markets and lead to a further US dollar appreciation, thereby straining economies with high leverage and balance sheet mismatches;
- Further build-up of financial vulnerabilities and implementation of unsustainable economic policies in the face of a subdued growth outlook and rising income inequality levels; and
- Shocks of a non-economic origin including geopolitical tensions and domestic strifes, rise in migrant flows, extreme weather events and other natural disasters.

Regarding our key exports markets, real GDP growth in the euro area stood at 2.2% during the second quarter of the year, down from 2.5% for the corresponding period of last year, reflecting mainly a slower expansion in exports, higher commodity prices impacting importing countries, and political uncertainty. Moreover, as per preliminary estimates, a further slowdown has been registered during the third quarter of the year, on account notably of the stagnating Italian economy and slower growth in Germany. In light of these developments, the

## Box I: Highlights of international developments

### Global activity levels

**World GDP growth**




**Global expansion becoming less synchronised**

**101 economies** (accounting for **47% of world GDP**)

are projected to register an upswing in 2018 ...

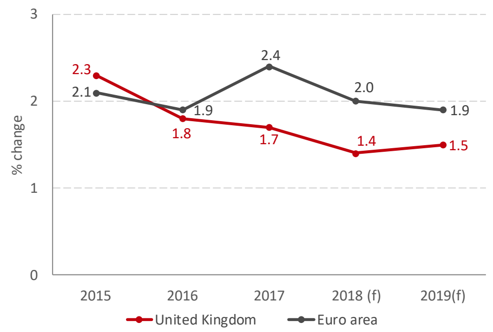
... while

**112 economies** (accounting for **75% of world GDP**)

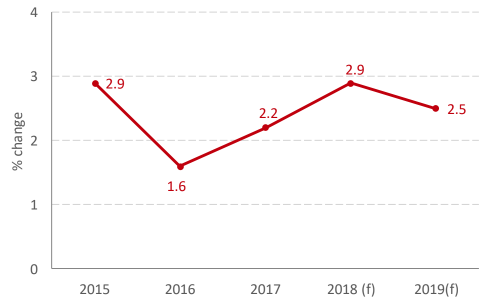
experienced an upturn in growth rates in 2017

### Growth forecasts across regions

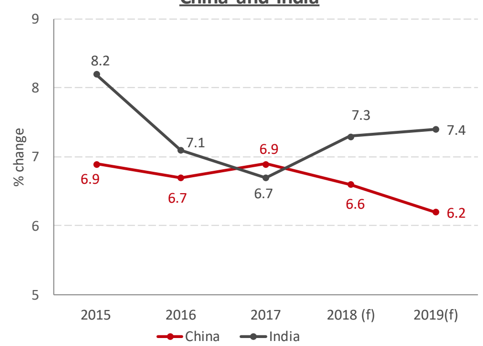
**Europe**



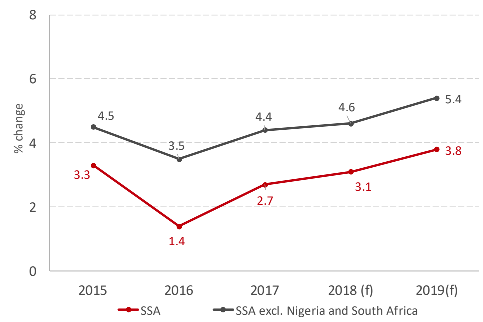

**United States**




**China and India**

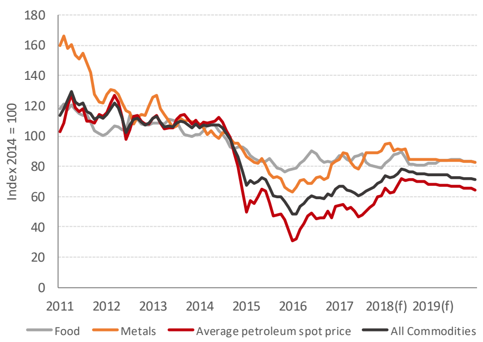



**Sub-Saharan Africa**

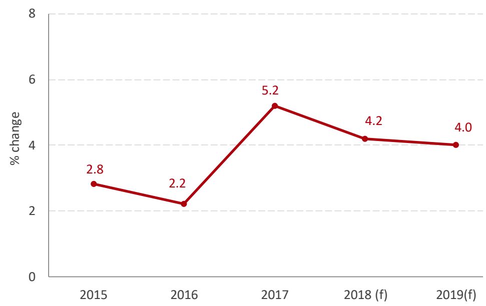



### Prognosis for other indicators

**Commodity and Oil Prices**




**World trade volume (Goods & services)**




*(f) forecast*

*Sources: IMF World Economic Outlook and MCB Staff estimates*

IMF has cut its forecast for the single-currency bloc for this year by 20 basis points to 2.0%. For next year, while the accommodative monetary policy stance should continue to underpin output, real GDP growth in the 19-member region is forecast to decline to 1.9%, due to an anticipated weakening in external demand amidst global trade tensions. For its part, despite improving marginally in the second quarter of the year on account primarily of temporary factors including the boost to retail sales and construction from the warm weather, growth in the United Kingdom should remain subdued going forward in view of Brexit-related uncertainties, and an anticipated slowdown in export growth although the recently-announced budget tax cuts and rising spending are likely to support activity levels. On a positive note, economic expansion in the US continued at a robust pace lately, thus leading the Federal Reserve to raise the target range of the federal funds rate to 2.0% – 2.25% in September last. The Central Bank also indicated it could raise interest rates on one further occasion before the end of the year and three times in 2019. That said, while growth is forecast to improve to 2.9% this year, the recently-enacted tariffs amidst ongoing trade tensions, are expected to weigh on economic activity in the US in 2019, with the growth forecast marked down, relative to the previous prediction, by 0.2 percentage point to 2.5%. Across emerging market and developing economies, while the prospects of many energy exporters have been uplifted by higher oil prices, growth has been trimmed down in Argentina, Brazil, Iran and Turkey, owing to global developments and country-specific dynamics. Besides, economic activity in China slowed during the third quarter of the year mainly due to the ongoing trade tensions, and is forecast to drop to 6.6% this year and 6.2% in 2019. In contrast, India, which, as per the World Economic Forum, has overtaken France in size of GDP measured in nominal terms, is set to stay one of the fastest growing economies worldwide, backed by structural reforms and a still-favourable demographic dividend. As for sub-Saharan Africa, economic growth is, on average, expected to gain momentum this year and next, supported *inter alia* by domestic policy adjustments, higher commodity prices, and improved capital market access, as gauged by the successful international sovereign bond issuance notably in Senegal, Angola and Ghana. When excluding South Africa and the other economic powerhouse of the region, namely Nigeria, from the computations, sub-Saharan Africa is projected to expand by more favourable rates of 4.6% and 5.4% in 2018 and 2019 respectively.

Brent oil prices have maintained an upward trajectory lately, reaching USD 86 in October, supported by a combination of robust demand and supply concerns. Overall, both the IMF and the World Bank expect oil prices – inferred from the average of Brent, West Texas Intermediate and Dubai Fateh spot prices – to stand at around USD 70 per barrel in 2018, representing a notable year-on-year increase. As for next year, the IMF anticipates oil prices to decline slightly to attain around USD 68.8, while the World Bank projects a further increase therein to USD 74. On the currency markets, a key highlight relates to the recent strengthening of the US dollar aided by strong economic data, widening interest rate differentials, rising risk aversion in markets and geopolitical concerns prompting flows to liquid and safe havens. In addition, the greenback has benefitted from the repatriation of funds by US companies to take advantage of cuts in US corporate tax rates.

# THE DOMESTIC ECONOMY

**Figure 1** **Main economic indicators**

| | Unit | 2015 | 2016 | 2017(1) | 2018(2) | 2019(2) |
|---|---|---|---|---|---|---|
| **Real sector** | | | | | | |
| GDP at market prices | Rs bn | 410 | 435 | 457 | 485 | 517 |
| Per capita GDP | USD | 9,228 | 9,598 | 10,396 | 11,182 | 11,466 |
| GDP growth (at market prices) | % | 3.6 | 3.8 | 3.7 | 3.7 | 4.0 |
| GVA growth (at basic prices) | % | 3.1 | 3.6 | 3.6 | 3.6 | 3.9 |
| Gross Domestic Saving | % GDP | 10.4 | 11.0 | 10.1 | 9.7 | 10.1 |
| Gross Fixed Capital Formation | % GDP | 17.4 | 17.2 | 17.4 | 18.1 | 19.0 |
| Private sector investment | % GDP | 12.6 | 12.8 | 13.3 | 13.3 | 13.3 |
| Public sector investment | % GDP | 4.7 | 4.4 | 4.1 | 4.9 | 5.7 |
| Headline inflation | Dec, % | 1.3 | 1.0 | 3.7 | 3.2 | 2.5 |
| Unemployment rate | average, % | 7.9 | 7.3 | 7.1 | 6.9 | 6.7 |
| **Fiscal sector** | | | | | | |
| Budget balance | FY, % GDP | -3.9* | -3.5 | -3.5 | -3.2 | -3.3 |
| Public sector debt | Dec, % GDP | 63.6 | 64.4 | 63.4 | 63.9 | 64.3 |
| **External sector** | | | | | | |
| Balance of visible trade | Rs bn | -74.7 | -81.0 | -99.7 | -113.4 | -121.2 |
| Current account balance | % GDP | -3.6 | -4.0 | -5.7 | -6.2 | -6.1 |
| Overall balance of payments | % GDP | 4.9 | 6.0 | 6.2 | 6.9 | 4.6 |

*(1) MCB revised estimates (2) MCB revised forecasts*

** The budget deficit for 2015 in the table relates to the January to June period as per official disclosures and based on computations from GDP for 2015H1*

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

## Economic growth

### Revised forecast for 2018

Our latest projections for 2018 indicate that economic growth would remain broadly in line with last year's outcome. Indeed, real GDP growth at market prices would attain 3.7% this year, which marginally undershoots the official estimates, while real growth in gross value added is now anticipated to stand at 3.6%, when computed at basic prices. When compared to our forecasts formulated in the MCB Focus edition of June last, our updated prognoses represent a downgrade of 10 basis points in each case, prompted mainly by the downward revisions in some of our export sectors. Specifically, our already-feeble outlook for the sugar sector has been further downgraded amidst unfavourable climatic conditions and weaker-than-anticipated export prices on the world market, while a lower outturn is now expected in the textile industry on the heels of a modest evolution in exports and higher pressures on margins. That said, economic growth would be underpropped by another resilient expansion in the financial and business services industry, as well as in the ICT sector. On another note, whilst facing up to increased competitive pressures, the tourism industry is set to maintain a somewhat appreciable performance this year, albeit registering a lower real growth in value added when compared to last year's outcome. Illustratively, latest figures released indicate that, on a year-on-year basis, arrivals grew by 4% during the January – September 2018 period while gross tourism earnings recorded a notable growth of around 12%, in nominal terms, in the first eight months of the year. Besides, notwithstanding measures earmarked by the authorities to tackle difficulties faced by operators, growth in value added of the domestic and export oriented manufacturing sectors would remain lacklustre, with an exception being the seafood segment which is forecast to post a noticeable expansion this year, on the back notably of favourable market dynamics. Conspicuously, a major driver of nationwide growth in output this year would be the construction sector in view of the line-up of large-scale infrastructure-upgrading ventures. In fact, a strong expansion is foreseen in national investment, with the ratio of gross fixed capital formation rising by 70 basis points to stand at 18.1% of GDP in 2018. Specifically, in spite of the associated sizeable import content, a substantial real growth in public sector investment is expected this year, with works notably on the site of the Metro Express project and ventures in the context of the Road Decongestion Programme unfolding. From another angle, while some delays have been observed in respect of earmarked energy projects, private sector investment would still sustain a positive real growth rate this year owing to the realisation of specific ventures principally related to Smart Cities and tourism industry, though the expansion is likely to be lower than in 2017.

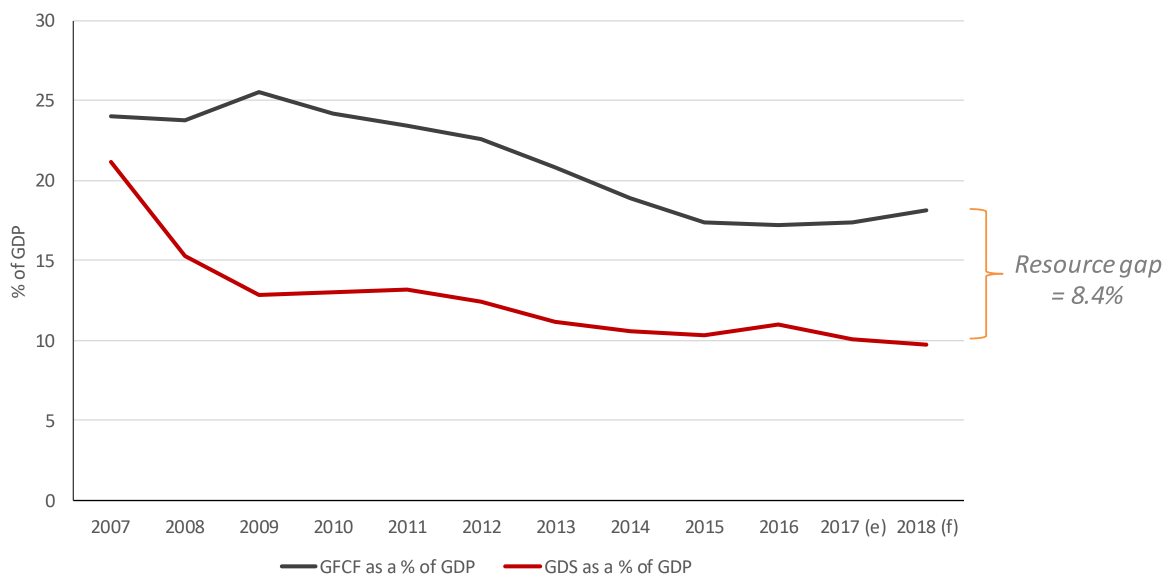
**Figure 2** **Evolution of real GDP growth forecast for 2018**

| Forecast as at | Statistics Mauritius (Official figures) | | Bank of Mauritius | IMF | World Bank | MCB | |
|---|---|---|---|---|---|---|---|
| | GVA at basic prices | GDP at market prices | GDP at market prices | GDP at market prices | GDP at market prices | GVA at basic prices | GDP at market prices |
| Oct 17 | - | - | - | 4.0 | - | 4.0 | 4.0 |
| Nov 17 | - | - | 4.2 | - | - | - | - |
| Dec 17 | 3.9 | 4.0 | - | 4.0 | - | - | - |
| Jan 18 | - | - | - | - | 3.8 | - | - |
| Feb 18 | - | - | 4.0 | - | - | 3.9 | 3.9 |
| Mar 18 | 3.9 | 3.9 | - | - | - | - | - |
| Apr 18 | - | - | - | 3.9 | - | - | - |
| May 18 | - | - | 4.0 | - | - | - | - |
| Jun 18 | 3.8 | 3.9 | - | - | 4.0 | 3.7 | 3.8 |
| Jul 18 | - | - | - | - | - | - | - |
| Aug 18 | - | - | 4.0 | - | - | - | - |
| Sept 18 | 3.7 | 3.9 | - | - | - | - | - |
| Oct 18 | - | - | - | 3.9 | - | 3.6 | 3.7 |

*Sources: Statistics Mauritius, Bank of Mauritius (Minutes of Monetary Policy Committee meeting), IMF (World Economic Outlook) and Article IV Consultation Report December 2017, World Bank (World Bank Global Economic Prospects) & MCB staff estimates*

From an expenditure perspective, notwithstanding the strong contribution from investment, nationwide growth is expected to be restrained by another poor showing in the external sector. In fact, while a robust expansion is forecast in net exports of services, key apprehensions subsist regarding our balance of visible trade, with latest figures indicating that total exports of goods has pursued its downward trend during the first eight months of the year, while the import bill rose on account mainly of higher international oil prices. Overall, exports of goods as a share of GDP is anticipated to fall by one percentage point to reach 16.8% of GDP this year, while the ratio stood at around 24% of GDP a decade ago. Consequently, net exports of goods would exert an influential drag on the country's expansion, rubbing around two percentage points from the real growth being envisaged for this year. Whilst being partly understandable on account of subdued private demand from selected trading partners, notably UK and the prevalence of global market disturbances, our trade patterns underscore, in some way, the sub-optimal nature of the country's business and investment climate, productive potential and external competitiveness. Indeed, as stressed in previous editions of MCB Focus, such trends necessitate close monitoring given the importance of exports as a key engine for achieving high growth over the medium to long run, with associated multiplier effects on the rest of the economy. This posture is, all the more, called for when considering the small size of our economy and the fact that the net impact of current household consumption patterns on output is generally limited by its relatively high import content. In this respect, it is worth noting that consumption has maintained a consistent growth over time, thus contributing to a decline in savings. Indeed, after oscillating around the 25% mark in the mid 2000s, the gross domestic saving to GDP ratio has pursued a downtrend in recent years, with the indicator forecast to drop below the 10% mark in 2018, for the first time in several decades, thereby causing the already-elevated resource gap to worsen this year. Such dynamics are cause for concern as they tend to accentuate the dependence of Mauritius on foreign capital flows in the long run. Towards mobilising savings and thence physical capital formation to meet our socio-economic aspirations, this situation underscores the significance of enhancing nationwide income generation and competitiveness levels.

**Figure 3** **Evolution of the resource gap**

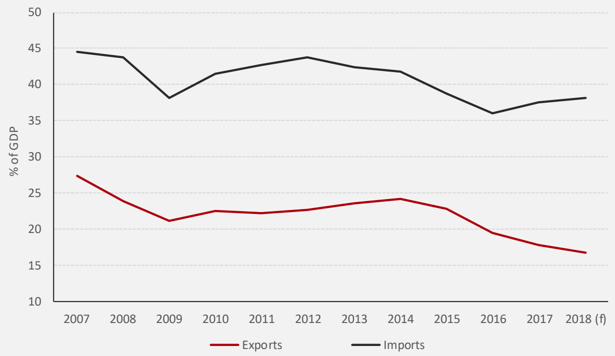



*(e) MCB revised estimates (f) MCB revised forecasts*
*Source: Statistics Mauritius and MCB staff estimates*

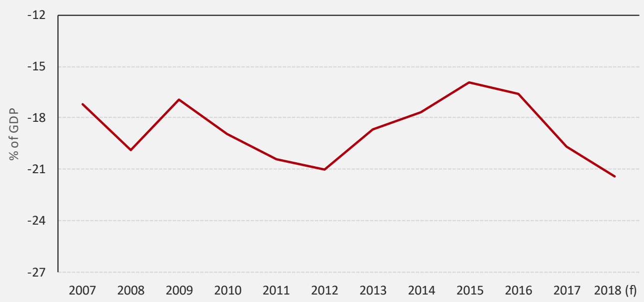
## Box II: Overview of trade dynamics and their relevance for the Mauritian economy

### Trade in goods

**Exports and Imports of goods**

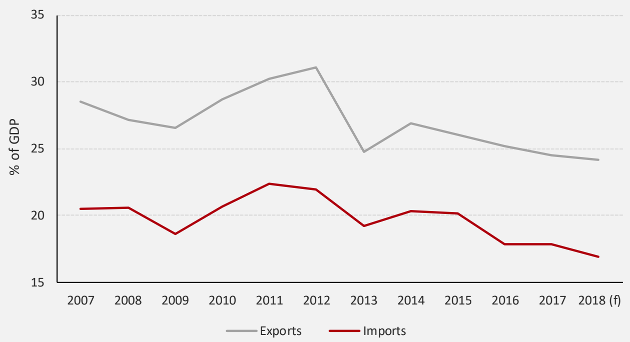



**Net Exports of goods**

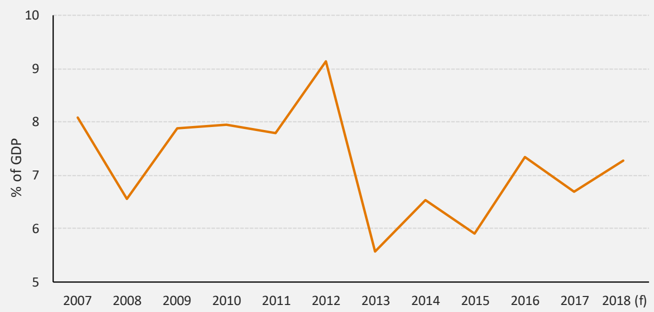



### Trade in services

**Exports and Imports of services**

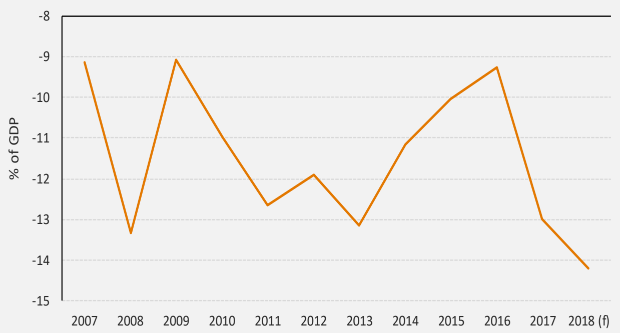



**Net exports of services**

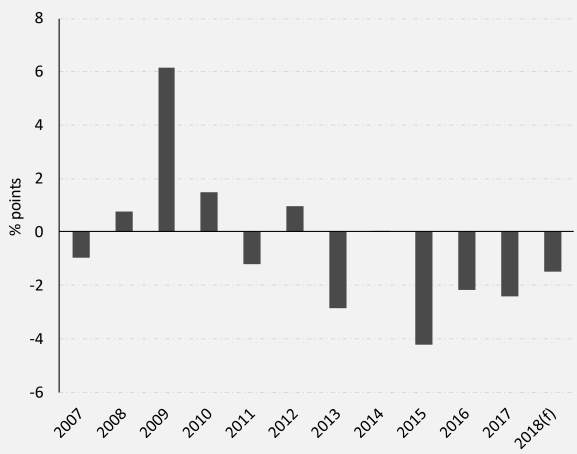



### Net exports of goods and services

**Share of GDP**




**Contribution to real GDP growth**



## Box II: Overview of trade dynamics and their relevance for the Mauritian economy (Cont'd)

### The need for further boosting international trade

There is a growing branch of the literature indicating that well-planned and strategically-executed trade policies can enhance a country's income-generating capacity and pave the way for achieving high and sustained levels of growth. In fact, trade-led inclusive economic growth is empirically found to support sustainable poverty reduction as well as significantly increase job opportunities for women. Fundamentally, as summarised in the empirical references below, open markets serve as a key determinant of trade and investment and facilitate the transfer of technologies, thereby underpinning economic development.

#### IMF – Economic benefits for export diversification in small states

Export diversification assists in reducing growth volatility and fostering economic development in small states by overcoming the limitations of size, through the access to larger markets and opportunities to achieve economies of scale in production.

#### World Bank – Exporter behaviour, country size and stage of development

Larger and richer countries have higher exports capacity on average and exporters in these countries are found to be more productive than the non-exporters. In addition, exporters dynamics have been found to be closely linked with the country development stage, with richer countries experiencing higher entrant survival rates as well as lower entry and exit rates. This is consistent with allocative efficiency improving as countries develop, where only the most productive firms grow and enter the exports market in developed countries.

#### World Bank – Africa Pulse

If trade integration is properly managed, it becomes a tool for sharing the risks that emerge from international macroeconomic shocks, facilitates the diffusion of technology and managerial practices, and helps reduce the anticompetitive practices of domestic firms. Closer trade linkages between African countries could thus provide an additional driver of growth and productivity, especially because they may enable countries to expand their markets and firms to operate at economies of scale.

#### Center for Global Development - Commitment to Development Index 2018

The index, which ranks 27 of the world's richest countries on policies affecting people living in poorer nations, looks at countries' tariffs, agricultural subsidies, and their restrictions on services and logistic trade costs. Altogether, the index indicates that a country's openness to trade can spur economic development in the world's poorest nations. Sweden, which topped the ranking, could be a key consideration for policy making as well as Netherlands, which scored best on the trade component of the index, having low agricultural subsidies and strong trade logistics and displaying openness to trade in services.

### Spotlight on emerging and developing economies

Interestingly, using a sample of emerging market and developing economies, a positive correlation can be established between trade openness, measured in terms of exports of goods and services as a ratio of Gross Domestic Product and the log of per capita income level.

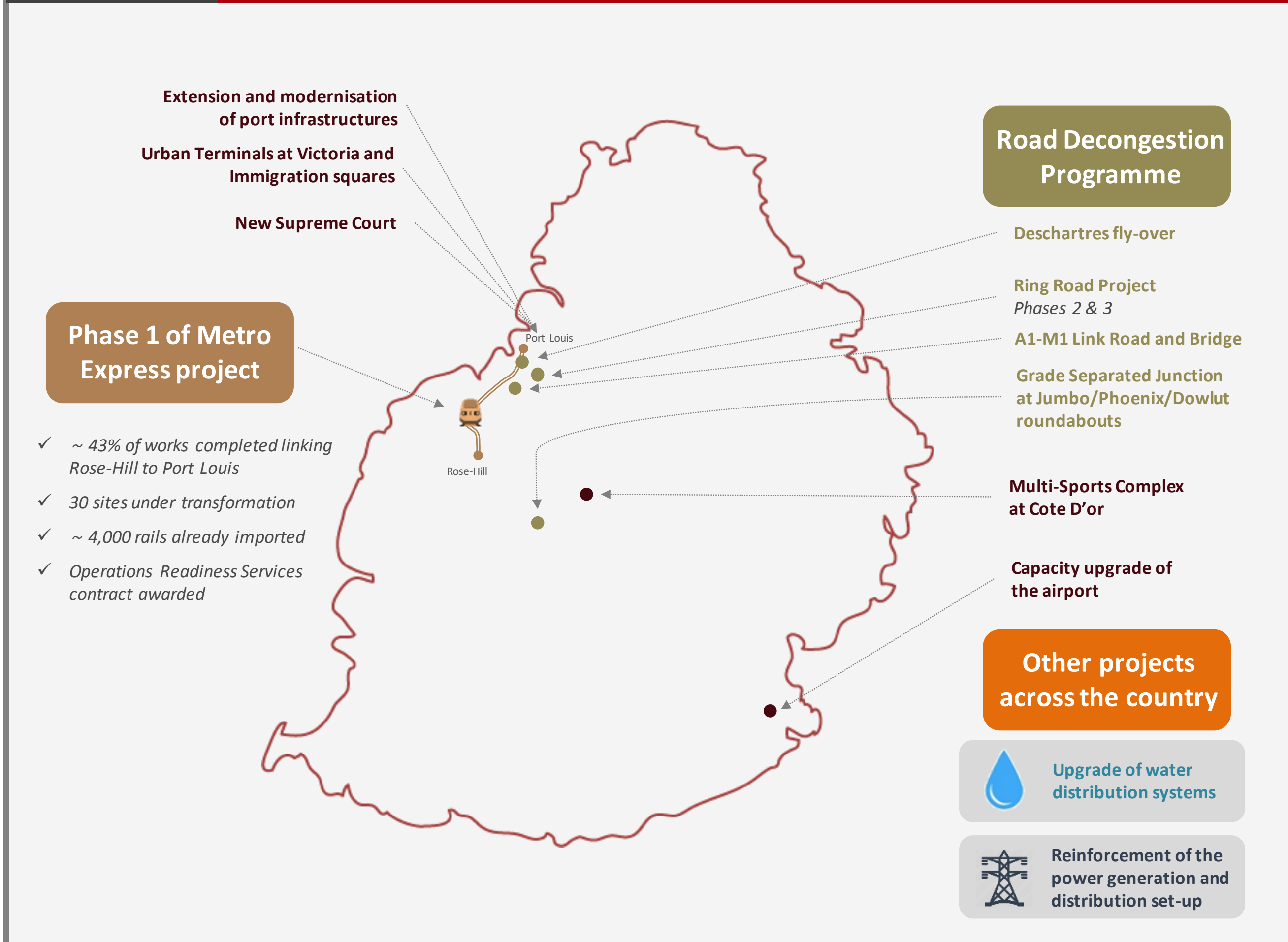

*(f) MCB forecasts*

*Sources: IMF, World Bank, Center for Global Development & MCB Staff estimates*

## Updated outlook for 2019

For 2019, the country's economic expansion is predicted to improve compared to this year's outcome, although downside risks to the growth outlook have risen. Real GDP growth is, in our baseline scenario, forecast to rise by 30 basis points to attain 3.9% when computed at basic prices and 4.0% when measured at market prices. Alongside factoring in a lower contraction in net exports of goods and services relative to 2018, this forecasted growth performance, which is broadly in line with that of the IMF and World Bank, is predominantly founded on another noteworthy expansion in public sector investment, with the indicator's share of GDP likely to increase by more than 80 basis points to stand at 5.7%. Essentially, aided by a relative improvement in project execution rates, the country is set to benefit from the full-year impact of some major ongoing ventures. As illustrated in the figure below, the key ventures that would be in the limelight next year include, amongst others, the Phase 1 of the Metro Express Project for which around 43% of works have reportedly been completed, sizeable projects in the context of the Road Decongestion Programme as well as upgrade of water/power distribution systems, modernisation of seaport/airport infrastructure and improvement of health and community facilities.

**Figure 4** **Overview of key infrastructure ventures**




*Sources: Public Sector Investment Programme, Ministry of Finance & Economic Development, Government Information Services*

For its part, private investment should register another positive expansion, in line with enunciated ventures, notably in respect of the real estate and property development, education, energy and some emerging segments. Overall, the gross fixed capital formation ratio would improve by a notable margin to attain 19.0% of GDP in 2019. In turn, higher investment levels should trigger another significant expansion in the construction sector next year. Likewise, the ICT and business and financial services industries should, in all likelihood, continue to capitalise on their sound fundamentals and competitiveness-enhancing moves to sustain resilient value added growth next year. That said, the evolution of the global business segment would continue to warrant attention as operators face up to heightened market uncertainties and business development challenges, amidst a more stringent operating framework. For its part, the tourism sector is poised to maintain a noteworthy expansion, backed by market promotional and diversification endeavours. On the other hand, the domestic and export oriented manufacturing sectors should yet again register subdued growth outcomes next year, partly reflecting the persistence of strains on our external competitiveness and domestic imbalances.

## Appraisal of growth performance

As things stand, the underlying reflection is that the macroeconomic outturn of Mauritius continues to warrant due scrutiny as the country remains faced with non-negligible inadequacies with regard to the resilience, quality and sustainability of its growth trajectory. As such, the following sections shed light on the source and depth of key identified threats, by appraising the economic growth forecast for next year.

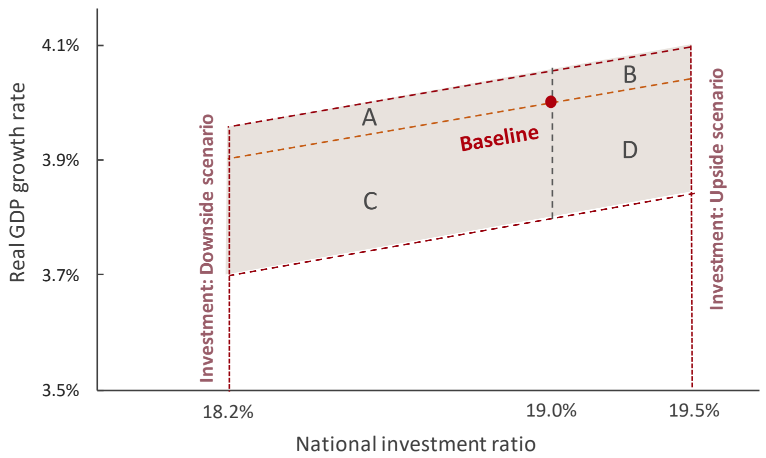
### Resilience of growth

While our baseline growth prognosis for 2019 evokes a pick-up in nationwide activity levels, it is worth noting that, when compared to our view expressed in the June edition of MCB Focus, the distribution of risks to the growth outlook is, on balance, more prominently slated to the downside. Notably, as depicted in Figure 5, the domestic growth momentum could be unsettled by the materialisation of mounting downside risks to the global growth outlook while a prominent rise in international oil prices could also matter. Besides, the country's economic growth performance could be pinned down by a lower-than-anticipated implementation rate in respect of the earmarked infrastructure-upgrading ventures. Additionally, it can also be noted that real GDP growth could end up being lower in the event that the global business industry registers a lower growth outcome than envisaged in our baseline scenario amidst a further escalation of market uncertainties and business development challenges.

**Figure 5** **Risks to the economic growth outlook for 2019**

| Scenario | Description and expected impact | Probability of occurrence | Indicative impact on baseline projected national investment ratio | Indicative impact on baseline real GDP growth forecast |
|---|---|---|---|---|
| **Upside** | Relative to the baseline scenario, the outlook for the external environment improves, notably in respect of our key export markets where higher growth is activated by decisive policy actions, thus fostering a better performance as regards our exports of goods and services | Low | Up to + 50 bp | Up to + 10 bp |
| | A higher-than-envisioned growth is achieved in respect of nationwide investment, spurred by a higher execution rate as regards public infrastructure projects amidst an enhancement of the authorities' capabilities | Low | | |
| **Baseline** | The external environment, notably in respect of our key export markets, continues to improve gradually, with the exception of the UK, in line with IMF's baseline growth scenario for the world economy, thereby contributing to a lower contraction in the country's net exports of goods and services | High | - | - |
| | Real growth in public sector investment is underpinned by the unfolding of large-scale ventures, with an acceleration in project implementation rates | High | | |
| | An expansion in private sector investment is observed, notably supported by undertakings in respect of real estate and property development and education segments, as well as the energy sector | Moderate to High | | |
| **Downside** | The outlook for the external environment worsens, relative to baseline scenario, with slowing private demand from our key export markets, further disruption in global trade policies<br><br>Higher competitive pressures in markets for exports of goods and services, compounded by a marked increase in oil prices leading to a more-pronounced contraction in the country's net exports of goods and services | Moderate | Up to - 80 bp | Up to - 30 bp |
| | A lower-than-envisaged growth in the global business sector mainly explained by tougher-than-anticipated market dynamics | Moderate | | |
| | A lower-than-expected implementation rate of public undertakings is attained, reflecting protracted delays in the materialisation of contemplated ventures<br><br>Delays in respect of the execution of earmarked undertakings notably in the energy sector lead to a lower-than-expected growth in private sector investment | Low | | |

**Alternative growth scenarios for 2019**




**A:** Better-than-expected external environment and lower-than-anticipated investment ratio

**B:** Better-than-expected external environment and higher-than-anticipated investment ratio

**C:** Worse-than-expected external environment and lower-than-anticipated investment ratio

**D:** Worse-than-expected external environment and higher-than-anticipated investment ratio

## Quality of growth

Furthermore, while the improving growth prospects for 2019 are encouraging *per se,* the quality of the forecasted nationwide economic performance needs to be carefully inspected. Basically, as opposed to being comprehensively underpinned by a broadening of idiosyncratic growth-stimulating foundations, the prognosis should be viewed in the context of the statistical impact of several years of restrained economic growth performance. Besides, concerns prevail regarding the country's inherent ability to entrench extensive grounds for wide-ranging employment creation and realising its social inclusiveness aspirations. In this respect, though a relative improvement in the trend is being observed, with the unemployment rate forecast to decline to 6.9% this year and further in 2019, the labour market remains engulfed in rather challenging territories. Specifically, whilst the unemployment rate fell by 0.2 percentage points to stand at 7.0% in the second quarter of 2018 compared to the corresponding period of last year, this has not been engendered by an improvement in net job creation. In fact, the level of employment fell by a notable 7,900 during the period under review. Conspicuously, the observed drop in the overall joblessness rate is linked to a marked decline of 10,000 in the labour force. In turn, this movement led to a fall in the national activity rate from 60.2% to 58.7% during the period under review, with the female participation rate standing at a more worrisome rate of 45.7%. As another cause for concern, male youth unemployment rate increased to 25.7%, compared to 19.8% for the second quarter of last year. Further, beyond headline figures, it is insightful to take note of the relatively elevated level of underemployment prevailing in the country, as highlighted by official figures for the year 2017. This underscores the noticeable underutilisation of a segment of the labour force, when gauged against the expertise, level of experience and educational attainment, as well as the number of hours worked by that particular segment. Overall, the afore-mentioned labour market figures and dynamics deserve close scrutiny insofar as they reflect the country's restrained ability to trace the route for achieving high and sustainable economic progress. In effect, the country is, thus far, being subject to proportionately lower factor inputs and a lack of intellectual capital than it could have possibly afforded and, thus, missing out on a potential source of growth.

## Sustainability of growth

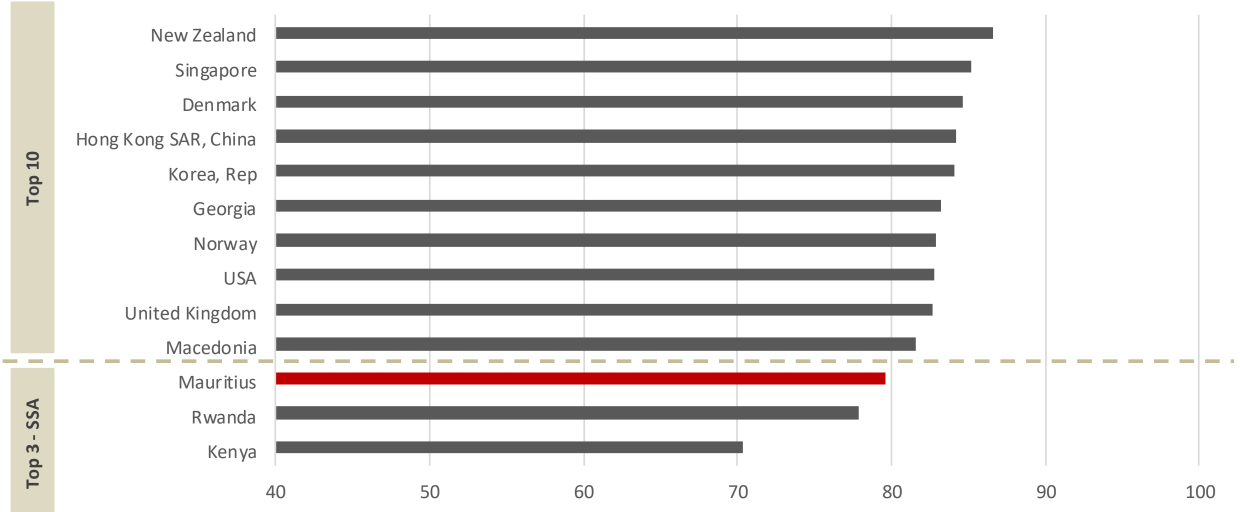
Beyond boosting aggregate expenditure in spite of the sizeable import content, the massive infrastructure push underway can be positively viewed since upgrades to infrastructure networks are warranted to enhance productivity and competitiveness levels, while responding to rising capacity utilisation, and achieving higher efficiency levels. However, it is worth stressing that, given their timespan, the direct ramifications of several of these projects on economic growth are likely to be essentially of a short-lived nature. As such, other growth-inducing avenues will need to be unlocked to enable the country to achieve its socio-economic ambitions, alongside helping to accelerate its graduation to the high-income nation league. Yet, notwithstanding trends characterising real GDP growth, apprehensions subsist as regard the intrinsic aptitude of the country to nurture a regenerated cycle of high and sustainable economic growth. In particular, the idiosyncratic capabilities of the Mauritian economy remain subject to circumspection, with its positioning relative to other nations across global rankings shedding light on its inherent performance. In fact, whilst it is comforting to take note of the further inroads achieved by Mauritius in its ranking in the World Bank's Doing Business Report 2019 (see Box IV) to stand at the 20$^{th}$ position amongst 190 countries, additional efforts are deemed necessary to further improve the quality of our business environment as well as uphold our competitive edge given the rapidly evolving international landscape. Specifically, as per the afore-mentioned report, key areas still deserving consideration relate *inter alia* to: (i) trading across borders, notably the cost to export and import both in terms of documentary

## Box IV: Doing Business – Performance of Mauritius

The Doing Business project, launched by the World Bank in 2002, provides detailed and objective data on 11 areas of business regulation affecting domestic small and medium-size companies. The report specifically measures complex regulatory processes by zeroing in on their quantifiable components, which can be contested, compared—over time and across economies—and, ultimately, reformed. Over time, Doing Business data has been widely used by governments, academics, researchers, journalists, international organisations and think tanks to guide policies for effective regulation based on measurable benchmarks, conduct research and develop new indexes. As per this year's report, the economies with the most notable improvements this year are Afghanistan, Djibouti, China, Azerbaijan, India, Togo, Kenya, Côte d'Ivoire, Turkey and Rwanda. Interestingly, one-third of all business regulatory reforms recorded by Doing Business 2019 were in the economies of sub-Saharan Africa.

As for Mauritius, the country has gained 5 spots relative to last year to stand at the 20th position amongst the 190 countries ranked. Worth noting, Mauritius is the only sub-Saharan African nation to feature in the top 20 ranking, with Rwanda ranked 29th worldwide. Basically, our ease of doing business scores across most of the indicators of doing business have improved, relative to last year. On the other hand, our scores in respect of 'Getting Credit' and 'Resolving Insolvency' remained unchanged.

**Ease of Doing Business scores for 2019: Mauritius vs. selected countries**

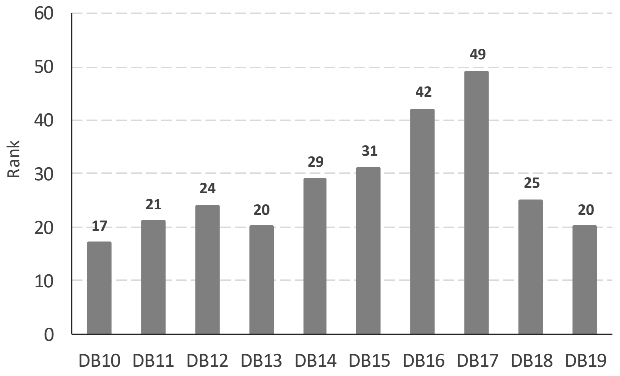



*Note: The ease of doing business score captures the gap of each economy from the best regulatory performance observed on each of the indicators across all economies in the Doing Business sample since 2005. An economy's ease of doing business score is reflected on a scale from 0 to 100, where 0 represents the lowest and 100 represents the best performance. The ease of doing business ranking ranges from 1 to 190.*

*Source: World Bank Doing Business 2019 Report*

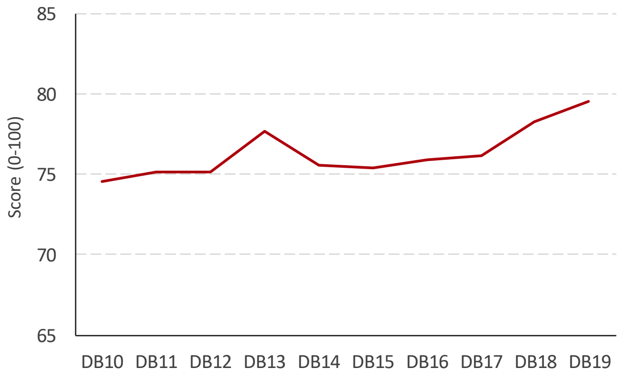
## Box VI: Doing Business – Performance of Mauritius (Cont'd)

### Evolution of our ranking




*Note: The rankings in the Doing Business reports for 2010 to 2018 have not been restated in this year's report. As such, the rankings have been taken as indicated in the afore-mentioned previous editions*

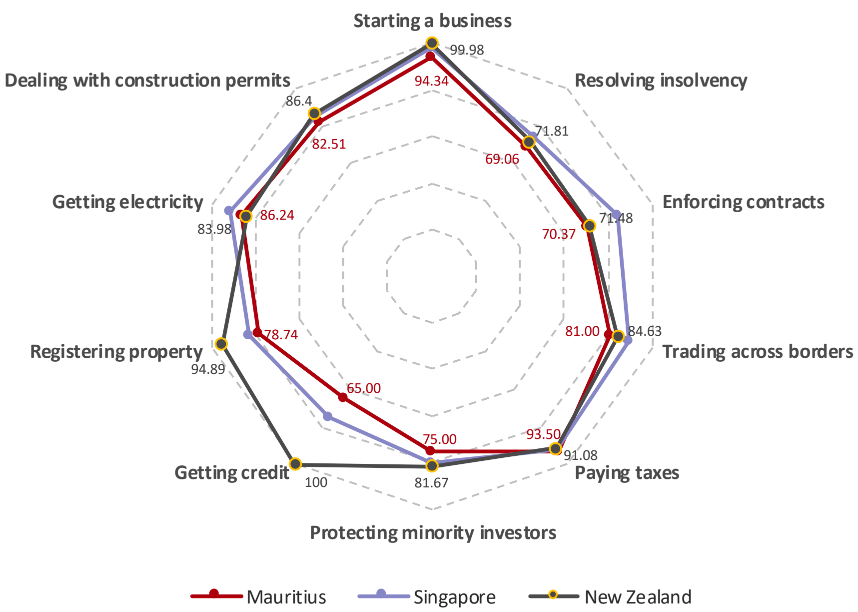
### Evolution of our ease of doing business scores




*Note: The scores in the Doing Business reports for 2010 to 2018 have been restated as per the Doing Business 2019 metadata to account for data revisions, and are therefore not strictly comparable*

### Radar chart: Mauritius vs. Top 2 performers

<u>Ease of Doing Business scores</u>




*Scale: Lowest score 0 center, Highest score 100 outer edge*

*Source: World Bank Doing Business 2019 Report* and border compliance; (ii) getting electricity, in terms of the cost measured in percentage of income per capita; and (iii) getting credit, principally in relation to the strength of legal rights index. Furthermore, whereas Mauritius remained at the 49th spot out of 140 countries in the Global Competitiveness Report 2018 of the World Economic Forum and retained its leading position in the sub-Saharan African region, concerns prevail in respect of the country's innovation capabilities, labour market dynamics and the depth of skillset and expertise of its human capital. In that respect, the report stressed that, *"the pillars where Mauritius delivers a weaker performance are those related to human capital...In particular, Mauritius is penalized by high redundancy costs and limited participation in the various levels of the educational system."* Some of these inadequacies have likewise been underscored in the Human Capital Report 2018 of the World Bank, which ranks Mauritius as 52nd out of 157 countries, alongside shedding light notably on the learning gap in our education system. The afore-mentioned trends characterising the positioning of Mauritius necessitate attention since they put into light the inherent limitations of the domestic economy, as exemplified by the difficulties confronting specific economic segments. In particular, while headway has been made in relation to the quality of the production apparatus and the value chain, the performance and outlook of the export oriented industries warrant attention in view of the key challenges and uncertainties faced. For instance, despite specific incentives put in place by the authorities, the following trends and developments deserve consideration:

- Tourist arrivals from China fell during the last three years, in spite of efforts to diversify our source markets. Additionally, heightened competition from regional peers, and the relatively high cost of air access continue to hamper development prospects
- The global business segment is facing up to an increasingly demanding operating landscape, spurred, notably, by amendments to the regulatory and tax framework and enhanced substance requirements towards fast-tracking the country's adherence to international codes and standards
- Alongside coping with declining area of land under cultivation, operators in the sugar sector are confronted by intensified competition on the world market amidst the abolition of trade preferences

At the expenditure level, although a lower contraction in the indicator is, as highlighted before, being envisaged for this year, pressures exerted on our net exports of goods and services continue to somewhat mar the economic expansion of Mauritius. From a policy perspective, moves in favour of encouraging local production can help to support activity levels. Towards this end however, it is important to maintain costs at internationally competitive levels, alongside setting up an efficient anti-dumping and countervailing framework to avoid distortions in consumption and investment patterns. That being said, from a broader perspective, the key salute for Mauritius, given its market size and economic structure, is to resolutely broaden its exports base and foster a significant diversification of exports of goods and services on both the regional and international scenes, insofar as these realisations should help underpin a high real GDP growth pattern over the long run. Overall, the challenge, in light of recent economic trends and the country's growth ambitions, is to create and embed a virtuous cycle as higher exports stimulate nationwide value added and income generation, which in turn will pave the way for enhanced trade patterns over time. A successful external trade agenda calls for the adoption of holistic measures to expand and diversify exports of goods and services on both the regional and international scenes. Initiatives are warranted to tackle supply-side inefficiencies as well as improve the competitiveness, connectivity and market access of our export oriented enterprises.

## Other indicators

### Inflation

A favourable outcome for the Mauritian economy relates to moderating inflationary pressures. Indeed, in spite of facing up to the relative strength of the US dollar and higher international commodity prices, headline inflation has pursued its downward trajectory embarked since May last, to reach 3.5% in September 2018. Alongside being underpinned by the cut in the prices of selected administered goods, this evolution can be largely traced to the further drop in vegetable prices after the hikes observed during the start of the year. On current trends and as the repercussions of earlier price movements become increasingly diluted in the computation, headline inflation is projected to stand at around 3.2% as at December 2018. Next year, despite factoring in the anticipated further firming up in the US dollar in line with the latter's orientations internationally, headline inflation would, as per our baseline scenario, maintain its downtrend to reach 2.5% as at December 2019. Whilst this should provide adequate backdrop for the maintenance of a broadly accommodative monetary policy stance, upside risks on our inflation outlook should, nonetheless, not be overlooked. These could stem notably from the pass-through, albeit limited, of potential adverse shocks in global commodity markets associated to geopolitical tensions amongst others, and a higher-than-envisaged strengthening in the US dollar leading to potential upward pressures on the price index.

### Public Finance

The budget deficit is projected to stand at 3.3% of GDP for FY 2018/19, broadly in line with the outcome of the last financial year. In spite of the expected significant rise in capital outlays linked to the deployment of infrastructure projects and higher projected recurrent spending on the back essentially of higher compensation to employees and social benefits, the forecasted budget outturn for the present financial year would be mainly underpinned by a noteworthy rise in revenue from taxes on goods and services and the receipt of external grants. Looking forward, it can be recalled that as per projections unveiled in the Official Medium Term Macroeconomic Framework (MTMF) released by the authorities in the context of the National Budget 2018-19, fiscal and debt indicators are anticipated to be engaged on an improving pathway over the periods ahead. Specifically, the budget deficit is expected as per the MTMF to slide to attain 2.0% of GDP in FY 2020/21 while gross public sector debt is predicted to be brought down to reach the statutory level of 60% as at end-July 2021. As highlighted in previous editions of MCB Focus, the achievement of such targets - especially when taking into account the rise in public sector debt which stood at 64.2% of GDP in September 2018, compared to 63.7% as at June last - appear a challenging task insofar as the improving trend in the fiscal indicators are grounded on the projection of a material stepping up of the country's economic growth over the periods ahead, which seems difficult to realise, in view of the unsteady operating landscape. Also, it is worth noting that, in the wake of consultations with the IMF, the line of credit obtained from India for the financing of the Metro Express project, would, upon drawdown, be included in the composition of debt as stressed in official pronouncements, and would consequently add pressure to the debt metrics. Moreover, the extent to which the leveraging of external grants can be sustained over time deserves attention. It can additionally be underscored that the recourse by the State Trading Corporation to the Subsidy Reserve Fund for cushioning against increases in petrol prices deserves consideration as it can trigger a shortfall in dividend to the Government. On the expenditure side, any slippages could cause undue stresses on public finances, while the efficient and timely execution of infrastructure ventures should be ensured, given the need to curtail unwarranted costs and rein in cost overruns.

Overall, the creation of adequate fiscal space for maintaining sound economic fundamentals is deemed crucial. Simultaneously, a key objective is to contain the gross public debt within manageable levels in accordance with statutory requirements. As such, further efforts are needed on the expenditure side to reduce fiscal imbalances, the more so when making allowance for the higher pension spending pressures likely to arise over the medium to long term in view of the ageing of the country's population. Concurrently, it is important to uplift the country's growth potential in support of higher revenue generation, while preserving the tenets of its competitive edge, with a prominent example relating to the upholding of the low and predictable tax regime that, it can be recalled, played a decisive role in stimulating investment and boosting production levels on the nationwide scale over the past decades. Additionally, efforts are deemed necessary to integrate the sizeable informal sector (estimated at around 20% as per an IMF working paper, entitled *'The Informal Economy in Sub-Saharan Africa: Size and Determinants'*) into the formal economy, with a view to reduce distortionary outcomes and hence enhance economic efficiency, alongside boosting revenue generation. All in all, such postures will enable the country to maintain its credibility vis-à-vis rating agencies and preserve the investment-grade status of its credit profile in support of endeavours to tap into international financial markets, alongside duly supporting financial sector operators in their regional expansion strategies.

## External front

The sizeable external imbalances continued to warrant scrutiny lately in view of the unsteady operating environment and persisting market access strains. For the first semester of 2018, re-exports declined by 24% and domestic exports fell by 4% on a year-on-year basis, on account principally of a notable drop registered in respect of exports of sugar. After making allowance for a 2% increase in the country's import bill amidst relatively higher international commodity prices, the balance of trade deficit worsened by some 7% during the period under review, with the adverse trends having continued in July and August. That said, the current account recorded a lower deficit of Rs 9.8 billion during the first semester of the year, after factoring in the noteworthy surplus on the services account owing to appreciable gross tourism earnings, and a narrower deficit on the secondary income account. This improvement in the current account position, coupled with a notable rise in direct investment flows, principally directed to the global business sector, contributed to an exceptionally high balance of payments surplus. The latter is officially estimated at Rs 25.7 billion during the first half of 2018, which is nearly four times the outcome posted during the corresponding semester of last year.

On the heels of the above observations, the balance of trade deficit is on course to deteriorate to attain around Rs 113 billion this year. As for 2019, the indicator is set to worsen further to reach around Rs 121 billion, representing around 23% of GDP, on account of (i) a subdued evolution in exports reflecting the increasingly competitive landscape and the enduring difficulties faced by some of our main markets such as UK and South Africa; and (ii) a significant rise in the import bill linked to the undertaking of infrastructure ventures, and higher food prices. Overall, the current account deficit is anticipated to stand at around 6% of GDP in 2018 and 2019, after making allowance for a surplus on the services and primary income accounts. All in all, the balance of payments should, in all likelihood, remain in a comfortably positive territory this year, though a slight narrowing in the surplus is being envisaged for next year. In fact, whilst the balance of payments should continue to be supported by sustained levels of capital and financial flows, including notably the disbursement of tranches relating to the grant and the line of credit received from the Government of India, the ramifications of potential shifts in investor sentiments amidst the increasingly stringent operating framework confronting the global business segment would warrant monitoring. As such, the positive outcome on the balance of payments should continue to be subject to scrutiny when making allowance principally for the intrinsic volatility of cross-border transactions of global business companies.

## CONCLUDING REMARKS

Amidst the increasingly uncertain and complex operating environment on the international front and the prevalence of supply-side bottlenecks locally, there is no doubt that Mauritius Inc. needs to do its utmost to create and nurture a strong and dependable foothold that will pave the way for the achievement of a high, sustainable and inclusive economic growth path. Basically, alongside making sure that contemplated infrastructure projects are deployed in a suitable and comprehensive fashion, while upholding their commercial viability, the implementation of deep-rooted structural reforms to restructure and rebalance the economy should, as a key offshoot, help towards enabling the country to elevate its potential growth rate from its current level of 4.0 - 4.2% range to around the 5% over the medium term. In this respect, alongside promoting local production, a key success factor given the very architecture of the domestic economy is to foster a meaningful broadening of our exports base and a significant diversification of our foreign markets. In that respect, referring to the characteristics and dynamics of the export sector across countries, the World Bank highlighted, in a recent working paper, that, *"firms that export are more productive than firms that produce only for the domestic market, and export quantity is increasing in productivity."* As such, a judicious diversification strategy would encompass notably: (i) export diversification across products, trading partners and service sectors; (ii) output diversification across economic sectors; and (iii) upgrading the quality of existing products and services. Specifically, efforts are warranted to boost the competitiveness levels of our agricultural and manufacturing products. This could be achieved through the increased servicification of manufacturing, which entails manufacturing industries buying, adopting, producing and selling more services, towards enhancing the efficiency of value chains. In that respect, as highlighted in a United Nations Conference on Trade and Development global forum, *"worldwide research shows that the degree of servicification is positively related to the level of sophistication in the industry and the economy".* In that respect, it appears sensible – considering their appreciable long-term revenue generation potential and prevalence of global megatrends in terms of demographics and living standards – to devote increasing attention to the exports of services in specific niche areas where the country has nurtured competencies, notably tourism, banking and non-banking financial services, and information and communication technologies. In the end, the aim is to establish an open, vibrant, innovative and investor-friendly economy, alongside moving up the value chain in terms of our trade patterns.

Furthermore, embracing key underpinnings will help to realise our macroeconomic aspirations. In that respect, the country should benefit from moves aimed at continuously strengthening the institutional and governance framework for further improving the climate for business and investment, as well as upgrading the quality of the country's human capital. With regard to the latter, there is particular scope for further enhancing the country's diligent, yet judicious, international openness to foreign labour in order to attract, retain and absorb foreign talent across the skill spectrum, which constitutes a key strategic thrust, given its notable impact on value added in the economy. Besides, in order to boost national productive capacity, it is highly desirable that our economy continues to enhance the speed and reliability of Internet connectivity, while further reducing the cost of access and encouraging innovation, with a view to promote the adequate unfolding of knowledge and learning spill-overs, as well as technology absorption, catch-up and transfer. All in all, the ultimate objective is to shift the technological and efficiency frontier of the country by stimulating the allocation of resources towards more value adding, innovative activities and productive sectors, in line with the endogenous growth theory.

Given the juncture at which it finds itself, Mauritius Inc. is left with no choice than to be sharp and pragmatic enough to overcome its challenges and achieve higher growth outcomes. As Steve Jobs once said*, "let's go invent tomorrow rather than worrying about what happened yesterday."* Indeed, it is time to leave the past behind and shape our future, together, through dynamic collaboration between public and private stakeholders which is key to achieve a Pareto efficient allocation of resources and optimise the welfare of our socio-economic fabric.

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Chief Strategy Officer

October 31, 2018

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