Occasional paper **No: 79**

MCB Focus

Post-Budget Outlook

June 2020

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RECENT DEVELOPMENTS

The international landscape

Back in January, the world economy was perceived as being in a better place and looked poised for a growth upturn. The global picture, however, has changed drastically in the last couple of months as the COVID-19 outbreak has spread at an alarming speed to every part of the world and infected millions. Commenting on the scale of the pandemic, the World Bank indicated in the June edition of its Global Economic Prospects that, "*The health and human toll is already large and continues to grow, with hundreds of thousands of deaths and many more suffering from diminished prospects and disrupted livelihoods. The pandemic represents the largest economic shock the world economy has witnessed in decades, causing a collapse in global activity.*" Such views are broadly in line with those expressed by the IMF in its World Economic Outlook (WEO) of April last. In fact, the necessary quarantines and social distancing practices put in place to contain the pandemic have put the world in a 'Great Lockdown'. Restrictions on mobility have dampened activity levels in sectors that rely on social interactions such as travel, hospitality, and entertainment. Likewise, business closures have resulted in disrupted supply chains, thereby taking a toll on production and consumption. Furthermore, the cross-border spillovers have impacted real sectors alongside disrupting financial and commodity trade patterns. Against this backdrop, global output is, as per the Fund's April WEO figures, projected to shrink by 3% this year – a decline in economic activity not witnessed since the Great Depression, despite the extraordinary efforts of Governments to counter the downturn with fiscal and monetary policy support. Basically, some 170 countries, i.e. almost 9 out of 10 countries, are expected to contract this year. Furthermore, on the heels of a further deterioration in global economic conditions observed in recent times, the IMF Chief Economist, Gita Gopinath, indicated, lately, that the Fund's updated forecasts due to be out on June 24 will very likely be worse. Worryingly, even the bleak international outlook is subject to significant downside risks and extreme uncertainty levels as regard the duration and intensity of pandemic. If the COVID-19 pandemic persists longer than expected, restrictions on movement and interactions may have to be maintained or reintroduced, prolonging the disruptions to activity and further setting back confidence. Disruptions to activity would weaken businesses' ability to remain in operation and service their debt, thereby potentially triggering bankruptcies and layoffs. Eventually, this unprecedented global downturn could even reverse years of progress toward development goals and tip at least 71 million people worldwide into extreme poverty levels, according to a World Bank report released in June.

Concerning the key export markets of Mauritius, the economic fallout of the pandemic is already being witnessed in first quarter readings. As per figures released by Eurostat, GDP contracted by 3.8% in the euro area during the first quarter of 2020 compared to the previous quarter. Within the single currency area, the

Box I: Update on the COVID-19 situation and its macroeconomic impact worldwide

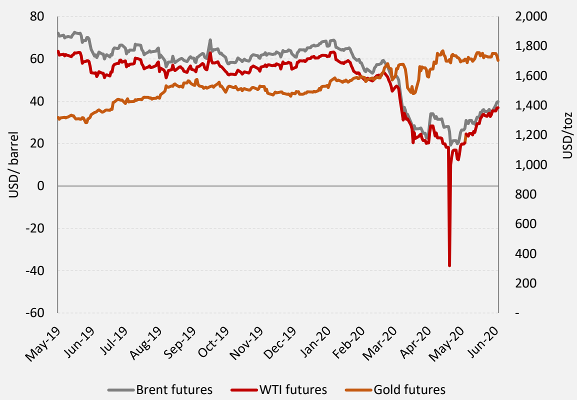
The virus has spread to more than 200 countries worldwide...

Confirmed cases worldwide
> 8.2 million

Death toll has reached
more than 440,000

... triggering turmoil in international financial and commodity markets ...

Evolution of oil and gold prices



> 30%
Decline in S&P and FTSE at their troughs
(compared to the beginning of the year)

- USD 37.6
WTI closed below zero for the first time in history

> USD 1,700
First time since 2012 gold price breached this level, fueled by safe-haven demand

... while the global economic outlook has deteriorated markedly ...

5% — Decline in merchandise trade in the first quarter of the year

22% — Decrease in international tourist arrivals in the first quarter (approx. USD 80 billion loss in tourism exports)

10.7% — Decline in working hours relative to the last quarter of 2019 (equivalent to 305 million full-time jobs)

Real GDP growth (%)

	2020 (f)
United States	-6.5
United Kingdom	-14.0
France	-10.0
Italy	-9.2
China	1.0
India	-3.2
South Africa	-7.0

Note: Forecasts of GDP growth in 2020 are as per respective Central Banks, except for India and China, which are as per World Bank Global Economic Prospects June 2020

... thereby prompting significant rescue measures of unprecedented magnitude

USD 10 trillion
Level of global fiscal support

USD 4 trillion
Magnitude of asset purchases by major central banks

Source: IMF WEO, WHO, UNCTAD, UNWTO, Bloomberg, Investing.com, and various central banks

French economy dropped by 5.3% during the first quarter, the steepest decline since records began in 1949 and the second consecutive quarterly contraction, meaning that France fell in a technical recession. Similarly, output contracted by historical margins in Spain and Italy during the period under review. Elsewhere, the US economy dropped by its fastest rate since the 2008 financial crisis, ending its longest expansion on record, while the UK registered a contraction of 2% during the first three months of the year, quarter-on-quarter, according to the Office for National Statistics figures. In the region, the South African economy is, as per a recent report by Capital Economics, estimated to have contracted by about 3-4% on a quarter-on-quarter and seasonally adjusted basis during the first three months.

Moving forward, a partial recovery is anticipated for 2021 with global growth reaching 5.8% as per the IMF April WEO, but this would materialise only if countries succeed with containing the COVID-19 virus and prevent liquidity problems from becoming a solvency issue. As the situation stands, however, there is profound uncertainty regarding the pace of the global recovery given the severe damage done and potential long-lasting legacies of the crisis. On this note, the OECD has stressed in its latest Economic outlook that, by the end of 2021, the loss of income would have exceeded that of any previous recession over the last 100 years outside wartime, with dire and long-lasting consequences for people, firms and Governments.

On another note, international financial markets have been extremely volatile, reflecting the exceptionally high uncertainty and the sharp deterioration in economic conditions. The flight to safe assets has triggered a sharp tightening of global financial conditions. Equity markets have sold off dramatically – the Dow Jones index and the FTSE 100, for instance, saw their biggest drops in the first three months of the year since 1987 – while market volatility spiked to its highest level since 2008. It is, nonetheless, worth noting that global markets have recovered some grounds since the end of March, with US stocks having recouped most of their losses for the year on the back of a rally spurred by central bank stimulus and optimism among investors after the easing of lockdown measures. As for emerging markets and developing economies, they experienced large capital outflows in excess of USD 100 billion since the onset of the pandemic as per IMF. Another important feature of the current landscape is the historic collapse in oil demand and oil price. The benchmark US crude oil contract – known as West Texas Intermediate (WTI) – traded with negative prices for the first time in history on 20th April after a lack of available storage capacity set off panic among traders who found themselves with nowhere to put the oil. In the wake of this development, Brent crude oil price, the international benchmark, hit a 21-year low. Nonetheless, oil prices appear to have bottomed out in April and are recovering gradually, supported by a progressive rebound in demand as some lockdown restrictions are being eased as well as the cut in oil production by OPEC and its partners. Overall, oil prices – inferred from the simple average of Brent, Dubai, and West Texas Intermediate oil prices – are expected to average USD 32 per barrel in 2020 and USD 38 per barrel in 2021 as per the latest World Bank forecasts.

The domestic scene

On the local front, the COVID-19 outbreak has – as it is the case worldwide – hogged headlines during the past months. Since the first three confirmed cases of COVID-19 were announced on 18 March 2020 in Mauritius, the authorities have deployed a number of sanitary and quarantine measures. The lockdown and curfew order imposed in the country since 20 March have successfully curbed the spread of the virus, with no new local positive case having been recorded during the past 53 days. Additionally, the authorities have introduced various economic relief initiatives to support businesses and households.

Key support measures deployed in the initial phase of the crisis

The authorities have, notably, introduced a Wage Support Scheme to assist private sector businesses in paying wages and a Self-Employed Assistance Scheme, with further measures unveiled to support SMEs and MMEs through the Investment Support Programme Ltd, the State Investment Corporation and Development Bank of Mauritius. Furthermore, new legislations have been passed to cater for the impact of the pandemic and to underpin the progressive easing of the lockdown. A COVID-19 (Miscellaneous Provisions) Act was passed on 15 May with amendments brought, amongst others, to various legislations, including the Workers' Rights Act and the Employment Relations Act, with the objective being safeguard employment during this period of economic downturn, while granting more flexibility through leave without pay with payment of transitional unemployment benefit and reduced hours for reduced pay under specific conditions as well as other arrangements such as 'Work From Home' and flexitime. Furthermore, the Bank of Mauritius Act was amended to allow the Central Bank to assist the Government in its fiscal measures to stabilise the economy amidst the pandemic. Moreover, a Quarantine Act was introduced with measures to prevent the resurgence of COVID-19 infection, and step up the preparedness and response of the country to any future pandemic.

Main initiatives taken by the Bank of Mauritius

The Bank of Mauritius (BoM) has also taken a series of measures to alleviate the financial burden of economic operators and individuals and protect jobs. Key measures taken include: (i) two consecutive cuts of 50 and 100 basis points respectively in the Key Repo Rate which now stands at 1.85%; (ii) a total package of Rs 9.3 billion, available through commercial banks, to help operators meet cash flow and working capital requirements from a Special Relief Programme of Rs 5 billion and an additional release of Rs 4.3 billion with the reduction in Cash Reserve Ratio from 9% to 8%; (iii) moratorium on capital repayment for existing loans for impacted economic operators and on both capital and interest for SMEs and individuals under specific conditions; (iv) a Special Foreign Currency Line of Credit of USD 300 million targeting operators having foreign currency earnings including SMEs; (v) a USD/MUR SWAP arrangement of USD 100 million to import-oriented businesses; and (vi) regulatory forbearance regarding various Bank of Mauritius Guidelines pertaining to the calculation of Risk Weighted Assets, Capital Conservation Buffer, and Debt-to- Income Ratio for residential property loans. The Budget also made provision for additional flexibility to the Bank to Mauritius to adjust the capital adequacy ratio, should the need arise or in exceptional circumstance.

In more recent times, the Bank of Mauritius indicated that it would provide an amount of Rs 60 billion to the state for sustaining economic activity and mitigating risks to financial stability, by leveraging rupee liquidity available on the market through the issuance of its own instruments. Additionally, it was announced that the Mauritius Investment Corporation (MIC) would be set up as a fully-owned subsidiary of the BoM to: (i) assist systemically large, important and viable companies in Mauritius, which are financially distressed as a result of the COVID-19 pandemic (ii) invest in companies geared towards building self-sufficiency in key basic necessities; (iii) invest in companies enhancing Mauritius as an innovation-driven economy; and (iv) support the development of return-generating key strategic assets and projects. Up to USD 2 billion from the foreign exchange reserves of the Central Bank would be made available to the MIC which will invest in eligible companies through a number of investment tools including equity and quasi-equity instruments.

Inclusion of Mauritius on the European Commission List

On 7 May 2020, the European Commission (EC) identified 12 high-risk third countries, including Mauritius, with deemed strategic deficiencies in their AML/CFT regimes. While the delegated regulation formulated by the Commission has been adopted in June, the list is scheduled to become effective on 1 October 2020. The list follows a revised methodology that the European Commission has issued and which is aimed at ensuring better alignment with the Financial Action Task Force (FATF) list. It is worth noting that in February 2020, the FATF included Mauritius on its list of 'jurisdictions under increased monitoring', while highlighting five action items that Mauritius should implement to contribute to improving the level of effectiveness of its AML/CFT regime. In turn, the inclusion of Mauritius on the FATF list followed the 2018 Mutual Evaluation Report (MER) on the country's AML/CFT framework by the Eastern and Southern Africa Anti-Money Laundering Group.

Overall, the inclusion of Mauritius on the EC list calls for attention to the extent that this can have a detrimental impact on the long-term attractiveness and competitiveness of the Mauritian International Financial Centre. Encouragingly, the national authorities expressed their high-level political commitment to accelerate efforts towards promptly removing Mauritius from the list. While reinforcing communication and strategic dialogue with the European Union, the Government recently announced that it intends to address the five remaining recommendations under the FATF Action Plan for Mauritius by September 2020 (i.e. one year ahead of the scheduled timeframe which was initially agreed with the FATF). In the Budget Speech, key initiatives towards these ends have been announced, including the (i) introduction of a new AML/CFT (Miscellaneous Provisions) Bill to complement the existing legislative framework; and (ii) setting up of a dedicated and specialised Financial Offences Court. A High Level Multi-Stakeholders Committee, chaired by the Prime Minister, is overseeing the implementation of the FATF action plan. Overall, it is important that the Mauritian jurisdiction capitalises on all levers to resolve identified shortcomings within set timeframes, with a case in point being the need to leverage well-calibrated collaboration involving public and private stakeholders. Fundamentally, the key objective is to further uphold the reputation of the Mauritius IFC as a fully transparent and collaborative jurisdiction of substance, which has a continuous commitment towards adherence to and effective implementation of best practices and standards.

National Budget 2020/21

Main thrusts of the National Budget

The National Budget 2020-2021 was presented on the 4th June amidst the exceptionally challenging context triggered by the COVID-19 outbreak that has brought the world to a near-standstill. The Budget which is entitled 'Our New Normal: The Economy of Life' attempts to help the Mauritian economy rise up to its challenges and adapt to the evolving realities emerging in the post-COVID era. Policies have been announced to, amongst others, stimulate nationwide investment, with emphasis on construction projects, encourage local production, support the development of SMEs, develop the pharmaceutical industry, enhance the blue economy value-chain and promote the use of digital practices and innovative technologies. Moreover, the Budget has, in alignment with previous pronouncements, reaffirmed the intention of the authorities to enhance the nationwide infrastructure set-up, notably at the level of the road network, social housing, utilities as well as the sea and air ports. Illustratively, total public sector investment is, as per the authorities, projected to stand at Rs 158 billion over the next five years, out of which Rs 40 billion pertains to FY 2020/21.

Main areas warranting attention

While several measures can be viewed positively as they attempt to lay the grounds for the recovery of our economy, the Budget pronouncements call for relevant assessment in specific areas. To begin with, the authorities now face the formidable challenge of realising contemplated moves in a comprehensive manner, while proceeding in an efficient and effective way to optimise socio-economic gains therefrom. Moreover, there are some apprehensions regarding the potential distortionary outcomes of further differential treatments being introduced on the fiscal front. Additionally, while the policy response needed to combat the crisis has, as expected, impacted public finances significantly, it is crucial to closely monitor fiscal risks towards fostering credible fiscal and public debt management during the post-COVID phase to support long-term economic development.

Ensuring the effective and comprehensive operationalisation of measures

A major success factor for budgetary announcements to generate expected results is to ensure that contemplated moves are realised in a comprehensive and prompt manner. This should help to absorb the current economic setbacks emanating from the crisis alongside helping businesses adequately deal with and adjust to the post COVID era, with its new normals.

A key focus area relates to the speed at which envisioned projects are implemented, particularly those forming part of the Public Sector Investment Programme. This is all the more crucial given that the highly challenging macroeconomic context is likely to exert a drag on private sector investment, such that public sector outlays would be a key lever for supporting the country's growth recovery. As such, emphasis should be laid on fostering institutional capacity building, ensuring judicious resource mobilisation, bolstering statistical data collection, achieving the proper prioritisation and alignment of projects, and stimulating the use of innovative techniques. Such postures are called for given that, as can be gauged by the historical project implementation rate, a notable share of enunciated projects forming part of the Public Sector Investment Programme has not materialised in a timely and holistic fashion, partly due to capacity inadequacies, administrative bottlenecks and the technical complexity of such undertakings.

At another level, some measures call for further clarifications as far as their modalities and specificities are concerned. A case in point relates to the Mauritius Investment Corporation (MIC) which is expected to play a crucial role in stimulating the recovery in the country's main economic pillars. As the situation stands, while the high-level governance structure of the MIC has been announced, further details are deemed necessary regarding the modus operandi and term sheets as well as specific conditions regarding the operationalisation of the MIC, notably with regard to: (i) how the USD 2 billion that has been earmarked thereto would be eventually utilised; (ii) how the entity would engage with commercial banks and other stakeholders; and (iii) the monitoring system to track the success of planned endeavours.

Guarding against the potentially distortionary outcomes of some policy measures

In another respect, though further insights will be unveiled in the forthcoming Finance Bill, the fiscal regime has been subject to further differential treatments on the income tax front, pursuant notably to: (i) the imposition of a levy on gross income – as opposed to profit – of companies with a turnover exceeding Rs 500 million, with tourism and global business companies being exempted; (ii) the extension of income tax holiday to a range of sectors and activities such as companies under the inland aquaculture scheme and to top worldwide universities setting up campuses in Mauritius; (iii) the allocation of tax incentives and imposition of additional exemptions and reliefs to a range of sectors and activities; (iv) the introduction of an Alternative Minimum Tax on companies carrying on life insurance business. In reference to the solidarity levy which has been increased from 5% to 25% on the chargeable income plus dividends in excess of Rs 3 million, the Minister of Finance has, in the summing up of National Budget debates, indicated that a cap of 10% would be introduced on leviable income with the levy being applied to individual Mauritian residents. In effect, this announcement implies that the total effective charge to any individual would not exceed 25% of total income. As previously indicated, the solidarity levy is applicable on dividends – which are distributed after tax – whilst excluding earnings from other similar asset classes such as bank interest, thus giving rise to potential suboptimal asset allocations. Furthermore, while the sustainability of the current pension system is under pressure in view of the rapid ageing of the country's population, the replacement of the National Pension Fund – a funded defined-benefit scheme – by the Contribution Sociale Généralisée (CSG) mechanism which is an unfunded system deserves scrutiny insofar as it implies a new tax on payroll both for businesses and their employees towards funding increases in the basic retirement pension. The CSG scheme – which applies only to private sector employees – would also have a bearing on other stakeholders including private pensions funds that would already be affected by the Portable Retirement Gratuity Fund contribution that is set to come into operation as from 1 January 2022.

Overall, while some immediate benefits of the fiscal developments can be highlighted, notably towards fostering social progress and providing breathing space in some instances, the short and long term efficiency and competitiveness impact of such measures should be carefully appraised insofar as Mauritius is moving towards a more complex and segmented regime, thus further departing from the low, simple and harmonised fiscal regime that has, over the years, enabled it to improve its business climate and boost foreign investment. This, in turn, warrants attention in view of the potential mixed signaling effect on the investment community that, could, if left unchecked: (i) give rise to a rechanneling of business and capital flows to other competitor jurisdictions; and (ii) impact our ability to retain local human expertise and attract foreign talents.

Upholding sound, sustainable and credible fiscal and public debt management

The worsening of fiscal metrics is likely to be a global phenomenon to the extent that the extraordinary socio-economic challenges arising from the pandemic call for sizeable support measures to weather the shocks. The IMF has, in fact, supported the surge in short-term public borrowing, saying it was necessary to fight the spread of the virus. In Mauritius, public sector debt – 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 – would, as per the authorities, amount to 72.7% of GDP in FY 2019/20 and rise to 78.2% as at FY 2020/21 after making allowance for the balanced budget driven by the contribution of Rs 60 billion from the Bank of Mauritius in the latter year. In gross terms, public sector debt would, as per the authorities, amount to 83.4% in FY 2019/20 before rising to 86.4% in FY 2020/21. As the economy recovers from the pandemic however, achieving progress on debt sustainability will be needed. On this note, the Medium Term Macroeconomic Framework highlighted that the fiscal strategy for the coming years would be focused on bringing down the debt ratio towards ensuring fiscal sustainability over the medium term by adhering to a general fiscal rule of limiting the interest payment to GDP ratio to below 3.5%. The authorities plan to achieve this by: (i) strengthening revenue collection and implementing a whole-of-government cash management approach; (ii) reducing the operating budget of Ministries and Departments through greater efficiency while enhancing effectiveness in service delivery; (iii) prioritising capital projects and programmes that will unlock growth and ensure the wellbeing of the citizens; (iv) reviewing operations of statutory bodies and local authorities to limit their dependence on the Budget; and (v) disposing of non-strategic assets and ensuring better returns on investments. Notwithstanding the above, a key priority for ensuring credible and sound fiscal and public debt management is the prompt reinstating of key public debt targets to serve as a guidance on the amount of debt reduction to be achieved and the appropriate timeframe. This is highlighted by the IMF's Fiscal Affairs Department in a report entitled 'How to calibrate fiscal rules – A primer' released in 2018 that *"Ceilings on public debt are a common feature of rule-based fiscal frameworks. As of 2015, about 70 countries worldwide had a fiscal framework with an explicit cap on public debt."* In another respect, the scale of the crisis has led authorities worldwide to undertake measures that may create a departure from conventional debt management practices. In that respect, the IMF stressed the need to foster sound debt management to ensure that fiscal sustainability is restored once the recovery gets underway. In cases where central banks are contributing to fiscal financing, the Fund indicates in a recent special series issued on 'Debt Management Responses to the Pandemic', *"Direct central bank lending to the government is a last-resort mechanism…Such departures ought to be temporary, be prepared to unwind them as soon as the extraordinary times end and communicate them effectively to market stakeholders."*

Indeed, while the marked rise in fiscal deficit and public debt observed is understandable given the need to tackle the health and economic crisis triggered by the pandemic, Mauritius should, in the post-COVID period, aim to embrace fiscal rules and frameworks that ensure the return to fiscal sustainability, alongside upholding our standing vis-à-vis our development partners and preserving the investment-grade status of the country's credit profile.

Official Medium Term Macroeconomic Framework

The significance of budgetary pronouncements can be appraised through the lens of forecasts made in the context of the official Medium Term Macroeconomic Framework (MTMF) released by the authorities. To begin with, it is worth noting that – in spite of factoring in a restrained statistical base triggered by two consecutive years of anticipated economic contraction (-5.8% in FY 2019/20 and -7.0% in FY 2020/21) and the support from the measures unveiled as part of the stimulus plan and policies previously announced in response to the pandemic – the authorities expect the Mauritian economy to rebound at a moderate rate of 4.5% in FY 2021/22. In fact, inferring from the official projections, it can be observed that the domestic economy would not yet return to its pre-pandemic level over the forecasted horizon when measured in terms of GDP at constant prices. Additionally, the MTMF of the authorities notes that there is extreme uncertainty about the evolution of the pandemic and significant downside risks to the outlook, while a resurgence of trade tensions and a prolonged drop in external demand could further dampen the medium term growth prospects unveiled. On the heels of the subdued backdrop, it might be difficult to achieve the double-digit expansion required in nationwide investment in FY 2021/22 and FY 2022/23 to achieve the officially projected nationwide investment rates in the latter years. Another telling observation is that, as per the MTMF, exports of goods and services would fall from 33.1% of GDP in FY 2019/20 to reach 28.6% of GDP in FY 2020/21. This would contribute to a further deterioration of the country's current account deficit, with the latter's share of GDP projected to worsen to 12.7.% in FY 2020/21 from 10.1% in FY 2019/20, before declining, but remaining quite elevated at 7.7% and 6.9% of GDP in FY 2021/22 and FY 2022/23 respectively. On the other hand, the country's gross official international reserves are, as per the MTMF, projected to pick up as from FY 2021/22 after a sizeable fall of around Rs 39 billion expected in FY 2020/21.

ECONOMIC OUTLOOK

Figure 1 **Main economic indicators**

	Unit	2016	2017	2018	2019[1]	2020[2]
Real sector						
GVA at basic prices	Rs bn	386	403	422	438	402
GDP at market prices	Rs bn	435	457	481	499	457
GVA growth (at basic prices)	%	3.6	3.6	3.6	3.1	-11.2
GDP growth (at market prices)	%	3.8	3.8	3.8	3.0	-10.9
Gross Domestic Saving	% GDP	11.0	10.0	8.9	8.8	5.5
Gross Fixed Capital Formation	% GDP	17.2	17.4	18.8	20.0	17.4
Private sector investment	% GDP	12.8	13.3	14.2	14.6	12.5
Public sector investment	% GDP	4.4	4.1	4.5	5.4	4.9
Headline inflation	Dec, %	1.0	3.7	3.2	0.5	4.3
Unemployment rate	average, %	7.3	7.1	6.9	6.8	-
Fiscal sector						
Budget balance	FY, % GDP	-3.5	-3.5	-3.2	-3.2	-13.6
Public sector debt	Dec, % GDP	64.2	63.5	64.9	65.5	75.8*
External sector						
Balance of visible trade	Rs bn	-81.0	-100.2	-112.1	-120.1	-123.1
Current account balance	% GDP	-4.0	-4.3	-5.8	-5.7	-14.1
Overall balance of payments	% GDP	6.0	6.2	3.5	6.6	-8.0
Memorandum item:						
Per capita GDP	*USD*	*9,598*	*10,407*	*11,124*	*11,060*	*9,142*

(1) Revised estimates (2) MCB forecasts

**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.*

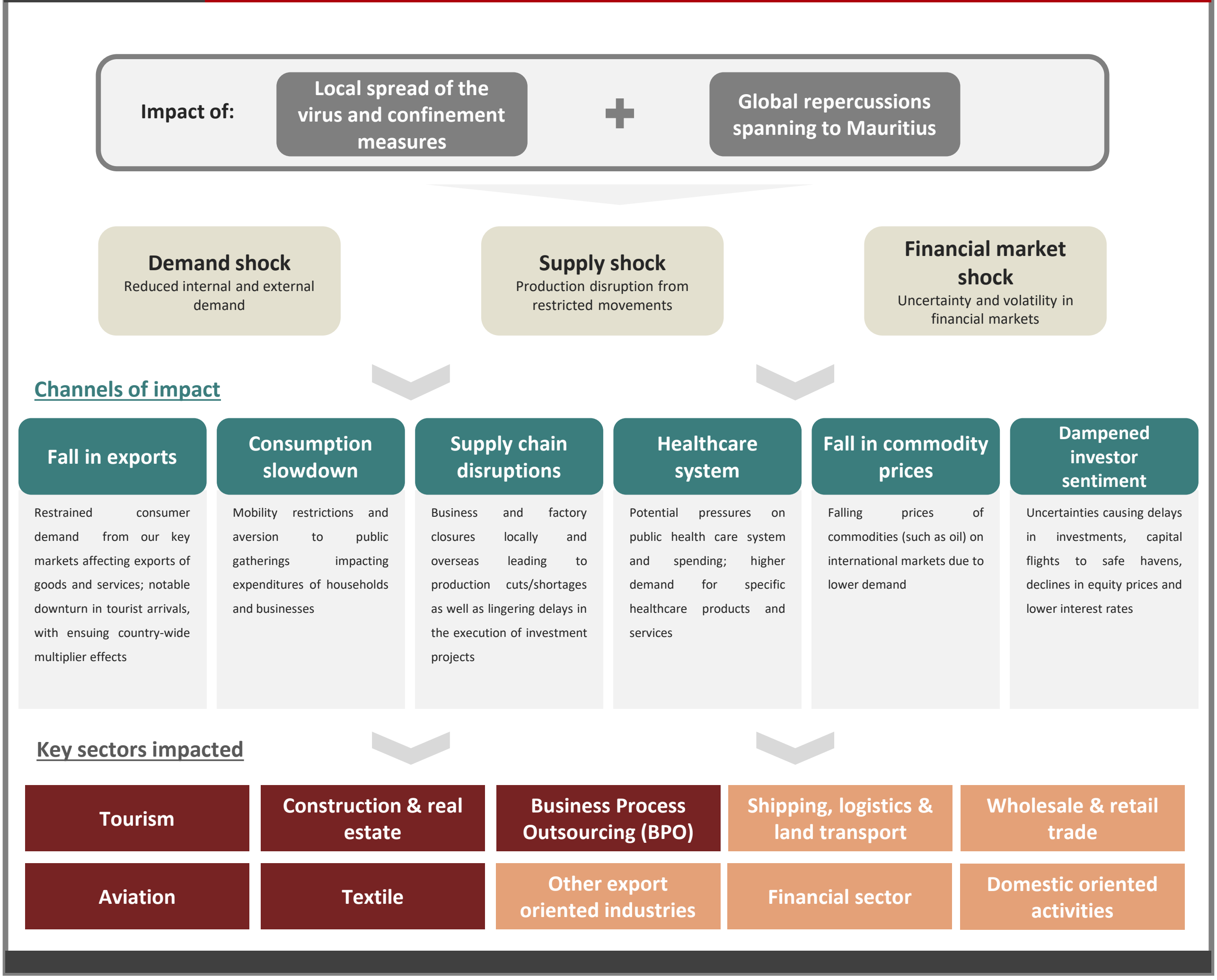
Sources: Statistics Mauritius, Ministry of Finance & Economic Development, Bank of Mauritius & MCB staff estimates

Economic growth

Updated forecasts for 2020

As matters stand, the full impact of the pandemic on the country remains subject to notable uncertainties in view of the highly dynamic nature of the operating landscape. Overall, the Mauritian economy would, as it is the case for many countries around the world, register a notable contraction this year. In fact, as per our revised baseline estimates which make allowance for the extension of the sanitary curfew on the local front until 30 May and the bleaker global outlook, real GDP growth is anticipated to contract by 11.2% this year when measured at basic prices and 10.9% when computed at market prices. The level of uncertainty around the growth outlook remains exceptionally high, with the actual outcome likely to hinge on the depth and breadth of the sanitary and economic crisis globally as well as the effectiveness of support and stimulus measures adopted by the authorities locally, including those recently unveiled in the National Budget.

Figure 2 **COVID 19: Key channels of transmission to the Mauritian economy**



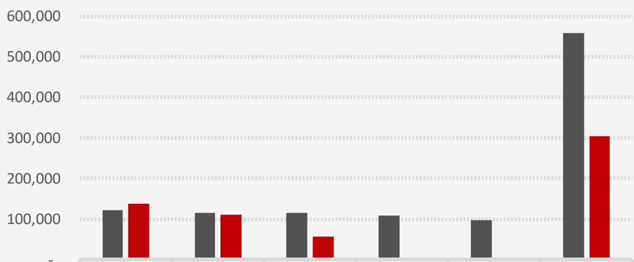
On the sectorial front, on account of the closing of frontiers and disruption to international air travel, a marked downturn is expected in the hospitality sector. In fact, while the Rs 9 billion earmarked in the National Resilience Fund to support to the national air carrier as per the National Budget should provide some support to the travel industry, tourist arrivals are projected to be severely impacted during the second and third quarters of 2020. Already, tourist arrivals dropped by 45% during the first five months of the year, while earnings fell by 14% during the first quarter. A modest pick-up in arrivals is foreseen as from Q4 2020, with a return to pre-pandemic levels not to be observed before end of 2021 / early 2022 as per our baseline scenario. Furthermore, whereas the seafood and sugar industries should display a fair degree of resilience to the context notwithstanding pressures on value added generation, the textile industry would, in all likelihood, experience a major slump on the back of a significant decline in demand from key export markets as orders are cancelled / postponed and foreign buyers face financial distress, while lingering production delays amidst supply disruptions would also dampen value addition in the sector. That said, a noticeable rebound in activities is anticipated by the end of 2020. At another level, the testing economic landscape abroad along with business closures, financial difficulties faced by enterprises and logistics disruptions are poised to weigh significantly on the execution of investment projects in the construction and property development fields. On this note, while the Budget unveiled plans for a major boost to construction activity, the implementation rate for public projects would warrant attention in view of historical trends, whereas private investment would remain hampered on the back of high economic uncertainty levels. A non-negligible downturn can also be expected in specific activities in the BPO industry, notably in respect of businesses dealing with France. In addition, the challenging economic landscape should take a toll on the performance of the trade sector and contribute to hampering value added generated by domestic oriented enterprises, although there could, in current circumstances, be some scope for boosting local production in specific segments. The situation is projected to gradually improve in line with resumption of activities by households and businesses in the country, with some support anticipated to emanate from earmarked Budgetary measures. As for the financial and business services industry, it would be impacted by the spillover consequences of the deteriorating landscape though the sound buffers that operators have accumulated over the years should deliver some welcome relief in partly cushioning the repercussions on their operating activity levels. Within this sector, the global business segment could, for some time yet, remain pressurised by muted investor sentiment and a more stringent operating environment. Notably, the country’s inclusion on the EU list could, if not promptly resolved, hamper the attractiveness and competitiveness of the Mauritian International Financial Centre.

From an expenditure standpoint, the Mauritian economy would be confronted by a noticeable decline in household consumption in the wake of confinement measures and a likely decline in the disposable income of those engaged in more vulnerable sectors. In addition to that, nationwide investment would, by a noteworthy magnitude, be disrupted by the challenging operating context. In spite of the planned implementation of major public infrastructure projects, the ratio of public sector investment to GDP is projected to drop from an estimated 5.4% in 2019 to 4.9% in 2020 on account of the inactivity during the lockdown period as well as likely execution lags. As for private sector investment, its share of GDP is set to decline from 14.6% in 2019 to attain 12.5% this year according to our baseline forecasts. On the whole, the country’s Gross Fixed Capital Formation ratio is projected to decline by 260 basis points to stand at 17.4% this year. On another note and as a further drag on the country’s growth performance for this year, net exports of goods and services are foreseen to materially deteriorate amidst the tepid external conditions, in spite of the relief to the import bill emanating from lower international oil prices.

Box II: Impact of the COVID-19 pandemic on the tourism sector in Mauritius

- The tourism sector worldwide has taken a massive hit from the COVID-19 pandemic. Indeed, globally, tourist arrivals were down 22% in the first quarter and could decline by 60-80% over the whole year according to the UNWTO. This decline in international arrivals in the first quarter translated into a shortfall of USD 80 billion in receipts. In Mauritius, according to latest official figures released by Statistics Mauritius, tourist arrivals decreased by some 45% from January to May 2020 when compared to the corresponding period last year. Furthermore, the authorities have indicated that the loss in terms of foreign exchange for the sector has been estimated at about Rs 12 billion for April and May 2020.

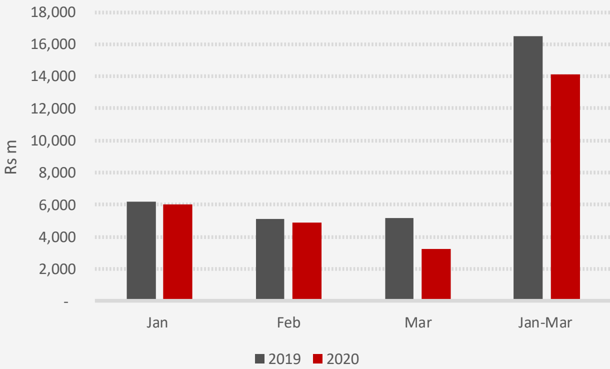
Tourist arrivals



	Jan	Feb	Mar	Apr	May	Jan-May
2019	122,273	115,613	114,419	108,565	96,814	557,684
2020	137,419	111,560	55,863	10	20	304,872

2019 2020

Tourism earnings



- The actual outcome would eventually depend on how the afore-mentioned factors evolve over time and the effectiveness of measures put in place locally and abroad to support economic activities.

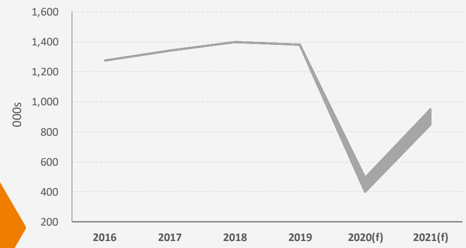
The following assumptions are made to estimate the potential loss in tourism earnings and determine the possible shape of recovery in the tourism sector:

- The pandemic fades in the second half of the year on the worldwide scale and containment efforts are gradually unwound, with international travel restrictions lifted only in late Q3 2020
- A modest pick-up in arrivals is foreseen as from Q4 2020, with a return to pre-pandemic levels not to be observed before end of 2021 / early 2022 based on projections of international tourist arrivals and views by local operators
- Despite benefitting from a weaker rupee, some hotels are expected to cut prices more than proportionately in the face of lower demand, with the average tourist also reducing its spending

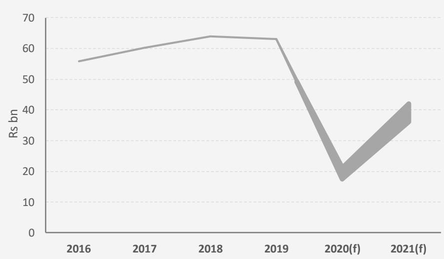
A shortfall in gross tourism earnings (compared to 2019 levels) of around Rs 40 billion in 2020

Likely shape of recovery

Tourist arrivals



Tourism earnings



(f) : forecast

Sources: UNWTO, MCB staff estimates, Statistics Mauritius & Bank of Mauritius

Preliminary projections for 2021

While we continue to be exposed to various unknowns – notably relating to sanitary conditions and the global economic landscape – an important technical rebound in growth can be foreseen for next year, as activities gradually resume within the country and in our key markets abroad. As per our current baseline estimates, real GDP growth is forecasted to stand at 7.9% in 2021 assuming an expected relative pickup – as from the latter part of the current year in general activity levels – though some sectors, such as tourism, would take some time to return to pre pandemic levels. There is, nonetheless, a high level of uncertainty around the strength of the projected recovery. The latter will, notably, depend on (i) the progressive mending of the global economic climate, as the pandemic is tackled; (ii) the volatility of conditions across international financial and commodity markets; (iii) time taken for business and investment confidence as well as household sentiment on the worldwide front (especially in our key export markets) to be re-ignited; (iv) the implementation rate of projects earmarked in the Public Sector Investment Programme; and (v) the effectiveness of local stimulus and support measures aimed at providing adequate wherewithal to economic operators and assisting them in their rebuilding endeavours, notably by means of assistance extended by the Mauritius Investment Corporation to identified business operators across sectors.

Other indicators

Inflation

On account notably of repeated hikes in the prices of vegetables and the continued strength of the US dollar on international markets, headline inflation pursued an upward movement in recent months, but remained low at 1.7% as at May 2020 compared to 1.0% a year before. In the months ahead, whereas the recent reduction in the price of cooking gas and relatively low commodity prices on the international front would provide some relief to the consumer price index, headline inflation is expected to maintain its rising pattern on the back of downward pressures on the value of the rupee amidst the difficult context – notwithstanding the recent strengthening against the US dollar – while the output gap is likely to temper the impact of the continued excess liquidity. Additionally, the potential spillover impacts of the recent Budgetary measure to increase excise duties on sugar-sweetened products can also weigh into the balance. Overall, barring exceptional events – particularly relating to the evolution of global commodity prices amidst any resurgence of geopolitical concerns – headline inflation is anticipated to stand at around 4.3% as at December 2020. In spite of this uptrend, an accommodative monetary policy stance is likely to prevail for some time yet in Mauritius owing to the highly challenging economic conditions.

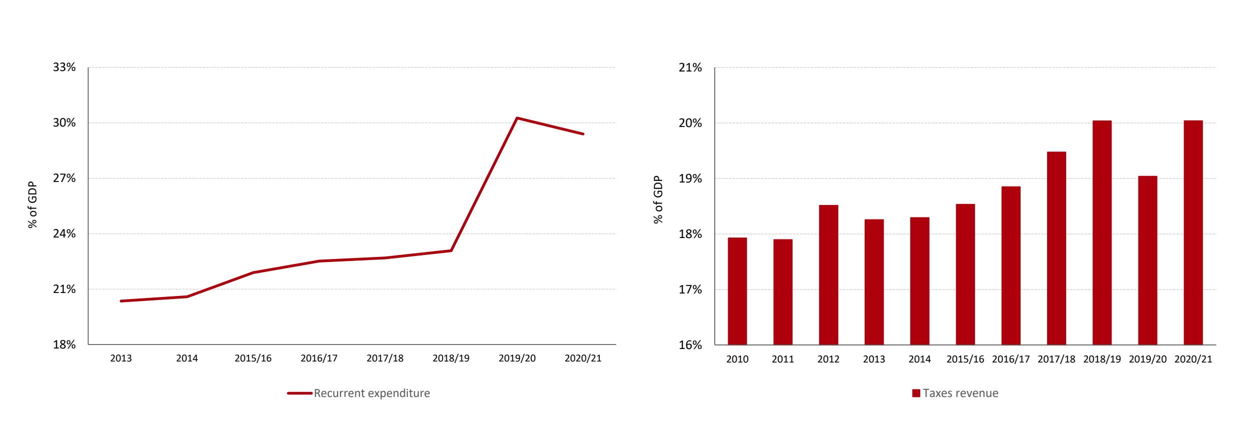
Unemployment

Notwithstanding dedicated measures earmarked by the authorities such as the Rs 15 billion allocated to provide an exceptional minimum monthly support of Rs 5,100 to each beneficiary of the 'Transition Unemployment Benefit' programme over the next six months, significant pressures are likely to remain cast on the ability of local business operators to sustain employment. This reflects the impact of the tepid trends in respect of private investment and the adverse effect of the contraction in aggregate wealth creation on revenue and financial position of operators amidst protracted labour market rigidities. Against this backdrop, we expect a rise in unemployment particularly in respect of SMEs and self-employed, while a non-negligible number of people employed in large establishments could fall into temporary unemployment (i.e. those on leave without pay with payment of transitional unemployment benefit) over the coming months. Even if the latter would, technically, not be accounted for in the computation of overall jobless rate in the country, a sharp increase is expected to be seen in respect of total labour underutilisation – representing the aggregate of unemployed, underemployed and those in the potential labour force – in the economy in 2020.

Public finance

For FY 2019/20, fiscal metrics should be impacted by dampened revenue collection of the Government amidst the difficult context and higher expenditures linked to support measures. As per the authorities, the budget deficit is projected to deteriorate to attain 13.6% of GDP for this fiscal year, as compared to a formerly-announced rate of 3.2%. There is an estimated notable shortfall of some Rs 20 billion on the revenue side, led mainly by lower-than-expected receipts emanating from taxes on goods and services, corporate profits as well as lower grants from foreign Governments. On the expenditure side, while an under-spending is estimated on the capital side when excluding the transfer of Rs 12 billion to Special Funds which was not budgeted, recurrent expenditure would shoot up by 16.4% relative to the budgeted projection to attain 30.3% of GDP. This is explained by the provision of a range of measures to tackle the economic and social challenges posed by the ongoing pandemic. With regard to FY 2020/21, the overall budget deficit is expected to be balanced as per figures formulated by the authorities. This will, as reported, be made possible via the exceptional contribution from the Bank of Mauritius of Rs 33 billion and Rs 27 billion to meet recurrent and capital expenditures respectively. Concurrently, a surplus is projected on the primary balance in FY 2020/21, which would reflect a marked improvement from the preceding year's estimated deficit of 10.7% of GDP. As for the coming fiscal years, both the budget balance and the primary balance are projected by the authorities to return to deficit positions. The exercise of sufficient fiscal prudence remains, therefore, crucial, especially given the challenging context prevailing locally and abroad. Indeed, while the marked increase in spending is understandable given the overwhelming crisis and the need to stem the advance of the virus and mitigate its economic consequences, it is important, when the crisis abates, to embark on a well-defined fiscal consolidation path backed by proper fiscal discipline in order to place public debt on a declining path. In that respect, further efforts are needed to avoid unproductive expenses. At the same time, it is important to uplift the country's growth potential to support higher revenue generation, while striving to maintain a competitive tax regime.

Figure 3 **Evolution of recurrent expenditure and tax revenue**



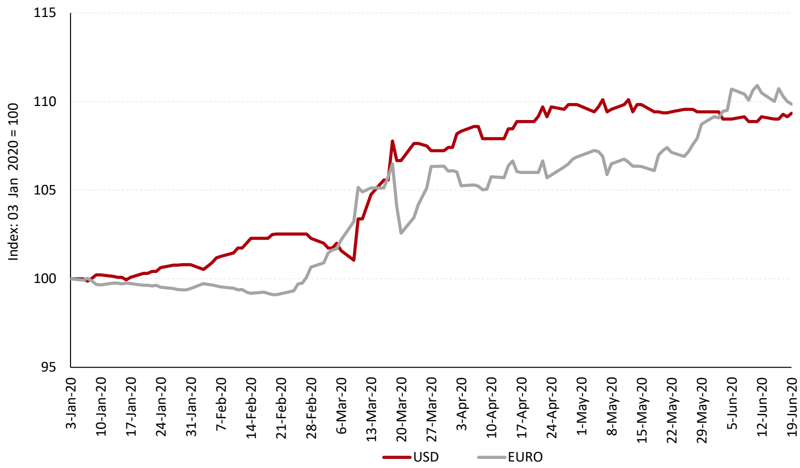
Source: Ministry of Finance and Economic Development

External front

The sizeable external imbalances continued to warrant scrutiny lately in view of the highly challenging operating environment. In fact, exports of goods contracted by an estimated 4.6% in nominal terms during the first quarter of the year, thereby contributing to a 7.5% rise in the balance of trade deficit, compared to the corresponding quarter of the previous year. In line with such trends and in spite of some relief measures announced in the Budget and the downward pressures on the value of the rupee, exports of goods are foreseen to fall by a notable margin this year against the backdrop of the significant economic downturn in our export markets in the wake of the pandemic. Thus, in spite of some relief conveyed to the import bill by lower international oil prices and the reduction in business operations locally, the balance of trade deficit is forecast to deteriorate further to attain around Rs 123 billon this year, i.e. about 27% of GDP.

Figure 4 ***Recent evolution of the rupee***

Evolution of MUR against USD & EURO



	Mid-rate	(Appreciation)/Depreciation of the rupee		
	19-Jun-20 MUR	m.o.m %	y.o.y %	y.t.d %
USD	39.82	(0.1)	10.5	9.3
Euro	44.59	2.7	10.8	9.9

An increase/decrease in the index corresponds to a depreciation / appreciation in the Mauritian rupee

Source: MCB staff estimates

With regard to the current account deficit, it is, beyond the above, anticipated to bear the brunt of the marked contraction being projected in gross tourism earnings as well as unfavourable trends regarding primary and secondary income amidst the challenging context. Overall, the current account deficit is set to breach into double-digit territory and stand at 14.1% of GDP this year. Furthermore, a marked decline is foreseen in the capital and financial flows on the back of adverse income generation by economic agents globally, strained investor sentiment and prevalence of high economic uncertainties such that the Balance of Payments would be in a deficit position for the first time in nearly 15 years. This could, in turn, exert further pressures on the exchange rate of the rupee, with the actual outcome to be determined by measures by the Bank of Mauritius, including the potential forex injections linked to the Mauritius Investment Corporation.

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Chief Strategy Officer

June 19, 2020

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