

CONJONCTURE

PluriConseil
THINKING OUT OF THE BOX!

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"Tout l'art de la politique est de se servir des conjonctures."
Louis XIV

Against the flow

Editorial - By Eric Ng Ping Cheun

All the hype about the current account deficit of Mauritius is redolent of the gloom brought about by the two rupee devaluations in the late 1970s and early 1980s. It reveals to what extent our opinion leaders and mainstream economists still labour under the mercantilist misconception that a nation can enrich itself by boosting exports and chasing imports away. They are modern-day mercantilists who believe our trade deficits should be reduced by lowering down the value of the rupee.

Mercantilism was an insidious economic theory that held Europe in its thrall in the 16th, 17th and 18th centuries. The mercantilists decreed that a nation's economic success could be measured by its stockpile of gold, and that the way to increase the pile was to encourage exports and restrict imports. In Book IV of the *Wealth of Nations* (1776), Adam Smith rose up against the mercantilists by demonstrating that open trade is "good", not "bad".

What matters is external debt accumulation

As stated in the Bank of Mauritius' monthly bulletin, provisional estimates suggest that the current account of our balance of payments worsened in 2005 to record a deficit of Rs 10 billion (representing 5.4% of Gross Domestic Product) compared with a deficit of Rs 3.2 billion (1.8% of GDP) in 2004. This marked deterioration is said to be largely due to a higher merchandise account deficit of Rs 23.5 billion in 2005 compared with a deficit of Rs 16 billion in 2004.

It is important to get an insight into what the balance of payments figures actually reveal and what they conceal. The question is: should

it be a matter of concern that the current account deficit is widening on the back of the import of merchandise? Imports can have a stimulating effect on the debtor's economy. Conversely, a current account surplus needs not be a sign of healthy economy. When, in 2002, it enjoyed such a surplus, equivalent to 5.2% of GDP, the Mauritian economy was growing at 2.1%, the lowest growth rate since 1983!!!

into default or subject to the International Monetary Fund rule. But the country is still far away from a debt collapse. To understand this, it is necessary to grasp the basics of the balance of payments accounting framework.

Debits equal credits and outflows compensate inflows

By definition, the overall balance of payments of

Year	Foreign Direct Investment		Direct Investment Abroad		Net Direct Investment
	Gross	Net	Gross	Net	
2001	+936	-747	-83	-83	-830
2002	+979	+962	-278	-257	+705
2003	+1,966	+1,732	-1,156	+153	+1,885
2004	+1,796	+307	-970	-871	-564
2005	+2,368	+707	-1,942	-1,402	-695

(Source: Bank of Mauritius)

Again in the year 2002, final consumer goods accounted for 28.2% of total imports. This share came down to 23.7% in 2005, which means that Mauritius imported an increasing amount of intermediate goods and capital goods used in the production process. A rise in the productive capacity of industries is likely to generate more value added in the economy.

a country can only be in equilibrium. Balance of payments accounting is based on the double entry principle with every item booked as a credit and a debit. Deficits and surpluses can only show up in the sub balances.

The real problem will come when the deficit in the current account widens due to financial obligations. It does not matter so much when a country has a high current account deficit for a few years as when such a level of deficit persists along with a long period of external debt accumulation.

A typical balance of payments (BP) contains three major sub balances: the current account (CA), the capital and financial account (CFA) and the change of reserves account (R), the latter being seen as a form of compensatory financing.

$$BP = CA + CFA - R = 0$$

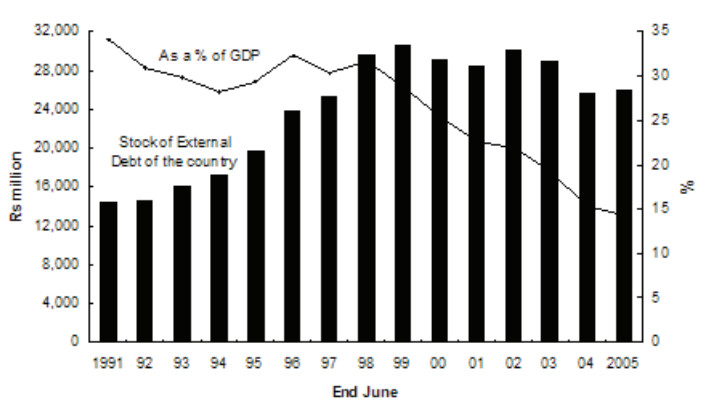
Bringing the change of reserves to the right side of the equation, one gets:

$$CA + CFA = R$$

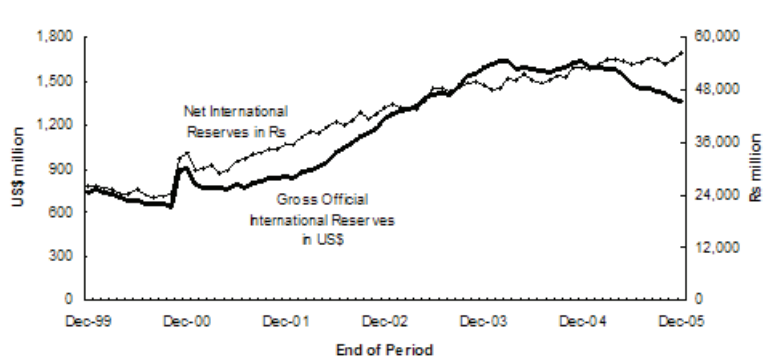
If payments of investment income to foreigners crowd out imports of physical goods, then local consumers will feel the pinch. In this case, a small economy like Mauritius can be forced

Continued on Pg 4 .../

Mauritius' external debt position is comfortable...



... but gross official international reserves have started declining



Is there a right time to invest?

By Daryl Liew

To buy or sell?

Investors are a jittery lot. I was talking to a couple of prospects in the last few weeks about investing their money for their long term goals and the common objection raised was whether now was the "right" time to enter the market. Top on their list of concerns was the threat of an avian influenza pandemic breaking out. With new reports of more and more people getting struck down by the bird flu each week, these investors were worried that a pandemic would drastically affect global markets and their investments.

The threat of the H5N1 avian flu virus is very real, having already killed more than 60 people and the slaughter of 150 million poultry. Quantitatively, the virus has caused US\$10 billion in lost trade so far. Indeed, the World Health Organisation recently released a report putting the potential cost of an avian influenza virus pandemic at US\$800 billion. They also estimated that the best-case pandemic scenario will result in global deaths of 2 to 7.4 million!

So based on all this information, should investors sit on the sidelines, bidding their time for the pandemic to strike before entering the market when prices fall? Well, the risk of adopting this strategy is that this bird flu threat may be a non-event and eventually blow over, for the time being at least, once the winter season in the northern hemisphere passes. What is the cost of this sit-and-wait approach? Equity markets traditionally do very well in the run-up to the year-end Christmas and New Year holidays, so these investors may have to forego some potentially nice returns while waiting for the bird flu to spread.

Timing the Market

This motivation to try to time attractive entry and exit points in the market is conceptually easy to understand. The fundamental goal obviously is to "buy low, sell high", remaining invested when the market is on the way up, while orchestrating pullouts whenever market downturns are on the cards. This strategy however is easier said than done, as not many people can successfully "time the market" on a consistent basis.

In fact, the best market strategists only attempt to identify the extreme scenarios, when either the markets are extremely undervalued or when the market has got ahead of itself. Those are the only two instances when changes to the portfolio are recommended. The strategy at all other times is to stay invested. The challenge however for most investors is having the discipline to stay the course – riding out the frequent small waves in the market, while avoiding the temptation of jumping ship at the first sign of trouble on the horizon. Investors have to recognise that these smaller swings are noise that eventually work their way out of the system.

The most commonly cited reason why investors should stay invested for the long term rather than pulling out at the first signs of trouble is that missing the potential recovery when the market turns up will significantly reduce your overall returns. The actual impact on your returns varies depending on what instrument you are investing in and where you get your data from, but some commentators say that missing the 10 best days in a year could cut your return by more than half.

While I believe that this probably is true, advocates of market timing would counter that missing the worst 10 days will similarly significantly boost your returns. I sought to test this out by looking at the daily returns over the past five years of the Aberdeen Pacific Equity fund, a unit trust that invests in Asia Ex-Japan equities. I then sorted out the fund's returns to find out the 10 best days in each year.

Well, missing out on the 10 best performing days would definitely adversely impact your overall returns. In fact, in three out of the five years, the cumulative returns from the 10 best days far exceed the returns for the year! On the flipside, the figures also showed that investors would have greatly benefited from staying out of the fund during its 10 worst performing days, potentially improving returns from between 12 to 25%!

So could a savvy, clairvoyant investor have successfully predicted and stayed out of the fund during its 10 worst days? In the remote probability that an investor may have successfully predicted these days, he most probably would have also missed out on some of the strongest rallies for the fund. This is because the daily performance numbers show that more than half of the 10 best / worst days tend to be closely bunched up together. The investor probably would be unable to reinvest in the fund a few days after selling out as it usually takes a week or so for the fund proceeds to reach him.

Hence it would seem that it is practically impossible for an investor to benefit from the 10 best days yet avoiding the 10 worst days. A far better and more feasible strategy would be for him to remain invested in the fund, riding out the ups and downs, so long as he truly believes in the underlying asset class – in this case, the merits of investing in Asia Ex-Japan equities.

Should you be investing now?

So, after all that, should investors be putting their money into the markets now? Well, my take on the bird flu situation is that it could be a non-event. Experts believe that the catalyst for a pandemic breaking out is IF the virus suddenly becomes transmissible between humans. Thus far, this doesn't look like it will

happen... yet. All the current cases of people getting afflicted by the avian flu have been because of direct contact with birds. In addition, I do believe governments all over the world and the WHO seem to be conscious of the risks and are taking the necessary steps to prevent and control such a situation from occurring.

Hence, people investing for their long term goals should stay invested, while those who currently aren't invested should start making their money work harder for them. Having said this, investors should be extremely careful about what they are putting their money in. A diversified portfolio approach that spreads the investments across different asset classes and sectors is strongly recommended, as this would greatly insulate the portfolio against external shocks.

To illustrate, pharmaceuticals could be one sector that would benefit from a bird flu pandemic. As such, maintaining an allocation to the healthcare sector in one's portfolio would lessen any adverse impact to other equity holdings. Another recommended best practice when investing in "uncertain times" is to spread out your investments over a period of two or three months, allowing for dollar cost averaging.

In conclusion, it is right that investors be aware of the potential risks in the environment. However, they shouldn't be paralysed by these risks into holding cash. Choosing to stay invested or to carry on with your investment is the best option so long as you have a properly constructed, well thought-out investment plan. Personally, I wouldn't even consider investing without such a plan.

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Accélération de la croissance mondiale : pour qui ? pour combien de temps ?

Par Jean-Yves Naudet

Le Fonds Monétaire International vient de publier un rapport globalement optimiste sur la croissance économique mondiale. Celle-ci reste forte et marque une accélération par rapport aux prévisions antérieures comme par rapport à l'an dernier. Mais cet optimisme doit se tempérer doublement. D'une part la croissance ne concerne guère la « vieille Europe », et tout particulièrement la France et l'Allemagne, d'autre part la croissance est menacée par les erreurs politiques qui pourraient être commises, aux Etats-Unis comme en Europe.

Une croissance de 4,9% en moyenne en 2006

Le rapport semestriel du FMI annonce un véritable printemps de la croissance mondiale. Globalement, le produit intérieur brut (PIB) devrait progresser en 2006 de 4,9% pour l'ensemble de la planète : on renoue ainsi avec les chiffres des trente glorieuses de l'après-guerre. Par rapport aux prévisions faites à l'occasion du rapport de l'automne dernier, l'accélération est assez sensible : 0,5% de croissance en plus. Or l'année 2005 avait déjà été une excellente année au niveau mondial, avec 4,8% de croissance. Et cette croissance devrait être durable, puisqu'elle serait encore de 4,7% en 2007 : trois années de suite à près de 5% de croissance, ce n'est pas rien.

Deuxième bonne nouvelle : cette croissance est encore plus rapide dans ce que l'on n'ose plus appeler le tiers-monde, tant il se développe rapidement. En 2006, la croissance moyenne des pays en développement et des économies émergentes serait de 6,9%. En particulier, l'Asie en développement connaîtrait une progression de 8,2%. Cette progression asiatique est tirée bien sûr par la Chine, avec 9,5% de croissance, mais aussi par l'Inde, avec 7,3% de croissance.

Autre fait notable : l'Afrique, que l'on pensait être un continent sinistré, marque aussi une progression sensible, menée par les pays qui ont accepté des réformes et l'ouverture aux échanges internationaux : le PIB augmenterait de 5,7%, ce qui n'est pas mal du tout. Le Proche-Orient serait exactement dans la même situation. L'Amérique latine est un peu moins dynamique, avec 4,3%, mais il est vrai que dans ce continent un certain nombre de pays ont fait des choix politiques hasardeux, qui risquent de ralentir la croissance : faire le choix du socialisme, c'est le plus court chemin vers la récession. Mais d'autre pays latino-américains tirent la croissance vers le haut, toujours ceux qui acceptent la logique des échanges libres.

2% de croissance seulement dans la zone euro

Bonne note également pour les pays d'Europe de l'Est, qui eux aussi ont accepté les réformes radicales qui s'imposent, à commencer par les réformes fiscales (*flat tax* par exemple) : la

croissance y serait cette année de 5,2%. Même la Russie fait bonne figure, avec 6% de croissance. Ce sont donc les pays occidentaux industrialisés qui sont à la traîne. Mais dans ce groupe, les Etats-Unis font toujours la course en tête, avec 3,4%, et le Canada avec 3,1%. Le Japon est enfin sorti de la récession, avec 2,8%. Et la Grande Bretagne, en recul sensible cette année, tombe à 2,5%.

Tout cela n'est pas extraordinaire, mais c'est dans tous les cas bien mieux que dans la zone euro, qui se trouve et de loin en queue de peloton. La croissance devrait y être de 2% à peine en 2006, en moyenne, et la France se situerait exactement dans cette moyenne. Quand à l'Allemagne, elle serait même en dessous avec 1,3% de croissance seulement. La vieille Europe se distingue donc et paye très cher son refus des réformes et son protectionnisme.

Comment expliquer les bonnes performances du monde entier et les mauvaises performances de la zone euro ? Il y a deux constantes dans les pays à croissance rapide : l'acceptation des réformes visant à libéraliser l'offre (concurrence, flexibilité du marché du travail, dérégulation, défiscalisation) et d'autre part la plus grande ouverture possible des frontières.

Or sur ces deux terrains la zone euro est encore très frileuse, particulièrement en France ou en Allemagne : le patriotisme économique (sévèrement condamné par le FMI comme étant « le vieux vin du protectionnisme présenté dans une nouvelle bouteille mal dénommée » !), le refus maladif de la moindre réforme (« *On ne peut plus embaucher à vie aujourd'hui* » a rappelé l'économiste en chef du FMI, visant la France) constituent les plus sûrs moyens de briser l'élan de croissance. Nous n'avons pas pris le train de la croissance parce que nous n'avons pas pris le ticket qui nous permet de voyager, celui de l'acceptation des réformes. Voilà pourquoi l'Europe est à la traîne.

Retour à l'argent facile ?

De plus l'Europe risque d'être pénalisée au cours des mois à venir si le dollar devait baisser substantiellement : les exportations vers les Etats-Unis et la zone dollar deviendraient problématiques. Arrivés à ce point, nous pouvons nous interroger sur la politique monétaire de la Réserve Fédérale.

Certes, on ne cesse de s'inquiéter de la hausse des cours pétroliers, qui battent en permanence de nouveaux records, atteignant, en termes réels, pratiquement ses records historiques. Certains pensent que cette hausse pourrait provoquer de l'inflation, la hausse du prix du pétrole (et des matières premières en général) se répercutant sur tous les prix. Mais il n'y a inflation que s'il y a une émission de monnaie exagérée.

Les propos tenus la semaine dernière par Ben Bernanke, pourraient laisser penser que le dollar serait volontairement déprécié, un retour à « l'argent facile » permettant d'alléger la facture pétrolière. Mais les Etats-Unis peuvent-ils effacer du même coup l'énorme dette qu'ils ont vis-à-vis des Chinois ? Ceux-ci accepteraient-ils d'être ainsi dépouillés, et n'auraient-ils pas la tentation de liquider toutes leurs réserves en billets verts, provoquant ainsi un dérèglement monétaire mondial ? Une révision totale de la gestion du dollar nous semble donc aujourd'hui improbable. D'autre part un élément d'optimisme est précisément la croissance mondiale car elle signifie aussi une intensification de la concurrence, de nature à contenir les prix en obligeant les entreprises à faire des gains de productivité.

Nous ne sommes plus en 1929, où chacun se réfugiait derrière d'illusoire frontières, mais dans des économies ouvertes qui tirent la croissance vers le haut. Certes, le FMI marque son inquiétude si jamais la politique se mêlait à la crise, provoquant d'artificielles pénuries en Iran, en Irak, au Nigeria ou en Amérique Latine. La géopolitique est capable de briser la croissance mondiale : on le sait hélas depuis longtemps !

Jean-Yves Naudet, professeur d'économie à l'Université d'Aix-Marseille III, est rédacteur-en-chef de Nouvelle Lettre, un bulletin édité par l'Association pour la Liberté Economique et le Progrès Social (ALEPS), fondée par Jacques Rueff.

MAIL

Vina : Je ne suis pas économiste mais je me permets de faire un petit commentaire à propos de l'accès aux ordinateurs. Cela m'est venu à l'idée quand j'ai lu l'article de Samad Ramoly (numéro avril 2006).

Il existe à Maurice un 'upgrading' régulier des ordinateurs dans divers secteurs. La plupart du temps, on achète du neuf et les anciens – encore corrects – vont dans un lieu de stockage. En ce qui concerne le secteur public ou parapublic, les ordinateurs sont empilés et considérés comme « *rubbish* ». Si on en parle à l'administration, on vous dit qu'il faut laisser ces ordinateurs là où ils sont pour le compte de fin d'année (audit).

Pour notre économie, est-ce que ces ordinateurs ne pourraient pas être offerts à des écoles primaires par exemple ? Dans le *Lower Primary*, ils ont besoin de quelques logiciels simples et ces ordinateurs seraient parfaits. Je ne comprends pas très bien la raison pour laquelle il faut toujours penser comme les pays riches et envoyer tout ce qui est matériel ancien au 'dumping ground'...

Samad Ramoly : Effectivement une très bonne idée pour réduire davantage le leurre numérique. Ceci est un exemple flagrant de ce qui constitue peut-être notre plus grand défi : l'optimisation de nos ressources et dans ce cas l'argent des contribuables.

Editorial

By Eric Ng Ping Cheun (Cont., from Pg 1)

If the level of reserves has to be maintained ($R = 0$), a current account deficit must be fully compensated by a net inflow of foreign capital (a positive capital and financial account). Or else, the central bank has to draw into the foreign exchange reserves so that the CA and the CFA balance. If the current account were positive, then the country would accumulate foreign exchange reserves.

The current account balance is the net result of the foreign trade in goods and services, of the foreign investment income and of the unilateral transfers. One can simplify the CA by leaving out the latter (assuming they are zero). Now, since interest and dividend payments from Mauritian investments abroad are registered as exports of services, and similar payments to foreign investments in Mauritius are calculated as an import, the current account can be reduced to net exports, i.e. Exports (EX) minus Imports (IM), of goods and services.

$$CA = EX - IM$$

The capital and financial account registers capital flows. An increase of net assets abroad held by the residents is counted as capital exports (CEX) – an outflow booked as debit. An increase in liabilities towards foreigners constitutes capital imports (CIM) – an inflow booked as credit.

$$CFA = CIM - CEX$$

The balance of payments equation then becomes:

$$BP = (EX - IM) + (CIM - CEX) - R = 0$$

Under the constraint that the level of foreign exchange reserves must be maintained, the so-called “Basic Balance” is as follows:

$$(EX - IM) + (CIM - CEX) = 0$$

A current account deficit implies a net sale of domestic assets to foreigners

When the current account is in balance ($CA = 0$), the CFA is in balance, too: outflows equal inflows. However, when the current account is in deficit ($CA < 0$), there must occur a net sale of assets ($CFA > 0$), i.e. foreign ownership of domestic assets must increase: foreigners either lend money to Mauritius (which thus accumulates debt) or buy its financial or real assets.

According to the Bank of Mauritius (BoM), the capital and financial account of our balance of payments, inclusive of reserve assets, recorded inflows of Rs 5.7 billion in 2005 compared to Rs 884 million in 2004. These surpluses have been used to buy additional goods and services from abroad, which are registered as debit in our current account.

A current account deficit basically means that the country spends more than it produces. For

this to be possible, the residents (individuals, businesses and government) must sell more assets to foreigners than they buy from foreigners. Excess spending implies debt accumulation or loss of domestic ownership. But if foreign financing is unavailable, the burden of adaptation will fall fully on foreign trade.

Mauritians spend lavishly on imported goods. But should the government be compelled to finance the current account deficit through the sale of some national landmarks, such as State Bank of Mauritius, Mauritius Telecom or Air Mauritius, to foreigners, a public outcry would follow. Since this scenario is unlikely to happen – for reasons best known to politicians –, it is debt which really matters, in particular when this debt is accrued by the government.

So long as countries that have a current account surplus finance the deficit country by exporting capital, and provided that exchange rates are flexible enough to do the balancing act, there will be no balance of payments problem. However, limits will show up sooner or later and will appear in the net investment income balance as external debt accumulation becomes unsustainable. Once market expectation takes hold that the deficit country will sell its assets more for debt service purposes than for financing the import of goods, the creditor countries will be tempted to turn the tap off.

Gross official reserves decreased by US\$ 264 million in 2005

Fortunately, Mauritius is not yet in this unenviable situation. First, its investment income account registered a net deficit of only Rs 17 million for the year 2005. Second, although the stock of the external debt of the country has increased from Rs 14.4 billion at end-June 1991 to Rs 26 billion at end-June 2005, in relation to GDP it fell sharply from 34.1% to 14.3%. As regards government's external debt, it stood comfortably at Rs 9.2 billion at end-June 2005 compared with Rs 10.8 billion at end-June 1998.

However, Mauritius is consolidating its external debt position at the expense of its foreign exchange reserves. During the year 2005, gross official international reserves dropped by US\$ 264 million, or by 16%, to reach US\$ 1,366 million. The reserves account, as a form of compensatory financing, recorded an inflow of Rs 4.9 billion, which is construed as the “deficit” of the balance of payments, excluding valuation changes.

Inclusive of the net foreign assets of banks, the end-December 2005 level of net international reserves of the country, exclusive of the purchase of aircraft, represented 31.4 weeks of imports. Such a level of import coverage is more than comfortable by international standards.

From this perspective, it is hard to understand why the intervention of the Bank of Mauritius on the interbank foreign exchange market remains very timid while demand for hard currencies has become structurally high... The only reason can

be that the BoM is using foreign exchange reserves as an ammunition chest for future intervention, namely to cover the shortfall of foreign currencies that Mauritius will incur due to the progressive 36% cut in the European guaranteed sugar price over the next four years.

While trying to avoid the risk of depleting its reserves in the long run, the BoM will have to keep selling dollars and buying rupees, not just to smooth out currency fluctuations, but also because the government wants to avert a devaluation of the rupee. A currency crisis happens when expectations take hold in the foreign exchange market that the central bank will run out of its reserves.

Bank of Mauritius' official data indicate that, on a 12-month running period, the rupee against the dollar, on a daily average basis, appreciated by 2.1% in 2004, then depreciated by 6% in 2005. Versus the euro, the rupee depreciated by 7.1% in 2004 and by 6.1% in 2005. Vis-à-vis the pound sterling, the rupee depreciated by 9.1% in 2004 and by 5.2% in 2005.

Despite the overall depreciation of the rupee vis-à-vis the currencies of our major trading partners, the terms of trade, which measure the price movements of exports relative to imports, did not move in favour of Mauritius: the index fell from 100 in 2003 to 97 in 2004 and to 87 in 2005, indicating that the real purchasing power of our exports has decreased.

Mauritius badly needs foreign direct investment

In lieu of exporting goods at competitive prices, Mauritius is exporting capital at a quicker pace. In 2005, gross direct investment abroad peaked to nearly Rs 2 billion, a figure which the outgoing president of the Mauritius Chamber of Commerce and Industry found “disturbing”. But every human being will put his money where his mouth is. Investors look for business opportunities, wherever they are, that reap the best return on investment.

So long as Mauritians make profits on their investments abroad and repatriate them, they must be encouraged in their endeavour. What is disturbing, in fact, is the deficit in the direct investment income account for the year 2005: foreign investors here received Rs 984 million whereas Mauritian investors abroad obtained only Rs 135 million. Does this mean that it is more profitable to invest in Mauritius than elsewhere?

For sure, a country needs capital imports, especially foreign direct investment. While gross FDI in Mauritius was Rs 2.4 billion in 2005, the net amount trickled to Rs 707 million. The best way to finance a current account deficit is, of course, through FDI. No country has the magic wand to sustain persistently high trade deficits while concurrently avoiding external debt financing, maintaining the level of foreign exchange reserves and stabilizing its currency.