

CONJONCTURE

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THINKING OUT OF THE BOX !

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

Positionner Maurice en temps de crise

Par Raju Jaddoo

Il convient de positionner l'île Maurice en présentant ses avantages forts pour l'entreprise et l'investissement, en donnant la liberté aux investisseurs de choisir Maurice plutôt que d'autres destinations, et en leur présentant la capacité de réinvention de Maurice. De la production du sucre brut à la création d'une 'île plateforme', en passant par le textile, le tourisme et les services, Maurice reste une économie ouverte et diversifiée qui rajoute de la valeur aux processus de création.

Trois plateformes mauriciennes

Il existe trois plateformes mauriciennes qui méritent d'être mises en valeur. Première plateforme : les ressources humaines. Selon le Bureau central des statistiques, 30 000 étudiants sont inscrits en études tertiaires. L'ouverture de l'économie facilite le recrutement externe des compétences pendant une période de transition où l'île a besoin de plus de cadres (*middle management*) qui ne sont pas disponibles sur le marché mauricien, notamment dans le secteur des technologies de l'information et de la communication (TIC).

Deuxième plateforme : l'infrastructure et la technologie. Nos *Business Parks* progressent vers des habitats technologiques (*plug and play environments*). Nous avons des câbles à haut débit tels que SAFE, et avec une projection de 10 Gbps en 2015, ainsi que des liens aériens et maritimes vers l'Europe, l'Asie, l'Afrique du Sud et le Moyen Orient.

Troisième plateforme : le climat des affaires (*Ease of Doing Business*). Maurice est un des endroits les plus favorables au monde pour les affaires et l'investissement. Le pays a été classé 24ème sur 181 pays dans le *Doing Business Report* de la Banque Mondiale en 2008 (32ème en 2007), et il a pour objectif d'être parmi les dix premiers en 2010. Il a été 7ème parmi 181 pays en création d'entreprise grâce au principe des contrôles ex-post et la création d'une entreprise de services type en 3 jours ouvrables. Enfin, il s'est retrouvé 11ème pour la protection des investisseurs et le paiement des impôts.

Parmi d'autres références internationales dont jouit Maurice, le pays a été classé 18ème sur 172 pays à l'indice de la liberté économique en 2007 ; 25ème sur 50 pays à l'indice A.T. Kearney des plateformes de services d'externalisation ; 30ème sur 70 pays à l'indice international des droits de propriété ; 55ème sur 122 pays à l'indice de la compétitivité globale en 2008 ; 26ème sur 167 pays à l'indice de la démocratie ; et première à l'indice Ibrahim Mo mesurant la bonne gouvernance en Afrique.

Les avantages qu'offre Maurice sont : 1) des recours juridiques allant jusqu'aux cours d'arbitrages industriels ; 2) un système de taxation compétitive et un barème unique à 15% pour l'impôt sur les sociétés, l'impôt sur les revenus individuels et la Taxe à la Valeur Ajoutée, ainsi qu'un système de collection simplifié, centralisé et en ligne ; 3) des exemptions de droits de douane sur les matières premières et les équipements ; 4) non-imposition des dividendes et des plus-values ;

5) libre rapatriement des profits, dividendes et capitaux ; 6) la possibilité pour une société détenue par des investisseurs étrangers (même à 100%) d'être propriétaire de ses locaux d'opérations.

Maurice est une destination où il fait bon de vivre et de travailler. L'île pourvoie la sécurité, un environnement bilingue, une dextérité culturelle qui découle d'une unique composition mauricienne, la démocratie, la stabilité politique, un état de droit, la chaleur de l'accueil mauricien, et la possibilité pour un étranger de s'acheter une propriété immobilière sous Integrated Resorts Scheme (IRS) ou Real Estates Scheme (RES).

Développer des solutions intégrées

Bien sûr, comme d'autres pays, Maurice fait face à des contraintes en termes énergétiques, de services publics, d'éducation, de santé et d'infrastructures urbains. Mais en développant des solutions intégrées, comme le fonds « Maurice Ile Durable », la plateforme globale d'exportation de services d'éducation et de santé, et le développement des villes modernes (*world-class cities*), le gouvernement souhaite positionner Maurice comme un pays d'avant-garde au diapason avec les grandes idées du monde (*zeitgeist*).

Maurice apporte de la valeur ajoutée dans les secteurs suivants :

1) La connexion internet et le Haut Débit : du 128 kbps en 1998 à SAFE en 2002, Maurice offre une connexion de 1 Gbps en 2008 grâce au Business Facilitation Act, et elle envisage une projection de 10 Gbps en 2015 porté par une croissance de la demande.

2) Les services TIC : des activités demandant de la main-d'œuvre qualifiée en 2002-2005 à des activités à plus forte valeur ajoutée, tels le développement informatique, le conseil informatique et les centres de données, ont émergé en 2008. On verra une projection de projets à très haute valeur ajoutée en 2010 – réseau international de commutation, architecture et design IT, des centres de recouvrement de données. Le centre de support technique d'Orange, un des quatre mondiaux (Inde, Egypte, Brésil) est un exemple de cette valeur ajoutée que Maurice peut apporter.

3) Les services financiers : grâce à un accord de non double imposition fiscale signé avec l'Inde en 1992, le secteur financier mauricien a pris de l'essor pour être aujourd'hui en mesure de proposer des produits sophistiqués, tels des produits financiers sharia, un marché de commodités africains (le GBOT), des produits dérivés et des contrats à terme (*futures*).

4) Le tourisme haut de gamme et le développement des services mauriciens : Maurice vise le marché de luxe avec ses hôtels haut de gamme, des touristes récurrents, des conférences, des loisirs et le développement des centres commerciaux. Dans la même lignée, un développement immobilier de luxe se développe pour ce marché. On peut

compter sur l'engagement de ces nouveaux résidents au développement du pays avec la création d'entreprises de services à haute valeur ajoutée, et de nouvelles villes aux normes internationales.

5) Un secteur manufacturier à haute valeur ajoutée : Maurice a construit, grâce aux avantages préférentiels avec la Communauté économique européenne, une industrie textile qui a su monter en gamme avec des produits de design et une intégration verticale. Malgré les chocs pétroliers et l'avènement de la Chine dans le textile mondial, le secteur textile mauricien se réinvente pour trouver des niches à valeur ajoutée, telles l'industrie de la mode et l'ingénierie de précision. D'autre part, Maurice produit aujourd'hui pour le marché de l'exportation des cathéters médicaux ainsi que des pièces pour l'industrie aéronautique.

Opportunités d'investissements

Il existe plusieurs opportunités d'investissements : le recyclage, l'efficacité énergétique et l'énergie renouvelable ; les services de santé et les sciences de la vie ; le secteur d'éducation et des connaissances ; l'hôtellerie, le tourisme et le développement immobilier des espaces de vie et de travail ; l'industrie de l'art créatif ; les infrastructures et les projets sous Public Private Partnership ; le secteur des TIC et de l'externalisation (*Business Process Outsourcing*) ; les services financiers ; et le secteur manufacturier à haute valeur ajoutée.

Il faut utiliser la force de frappe du *Board of Investment* (BOI) pour stimuler l'investissement local, et les contacts faits à l'international pour promouvoir des partenariats entre les investisseurs locaux et les promoteurs étrangers intéressés par des projets locaux et régionaux. La BOI a mis en place les mesures du gouvernement dans le cadre du *Additional Stimulus Package*, telles les réglementations sous RES.

Etant membre de la *Southern African Development Community* (SADC) et du *Common Market for Eastern and Southern Africa* (COMESA), Maurice a un bon positionnement régional avec un marché de 68,6 millions d'habitants et un revenu moyen par tête au-dessus de US\$ 3 500. La connectivité de l'île avec l'Afrique, l'Europe et l'Asie est intéressante pour les activités d'externalisation. Maurice est aussi la plateforme idéale de services financiers pour l'investissement direct étranger vers l'Afrique, pour le commerce avec Afrique ainsi que pour la gestion de patrimoine pour les grosses fortunes régionales.

Finalement, Maurice a aussi un bon positionnement sur des marchés porteurs, tels les marchés traditionnels européens et les nouveaux marchés que sont l'Inde, l'Afrique du Sud, le Moyen Orient et la Chine. Maurice a déjà commencé à penser à se positionner sur d'autres marchés, notamment la Russie et le Brésil.

Raju Jaddoo est le directeur général du *Board of Investment*.

The Mauritian economy on a razor's edge

By Anil Gujadhur

It is as hard right now to predict when and by which sparking event will the current economic downturn be reversed. Someone may pull the wrong trigger, such as reversing free trade, which would have second round unforeseeable effects, deepening the crisis. I have the impression that while you can predict microeconomic developments that are closely knit with predictable greater accuracy, global events like what is embracing the world today can at best be predicted only tentatively as you cannot know which economic engineering could intervene later to close the gap or widen it further.

You sense something is going to be wrong or right *ceteris paribus*, but you cannot put a number or precise date to it. If your assumptions behind that sensibility are seriously affected on the way by the turn of events you could not have reasonably foreseen, you would have to take back what you said.

I believe Professor James Meade made the right real prediction on the negative economic impact of a galloping demography in Mauritius, but he did not reckon that the country will enjoy more degrees of freedom by opening up with a (probably unthinkable at the time) diversified economic base as trade would become more accommodating under the Lomé Convention which came much after his prediction. But making that prediction, right or wrong, is worth the while.

Lack of market diversification

Mauritius is not an economy with a huge self-contained internal market in which the authorities can compensate for faltering economic growth by simply stimulating internal demand. It is an economy that grows or contracts depending on the strength or weakness of demand for its exports of goods and services in specific foreign markets.

Current economic forecasts indicate that those foreign markets are not likely to increase their demand from countries like Mauritius so soon. Even China is being buffeted by this factor. This clearly means that we are paying a heavy price to the extent we are (have been) unable so far to broaden our access to other external markets beyond our traditional external markets.

This lack of pragmatic diversification is showing up in the prevailing poor countries showing on our traditional external markets. For all the talk we hear, we appear to be frozen with regard to such efforts, be it for tourism, textiles, financial services or attracting compensating capital investments.

We have been treading on this razor's edge for a number of years. One would recall the warnings we received in 2002-2003 when our textile exports started shrinking due to such external factors like demand from our traditional external markets shifting away to new sources of more efficient, cost-effective supply in south and south-east Asia.

No lessons were learnt. Rather, classical depreciation of the rupee was advocated

and even acted upon. This has no doubt whetted the appetite for more depreciation, when it is not the exchange rate of the currency that is itself being blamed squarely for all the failings.

We are no doubt facing dire economic circumstances from externally induced slowdown of demand for our exports. This is the reason for the economic contraction being experienced in Mauritius in the prevailing set-up of the economy. It appears to me that an attempt was made to specifically criticizing monetary and exchange rate policies again in 2007 for what was going on at the level of the economy. It was perhaps believed that if interest rates were slashed, that would bring the remedy for falling export order books. Untrue, of course!

I wonder whether anybody has actually quantified the little benefit such interest rate reduction would have had on the affected export sectors in overturning the falling order book situation. If that was the case, was it correct to impose the full burden of adjustment for the external factors on monetary policy alone? Has not the continuing retreat of portfolio and investments from Mauritius, due to the shortage of liquidity in global markets, made void this kind of policy-making?

The limits of monetary policy

As far back as 1936, John Maynard Keynes argued that monetary policy is ineffective under conditions of economic depression but that fiscal policy is the remedy in such circumstances. He basically recommended large-scale deficit spending by the governments. Later, Milton Friedman, on the other hand, postulated that monetary policy could have prevented the Great Depression.

The current failure of monetary policy to address the problem of depression in the industrialized economies has proved, if it was at all necessary, that Keynes got it right. The remedy for the

current recession in the large economies with huge internal markets lies in fiscal policy flogging up demand, preferably in a coordinated manner so as not to make the global economy have to face up to protectionism.

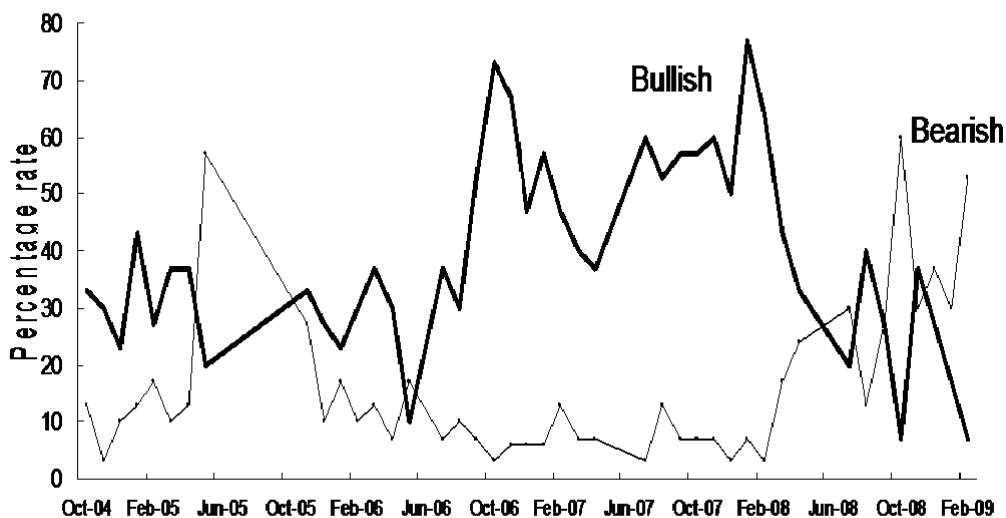
Mauritius is suffering the consequences of the length of time it will take to make those economies on which we depend for our exports work themselves back to the era of mutual confidence that spurred on so many past years of uninterrupted global growth. We can then tag on once again to the global bandwagon, being neither a market maker nor a market player of any significance at the global level. No magician from over here will deliver this enduring solution for Mauritius until the global economy turns around again.

No one is against mitigating fiscal actions to keep the pot boiling so long we do not overstep on the side of inflation or bring about excessive public debt. We can of course go some of the way cutting prices of exports to the extent possible, but that will be at the inevitable price of creating social tensions eventually once you have hit the limits of tolerance of the workers and the population. This is incidentally the element on which advocates of currency depreciation are actually taking a bet.

Monetary policy has single-handedly been made to contribute to its limits in an economy of the Mauritian type. This is an unfair burden. One runs the risk of making blunt and even counterproductive the monetary policy instrument by milking it dry in this manner. Let the other actors play their part instead of over-working the monetary policy instrument which is ineffective in the current situation facing external global markets.

Anil Gujadhur is a former First Deputy Governor of the Bank of Mauritius.

Market sentiments on the Stock Exchange of Mauritius



(source: Economic Surveys of PluriConseil over a sample of 30 economic and financial analysts)

Navigating the bear market

By Sameer Sharma (cont Pg 4,5)

Frontier markets such as Mauritius have historically enjoyed low correlation with other emerging and developed market indices. This coupled with the inefficient characteristics of such markets increased the potential for portfolio diversification by fund managers worldwide. It should not surprise the readers then that the recent launch of various frontier market indices was followed by relatively large foreign investments in these markets.

The problem with this assessment is that return distributions of frontier stock markets are far from being normal and that the over simplified correlation coefficient only measures linear relationships between two variables and is highly sensitive to outlier events. Due to heteroscedasticity and the non linear nature of financial time series data, this coefficient cannot possibly give you the whole picture and may not always be relevant.

Mauritian stocks may have historically enjoyed low correlation with other markets, but since the economy is highly impacted by what happens to the countries that it exports to or from which the tourists come from, eventually correlations change. There was no evidence of increased correlation for example until the middle of last year.

The diversification benefits are not constant over time and at best markets such as Mauritius may simply be lagging global markets. Furthermore, if one were to look at the daily data of the past three years alone, the local market has been characterized by a Kurtosis that is superior to 10 with a slightly negative skew, something that cannot possibly be ignored when local and foreign institutions allocate funds to such a market.

Quantitative models in fact have always suggested that the traditional 60:40 local/foreign allocation is based more on subjectivity than on anything else. When one considers the number of available sectors, stocks and the illiquid nature of such a market, overexposure to local stocks can be dangerous.

Sometimes, certain quarters in Mauritius will tell you that the Beta coefficient of their listed company is low and offers good diversification potential. What they fail to tell you is that when stocks are illiquid, their Betas will obviously not be statistically significant or/and may be low due to the smoothed price series data that come with low liquidity.

Uncertain outlook for the Rupee

It is not too hard to manage funds while it can be less obvious to notice anomalies when the local market is giving out 60% growth per annum. But when the value at risk (VaR) measures began to pop upwards (tail risk) in 2008, it was no laughing matter.

My views on the Rupee (MUR) and on Mauritian stocks have been fairly constant since early last year. Unless you have a long term view (more than 5 years), you should be in cash and in FOREX. For those with longer term investment horizons, buying on the dips is the only viable play at this point and even there, you need to go in at the speed of a turtle.

Professional traders can look at pairs trading opportunities. I have also been very negative on commercial real estate, especially commercial real estate fund investing in a sector that is characterized by unattractive rental yields relative to long term bond yields, captive real estate funds and highly optimistic valuations and Internal Rate of

Return figures in general. We are still waiting for the Central Statistics Office (CSO) to set up a real estate index.

If one is to chart the SEMDEX, the broad-based index of the Stock Exchange of Mauritius, one must first look at the evolution and the outlook on the Rupee. When foreigners sell stocks en masse to exit the island in an environment where the supply of FOREX continues to tighten, you do not need to be a financial guru to realize that the outlook for anything Mauritian is not stellar. If foreigners want to buy Mauritian stocks, they will have to buy Rupees first.

As at mid February, net outflows by foreigners (year to date) stood at the tune of MUR 127.6 million! The MUR/USD exchange rate has been breaking its 40 day highs on a consistent basis as both short and longer term momentum have continued to increase.

The divergence index has continued to point towards selling Rupees on any pullback. The 10 day moving average crossed the 40 day moving average weeks ago and remains in bearish territory. The dollar has also strengthened versus most major currencies in recent months as investors have fled to the perceived safety of the greenback.

The outlook for the Rupee remains uncertain with only weak evidence of trend exhaustion at Rs34/USD (selling) detected. There is no reason to call a bottom on the Rupee so far based on such weak technical evidence.

Foreign investors want to avoid countries with high current account deficits, near zero or negative balance of payments outlooks, low productivity growth rates and countries whose central banks are controlled by politicians and lobby groups via an almost incompetent Monetary Policy Committee (MPC) that is made up of more accountants than real economists. Some may argue that the differential continues to favor holding onto Mauritian assets but the fact is that risk premiums are not constant over time and if you had followed that high differential argument, you would have lost a lot of money.

In this current environment, investors have more confidence in the near zero interest yielding dollar than on the 6.5% yielding Rupee. If policy makers want to reduce volatility, then they need to at least maintain the differential as is, something I had mentioned months ago. But then again some do not like to listen or prefer to revert to the "competitive Rupee" or "cost of capital reduction" arguments. Besides, the lobby groups want rupee depreciation and push for it as it artificially boosts accounts of exporters and hotel groups.

Banks are expected to continue to favour holding onto treasuries rather than lending it in this uncertain environment and hence short term and medium term bond yields are expected to continue to face downward pressure, which is why risk premiums and expectations of where the differential will be impact the exchange rate as explained above!

The Finance Minister has also already talked about how there is "more room" for further monetary easing to the Joint Economic Council, the mother of all lobbies, recently despite the fact that officially the MPC of the "independent" central bank has yet to meet or even debate the issue. I think that we all know where interest rates are going over the next two MPC meetings and unfortunately this expectation is more based on politics and the

control that the lobby groups have on the media and election financing than on the "ambiguous" inflation outlook.

When the Governor of the Bank of Mauritius (BoM) dared to point out his views on interest rates and inflation in 2008, media articles about his administrative skills suddenly appeared on a weekly basis. Now that "the King" has backed down due to political pressure, these articles have also disappeared.

If you are looking for correlation in Mauritius, just look at the amount of articles about export sector difficulties that appear before an MPC meeting and the interest rate decision that tends to follow! I cannot possibly be the only one to have noticed that interest rates tend to go down after Mauritius Exports Association meets with the BoM!

Weak monetary policy transmission mechanism

The weakening Rupee has already negatively impacted gasoline prices recently and may also be keeping inflationary expectations from falling as fast as it should be, something that should not be ignored by a properly functioning central bank. In fact the first inflationary expectations survey of the BoM only confirms my view that monetary policy has largely ignored inflationary expectations, the key driver of inflation in the future, due to outside pressure and MPC incompetence. The backward leaning and smoothed core inflation rates that the BoM publishes have yet to capture this.

The BoM may switch from headline to year on year inflation, but inflationary expectations are not budging down as fast as expected and its monetary policy statements are not really addressing the obvious. The financial market in Mauritius is no longer as naïve as it was years ago to buy whatever the MPC and politicians want to print. Hence, I have to again widen the inflation forecast to 5.5-7% for December 2009 due to increased uncertainty with reduced visibility in 2010.

Some still debate about whether they should target core inflation, overhead inflation, PEPI, PPI or the neutral real interest rate. An argument can be made for a small open economy to target domestic inflation or target the neutral real interest rate but targeting nothing is ridiculous. Other indices are just too volatile and too difficult to forecast. A volatile Rupee leads to higher inflationary expectations and does not allow the economy to benefit from global deflation.

I am not telling the BoM to prop up the Rupee, as fundamentals should dictate that, but letting politicians talk about interest rate cuts before MPC meets tells me that I need to sell the Rupee, something the BoM should try to avoid. Do not add salt to the wound please and do not make it that easy for investors to make money by selling Rupees!

What is more worrying though is how interest rates such as the interbank rate behave in Mauritius. The market has permanent structural excess liquidity and the interbank rate is too volatile to allow for more complex instruments to be created in the future. The BoM which was conducting Repo transactions just weeks ago is now conducting reverse Repo transactions as excess cash holdings of banks have picked up well above the Cash Reserve Ratio requirement. Monetary easing has ignored the weak nature of the monetary policy transmission mechanism because of lobby pressure tactics, and this

Navigating the bear market

By Sameer Sharma (cont from Pg 3)

continues to hinder the development of more sophisticated financial instruments that can allow institutions and firms to manage risks more effectively. Whether we look at deposit rates, the Repo Rate and its corridor, interbank rates, the prime lending rate or short term Government borrowing rates relative to each other, the system is not as strong as it should be.

Monetary easing cannot work when the transmission mechanism that links itself to inflationary expectations remains weak. I highly doubt that easing can help firms as much as has been publicized by a biased pro lobby media when capacity utilization rates of firms are falling (due to falling external demand).

A fiscal response is the only albeit limited answer. Pumping liquidity into the money markets will only add more downward pressure on yields and increase excess cash holdings of banks as has been happening so far, something our policy makers do not seem to want to accept yet. Yes the fundamentals are weak and the Rupee is depreciating but don't help create a downward spiral and be more responsible about the differential. Look at more than the interest of the lobby groups for a change.

Increased lack of visibility on the earnings potential of stocks

Foreign outflows coupled with the more defensive strategies adopted by local institutions in recent months cannot bode well for the stock market whose technicals remain extremely weak. There is no firm reason to call a bottom at this point while I do believe that we are heading towards a sideways and even more volatile market in the coming weeks. With recession in Europe expected to last longer than previously anticipated, there is increased lack of visibility on the earnings potential of stocks even in 2010.

Until there is more clarity, cash remains king. Growth should underperform its 15-year trend by 1%-2% in 2009 and fiscal stimulus needs to be accelerated to give the economy a chance to reach the psychological 4% CSO forecast. Spending in infrastructure projects in particular needs to be speeded up and firms need to cut costs even if it means job cuts and CEO wage cuts. Better management can do more for the firm than government help.

Despite all the gloom, the lagging nature of this market (versus global markets) may provide a timeframe for reentry into stocks. So how will you time reentry into the Mauritian market by looking at what happens around the globe? Until the Yen showcases a continued depreciating trend versus the dollar, until the US defense sector index does not rally, until the TUT spread reverts back to pre crisis levels, until the spread between LIBOR and the Fed Funds Rate does not tighten back towards historical levels, until the spread between the Nasdaq 100 and the S&P 500 does not signal a change in the cycle, and until the Dow crosses 8,800 (resistance), do not get into either the US market without protective puts or the Mauritian market without stops for that matter. Right now the technicals are bearish and when markets fall, you should not be buying unless you have a very long term view and a well thought out investment strategy along with an exit plan.

Analysts on television will always tell you to buy when markets fall because they tend to have an interest in doing so. But you should only buy when prices have bottomed of course and you should

never stand in the way of momentum because it will run over you even if your discounted cash flow model gives you a higher theoretical price for the stock. If local institutions have not been aggressively increasing their cash positions, then they have simply not been doing a good enough job because it has been pretty obvious that this market was going nowhere but down for at least seven months if you looked at the most basic of technical indicators.

Those that did not see the obvious head and shoulders pattern in 2008 and did not rebalance their portfolios towards cash and FOREX have lost a lot of money. Yes, there are some ridiculously cheap stocks in Mauritius right now and if you are young and want to plan for your retirement in 20 years, do not ignore such valuations but come in slowly on the dips and never question market direction.

On their part, institutions also face liquidity issues in the wider market that prevent them from raising cash as much as targeted but it can certainly be done and they had a very long time to gradually do

While the Mauritian market does not have any derivative instruments, it is possible to create synthetic puts that will allow institutions such as mutual funds to limit losses. The implementation of such a programme that enjoys a convex payoff structure requires sound understanding of the advantages and limitations of the Black and Scholes option pricing model. Such a programme would have been ideal during the pronounced down trend of the past ten months.

However, it is important that such a programme be implemented on the top 10 most liquid stocks of the market and that the underlying portfolio have a tracking error close to zero versus the capitalizations of those largest stocks. It is also important to consider transaction costs while not being blinded by trying to save 50 basis points and losing much more on the downside.

The question of frequency of rebalancing can best be answered by two points.

The frequency of rebalancing will depend on the calculated Gamma and the level of certainty of the fund manager as to whether the market will continue to trend. Such a strategy will not negatively impact the performance on the downside

Synthetic Put						
Portfolio Value Rs M	90.00	88.00	92.00	80.00	78.00	80.00
Strike Price Protection Desired	85.00					
Short Term Deposit Rate Bank	0.06					
100 Day Annualized Rolling Standard Dev	0.25					
	0.38					
Number of Months in Inv Programme	6.00	5.00	4.00	3.00	2.00	1.00
Number of Months in a Year	12.00	12.00	12.00	12.00	12.00	12.00
Time Period of synthetic	0.50	0.42	0.33	0.25	0.17	0.08
Dividend Yield of tracked market or top 10 stocks	0.03					
d1 of Black Scholes with Div included	0.48	0.36	0.68	-0.37	-0.75	-0.78
d2 of Black Scholes	0.31	0.20	0.53	-0.50	-0.85	-0.85
N(d1) Delta of a Call	0.69	0.64	0.75	0.35	0.23	0.22
Delta of a Put	-0.31	-0.35	-0.25	-0.64	-0.76	-0.77
% Bought or Sold from Original 90M		-4.39%	6.49%	-32.56%	-45.19%	-45.92%

so because this bearish trend is not new. How should institutions, especially pension funds have reacted and how should they react now then?

Creating synthetic puts for the stock market

The CPPI asset allocation strategy can simply be defined as: Amount in Stocks = multiplier m * (Portfolio Value - Floor)

Essentially, this dynamic strategy would allocate m times the difference between the actual portfolio value and the minimum acceptable return. In general the multiplier hovers at around 2. If for example current portfolio value stands at 100 million and the floor stands at 75 million, the amount that should be invested in equities would be 50%, i.e. (100 minus 75) times 2, with the rest being held in cash or/and bonds. The portfolio is then rebalanced periodically as the portfolio value changes.

The CPPI technique is also used to maintain the guaranteed component in a capital guaranteed structured note when the zero coupon bond yield is too low to make the structured note competitive and in order to increase the potential for profit for the investment bank.

or on the upside as its characteristics are almost similar to the CPPI allocation technique.

But during a sideways (flat and choppy) market characterized by excessive volatility, the potential for losses would increase (nothing major) although performance should prove similar to the buy and hold strategy even then. The reason why losses may be incurred when volatility increased is because the position is still long Vega exposure and is obviously sensitive to the Gamma.

As long as managers understand that the leptokurtic nature of the local stock market may not permit such a method to yield perfect results and as long as they understand that they need to analyze the Gamma before looking at the Delta, such a synthetic put would have reduced the downside of many institutional portfolios that are heavily biased towards the largest and most liquid stocks.

Admittedly, this market can sometimes be so shallow that if all large institutions were to adopt such a strategy, volatility would increase. In that case, the payoff would fall unless the frequency of rebalancing was to be increased further and the rewards of a concave strategy would increase. The opposite is also true but that is what markets are all about. The appropriate

rebalancing frequency for Mauritius is likely to be measured in days rather than months. While not showcased in the example, the delta can also be impacted by interest rate changes (rho risk).

Structural bear market

This portfolio insurance strategy and the CPPI strategy would work in trending markets and would yield superior payoffs than the archaic buy and hold strategy. In a sideways market however, the constant proportion strategy along with its concave payoff structure would prove to be more effective. Managers would allocate x% to each asset class and subject to their sideways market outlook and would constantly readjust the portfolio so that the allocations would not change.

For example, if the target allocation for stocks was equal to 60% of the portfolio and that after y months, the portfolio was comprised of 50% stocks, the manager would add 10% to stocks by selling 10% of some other asset class such as bonds in the portfolio to maintain constant balance.

Short term volatility spikes could be more properly analyzed in the GARCH framework. Unlike technical analysis, the use of synthetics does not decay over time and is appropriate for asset managers and can add alpha to a portfolio.

While the use of synthetic puts can increase downside protection and represents the basics of financial engineering, this simple application to portfolio management should not be taken lightly and could spell trouble for the novice. A firm understanding of stochastic processes is recommended.

In sum, we remain in a structural bear market until the technicals change and cash and FOREX remain the two best bets for capital preservation in this difficult context. While market timing and calls for market bottoms can be an almost impossible task to master, there are obvious technicals and data that institutional fund managers should consider when making their investment decisions. The SEMDEX does have statistically significant autocorrelation properties which allow technical analysis based trading strategies to work although one should discount the less liquid stocks from this analysis.

One must however remember that the profitability of quantitative trading strategies decays over time due to increased use of the model and hence needs to be constantly adjusted as the equity curve reaches its half life. Unfortunately, the financial tools available to the financial sector remain primitive in Mauritius thanks to the size of the market and to the lobby groups that have become part of the problem rather than the solution. Also remember that stocks do not evolve linearly and hence do not be blinded by moving averages alone, but go for more complex signal processing based models when trading.

Making money and building expertise

The first rule in finance is to make money and the second rule is not to forget about the first one. Analysts and fund managers are paid high salaries and bonuses all around the world in order to make sure that they can preserve most of your capital when times are tough and make your money when markets are bullish by beating well specified benchmarks, and if they cannot do that they tend to be fired.

Local investors will need to be more demanding towards their local fund managers who will need to do more active management that generate alpha without the added Beta and be more open about the benchmarks they use in order to earn their fees. Factsheets of funds need to be more open and

detailed.

Expertise will need to be built up in house over time at competitive rates rather than be almost completely outsourced to overseas consultants or fund houses who tend to generate Beta rather than alpha in exchange for the infamous trail fee. Non accounting designations such as the CFA, CAIA and the FRM (or Msc Finance degrees) will need to become the norm in the non accounting related financial sector.

Mauritius needs to move up the value chain and profit from its fiscal paradise status. Finance and economics are ever evolving fields and those that believe that learning ends upon graduation will find that their knowledge can become rather dated after a few years.

With free cash flow of the major non bank related stocks having tightened dramatically, downside risks to stock prices cannot be ignored yet. The Obama mania is passing fast with global markets reacting negatively to his initial stimulus plan. The Dow's fall towards the 7,500 range is a dangerous technical warning sign which does not bode well for the global economy.

The outlook for the Mauritian economy is expected to continue to deteriorate at a faster than previously expected pace over the next three quarters with the fear that increased downside forces will more than counteract the local stimulus package. It should not surprise the readers then as to why foreigners have been net sellers so far on the Mauritian stock market.

Foreign Direct Investment has slowed down in 2008 and Integrated Resorts Scheme related inflows remain highly volatile and banks need to be careful about loan portfolio concentration. Rather than trying to destroy the monetary policy transmission mechanism, with the Rupee depreciating and inflationary expectations remaining well above the comfort zone, policy makers should begin to prepare the population for the inevitable tough times that lie ahead.

Rupee depreciation will not work this time, the manufacturing and export oriented sectors are structurally weak as evidenced by their negative total factor productivity record and hence are

highly vulnerable to exogenous shocks. Some companies require consistent Rupee depreciation in order to stay alive as they lack meaningful comparative advantages and the recent turmoil in Madagascar cannot possibly help matters.

The stock market has not bottomed out yet

On their part portfolio managers will need to stop calling bottoms before they happen as credibility is too precious an asset in fund management. They will need to offer more options to investors in order to retain their capital. The commodities exchange in Mauritius can eventually offer some interesting trading opportunities in commodity futures, a field that is both complex and full of potential for a trader. In fact technical analysis and more complex signal algorithms that use neuron networks to generate trades tend to do better with futures than with stocks due to pricing inefficiencies.

On their part banks will need to hire the right people who understand the concept of delta neutral hedging and the lucrative roll yield that comes from a normal backwardation and the risks associated with that when backwardation turns into contango. The stock market is another story. Worryingly, redemption pressure leading to a downward spiral in stock prices has shown an upward trend in recent weeks. Nobody knows where the bottom is yet and capital preservation was and remains the best option so far.

Just look at a SEMDEX chart, show me the support level, show me a recent new high, show me the foreigners coming back, do not tell me to buy just because Price Earnings Ratios are low! Fund managers should remember that if their portfolios have lost 50 percent of their value since this crisis began, they will need to get 100% returns just to get the capital they lost back.

It is never a good idea to follow the CFA book by heart. Naïveté in finance does not pay well. All I see right now are new lows, and so I cannot possibly be a buyer at this point especially when I consider the outlook on the Rupee.

Sameer Sharma is a Canada-based financial analyst.

SEMDEX and Adjusted Trend Tracker



How best to weather the storm

By Christopher Tan

It was a bright and sunny day. You were walking through the jungle and on your way to your objective many kilometres away when without warning, a big storm came raging. But like all good soldiers with only the mission in mind, you walked on, unclear with what lies ahead. As you continue walking, it became clearer what damages this storm has caused to the route. You have now 3 choices:

a) Continue the same route that has been marked out for you by your reconnaissance team. You may take longer to reach your destination as the storm may have caused fallen trees and other damages. But this route gives you high certainty of reaching the objectives as it is a tried and tested route.

b) Detour to a new route, it is more open, with lesser obstacles but because it is unmarked, there is a need to navigate and make decisions along the way. You may reach the objective on time if you make more right decisions than wrong ones. But the certainty is unknown because no one has walked it before.

c) To give up and turn back.

How many times have you face a decision like that? Over the last few months, my investment team and I had exactly the same dilemma. We were on our way to achieving clients' financial goals with good investment returns when out of the blue, a financial storm hit us. After a while, it became clearer to us that this may not be a normal storm. What damages will it do to our clients' objective and which route should we take?

Confronting the brutal facts but yet retaining the faith

We had to go back in time, starting from 1900 to find out. Data dating this back were hard to obtain. Even with the wealth of information we can find in Bloomberg, we had to make a trip to the library to get everything that we need. My team spent many tireless days and nights working on it and this was what we found out:

There were 3 of such big storms in history since the 1900: they are the 1930s *Great Depression*, the 1970s *Stagflation* and the 1990s *Japanese Deflation*.

The 1929 Depression: After a period of excessive leverage for banks in the 1920s, the stock market crashed in 1929. Banks fell due to debt defaults and massive deposit withdrawals. Plunging asset and commodity prices led to hyper price deflation in the initial years. Dramatic drops in demand led to widespread unemployment and poverty. The government did not inject enough money into the banking system, creating a shortage in money supply. Banks became extremely conservative in their lending. The government worsened the situation by increasing taxes in 1932. The Dow recovered to the pre-crisis level only in July 1954.

The 1970s Stagflation: In anticipation of price increases, people kept buying more goods. With more demand, wages were pushed up, leading to an upward price spiral. This worsened when oil prices soared during the oil crisis, caused by political tension in the Middle East in 1973. Excessive stimulative monetary policy sparked a runaway wage-price spiral. Government borrowing pushed up interest rates and increased costs for borrowing. Business investment suffered and unemployment rates rose. The US Federal Reserve chose to sharply hike interest rates into the double-digits from 1979-83 to tame inflation. This caused the economy to fall into a recession until 1983.

The 1990s Japanese Deflation: Loose monetary policy sustained stock and property markets rallies in the 1980s. When the asset bubble burst in late 1989, the government took 3-4 years to increase government spending. Interest rates took almost 9 years to come down to 0 percent. Stock markets and property markets crashed. Property prices declined between 3%-6% p.a. annualized through 1990-1998. Banks did not write off losses and the government sustained failing banks and businesses using subsidies, thus prolonging the crisis.

During these 3 periods, equities did badly. Bonds gave decent returns during the great depression and Japanese deflationary period. Commodities did well during the 1970s stagflationary environment. Using the historical returns of different asset classes during these 3 periods, we back tested our diversified portfolios and it became very obvious.

Our research showed that in the first 10 years, traditional diversified portfolios were categorized by inconsistent, extremely low and sometimes even negative annualized returns. It was only from the 10th year onwards that returns became consistent and stronger; albeit still lower than what clients will require because of a lost decade of returns. Although returns were high during the stagflation period, inflation was also as high as 8%, so real returns are nothing to shout about.

The current downturn is not the usual cyclical one

So what are the chances of the current crisis being "a big one" like the above 3? We believe that it is likely as the current downturn is not the usual cyclical one but one caused by much structural problems. There are excessive debt level amongst consumers and institutions.

Financial and non-financial institutions are falling like dominoes in a pack. There are much fear in the environment and hoarding of monies. This crisis has also spread all over the world. Just like the jungle situation, we now have to deliberate to make a decision.

Situation 1: You do not have enough time as you need the money very soon. Achieving your original financial goal is not important now. **Decision:** Get out of the market now and turn back, you can't take and don't need to take this risk. You need to review your financial plan to see how much you should get out.

	Annualized Back-Tested Portfolio Returns (from 2 nd Year of Crisis to 15 th Year)		
	Balanced Portfolio	Aggressive Portfolio	100% Equity Portfolio
Great Depression	4.0%	3.5%	2.5%
Stagflation*	11.5%*	12.0%*	12%*
Japanese Deflation	4.0%	2.5%	0.5%

Situation 2: You do not have enough time but achieving your financial goal is very important. **Decision:** Detour and take a new route. The time-tested way of asset allocation, staying invested and riding out the volatility may not work as there may not be sufficient returns in the next 10 years. The new route entails navigating through this crisis, making decisions on which asset classes to be in. This is not a tested route, but you have no choice, you don't have time unless you are prepared to delay your financial goal. If we are in a stagflation scenario, you need to review your financial plan to make necessary changes.

Situation 3: Have more than enough time or can delay the time in achieving financial goal. **Decision:** Continue with the current route of asset allocation, keep investing, ride the volatility. Although it takes a long time to reach your goal, this is the most tried and tested route. You will achieve your goal with high certainty as 100 years of history has shown us. However, you must be prepared that the returns will be lower than what you originally expected as it is hard to catch up after a decade of lost returns. You need to review your financial plan to make necessary changes.

Prediction is gambling

So what if we are wrong and this is just a normal downturn and will recover this year like what a lot of optimists are predicting? In the 1930s, the US government, scholars such as Irving Fisher and businessmen such as Henry Ford predicted an early

recovery. They were humbled. In the mid 1990s, the US government including Alan Greenspan, Robert Schiller from Yale forecasted an unsustainable bull run; the market ran for 13 years till 2000.

No, we are not going to be in the business of prediction. That's gambling. Neither are we going to be naively optimistic or sadly pessimistic. We are in the business of putting in place processes to prepare for the worst but keeping faith that this crisis will pass, like all others. You will quickly realize that, if a fast recovery comes, we will not be worse off then if we have not made a decision.

Ever since our research, I became especially burdened by the advice our industry has been dishing out. Many are telling that 2009 will be a happy year. Stockbrokers are saying this is the best time to trade stocks. Property agents are telling everyone to buy property, financial experts are asking everyone to stay invested, keep investing, ride the volatility and things will pan out.

I must admit I was guilty of it too, before our research that is. Some are predicting where to put our money in 2009, as if we are only investing for a year. I just hope all of us are not selling our wares just to keep business going.

During the Vietnam War, many US POWs died at prison camp "Hanoi Hilton" because they all hoped and believed that they will get out by Good Friday, Easter, Thanksgiving, Christmas Day. But when these came and gone, soldiers died with a broken heart. Jim Collins wrote in his book "Good to Great" that one man by the name of Admiral Jim Stockdale survived because he never predicted when he will get out but lived each day "confronting the brutal facts" and yet retaining the unwavering faith that he will live to see light again.

Napoleon Bonaparte once said: "Take time to deliberate, but when time for action has arrived, stop thinking and go in".

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La guerre des changes Par Jean-Yves Naudet

La guerre des changes est-elle déclarée ? Le Président Obama a ouvert le feu, accusant la Chine de manipuler le yuan ; celle-ci a répliqué vertement au nouveau président, qui défendrait le protectionnisme américain. Au-delà de cet échange, on accuse d'autres pays, comme l'Angleterre, de laisser filer leur monnaie pour favoriser leurs exportations. Le problème posé est celui des interventions étatiques sur le marché des changes, une habitude qui ramène au bon vieux temps des changes « fixes ». Si l'on veut échapper à la catastrophe des années 1930, il est urgent de restaurer un libre marché des changes.

Le taux de change est un prix

Dans cette question des changes, toute la difficulté vient de ce que l'opinion, comme les gouvernants, a du mal à comprendre qu'un taux de change est un prix. C'est le prix d'une monnaie (ou « devise ») par rapport à une autre. Ce prix doit donc dépendre, comme tout prix, de l'offre et de la demande des deux monnaies considérées.

D'où viennent ces offres et demandes ? Des besoins du commerce, des besoins du tourisme, des mouvements de services, des mouvements de capitaux à long terme (investissements, opérations en bourse à l'étranger) et des mouvements à plus court terme, y compris les mouvements spéculatifs, qui jouent un rôle pour équilibrer les divers marchés en jouant sur les différences de prix ou sur les anticipations.

Voilà qui pousse les gouvernements à « reprendre la main » et à « administrer les prix ».

Les changes fixes ont des effets pervers

L'administration des prix peut prendre la forme simple des « changes fixes » : un accord international établit une valeur « officielle » de chaque monnaie, les parités entre monnaies sont connues de tous. C'est sans doute ce à quoi rêvent les partisans d'un « nouveau Bretton Woods ». Mais précisément ces accords n'ont jamais été respectés, dévaluations et réévaluations se sont succédées pendant trente ans. Est-ce ce retour à la souveraineté monétaire que l'on souhaite, avec son cortège d'effets pervers ?

Milton Friedman, entre autres, a dénoncé les changes pseudo-fixes où finalement les banques centrales sont amenées à gonfler ou dégonfler la quantité de monnaie qu'elles mettent sur le marché pour faire monter ou descendre sa valeur et la ramener à sa parité officielle. D'une part, elles n'y parviennent jamais : la pression de la demande internationale est plus forte que les manipulations des banques centrales. D'autre part elles perturbent l'économie nationale en faussant tous les prix, conduisant à l'inflation et au chômage.

Depuis le 1er avril 1978, les monnaies varient à chaque instant, comme par exemple le dollar par rapport à l'euro, reflétant les réalités des marchés. Les changes sont « flottants ». Cet environnement monétaire a été tout à fait propice au commerce mondial et aux investissements

pays ne jouent pas le jeu des changes flottants. En général, ils essaient – par des interventions sur les marchés des changes, mais sans fixer de parité officielle – d'empêcher leur monnaie de trop s'apprécier. C'est à l'évidence ce que fait la Chine. En effet, la bonne santé du pays et les excédents extérieurs devraient logiquement conduire à une appréciation du yuan.

La monnaie chinoise devrait être recherchée par tous les opérateurs du monde entier, et son prix devrait monter. Mais le gouvernement chinois veut inverser cette tendance et fabrique chaque jour davantage de yuans et achète davantage de devises étrangères (ce qui gonfle ses réserves et alimente son fonds souverain). Il essaie ainsi de favoriser ses exportations, la faiblesse de sa monnaie diminuant le prix de ses marchandises destinées à l'étranger.

Les Chinois ne sont pas les seuls tentés par cette opération. On dit que les Anglais pratiquent de même avec la Livre, qui a perdu en quelques semaines près de 30% de sa valeur : acheter anglais devient une bonne affaire, et les Anglais devraient se détourner des produits importés. La Banque Centrale Européenne est pressée depuis des années de rompre avec « l'euro fort ». Enfin, dernier en date, le Japon est aussi suspecté de maintenir le yen à un niveau totalement artificiel.

Guerre des changes et protectionnisme aggraverait la crise

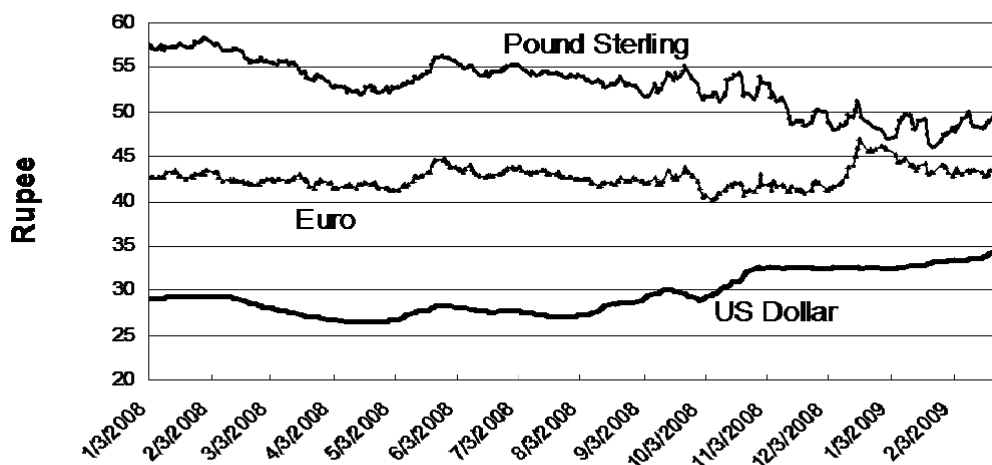
Reste le billet vert. Sa valeur n'a cessé de souffrir de la politique menée par la Réserve Fédérale américaine depuis vingt ans. Pour l'instant, les Etats-Unis dénoncent la Chine : « *Barack Obama pense que la Chine manipule sa devise* » a déclaré Timothy Geithner, secrétaire au Trésor. Réplique dès le lendemain du ministère du commerce chinois : « *Le gouvernement chinois n'a jamais eu recours à une supposée manipulation de devises pour engranger des bénéfices en matière de commerce international. Critiquer sans fondement la Chine sur la question des taux de change ne fera que servir le protectionnisme américain.* »

Il est vrai que certains démocrates protectionnistes veulent que le plan de relance Obama précise que les investissements publics programmés ne pourraient être construits qu'avec de l'acier américain. Les Américains laisseraient-ils « filer le dollar » un peu plus pour protéger leur économie en difficulté ?

Si l'on se réfère aux années 1930, c'est le repli des économies nationales et la chute vertigineuse des échanges extérieurs qui ont aggravé la crise. La mondialisation est le vrai moteur de la croissance et la seule vraie chance de reprise. Compromettre la mondialisation par une guerre des changes menée par les banques centrales serait réellement suicidaire.

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Indicative Selling Exchange Rates of the Mauritian Rupee (From 3 January 2008 to 24 February 2009)



Daily basis
(Data: Bank of Mauritius)

Sur un marché libre, l'ensemble détermine le prix, c'est-à-dire le taux de change. Comme tous ces éléments varient tout le temps, la valeur des monnaies change à chaque instant. Voilà qui gêne beaucoup de monde, car certains envisagent encore la monnaie comme un élément de la souveraineté (comme le drapeau ou l'hymne national) et donc comme immuable.

internationaux, et la croissance de l'économie pratiquant le libre échange a été spectaculaire.

Le retour des manipulations de change par les banques centrales

Quel est alors le problème ? C'est que certains

The ineffectiveness of monetary policy

By Eric Ng Ping Cheun

A financial crisis has led to a severe recession in developed economies. Can the reverse be true for Mauritius? The country has escaped the financial meltdown due to the fact that banking practices are essentially deposit funding. However, an economic downturn might have serious repercussions on the banking sector.

On the stock exchange, Mauritius Commercial Bank and State Bank of Mauritius have suffered a massive setback, being at their lowest price since December 2006. A contraction in textile and tourism activities will inevitably eat up banks' profitability although their exposures to these sectors vary. A general economic slowdown will reverberate through the banking industry as the latter is deeply integrated into the real economy with credit to the private sector representing 84% of gross domestic product.

The Mauritian government has come with an additional stimulus package aimed at staving off recession. The Bank of Mauritius (BoM) has cut the Key Repo Rate by a total of 250 basis points during the year 2008. These measures draw on the teachings of Keynes and Friedman that if bankers are reluctant to lend, it is the duty of the government and the central bank to keep the flow of lending so as to maintain the overall spending in the economy.

Good credit leads to productive consumption

While it is true that credit is the key to economic growth, it is doubtful that spending is what drives an economy. One must make a distinction between good and bad credit, as well as between productive and non-productive consumption. Good credit comes from the pool of real savings, and it allows someone to consume in order to produce (productive consumption). Bad credit is money unbacked by production but created through artificially low interest rates, leading to an exchange of nothing for something (non-productive consumption).

For instance, the government could employ individuals, or subsidise private firms, to dig holes in the ground. The money that it pays them will boost consumption. Since government does not generate wealth, it secures the money through taxation, by printing money or by borrowing. Not only is there a diversion of wealth, but the holes do not contribute to people's well-being.

Some industrialists, dissatisfied with the government's package, advocate further stimulus measures but do not bother about how these are to be funded. They just want to save their personal business. They are too narrow-minded to realize that more public spending and loose credit only foster non-productive consumption and weakens the process of wealth formation.

Credit to the private sector dipped by 2.4% in November 2008, but expanded again by 2.8% in December. Credit growth rate for last year was 26%. Even if banks are being cautious about lending, credit continues to flow smoothly. However, the increasing excess cash holdings noted during January suggests that lending is likely to decelerate in the coming months.

Excess liquidity is structural

In his *Letter to Stakeholders* published on 3 February 2009, the Governor of the BoM,

Rundheersing Bheenick, admitted that there was "structural excess liquidity in the system". Since the end of October 2008, banks have been holding much more than the minimum requirement. While the cash reserve ratio has been set at 4.5%, the average cash ratio stood at 5.48% for the maintenance period ended 1 January 2009, 5.95% for 15 January and 6.06% for 29 January. For the first time since May 2007, the BoM conducted a Reverse Repurchase Transaction on 13 February, absorbing Rs 800 million, half the amount received.

This excess liquidity should normally go to treasuries, but their prices are steadily rising: the overall weighted yield on Treasury Bills (Bank Rate) has shed 247 basis points since the last rate cut on 8 December. The secondary bond market is a total failure as no trading of bills has occurred on the stock exchange since May 2008. There is no proper interest rate transmission mechanism: the overnight Interbank Rate moves inside and outside its set limits, and it goes closer to and further away from the Bank Rate on a weekly basis. Interest rate expectations cannot be formed in a rational way but on lobby considerations.

The build-up of excess reserves in Mauritian banks can be construed as evidence of a Keynesian "liquidity trap". According to Keynes, when the rate of interest falls to a certain level where "almost everyone prefers holding cash to holding debt which yields so low a rate of interest", central banks can "lose effective control over the interest rate". The liquidity trap represents a process whereby people raise their cash holdings in direct proportion to an increase in money supply, thus neutralising the latter's effects. In 2008, deposits grew at an annual rate slightly higher than broad money.

In case the Mauritian economy stumbles into a liquidity trap, monetary policy will no more be effective. Government's response to the global crisis cannot therefore rely on what the Finance Minister, Rama Sithanen, calls a "softer monetary policy". Anyway, the decline in headline inflation (to 9.3% for the twelve months ended January 2009) is too slow to warrant a further monetary easing at the next meeting of the Monetary Policy Committee on 26 March. True, year-on-year inflation for January

2009, measured as the percentage change in the consumer price index compared with January 2008, dropped to 5.2%.

In a statement at the conclusion of a staff visit to Mauritius released on 20 February 2009, the International Monetary Fund opined that inflation measured on a year-on-year basis "is a more appropriate measure than the frequently used backward-looking average in guiding monetary policy decisions". The problem is that year-on-year inflation needs to be adjusted for seasonality, and besides the population has learnt to base their inflation expectations on headline inflation.

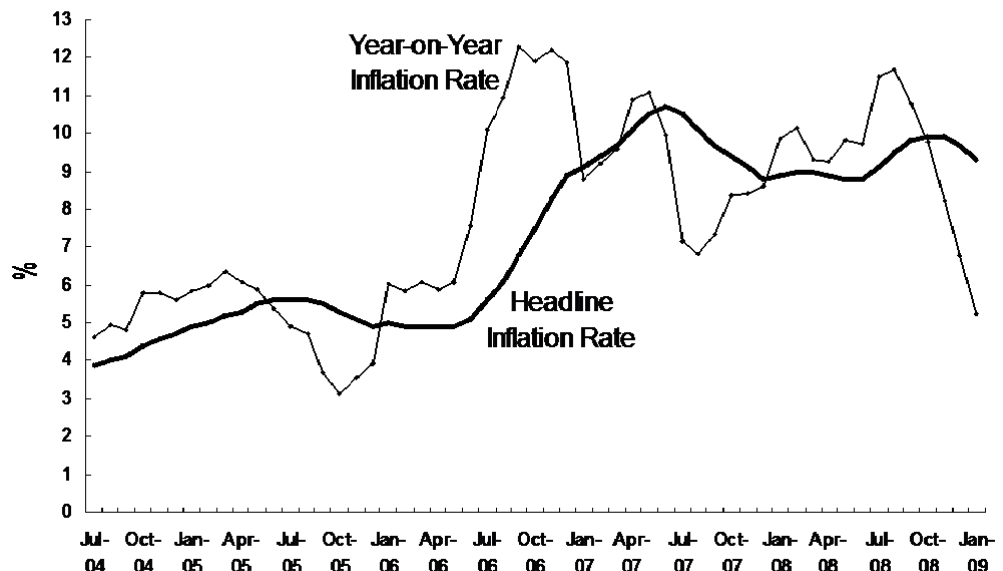
Responsible lending fosters economic growth

The BoM would be wise to leave the Repo Rate unchanged, but it should not overlook the problems caused by low interest rates. In addition, the sharp depreciation of the rupee is fuelling cost-push inflation. And the expansionary budgetary policy has steered the course of future demand-pull inflation.

A politically expedient government has to show that it is doing something, though the impact of fiscal policy may be limited. For a supposedly independent central bank, it can take the liberty of doing nothing. Such a policy would root out non-productive activities as interest rates would reflect the real cost of funds to banks and the risk taken by borrowers. That is the foundation of responsible lending.

Also, an absence of monetary policy would compel all stakeholders to fix structural problems. Thus, the government would have to curtail public spending and taxes, and to liberalize the economy further, especially the labour market, to allow a rapid allocation of productive factors, particularly labour, to profitable sectors. Economic agents would need to improve their finances by cutting costs and paying off loans. There is not much Mauritius can do beyond a flexible labour market, an austere public sector and a lean private sector.

Annual Inflation in Mauritius



In his *Letter to Stakeholders* published on 3 February 2009, the Governor of the BoM,