

# CONJONCTURE

PluriConseil  
THINKING OUT OF THE BOX!

Bilingual Journal of PluriConseil  
N u m é r o 40 - Juillet-Août 2009

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

## Assessing the IMF proposal for 'free float'

By Feroz Dahoo

To say that the world is in crisis is to echo the thoughts and sentiments of a generation of people who may not have seen such crises globally. The word 'crisis', accordingly, has almost lost the theoretical understanding it once had and slipped into a kind of rhetoric that is now consistently invoked by politicians, business community, employers and consumers alike whenever they find their convenience.

Human nature being as it is, once we are over the emotional feeling of an event, we immediately grapple to the next sensational item. However, the world is facing a major credit and liquidity crisis that is not allowing its impact to recede and bring matters back to normalcy. In that storm of uncertainty, the International Monetary Fund (IMF) has recently suggested that Mauritius need to consider adopting the 'free floating' foreign exchange model as against its prevailing 'managed float' model.

### The shift from the 'managed float' to the 'free float' is not appropriate

Since the collapse of the fixed exchange rates of the Bretton Woods system in 1971, currencies have generally been free floating and subject to the market conditions of demand and supply, and also used as a strong monetary policy tool to achieve desired results. Exporters in Mauritius have always demonstrated their clear desire for a weak rupee, importers and consumers for a strong one, and the government for a stable one. In this foray of hankering, let us try to reach a common consensus.

Since the government has the sole ability to levy taxes, print money and regulate financial markets, it goes without saying that the new model proposed by the IMF requires the approval of the former. Government will certainly have regard to the shifting of power from the regulators to the traders in the market. Though they are mandated to act responsibly, some 'vulture' traders may also practice speculative attacks in free markets.

With regard to our currency and the existing regime where the managed float has served the country so well over the years, the government's will to surrender to the new exigencies of the IMF may well face resistance amidst its own ranks. The recent crisis has definitely sent the convincing signals to the policymakers that regulation and control are key to our financial and economic systems. World economic growth is suffering, and the shift from the 'managed float' to the 'free float' is not considered appropriate at this moment.

In the current situation, the government should be more focused in strengthening its macroeconomic policies and realign all its sectors to achieve greater economic convergence. With the existing mechanisms in place, the government should rather spotlight and strengthen its formal system of coordination to avoid excessive exchange rate misalignments and volatility. A time frame for studying the IMF proposal for the 'free float' must be envisaged and a proper implementation plan thereafter.

Is it time to get rid of the legacy systems and breed high respects for being in the league of free floating foreign currency exchange regime or pursue the discussions in attempting to understand the granularity of the Mauritian economy and social structures before putting a time horizon for its adoption? The Mundell-Fleming model of making a choice between fixed and floating exchange rate regimes is back on track with the arguments that an economy cannot simultaneously maintain a fixed exchange rate, free capital movement and an independent monetary policy. This is the 'irreconcilable Trinity' being pulled by the government, the business community and the consumers. In this 'trilemma', somebody must be in charge of the situation.

### The downside risks of no growth is still present

On 22 June, the Monetary Policy Committee (MPC) concurred to keep the key Repo Rate unchanged at its 5.75%

agreed previously. The MPC reduced the key Repo Rate by 250 basis points in the previous three sittings, but this time the decision was unanimous, and the resolution to keep interest rate unchanged may be explained by the upside risks consideration.

Fuel prices have doubled from US\$35 to around US\$70 in a span of time similar to that when it fell from US\$147 to US\$40. The signal is clear that such rapid increases may be further evident given the pronounced desire of OPEC members for fuel price to be around US\$85 per barrel. Food prices are also in the upward move. In such a situation, MPC members may have been guided to consider the upside risks of such price hikes and its impact on the local market.

Green shoots are visible and the expectation for a sustained economic growth rate is positively being mentioned. Moreover, the previous rate cuts effects are still to be felt in the market and the time gap between the implementation and effects is expected to show in the near future. The massive amount of liquidity in the market in the aftermath of the stimulus package may have also been considered in keeping the interest rate unchanged. Inflation control has been the main point.

The downside risks of no growth is still present and any such occurrence against the odds may still be rectified during the next MPC sitting on 29 September. Government has to encourage savings and reduce the huge amount of liquidity in the market in fighting against the threats of rising inflation. Though the inflation rate has been falling lately, it cannot be left unattended in light of the social consequences of unemployment and rising cost of living.

Feroz Dahoo is the chief executive officer of Thomas Cook (Mauritius).

## Do currencies really float, swim or just sink?

By James Benoît

When we ask whether the Mauritian rupee should be allowed to float, there seems an implied fear and, in some cases, hope that it will immediately sink! That is the consensus opinion it seems to me, or at least it seems that is the major fear. That fear is unfounded. I think the Mauritian rupee could turn out to be a strong swimmer, should it be decided to let it float!

We are living in a new banking, financial and trading world now or at least one in which the established consensus on how such business is conducted around the world is ending. The Global Financial Crisis means the end of an era in which low cost, export-led growth often using exchange rate depreciation was the chosen economic model used around the world by countries to sell their goods and services to America largely, and to a lesser extent Europe. That world no longer exists and hence our view that currencies must adapt.

Both Germany and China have used their explicit or implicit fixed exchange rate regimes to follow export-led growth, with their surpluses being recycled to fuel consumption and housing booms in the 'deficit' countries notably the United States. With the unrelenting slowing down of the world economy and the credit crunch leading to global deleveraging, this is no longer sustainable. In fact that model may have been one of the chief causes of the Global Financial Crisis.

China is now desperately trying to boost domestic demand through an infrastructure-led fiscal stimulus. What

not really possible to envision much else.

So, when we say that floating the rupee could be dangerous, we must not also ignore that we may be accumulating a lot of other dangers which surely and inevitably will impact us by using a fixed or aggressively managed floating regime.

### Three aspects of exchange rate management

The Mauritian economy is becoming more diversified. If we do succeed in our ambitions to be a true regional financial and business services centre, we may be linking our currency management to the Euro or the Dollar: this may be wholly inappropriate to the diverse range of business flows that we are in fact serving and the range of economic actors involved in them.

If however we continue to believe that we should aggressively manage our floating rate, then there are three aspects of exchange rate management that our policymakers must think about: 1) the stock of foreign exchange reserves with which to manage the float, 2) the extent to which we use these reserves to stabilize the exchange rate, and 3) the extent to which we might also use interest rates to stabilize the exchange rates.

The stock of currency reserves for managing a float is like having a good, buoyant lifejacket. A country that floats without regard for the level of the exchange rate will not need a lot of reserves to manage its exchange rate.

one direction or the other when in fact that is better than floating around in crashing waves!

That then makes us ask how much should we attempt to manage exchange rates by intervening in the foreign exchange market? The exchange rate could be more volatile in the current period because of a large external shock leading us to intervene to keep the exchange rate within certain limits. But even this identification of a shock that demands our intervention could be difficult to undertake depending on how comfortable we are with the accompanying volatility of reserves. And how do we know when enough intervention is enough?

Of course, intervention in the foreign exchange market is not the only tool for managing the exchange rate. We can also affect it by tightening or loosening monetary policy, i.e. the interest rate policy. This is more controversial. Tightening monetary policy will result in pressure for appreciation of the local currency, and loosening monetary policy will result in pressures for depreciation.

But interest rates are a blunt tool since they may be changing for other reasons such as inflation targeting or investor sentiment toward emerging markets. Under a pure floating regime, we should be able to set interest rates independently in order to achieve whatever objectives we desire, and let the exchange rate absorb the shock except if we float with an inflation target to control economic demand.

### Managing the float is not truly cost free

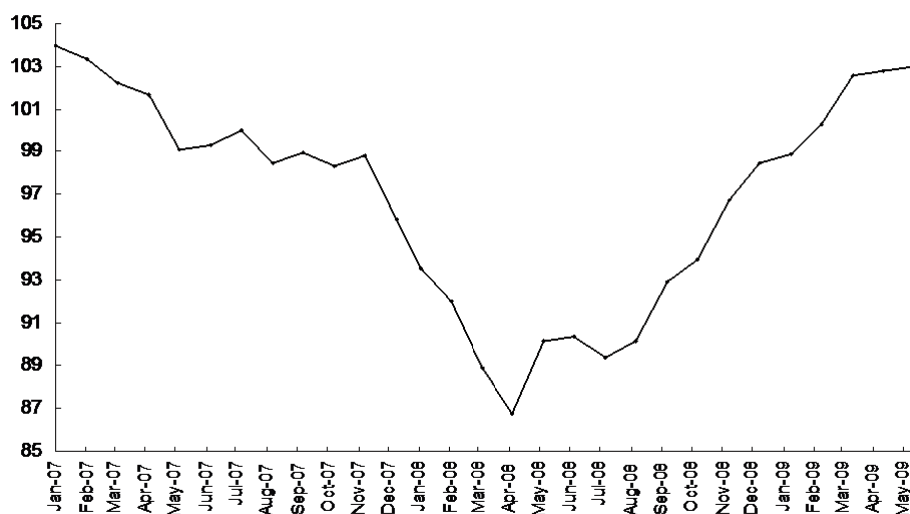
So in summing up, a truly 'free' floating foreign exchange regime requires the public along with policymakers to understand that it is not ultimately free. There is always a price to be paid, which is, perhaps, great volatility in the exchange rate, or at least less policy driven control of what the proper exchange rate should be.

We should also understand that aggressively managing the float is not truly cost free or a guarantee of business stability. Our level of foreign exchange reserves, and the hidden costs of controlling the level of volatility that we expose ourselves to and our level of inflation all can have major consequences which may be just as dangerous or distorting to our economy as Floating Freely.

But I would not at all bet against Mauritius' ability to cope, in fact swim strongly, in a more dynamic and floating environment. We may well have a good lifejacket to protect us if we decide to float. But we would need to ensure this is taken as a measured and deliberate choice at a time of our choosing.

James Benoît is the chief executive officer of AfrAsia Bank.

**Mauritius Exchange Rate Index (based on the currency distribution of merchandise trade and tourism earnings)**



An increase (decrease) in the index indicates a depreciation (appreciation) of the rupee  
(Data: Bank of Mauritius)

will other countries like Mauritius do? Do we need to fundamentally review what currencies we benchmark the rupee against, taking into account this post leveraged, post American and European consumer world we now live in? Remember just a few years ago, it was

The rate will move with the prevailing current. In contrast, countries which are not willing to let the exchange rate fluctuate need a large cushion of reserves to achieve this in extreme or persistent shock situations. But a big lifejacket may not make it easy to swim in

Le budget de 2009 a été présenté sur un ton d'austérité, mais il donne aussi confiance au monde économique du pays. Il reconnaît qu'effectivement la crise mondiale a rattrapé Maurice et que des mesures doivent être prises afin de minimiser ses effets sur la population locale. Les mesures budgétaires vont aider à booster notre économie, ou tout au moins réduire les effets négatifs de la crise.

Tout d'abord, les grands projets d'infrastructure. Ceux-ci ne sont pas vraiment nouveaux, nous les connaissons tous, mais « Anne ma sœur Anne, ne vois-tu rien venir ? ». Ils sont essentiels à notre développement et procureront un emploi de main d'œuvre conséquent si les travaux sont effectués par des entreprises mauriciennes. Malheureusement, ils sont souvent réalisés par des compagnies étrangères employant leur propre main d'œuvre : les firmes locales n'ont pas nécessairement la capacité de réaliser ces projets d'envergure seules et à des coûts compétitifs.

Cela peut être un débat à lui seul mais, en résumé, il est indispensable d'impliquer des compagnies mauriciennes dans ces projets pour retirer le maximum de bénéfices tant du point de vue « *knowledge transfer* » que du point de vue économique. Les Mauriciens paieront des taxes et consommeront localement, s'acquittant de la taxe à la valeur ajoutée et créant du business additionnel pour les autres : un effet boule de neige.

Un aspect qui n'a pas été souvent évoqué : les coûts cachés dans les retards d'exécution, les principaux étant le carburant perdu dans les bouchons ainsi que le temps. Par rapport à cela, il faudrait penser à certains projets moins ambitieux certes mais qui pourraient améliorer plus rapidement la situation. Par exemple, un tunnel ou *Fly over* pour ne pas avoir à croiser l'autoroute en entrant dans ou en sortant de Port-Louis. Il existe des *Quick Win* qui peuvent encore améliorer le quotidien, mais personne n'en parle !

### Profiter de la crise pour rendre les entreprises plus efficaces

Parmi les grands investissements que le ministre des Finances, Rama Sithanen, a cités, certains sont ciblés pour protéger l'emploi : Rs 3 milliards pour le *Saving Jobs & Recovery (SJR) Fund*, et Rs 500 millions pour la *State Investment Corporation (SIC)* afin d'acheter des actions des compagnies en détresse. Concernant le *SJR Fund*, certains secteurs sont spécifiés comme les petites et moyennes entreprises, le textile et la manufacture.

Cependant, le plus important est de savoir comment cela sera appliqué. Tout comme le *Stimulus Package*, il ne faut pas injecter de l'argent dans une compagnie sans avenir, mais il convient de profiter de cette crise pour rendre les entreprises plus efficaces pour qu'à la prochaine crise ces mêmes compagnies ne se retrouvent pas de nouveau en difficulté.

Le budget pour la SIC permettra aux compagnies ayant des difficultés de trésorerie de convertir leurs terrains et bâtiments en cash, tout en assurant à la SIC un revenu et patrimoine foncier. Ceci est très intelligent, car l'argent du contribuable est ainsi investi, et la SIC

## Le Budget de la crise ?

Par Thierry Vallet

recevra des loyers avec une possibilité de revente, soit à l'entreprise qui avait dû céder ses actifs, soit à une tierce partie avec une plus value : cette mesure, si elle est bien gérée, sera une formule gagnante.

D'autres mesures affectent les entreprises mauriciennes dans son ensemble, mais certaines n'ont pas été très commentées. Tout d'abord, Rs 1 milliard pour une Assurance Crédit à L'Exportation. Aujourd'hui, beaucoup d'entreprises ne peuvent pas exporter sans prendre de risque sur l'acheteur. Et cela, ce n'est pas le métier de l'entrepreneur : une facture impayée peut mettre en danger la pérennité de la compagnie.

Ces assurances crédits sont très courantes en Europe, mais beaucoup plus difficiles à obtenir sur des compagnies asiatiques, et encore plus en Afrique. Si cette assurance crédit est bien gérée, elle peut apporter beaucoup aux entreprises exportatrices ou à celles qui veulent exporter. C'est aussi une formule gagnante si sa mise en application est bien faite.

Autre mesure importante, la possibilité de transférer un terrain dans une compagnie sans frais afin de capitaliser la structure. C'est encore une excellente idée, sachant que beaucoup d'entreprises mauriciennes sont sous-capitalisées.

On note aussi l'accès aux finances à moindre coût : on peut moderniser les équipements grâce à des emprunts à taux réduits (au taux Repo) au travers des compagnies de crédit bail. Une ligne de Rs 300 millions est ainsi allouée aux PME, conforme avec la logique de rendre les entreprises plus efficaces.

Le ministre des Finances a aussi spécifié que les compagnies ne doivent pas distribuer des dividendes si le « *solvency test* » ne passe pas. Ceci devrait être une évidence, car il existe déjà dans le *Compagnies Act*, mais il est fréquent que certaines entreprises vivent au dessus de leurs moyens, entraînant ainsi des problèmes structurels.

### Améliorer la trésorerie des entreprises

Concernant l'immobilier et l'hôtellerie, plusieurs amendements sont apportés pour soutenir ces secteurs. D'abord, concernant les projets IRS/RES, le paiement du *Land Transfer Tax* de 5% peut se faire en quatre fois au lieu d'un paiement unique à la signature de la vente. Cela ne change en rien la profitabilité du projet mais permet de ne pas avoir recours à des facilités additionnelles en gardant 3,75% du prix de vente au début, donc une meilleure trésorerie dès le départ.

Ensuite, et c'est beaucoup plus important, les projets IRS auront la possibilité de vendre des terrains nus à condition que toutes les infrastructures soient en place. Cela permettra à certains projets de doper leur vente avec un paiement immédiat, donc une rentrée de devises plus rapide, tout en diminuant les garanties à donner pour le promoteur.

Cependant, un autre concurrent vient s'installer dans la cour des IRS/RES.

C'est la possibilité pour les hôtels de vendre des chambres ou villas en *lease back*. Cette formule ne s'adresse pas à quelqu'un qui veut résider à Maurice, mais plutôt à un investisseur pur. Cette formule marche très bien à l'étranger et certains groupes hôteliers internationaux utilisent ce système pour réduire leurs besoins en capitaux sur des projets spécifiques. Reste à savoir les conditions qui seront attachées à cette vente. L'option la plus probable serait que ce soit copier coller sur *Integrated Resort Scheme*.

Autre point très positif pour les promoteurs, c'est la possibilité d'emprunt en roupies par les acheteurs à condition que le repaiement soit fait en devises. C'est encore une formule gagnante. En effet, depuis la crise financière, les établissements bancaires locaux ont des difficultés à prêter en devises, ce qui est un gros frein pour les éventuels acquéreurs de villas qui doivent tout financer par eux-mêmes ou presque.

Quelques petits aménagements aussi ont été permis pour alléger la trésorerie des hôtels avec des paiements différés sur 3 à 5 ans de *lease*, et une aide du gouvernement pour maintenir les emplois en cas de reconstruction d'un hôtel. S'ajoute à cela la disparition du *travel tax* sur Rodrigues, ce qui ne peut qu'être bénéfique pour le tourisme rodriguais.

Enfin, le secteur immobilier dans son ensemble va aussi bénéficier d'un *Land Transfer Tax* uniformisé à 5% jusqu'en décembre 2010, particulièrement intéressant pour les projets de plus de Rs 50 millions ainsi que pour les propriétaires de moins de 5 ans qui devaient payer 10% de transfert et sur les projets de plus de Rs 50 millions qui devaient payer jusqu'à 15%.

### Les services victimes de leur succès

Deux secteurs touchés : les télécommunications et les banques. La taxe de solidarité existait déjà sur les banques mais elle a été doublée. Victimes de leur succès, ces secteurs vont aider à augmenter les revenus de l'Etat. Comme l'Etat veut attirer des banques, notamment islamiques, est-ce judicieux de taxer le chiffre d'affaires en même temps ?

Le dernier important changement est l'obligation des GBL2 (sociétés de droit mauricien autrefois appelé offshore) de divulguer les identités des bénéficiaires qui sont déjà connus des *management compagnies* et des banques. Cela ne devrait pas affecter leurs revenus comme tels mais au contraire consolide par la même la position de Maurice sur la liste blanche de l'OCDE. Ainsi le risque d'opérations frauduleuses pouvant affecter l'image de Maurice est réduit. Il est certain que d'autres juridictions peuvent tirer profit de cela, mais est-ce que ce sera durable ? Vaut mieux tenir que courir.

La communauté économique en général doit donc apprécier ce budget, mais l'éternelle question se pose : les paroles vont-elles se transformer en actes ?

Thierry Vallet dirige le développement stratégique de la banque AfrAsia.

## Taking the pulse of the rupee

By Sameer Sharma

The month of May has traditionally been a month where fund managers and traders book profits and stay away but this May, things were much more volatile and the month of June has not disappointed in terms of stress and excitement either. As the world economy continues to show signs of moderate recovery, commodity prices have continued to rally despite still weak global demand. Inventory levels for oil remain at ten-year highs but this has not stopped oil prices from reaching USD 70 a barrel.

Monetary expansion which aims to create inflation has had a positive impact on asset prices but has also caused long term bond yields to move upwards despite the Federal Reserve's long term bond purchase programme. More and more investors are getting increasingly worried about unsustainable fiscal deficits, the volatility of the US dollar and its viability as a reserve currency and inflation two years hence.

Inflation worries come at a time when the global economy continues to witness strong deflationary pressures as excess slack in major economies continue to pin down price increases across the board. Furthermore, while the outlook on the global economy appears to be slightly rosier in 2010 than in 2009, a major reason for the current stock market rally, the World Bank only expects the world economy to clock 2% in 2010 despite a favorable base effect with consumer demand in a deleveraging world economy expected to remain weak. So how do we make sense of it all and how do we invest in such an environment then?

### Unpredictable oil prices

Firstly, one must understand that since the March rally began in this long term bear market, the US dollar has depreciated steadily versus major trading currencies and even the Mauritian rupee. As the dollar depreciated, commodity prices which get priced in dollars invariably went higher, but is this doubling of oil prices in a global recession justified? If anyone had come close to a trading desk lately, he would have noticed that paper interest in oil futures continued to pick up during the months of April and May, especially as oil prices breached important technical levels.

As the contango flattened, we have seen resurgence in hedge fund and pension fund interests via the exchange traded fund route while in recent days we have also seen a certain degree of selling in call options on oil futures at around the USD 75 dollar mark. It is however very difficult to predict oil prices right now because exchange traded funds and even companies that are actively using these new instruments to hedge themselves (by profiting when commodity prices increase, they make up for losses in terms of higher input costs) are playing an increasingly big role in shaping the direction of oil, base metals and agricultural products.

From a technical perspective, oil prices have currently formed a double top and failed to breach the important resistance level of USD 72 a barrel. This also explains the option sales in the mid 70s range. However with the outlook on the dollar appearing to remain uncertain and with paper interest remaining unpredictable, oil can only be traded on a day-to-day basis.

This same logic works for gold as well. Gold works well as a diversifier in one's portfolio but having a major stake in the precious metal tends to cause more pain than glory. Only in Mauritius, of course, will unqualified politicians profess on a different tune. We continue to see the euro having some strength left in it to try to test the important 1.43 resistance level. An uncertain outlook on the US dollar in a world where risk aversion has fallen somewhat continues to make commodity price predictions beyond a weekly (at best) basis impossible. This is another reason why long term bond yields and even medium term bond yields are rising. Traders feel increasingly uncertain about inflation despite the facts on the ground.

The S&P500 index on its part is currently engaged in the right shoulder of a head and shoulders pattern with a short signal remaining in place since mid June. We are however currently approaching critical levels as the Moving Average Convergence Divergence (MACD) line approaches its signal line from the bottom and as the Relative Strength Index continues to remain in sink with the price chart. The first week of July is likely to be a key week for global markets as important levels get tested. Should the S&P500 head and remain below 900 for some time, we could see a 10-15% correction in the market as the head and shoulders pattern gets confirmed. For the rally to continue, the S&P500 needs to breach 950 and break past the head.

### Hedge funds are making a come back

Signals on the Nasdaq however, appear to be relatively better and investors should look at technology stocks for potential gains. We have seen recent gains coming from Apple after the mid-June correction, and the first week of July should either confirm or cancel out the bullish signal on the Nasdaq. In this environment, hedge funds are making a come back. Long Short and Market Neutral hedge funds for example which had made tons of money by being long energy stocks while being short the overall market index, are currently long high dividend yield stocks, utilities related companies, consumer staples stocks while being short the overall market.

In the near future, one would expect a certain degree of adventurism in technology stocks. While the short signal on the overall market remained in place as at 27 June, we need to understand that one of the positives for the overall stock market right now is the fact that there is a lot of pension fund and mutual fund money on the side, some of which has come in as well. This has forced a lot of traders and hedge funds to cover their short positions especially during afternoon sessions. There are board meetings going on right now across the fund management industry and many funds are lagging their benchmarks and want to catch up quickly. This remains a positive technical sign for the market, and one needs to watch key support and resistance levels on a daily basis in order to gauge the direction of the market.

We also need to look at the Japanese Yen which is currently stalling. The market will only gain upward momentum with a depreciating Yen, something that has become difficult to predict after the US dollar has come under heavy criticism. China continues to call for the dollar to be replaced as a global reserve currency. We hear talk of the SDR and

other types of baskets and the small probability that the US dollar may lose its AAA rating in three years should the fiscal deficit not be controlled, but so far nothing seems to be concrete enough to warrant less volatility.

This is why it is very difficult to predict where asset prices will go beyond the week. Those who understand how to build modern trading algorithms and understand technical analysis do not however need to be predicting things: they only need to follow the momentum after they learn how to read it.

### Too many unknowns on the dollar

The breakdown in support for the US dollar versus many world currencies has also positively impacted the Mauritian rupee. In fact the bear Rupee trade on the dollar ended sometime in early May as the Rupee confirmed a head and shoulders pattern and as its moving averages told us that the depreciating party was over much to the disdain of the infamous Mauritian lobby groups. Since then, the trade has been towards the euro and even the South African Rand which has been a strong currency as commodity prices have rallied.

While that trade appears to be nearing its end as well, the Rand which is highly correlated with commodity prices appears to be a moderate hedge against commodity price hikes and needs to be considered in a well diversified basket that should include the Brazilian Real, Canadian Dollar, Australian Dollar and other strong Asian currencies (which can be bought via ETFs that can even simulate the performance of non tradable currencies).

In fact this notion that investors need to be trading only one currency at a time is a fallacy. Investors need to diversify their portfolios and add various currencies while still maintaining the US dollar and euro as their biggest holdings. The key to managing a foreign exchange portfolio is diversification right now because there are too many unknowns on the dollar and even the euro to a lesser extent and yes even including gold should be pursued although that allocation should never surpass 10% of the total portfolio.

Key levels for the Rupee (average of bid and ask) are as follows. In terms of resistance, the Rupee needs to break an average 32.95 per USD in order to have a chance to test 33.50. I do not see this as being likely for now. In terms of support levels, the 31.75 range where the 200 day moving average currently stands is an important level. Should the Rupee breach this level on the downside, we could see appreciation towards the high 30s.

Overall the outlook remains uncertain in the medium to long term but in the short term, the outlook is rather more stable, especially following the surprise decision of the Monetary Policy Committee (MPC) to keep the key Repo Rate on hold. There is still money to be made however versus other emerging currencies and from time to time, even the euro but the bid ask spreads in Mauritius are not attractive and investors should seek to trade other currencies in foreign accounts for holding onto local accounts.

Giving away 5% spreads to your local bank is not good from an investment perspective unless you need to convert back to Rupees (or convert your Rupees

to foreign currencies at first). While US dollar/rupee volatility has come down along with a slight adjustment of the spread in recent weeks, trades can be rather unprofitable if investors and speculators do not consider this important factor. However, one should not doubt that there is still money to be made in foreign exchange.

**The local stock market is pricey**

With regard to the Mauritian stock market, we have almost completed the reverse head and shoulders pattern and the market is still expected to lag global markets. However, I find the market rather pricey for a stock market made up of hotel stocks and banks that lend to them and to unproductive companies in the manufacturing sector. While the interest rate spread remains highly attractive if you are a bank in Mauritius, I, like many foreign investors, will continue to prefer more concrete companies in Africa that are likely to benefit from higher commodity prices and consumption levels (should the world economy improve as expected albeit slightly) rather than on hotel stocks.

Yes you should follow the trend without question, but then again there is much more money to be made outside than within Mauritius, and this is why foreign investors are not coming back as fast as they left. In a mild economic recovery, I will invest in stocks that produce concrete assets and goods; I do not yet see the necessary global environment for tourist travel in overpriced and far away destinations. In sum, I would rather invest abroad than in Mauritius. Being more optimistic on the global economy is one thing, but thinking that Mauritius will recover as fast as other countries that have much stronger fundamentals and do not suffer from zero total factor productivity growth syndrome is wishful thinking.

As readers of *Conjoncture* know, I have never been one that ever joined the "economic miracle" bandwagon and the latest official productivity figures can only confirm my view. Mind you, the exporters

continue to ask for a weaker rupee, but we have seen more than a decade of depreciation and yet in that sector in particular, total factor productivity growth has remained negative. You wonder by how much they want the rupee to depreciate before they become competitive, 50, 60? I will not hold my breath.

What the so called experts that run many of these lobby groups fail to understand is that it is actually inflation that comes from an ever depreciating currency that has created some of this wage pressure in their sector. Unit labour costs are high for many reasons in Mauritius, one of which is obviously inflation and tight labour supply which has made wages go up at a higher rate than labour productivity growth. In such an environment, it is only a question of time before an industry falls pray to global competition, a crisis only comes to speed things up a bit.

You cannot have inflation average more than 6% over the past decade and a half and expect that wage growth will remain below labour productivity growth. The Bank of Mauritius (BoM) sadly has done a poor job on the inflation front perhaps because it appears that the Finance Ministry has tried to control things a bit too much and perhaps because lobby groups have tended to attack the Governor directly or via the politicians from both sides too often. Then again, you reap what you sow.

The zero total factor productivity growth figures are official figures that are beyond debate but never seem to make it in the economic miracle reports we tend to hear about. To me, it is obvious that there will be no miracle until there is positive productivity growth and until total factor productivity growth accounts for a larger share of total growth.

With the savings rate showing a worrying downward trend, we need to be worried about our growth prospects in a weak global environment if we plan to depend on growth in the capital stock to save our behind all the time. Here is the fallacy, our venerable central bank tried to keep

real interest rates negative for far too long and the result is lower private savings.

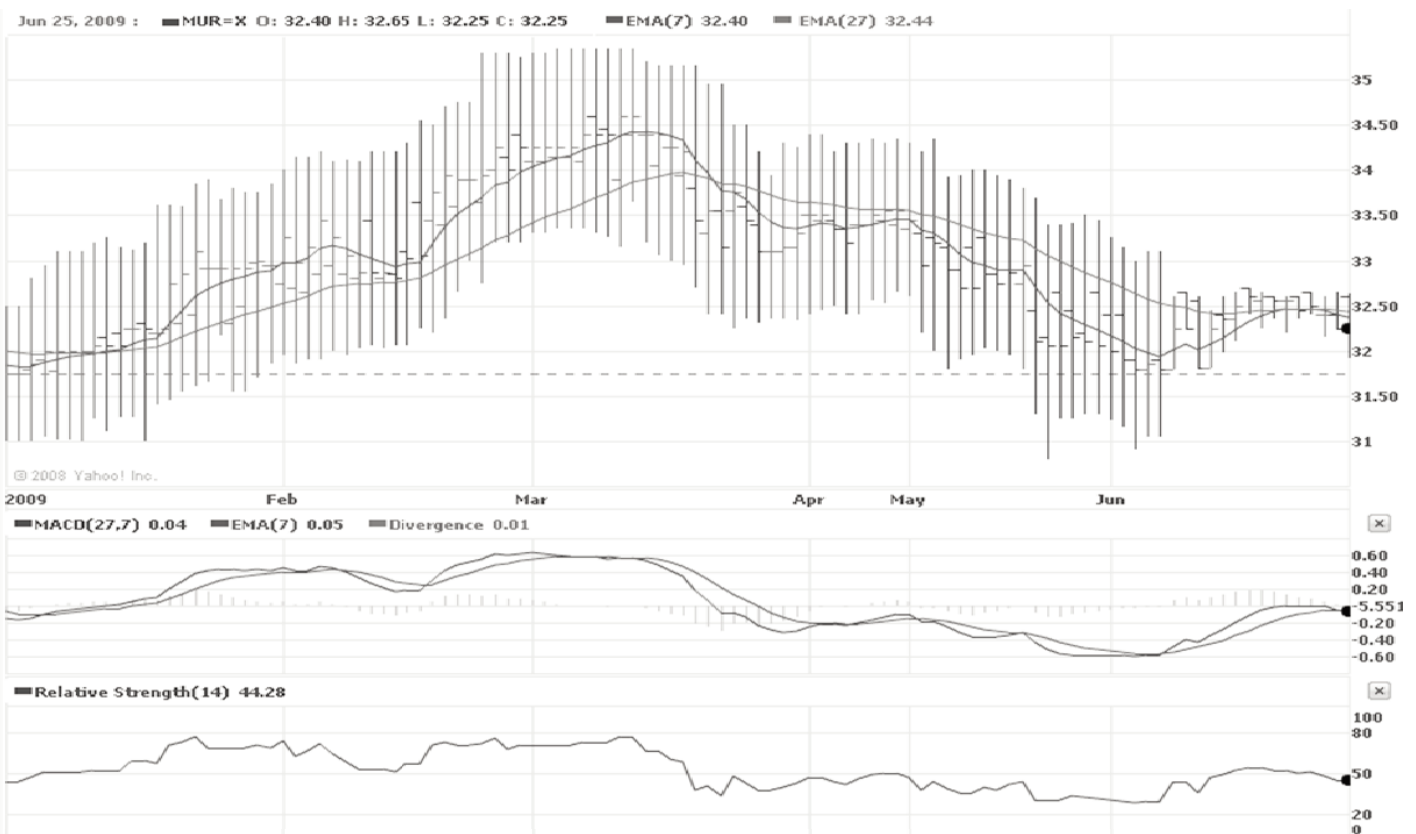
**Inflationary expectations seem to remain alive**

I have to say that the MPC has surprised me with its interest rate decision. I was expecting politicians to be a bit more convincing than that but the right thing was surprisingly done. The median policy interest rate in developing economies remains at 6.6%. However, one needs to look at the evolution of the local 364-day Treasury Bill yield and the bid yield range to realize that inflationary expectations seem to remain alive despite talk of the contrary.

At this point, I want to continue to point out that while I was against headline inflation being used as an inflation target or mentioned at all, jumping to the leptokurtic rightly skewed extreme in the form of year on year inflation is a recipe for disaster because the latter measure is simply unpredictable due to the weight of commodities in the index. Such a measure will never anchor inflationary expectations and basing monetary policy on this volatile measure is error prone and may erode the credibility of the BoM as it fails to achieve what it targets. Fluke is one thing and can always happen, but over the next two years, we will certainly see the problem with targeting year-on-year inflation.

The BoM needs to target a domestic measure of inflation similar to Core inflation or a statistically smoothed inflation rate that is of course not as smoothed and irrelevant as headline inflation itself. We need to seek for something that is targetable and is in between headline and year-on-year inflation in order to build up the credibility of the BoM. Let us hope that policymakers get it right.

Sameer Sharma is a Canada-based Chartered Alternatives Investment Analyst.



## Law of the seeds

By Christopher Tan

Over the last few months, we have been so burdened by the crisis. This crisis has caused many of us to lose as much as 40-50% of our hard-earned monies, and in some cases, all our monies. Articles after articles have been focusing on this crisis. Financial experts are all dishing out investment advice. Economists are all making their guesses on where the economy will go. Clients are blaming their advisors. Public activists are lobbying for justice to be done. Financial institutions are fighting against allegations of mis-selling.

Everyone is waiting for an outcome. Everyone is hoping that the economy will improve soon. Many are hoping that government will step in to recoup their losses. It has been a tiring 6 months, isn't it? The pain of losing our funds, the anger of feeling mis-sold to, the fear of losing our jobs, the hope that the economy will recover soon have consumed us and in some cases paralyzed us. But instead of fearing, blaming, hoping, maybe the best thing to do is to accept the fact that it has happened and now make plans to cope with it or to capitalize on it.

So what can you do?

### If you are not financially independent but your job seems secure

You are in a good position to take full advantage of the current situation. The first thing you should really do is to visit your entire financial plan all over again. The current crisis has wiped out a large part of your investments, but you are not over yet. Find out how much you are behind your goals now because of the fall in your investments and know the new required rate of return needed to reach your goals. If it is probably higher than before, it means you have to take more risks to achieve your goal.

If you are not prepared to take more risks, you must be prepared to lower your goals or be prepared to invest more. Once you have accepted this fact, you must now work towards "raising cash" to make your investments. While many feel that a crisis is the worst time to "raise cash", for an individual, this may be your best time. By raising cash, I mean lowering expenses to create more surpluses for yourself.

Begin by doing a budget. Determine your target saving amount per month and cut your expenses so that you can achieve

that. You can cut your expenses by re-financing your mortgage (especially since you are creditworthy), cutting down on luxury, looking for cheaper options in your shopping, wait for better deals because there will be plenty in a crisis.

One other way is to re-look into your insurance plans again. For the longest time, I have been advocating that we restructure all our insurance plans from whole life to term plans. Not only because almost all of us will never need whole life protection, and that term plans are the only way to cover ourselves fully, but also it can save you a lot of unnecessary expenses.

### If you are not financially independent but your job seems to be at stake, or you have lost your job

First of all, I am sorry about you losing that job. It is never easy. But again, take courage that this is not over for you yet. The crisis will pass. Your focus is to plan towards meeting your short-term needs more than your long-term goals. The first thing you can do is to know how long you or your family can last without a job. If you have 6 to 9 months buffer, you should be fine.

As you look for a new job, start to cut down on your expenses. Whatever I have suggested above (except for the re-financing part) will work for you. In addition, you will really have to consider downgrading your house or even selling that car of yours if necessary. This crisis is not a normal crisis; you have to be prepared that it will take a while to recover as the current crisis is a structural breakdown of the financial system. The earlier you accept this fact, the better it will be.

### If you are financially independent but you are being laid off, or you are retired

Of all people, you should be the last one to complain. Thank God that you are financially independent. I guess, for you, this is the best time to sit down and reflect upon your options. This crisis may be a sign to tell you that it is time you slow down and enjoy that life that you always wanted, with the people you love and that you most cared about. Take that vacation that you deserved, plan to do those things that you always dream

about.

Plan your second part of your life, how you can use your experience, expertise to advise and help people in this crisis. You are in a very good position to be at peace with yourself. To me, this crisis is a blessing in disguise to you. You have been forced to slow down, why do you want to work and slog so hard anyway? Life is more than work, isn't it?

Whatever I have written seems so simple, isn't it? But isn't it true that the most beautiful things in life are really the simplest things? But the most difficult things to do in life are also the simplest things?

I have been doing the same for myself and my clients. This is not the time to sit down and do nothing. You can be angry, fearful, discouraged. But now is the time to refresh yourself, rise up, do your financial plan all over again and face the future bravely. Once you have done these simple things, I assure you that you will be happy once more, just like me and many of our clients.

This crisis shall pass, it always has and it always will.

Christopher Tan is the CEO of *Providend*, Singapore's sole fee-only independent private wealth management firm.



Published by PluriConseil Ltd

Director: Eric Ng Ping Cheun

Address: 27, Mgr. Gonin Street, Port Louis, Mauritius

Tel: (230) 213 6719

Fax: (230) 234 2761

Email: [conjoncture@orange.mu](mailto:conjoncture@orange.mu)

Website: [www.pluriconseil.com](http://www.pluriconseil.com)

Printed by Cathay Printing Ltd

Reprint of articles is allowed upon written authorization of the publisher.

## Des politiques monétaires « non conventionnelles »

Par Jean-Yves Naudet

Nous n'avons cessé de critiquer les politiques keynésiennes de relances budgétaires (explosion des dépenses publiques et des déficits) et monétaires (baisse des taux d'intérêt) et nous nous sommes demandés si la vraie menace, ce n'était pas l'inflation. Cette analyse est confirmée par les dernières évolutions de la politique monétaire avec des politiques monétaires « non conventionnelles » : financer la dette publique par création de monnaie et faire tourner, comme au bon vieux temps, la planche à billets en soumettant les banques centrales au bon vouloir de la classe politique. C'est le plus court chemin vers l'inflation.

### Politique monétaire conjoncturelle ou automatique ?

Tant qu'il existera des banques centrales, ayant le monopole de la création de monnaie, il y aura le risque de politiques monétaires non appropriées, et notamment d'une création excessive de monnaie conduisant à l'inflation, puisque celle-ci « est toujours et partout un phénomène monétaire » (Friedman).

En attendant mieux (concurrence monétaire, étalon or), un moindre mal consiste à retirer aux hommes politiques toute influence sur la création de monnaie et à empêcher une politique monétaire conjoncturelle (keynésienne, cherchant, en vain, à contrecarrer l'évolution économique). C'est ce que Friedman appelle la politique monétaire automatique : accroître chaque année la quantité de monnaie d'un même pourcentage (règle du k%). « Remplacer le gouverneur de la banque centrale par une exponentielle » : plus de manipulation de monnaie.

Le premier pas vers la sagesse avait été franchi en rendant les banques centrales (notamment la Banque centrale européenne) indépendante de tout pouvoir politique. La BCE s'était même un temps fixé un taux de progression de la masse monétaire (et un objectif d'inflation limité à 2% par an), mais avec la crise elle a rejoint les Américains en revenant à des manipulations de taux d'intérêt. Aux Etats-Unis, la Fed était depuis longtemps championne de cette politique, et sa volonté de taux d'intérêt artificiellement bas, favorisant un crédit irresponsable et bon marché, est largement à l'origine de la crise actuelle.

### Fausse créances ou vraies créances ?

Comment font les banques centrales pour créer cette monnaie ? Elles achètent des « papiers » représentatifs de créances, c'est-à-dire de crédits accordés par les banques à l'économie ; les banques se refinancent auprès de la banque centrale : en fait c'est elle qui prend l'initiative en achetant ces « papiers », en les monétisant (*Open market*).

Dans ces conditions, comme Jacques Rueff le soulignait (« Rétablissez l'ordre monétaire ou acceptez l'esclavage »), la qualité des créances est fondamentale : si on monétise de « fausses créances », des crédits peu fiables, n'aboutissant pas à des créations de richesses, on crée de la fausse monnaie et de l'inflation. C'est vrai pour les créances du secteur privé ; or les banques centrales achètent de plus en plus de créances douteuses.

Mais cela pose la question des créances sur l'Etat, car un déficit budgétaire financé par création de monnaie (la fameuse « planche à billets » chère à la IV<sup>ème</sup> République française) est par nature inflationniste, puisque créant de la monnaie sans contrepartie de vraies richesses. Voilà pourquoi cette piste avait été peu à peu abandonnée : plus les banques centrales devenaient indépendantes des gouvernements, plus le risque que les gouvernements les obligent à financer leurs déficits s'éloignait.

Cela a volé en éclats avec la crise. Les gouvernements, par leur relance budgétaire, ont fait exploser les déficits, donc les emprunts. Les voilà qui s'affolent devant leur ampleur : la commission européenne annonce une dette publique en France égale à 86% du produit intérieur brut en 2010 ; plusieurs Etats ont vu leur note, concernant la qualité de leur signature, dégradée ; un nouvel emprunt d'Etat a été boudé en Angleterre ; le déficit américain ou anglais (donc le financement nécessaire par emprunt) atteint 50% du budget ! L'épargne risque de ne pas suffire. Pourquoi ne pas recourir à la banque centrale, à la création de monnaie ?

### Banques centrales et Grand Satan

Il lui suffit de racheter massivement des emprunts d'Etat, des bons du Trésor. C'est cela les politiques monétaires « non conventionnelles ». C'est ce que viennent de faire le Japon, puis le Royaume-Uni. En mars dernier, les Etats-Unis à leur tour ont succombé à ce péché monétaire en annonçant que la Fed allait acheter 300 milliards de dollars

de bons du Trésor américains à long terme.

Jetant leur indépendance aux orties, les banques centrales se mettent au service des Etats. Elles deviennent de simples relais de transmission des Etats et de leur laxisme budgétaire. Elles espèrent aussi ainsi faire baisser les taux longs, pour que les Etats puissent continuer à emprunter à bon marché.

Le cas de la BCE est un peu à part, car les traités garantissent son indépendance, contrairement aux souhaits des hommes politiques. Mais la pression est de plus en plus forte. Faute de pouvoir pour l'instant acheter des titres publics, elle a annoncé 60 milliards d'achats d'obligations sécurisées ; mais les gouverneurs se déchirent : celui de la Slovaquie suggère d'acheter d'autres catégories de titres, dépassant les 60 milliards ; celui de la Bundesbank dit au contraire que c'est un maximum ; celui de la Slovaquie n'exclut rien. C'est « la cacophonie publique des banquiers de la BCE », ce qui n'est jamais bon pour la monnaie.

De nombreux hommes politiques veulent donner le coup de grâce et permettre à la BCE d'acheter des titres publics, donc de financer les déficits budgétaires par création de monnaie. La BCE y perdrait, avec son indépendance, toute crédibilité. *Le Monde* va jusqu'à parler du « martyr des banques centrales », dans un excellent article de P-A Delhommais, qui dit que plus qu'une crise du capitalisme, la crise des subprimes apparaîtra comme « la conséquence du grand fiasco des politiques monétaires ». « La gestion de la monnaie est redevenue politique (...) avec les risques de perte de légitimité et de confiance » (donc d'inflation) : « une sorte de grand bond en arrière monétaire ». Retour à Napoléon.

Le président Jackson avait refusé la création d'une banque centrale car « le Grand Satan surgit d'une trop grande concentration de pouvoir dans les mains de quelques uns ». Nous y voilà. La monnaie avait échappé aux hommes politiques ; ils viennent de prendre leur revanche : l'ours a repris la garde du pot de miel. Chacun en paiera la facture demain.

Jean-Yves Naudet est professeur d'économie et dirige le Magistère "Journalisme, Communication, Economie" de l'Université d'Aix-Marseille III.

## In praise of endogenous growth

By Eric Ng Ping Cheun

We are a bit lost in these projects worth billions of rupees announced in the budget speech. Astronomical amounts naturally titillate the minds of those who see keynesianism at work in the 2009 national budget. However, every expenditure made by the state to boost the economy is not necessarily labelled keynesian. Had it been enough to pump money in the economic system to create growth, the African continent would have already become well developed today...

This not-so-keynesian budget has rightly provided no tax incentive that stimulates consumption. When final consumption represents 90% of gross domestic product – a record level since 1976 –, it would have been unwise to reduce the rate of Value Added Tax. It is preferable to motivate enterprises to sustain their production in a way that allows employees to keep their job and maintain their consumption.

Neither has this budget brought down customs duties, ending a tradition established in previous budgets. In last year's budget, the government forewent Rs 1.8 billion in terms of reduction in customs duties for the benefit of the population. This year, the decision to keep tariff barriers intact gives a respite to the local industry confronted with severe foreign competition.

On account of the yawning trade deficit, it would have been irresponsible to encourage imports and, consequently, the depreciation of the rupee. Although being still at a comfortable level of six months of imports, our official reserves must be well managed for the country to avoid having recourse to a credit facility from the International Monetary Fund.

Thanks in part to customs duties remaining unchanged, the budget deficit will stay within reasonable limits.

States where the budget deficit has risen above 13%. The most important thing is that our deficit finances investment rather than consumption as it is essentially due to capital projects.

### The 2009 budget has a Ricardian taste

In an open economy that has macroeconomic links with other countries, the trade balance, the budget deficit, private saving and private investment are variables that are determined together. Imports constitute present consumption while exports represent future consumption. National saving remains low in Mauritius (14.3% of GDP in 2009) as much because the government budget is always in deficit as because the country exports less than it imports. The idea that the budget and trade deficits are 'twin deficits' has never been so true today.

Fortunately, the 2009 budget has ignored Keynes in favour of Ricardo. It underscores the 'Ricardian Equivalence' of taxes and budget deficits that when government increases the deficit after having reduced taxes, consumers anticipate that they will pay higher taxes later to limit public debt. Let us hope that they will augment their private saving in order to compensate for the lack of public saving.

The 2009 budget has catered for some supply side measures. The small and medium enterprises, mostly affected by cash flow problems, will have more than one billion rupees at their disposal to modernise their production equipment and to get further capital from commercial banks. In the big corporate sector, hotels and construction companies will avail of a fiscal remittance of Rs 550 million whereas profit-making banks and telecommunication firms will incur a solidarity levy to the tune of Rs 820 million.

trade deficit. Such an approach can save jobs and bring in tax revenue to the state coffers. Since this budget is not really a Keynesian one, what is it then?

It appears to espouse the principles of the new classical school, illustrating the idea of endogenous growth.

### Growth is the result of the deliberate actions of economic agents

We should restate the concept of growth without giving credit to neo-Malthusians who question the notion of growth, nor to economists who view growth from an accounting perspective. First, we should ignore the tyranny of statistics which defines growth simply as a real increase in GDP. When we say that overall growth is 2.5% in 2009, we do not learn anything about the diversity of growth rates within our economy. We mistakenly look at growth in a holistic manner when it has microeconomic foundations.

The sources of growth come not only from labour (quantity and quality of workers) and from capital (volume and rejuvenation of capital), but also from a third factor, the institutional factor. The accumulation of physical capital is in itself insufficient to produce unlimited growth because of the decreasing marginal productivity of capital. Instead, growth should be seen as the result of an endogenous process, the result of the deliberate actions of economic agents. Nevertheless, the government has a role in initiating policies that influence the growth rate of the economy.

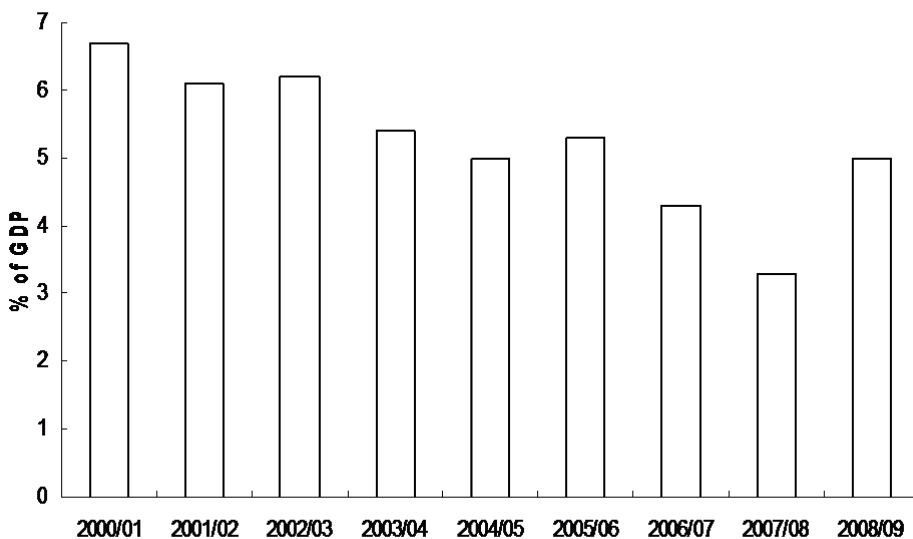
There exist a growth engine and a growth catalyst. The engine is the human capital. Knowledge helps in the production of goods and services, and accumulation of knowledge raises productivity. Per capita income can rise on the back of human capital, independently of exogenous technical progress or of population growth.

What acts as catalyst is public spending in infrastructure leading to an increase in the productivity of private assets. For this to happen, the government must tax corporate income if private firms are unable to provide the infrastructure that are essential to them to operate.

The 2009 budget contains incentives which foster endogenous growth through an efficient resource allocation. Firstly, the setting up of a new university campus and the numerous training initiatives should encourage parents to endow their children with a higher human capital by investing in their education. Secondly, businesses need only the presence of an active government that does not take away their traditional motive of profit maximisation.

When government takes the lead in cutting costs through budget restrictions, the private sector cannot get behind. The current global crisis compels every one to join into a national effort of cost consciousness and to have a social conscience.

Budget Deficit as % of GDP



(Data: Ministry of Finance)

With a deficit of 5% of GDP, Mauritius is among the most conservative countries in fiscal policy, in sharp contrast with the United

The 2009 budget is coherent in that it revamps the economy from the supply-side while at the same time trying to restrain the