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

The unfinished business of economic reforms

By Akilesh Roopun *(Cont Pg 4)*

The Mauritian economy is expected to grow by 4.6 percent in 2010, according to the Central Statistics Office, indicating that the upturn is well underway. Apart from private investment which is expected to shrink by 2 percent, all the growth engines are gaining traction as the economy leaves the rough waters. With elections behind us, we expect a more serene business climate in the second half of the year, assuming continuity of economic policies, including the exceptional fiscal stimulus and loose monetary conditions.

The momentum of economic reforms must be maintained. The new government has a clear mandate to build strong infrastructure and deliver globally competitive businesses amidst an arduous global economic convalescence. Ongoing uncertainties in Europe, which is our main export market, could cloud prospects of a solid upturn and involve policymakers in fire-fighting at the expense of devising policies to fix longer-term issues in the economy.

The €750 billion European Union Stabilization Mechanism might have reassured global financial markets, but has left European households in doubt. European consumers are not prepared for the ensuing austerity. They will have to adjust spending to cope with the new situation. Mauritius' garment and tourism industries will bear the full brunt of this adjustment. Recovery can therefore be more laborious than expected if household demand conditions in Europe remain shaky.

Several supply-side constraints

But a sustainable economic healing and a long-term resilience require deep shake-ups in the productive apparatus. The Mauritian growth model is still marred by several supply-side constraints. These include a limited resources and skills base, a mismatch of skills in the labour market, inadequate industrial capacity to take on new opportunities in the high value-added industries and acute infrastructure deficiencies as well as many other structural weaknesses such as subdued productivity and a widening resource gap on account of a falling savings rate. Besides, a persistent external balance deficit suggests that the country is living beyond its means.

Conversely, economic reforms introduced in 2006 have allowed the economy to pick up pace in 2007 and 2008 and more crucially to weather the global storm in 2009. Government should tackle the unfinished business of economic re-engineering to move the country to a new plateau of global competitiveness.

Public sector reforms must be a policy priority as the design, implementation and delivery of public services continue to be sub-standard and do not meet the requirements of a modern economy. If anything, inefficient institutions end up exacerbating many of the aforementioned flaws.

The weakness of savings is a major cause for concern and will prevent the economy from realizing its full potential. The resource gap will widen to a worrying level due to a degenerating savings ratio, which means less resources will be available to fund productive investment in the future.

Labour cost has unceasingly outpaced productivity, thus eroding the competitiveness of the local industries in the international markets. To make up for this deep-rooted disadvantage, export industries have continuously lobbied for a weak rupee, which is yet another major source of macroeconomic imbalances. Improving productivity through the use of better technology, innovation and enhanced human capital should be a prime objective of economic policy.

Sound public finances are key to macroeconomic stability

On the external front, the current account of the balance of payments will remain under pressure in the years to come.

The current account deficit stood close to 10 percent of GDP in 2009 and only a very modest improvement is foreseen this year. Whilst there is consensus that we must produce and sell more to the rest of the world, there is a conjuncture of factors that calls for a rethinking of our import strategy, not to say to the entire economic development model. We need to have a dispassionate and holistic view on imports substitution.

The global crisis, climate change and growing food and energy insecurity are reasons why the country should try to build local capacity to cater at least for our internal consumption and reduce reliance over imports in these critical areas.

Of access to financial services

By Eric Ng Ping Cheun

In Mauritius, there is a lot of discussion about access to finance, but very little is said about access to financial services. The seminar recently organized by the Financial Services Commission on that last issue was laudable in itself, since it raised awareness of the difficulties of ordinary citizens to grasp and take advantage of the non-bank financial products that are available on the local market. But instead of being a talking shop, the industry needs to professionalize its approach to bring these products within the reach of the laymen.

It goes without saying that there are not enough interaction, communication and exchange of ideas between the financial services providers (supply) and the consumers (demand). This information gap constitutes an obstacle to the potential customer to meet the real service provider. The whole problem stems from the absence of a structured approach on the supply side as well as on the demand side.

Indeed, service providers do more selling than tendering professional advice. For sure, in all business, sale is primordial for a firm to make money and to survive. However, a true financial services provider is not only a seller but an adviser as well. When a potential customer resorts to a service provider, he regards him first as an adviser and second as a seller.

A well-structured professional advice

It is by offering valuable advice to the client that the service provider can foster a relationship of trust with him, which is the best way of nurturing customer loyalty. But how many financial institutions in Mauritius provide professional advice in its proper sense? Such a service must be well-structured so as to bring value addition through customer relationship management.

One must reckon that things have improved in this area. Insurance, stockbroking and investment companies are today aware of the importance of research in their business. They recruit analysts to carry out research work, and they publish flash notes and fact sheets. However, their analysis papers are often very descriptive and not analytical enough.

It is true that not many professionals are willing to make recommendations although they are competent to do so. Now it is expected from a professional that he voices out his opinion, knowing well that he may err. It forms part of his job to be wrong in his forecasts.

But one can understand why it is difficult for our financial services providers to offer professional advice: the customer expects to get this service for free. Mauritians are the sort of people who bring their cheque book along with them when they contact a lawyer or consult a private doctor, because they know that they are not entitled to a legal or medical service free of charge. But when they solicit an economist or a financial adviser, they presume that his services are free.

The notion of paid service

Since free professional advice is not without costs, obviously it can only be a minimum service. To access to a well-structured professional service, the consumer must accept the notion of paid service, as it is practised in developed countries.

From this perspective, a professional approach on the demand side is needed too. It means that the consumer should require of the supplier a quality of service that gives him value for money. In case he is not satisfied with the service offered, the consumer could denounce the firm publicly and even make representations to the regulator.

The problem is that there is still not an association for the protection of consumers of financial services. Such an organisation is essential to defend consumers who are victims of a deficient paid service. For their part, financial services providers have regrouped into several organisations to protect their interests.

In the absence of an association for consumers of financial services, it is the regulator who eventually takes on the role of defending them, although it is bound to remain neutral between the consumer and the service provider. Paradoxically, it is in the interest of the service providers to promote the setting up of such an association. If this happens, the conditions will be conducive to a better regulation of their activities and to a better access to financial services.

Throwing caution to the wind

By Sameer Sharma

Over the past few months, investors have become increasingly bullish about global economic prospects and hence on the markets as well. On the 12th of April the volatility index or VIX fell to a near three year low of 15.57, the CBOE equity put/call ratio fell to a decadal low of 0.32, various surveys pointed out that around 56% of investment advisors were bullish while the majority of the remainder were neutral and while this list can go on, it is important to also point out that the cash levels of mutual funds in the United States fell to around 3%. This cash level is important because mutual fund Mondays (mutual funds investing on the first day of the week) have been a major boost to the uptrend we had seen since February 2010. It is always during times of market euphoria that corrections occur and over the past few weeks, this is exactly what we have seen.

Of course markets tend to get ahead of themselves, which is why behavioral finance has become so important over the past decades but certainly we have seen some genuine improvements in the US economy. Quarterly market data indicates that company earnings have mostly beaten analyst expectations, more so on the bottom line than top line. We have seen a 3.2% first quarter GDP growth in the US, ISM figures have improved and consumer confidence has progressed while unemployment has fallen modestly.

The consumer discretionary space has continued to outperform the market index indicating that investors at least believe that we are in the beginning stages of a cyclical uptrend. Corporate balance sheets in the US look sound and until very recently corporate spreads have been falling earning corporate and high yield bond investors solid returns. The problem with all of this has been human in nature. Most analysts got ahead of themselves as they almost always do.

A moderate economic recovery

Talk about a v-shaped recovery came back to life recently and in reality that type of recovery does not make any sense. Again when it comes to bottom line earnings growth of companies, cost cutting and accounting can play wonders, but when you looked at top line revenue growth, things looked positive but moderate in line with the theory that we are in for a moderate recovery.

Consumer confidence may be up but the index currently stands at 57.9, which is a far cry from the 100-140 1995-2006 average. Home sales figures remain biased by fiscal stimulus money and when it comes to consumer spending, latest figures point towards continued weakness and have fallen short of expectations. In the oil market, we have seen contango coming back, and some key commodity related stocks have suffered because market sentiment about how many shipments of metals and oil China will order has fallen.

What we need to understand is that we are in the midst of a moderate economic recovery being led by emerging economies such as China and that we cannot possibly justify the asymptotic uptrends we have been seeing in various markets. If this recovery is being led by emerging markets, especially China, then how has the Chinese market been doing? The SSE Composite Index had already peaked in August 2009 and has continued to underperform the US market since. In fact, if you look at the latest US market fall, the Chinese stock market had already given us a short signal since April 19th when the S&P500 was still rising.

Again, as I have been continuing to harp about for a while now, the dollar has a major impact on what happens to stock markets in the US, Europe and Asia because of the carry trade effect. When oil and equities are moving together, it is almost always the case that it is a currency issue. In recent days, we have seen the dollar appreciate and you know where global markets have gone.

There was a bit of a breakup in correlations in the US at least during the February- March timeframe, but if you were disappointed in the EUR/USD for market cues, then the Yen dollar relationship came back. It is also not always the direction of the currency but the velocity at which the dollar appreciates that can create market down moves and lately we have seen both direction and velocity on the dollar appreciation front.

Blame the socialist policies of European governments

Now we all know what has happened to Greece and the anti austerity reform protests in Athens have not helped matters. The fact is that even if Greece implements those deep fiscal deficit cuts, growth will take such a hit and debt to GDP levels will still remain so high in years to come that default is still likely. We also need to be worried about Portugal which may be downgraded in the coming months, and Spain does not look that great either.

Two years ago we had blamed the banks in the US for lending to everyone, now we can safely blame the socialist policies of various European governments that have debt levels that are completely unsustainable. The spread between German bonds and those of troubled Greece, Spain and Portugal have widened dramatically, putting the future of the euro and the European Union into question. This conundrum is showcased in that the 10 year Treasury bonds of Greece are the highest, the profligate Portuguese come in second, the notorious Spaniards come in third and the responsible Germans still get their debt for cheap.

Now remember, this is supposed to be a union and hence all ten year treasuries are supposed to trade at pretty much the same yield as you can see for most of the period. The Greek contagion is for all to see but even Italy and France are not out of the loop unless the EU fixes its problems soon. I think that they will come up with something but bond vigilantes are perhaps right when they say that eventually those countries will probably choose the option of debt restructuring simply because deep fiscal deficit cuts will create much a protest and will impact growth in a continent where GDP forecasts are already quite tame. Bond holders do not like that prospect and the market is punishing them for it.

Now that we have got all the background information, we need to know what we will do as investors. In terms of technicals, the Relative Strength Index of the S&P500 confirmed divergence from price chart on the 23rd of April indicating a top in that bull phase. We then received a short signal coming from the MACD on the very next day and since then the S&P has broken the important 1168 support level taking it towards the testing support of 1140-1150 area as at the 6th of May. While one should continue to avoid European markets, only institutional investors should remain long US stocks as long as those levels hold but need to exercise great caution. If we are unable to sustain those support levels, then a 10-15% correction is very likely and of course that is assuming Europe gets its act together, which it must.

Again I have always been advising to book profits along the way of any rally but right now you need to be very careful. Within the equity portfolio, investors need to rotate towards high dividend yield plays and towards the foods and the underperforming health care defensive plays (even utilities for a more medium term play) and of course you need to look at the dollar very closely.

Emerging markets are undergoing quite a rollercoaster but I still think that on any stabilization of the dollar, you can still find value out there in Asia but your timing will be key. Active management will be important, for you will need to seek value rather than follow the dying beta driven rally. With all this currency volatility, gold has again shown its true value as an insurance policy and holding around 8-10% gold in any diversified portfolio at this stage remains a good bet.

Downside risks to the Mauritian stock market

With regard to the Mauritian market, there is not much to say or add beyond the simple fact that with Europe and the euro in trouble, the local stock market is likely to remain under its current zig-zag formation and really go nowhere. The key levels of 1615-1630 on the downside and 1740-1760 on the upside remain valid. Do nothing until those levels are breached one way or another.

As at the 6th of May 2010, the market was engaged in the right shoulder of a potential head and shoulders pattern indicating further downside risk but one must wait for the key levels to be breached in order to place trades. The euro continued to face downward pressure during the first week of May and this is a key danger to the Mauritian market. Should the euro breach 1.18, support only exists at between 1.03-1.08 dollars per euro. These levels could create significant downside risks to the local market with a potential for a 50% retracement from the market high.

The latest revenue growth figures for Sun Resorts (as at time of writing) remain dismal even if you look at continuing operations, growth in credit extended to the private sector remains poor, excess reserves of banks are higher than the minimum required and the treasury bond market continues to see brisk demand in the country, money supply growth looks tame, which points out that bank results will not show the recovery we need to see to justify a much higher move from here. This is why we need to be careful before coming out with those Central Statistics Office forecasts. The market is telling us a very different story so far.

The key here is that revenue growth needs to show signs of improvement before you start to buy again, so right now just hold within the technical bands mentioned above. Office demand also continues to remain poor. For years, I have been writing about how project managers have been underestimating risks and been overly optimistic on valuations despite the fact that rental yields have remained barely attractive versus long term government bonds.

The need to value projects better

Cash flow projections are often overly optimistic, assumptions sometimes even comical and there is a lack of stress testing and scenario analysis. Discount rates used (the inverse of the cap rate) do not always reflect the risk premium on top of long term Government bonds as well and nor are they adjusted enough in different economic conditions.

You would be surprised to know that there are many project managers out there who do not know how to calculate the weighted average cost of capital. This phenomenon is not only existent in the speculative commercial property market, but if you just look at what Naïade Resorts, a public company, has done over the years, it becomes even clearer. The management team has done a poor job and the global slowdown is no excuse.

The problem with many investors in Mauritius is that we always buy into the story too easily and then end up getting killed. Now when it comes to commercial real estate, things will eventually improve but I do believe that people need to understand how to value projects better and incorporate risks into their cash flow projections and into the discount rate used better. This will make for a healthier market.

When it comes to the fund managers who invest in local stocks, they simply need to understand that you cannot allocate more than 60% of your portfolio in local stocks; this is not a liquid and diversified US type market where such things can be done. We also need a proper secondary bond market because we do need a higher local fixed income component in many of those diversified portfolios. Investors also need to do their homework better.

You have so many brokers in Mauritius who now also directly or indirectly manage the wealth of high net worth individuals by investing in stocks. The problem is that brokers gain from a higher trading frequency, which may not always be in their interest. You need to ask the right questions to your money managers and move towards institutions that offer you greater transparency and provide you with the performance to back it.

To my knowledge, only one local asset management company provides you with so many fact sheets on their website from local to foreign, and they even include a quarterly newsletter to tell you what they are doing right and wrong. That is indeed rare in Mauritius. In turn, local institutions need to strengthen their investment teams and become more quantitative rather than overly qualitative when it comes to analysis, portfolio optimization and management.

Productivity and wage growth must converge

Regulations on their part need to be strengthened especially when it comes to the need for mutual funds to have appropriate benchmarks and to respect those in spirit and content. The new government needs to give more independence to the Bank of Mauritius so that the monetary policy transmission mechanism gets strengthened and money markets function properly. Just take a look at the interbank rate versus the lower band of the Repo corridor and you will understand that we are a long way off from creating a healthy money market and eventually a healthy secondary bond market with adequate volume that will allow money managers to diversify away from just holding local equities for the most part.

Finally, with the expectations that various revenue generating schemes such as the National Residential Property Tax and tax on interest will be rolled back, the increasingly left leaning government with a new Finance Minister at its helm must clearly explain how they will make up for the revenue shortfall. The market awaits their answers at a time where profligate Governments across the globe are paying the price of unsustainable fiscal positions.

We need not undo the fiscal gains made in the past and we need to continue to engage in strong labour reforms and check wages while at the same time reforming the central bank so that it can achieve low inflation over a two year period (to lower those wage compensation pressures). The savings rate has not fallen because of the tax on interest rates whereas its removal may stimulate things.

Will this more left leaning government continue to have the support of the Monetary Policy Committee to lower the cost of debt to finance those electoral promises and to please certain lobby groups? We cannot sustain wage growth above our dismal productivity growth record forever, we need to continue to reform and improve productivity on one hand and cool wage growth on the other so that both productivity and wage growth converge.

Real interest rates were negative during the 2005-2008 period. We do not need negative real interest rates to force people to consume more and embellish growth figures that are unsustainable. We need to remain responsible, for we risk undoing all the good that has been done while accentuating the bad.

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

In crisis do the right thing

By Christopher Tan

We know what clients need is only the average returns of the market or their portfolio. There is no need to take the risk of being wrong by guessing where markets are headed. True, we should have a view of where the market is heading. But there is a need to differentiate between views and actions. Views simply prepare you for the ride ahead. But it does not mean you need to stop moving or change your course of action all the time, especially if you know that a wrong view may derail your plans.

We know that three of the worst things to do in investing are: (1) Selling in a falling market and buying in a rising market, (2) Trying to guess when to sell and when to buy because most people (including experts) get it wrong most of the time and (3) Knowing the above two yet still go ahead to do it because of fear and greed.

Actually, both the clients and their advisers know the first two investment mistakes. However, it is really only the advisers who can hold the clients tightly and prevent them from committing the third. But which is easier? To give in to the client's fears to sell and join in the market's panicked selling, leverage on client's greed and buy when the market is euphoric? Or plead with the clients to hold on tight and keep their eyes on the goal and not succumb to their fear and greed at the risk of incurring their wrath?

We know the former is easier than the latter but the advisers' responsibility is to do the difficult thing because clients did not engage advisers to give them what they want but to tell them what is best for them. Moving our portfolios to cash would have been much easier, we will look smarter in front of clients, retain them and will not suffer a large drop in revenue. But we will be saving our own skin at the expense of our clients' financial future. That is why we refused to do it.

In this industry that is so compensation driven, it is already very difficult to do the right thing during good times, let alone bad times. But it is in a crisis that correct decisions are needed even more. It is a true test for investors, and especially for advisers.

In Dr. Spencer Johnson's latest book "Peaks and Valleys", he said: *"Peaks and valleys are connected. The errors you make in today's good times create tomorrow's bad times. The wise things you do in today's bad times create tomorrow's good times."*

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L'impasse européenne

Par Jacques Garello

Tournant historique, Victoire de l'union, Solidarité européenne : l'accord financier intervenu entre les chefs d'Etat des Vingt Sept a été salué comme une avancée décisive dans la construction d'une nouvelle Europe. Je ne suis pas un fanatique de cette construction, mes préférences sont toujours allées vers une Europe espace, une Europe sans frontière, plutôt que vers une Europe puissance, un Etat centralisé et dirigiste. Mais je crois que les constructivistes se font beaucoup d'illusions, car ledit accord financier va déboucher sans doute sur une double impasse : économique et politique.

Du point de vue économique, que vient-il de se passer ? Les Européens ont mis en place un système destiné à sauver l'euro, et à éviter la faillite de quelques pays de l'Euroland. Il s'agit d'une promesse de coopération monétaire, dont l'histoire nous apprend qu'elle ne peut être tenue à plus ou moins long terme.

En 1873 les pays de l'Union Latine (France, Italie, Espagne, Suisse, Belgique) avaient voulu sauver le bimétallisme (à cette époque l'usage simultané d'or et d'argent comme métaux de référence ne résistait plus aux variations de la valeur marchande respective des deux métaux). Quelques années plus tard, c'était l'échec total et l'argent sera définitivement démonétisé (sauf aux Etats-Unis).

Entre les deux guerres, au lieu de retourner à l'étalon-or, un nouvel accord international (Gênes 1922) créait le système d'étalon change-or (gold exchange standard) fondé sur une fiction : la devise-or vaut l'or. Certains pays étaient autorisés à définir leur monnaie par une parité fixe à l'une des devises-or (la livre sterling, le franc français et le dollar américain). Mais les piliers du régime se sont effondrés ; la France, l'Angleterre et les Etats-Unis ont dévalué leurs monnaies qui auraient dû rester « fixes ».

Le scénario se reproduit en 1945 avec les accords de Bretton Woods qui créent le Fonds Monétaire International en même temps que le système de gold exchange se fonde sur le dollar, seule monnaie rattachée à l'or par une parité fixe (35 dollars l'once).

Hélas le dollar va à son tour s'effondrer et avec lui en août 1971 le système entier, tournant définitivement la page des changes fixes et de la coopération internationale pour ouvrir celle des changes variables et de la concurrence monétaire.

Les Européens, toujours réticents à l'égard des marchés des changes, ont essayé de se donner un système de coopération en créant successivement le système monétaire européen (avec le serpent), puis l'écu (*European Currency Unit*) qui perdra toute signification après les dévaluations du franc français dues au tandem Mauroy-Delors.

Les accords de coopération monétaire ont toujours échoué

L'euro a été conçu suivant un principe nouveau : les monnaies nationales disparaissent, et une monnaie unique est confiée à une Banque Centrale Européenne indépendante des pouvoirs politiques, tant nationaux qu'européens. Aujourd'hui, l'euro est dans la tourmente, et pour en sortir les Européens prennent deux dispositions : d'un côté ils violent l'indépendance de la BCE et l'obligent à émettre de la monnaie fondée sur des créances plus que douteuses, accumulant ainsi tous les germes inflationnistes, d'un autre côté, ils créent un Fonds Monétaire Européen sur le modèle du FMI, par apport de capitaux dont on se demande d'où ils viendront puisque les principaux « sauveteurs », mise à part l'Allemagne, sont eux-mêmes menacés de noyade.

Pour conclure sur ce point, les accords de coopération monétaire ont toujours échoué parce qu'ils sont passés entre Etats qui sont unanimes quand il n'y a aucun problème, mais se séparent et reprennent leur souveraineté nationale dès que cela les arrange.

L'impasse politique est tout aussi certaine que l'impasse économique. Car il y a la façade, faite des déclarations apaisantes voire enthousiastes des dirigeants politiques, et la réalité, qui est celle de très profondes dissensions entre les Etats. Elles ont été étouffées le temps d'un dimanche, mais n'ont pas fondamentalement disparu.

La plus visible est celle entre l'Allemagne et la France, dissension entre l'Europe de la rigueur budgétaire et monétaire et celle du laisser aller généralisé. L'amicale pression de Nicolas Sarkozy et Barak Obama sur la Chancelière n'a pas manqué de piquant, puisque Etats-Unis et France ont été les chantres des déficits budgétaires massifs pour financer le « stimulus » de la « relance », et qu'ils implorent maintenant la fourmi allemande d'écouter le chant des cigales.

Mais Angela Merkel a déjà payé la facture, ses électeurs hostiles au sauvetage de l'euro ont fait basculer la majorité du Bundesrat, et l'alliance avec les libéraux est très menacée. Les Britanniques se sont retirés du jeu. Au sein de l'Union la fracture entre Euroland et les autres est toujours très visible.

Au sein même de l'Euroland, les pays du Nord ne sont pas heureux de voir leur équilibre économique menacé par le laxisme des pays du « Club Med ». Il est vrai que la France a une place privilégiée : moins laxiste que la Grèce, mais moins vertueuse que l'Allemagne, la France peut contribuer aux 750 milliards d'euros constituant le Fonds Européen en se disant qu'elle ne manquera pas d'en bénéficier bientôt.

Je ne voudrais pas conclure sur ces pronostics négatifs et pessimistes. Il y a quelque chose de bon dans ce qui vient de se passer. La preuve est faite que la construction d'une Europe politiquement unifiée est un danger, mais aussi une illusion. Il n'y a désormais que deux issues : ou la fuite en avant et la pire des crises que les pays européens auraient connue depuis cinquante ans, ou bien le retour à la discipline budgétaire et monétaire dans chaque pays, le recul de l'Etat au niveau national et l'abandon de la chimère d'un Etat européen.

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The unfinished business of economic reforms

By Akilesh Roopun (Cont from Pg 1)

The emphasis on substituting fossil fuels for renewable sources of energy which are available locally is a step in that direction. Policies to increase local food production and recent inroads in milk production are in line with this approach, but need to be beefed up. At the same time, export industries must be encouraged to increase the local value addition of their products and services.

Sound public finances are key to macroeconomic stability and an essential prerequisite to build cushion in anticipation to future shocks. The Alliance de l'Avenir government has constructed its electoral economic manifesto under the premises of economic recovery prospects. All policies will have to stand on their own, without, in principle, any support from the stimulus package beyond 2010. But the uncertain climate in Europe can complicate things.

At a time when government may have been contemplating to claw back the fiscal stimulus package introduced at the height of the global crisis, it could be forced to expand such package, particularly in terms of providing assistance to vulnerable export industries, in a bid to stave off unemployment.

The elimination of the National Residential Property Tax and the tax on savings will not impact too much the revenue streams of government. Even though the value added tax rate will remain unchanged at 15 percent, the new government will in the next couple of years attempt to increase its VAT-based income by adopting pro-inflation policies. Higher consumer prices will generate more money in the government coffers without raising the tax rate.

The new government will be even more tempted to finance its deficit through inflation as import duties are bound to come down both in line with international trade commitments and also in view of making Mauritius a duty-free island, something the new Finance Minister, Pravind Jugnauth, will very likely push through in the Cabinet.

The need for a multi-pronged policy strategy

Government will have to keep fiscal consolidation on track and reduce public debt as a percentage of gross domestic product over time. They are relying on economic recovery to boost fiscal revenues. According to the International Monetary Fund forecasts released in February 2010, the budget deficit for 2010 will be 4.5 percent of GDP. The deficit is expected to fall to below 4 percent in 2011 and about 3 percent of GDP in 2013.

This estimate is on the assumption that a substantial part of the fiscal stimulus package consist of bringing forward public infrastructure investment projects: these can be delayed if the economy seems to be overheating, In any case, the full programme is unlikely to be implemented. The new social spending plans, on low-cost housing for instance, may cause a higher deficit. The 3 percent deficit target may therefore not be reached in 2013. For the sake of clarity in economic orientation, Mr Jugnauth should present a kind of a 'transition Budget' shortly even if policies are more likely to remain unchanged. In a nutshell, unlocking the potential of the economy can be addressed through a multi-pronged policy strategy involving the following course of action: a continuation of sound fiscal and monetary policies; building on the comparative advantages of the Mauritian economy and developing new high-value added sectors through the stimulation of centres of excellence while reducing dependency on sectors at risk; making progress towards 'formalising' the informal economy; fostering entrepreneurship and assisting small and medium enterprises to move to higher level of productive capacity; reducing dependency on imported fuel and commodities, and assisting the development of green industries and new high-value export opportunities in these sectors; human resource development to match job creation in the new sectors of the economy; shifting the emphasis from welfare assistance to ensuring that everybody will have the right skills and tools to take control and assume responsibility for their own destiny.

In order to facilitate the achievement of these objectives, it would be necessary to continue to increase the flexibility of labour market, improve the skills of the labour force and, more generally, stimulate private entrepreneurship.

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