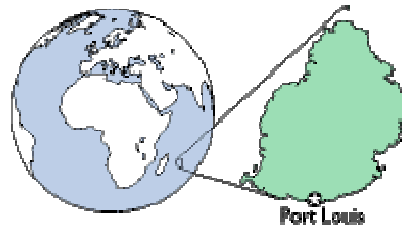


COUNTRY REVIEW

Mauritius



16 July 2010

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EULER HERMES COUNTRY RISK GRADE: BB

Country Risk Grades are on a scale of AA, A, BB, B, C, D
where AA is the lowest and D the highest risk.

Strengths

- Well developed, stable political system with regular peaceful transfers of power
- Sound track record of policy implementation
- Few ethnic/religious tensions despite significant cultural diversity
- Good international relations
- Robust growth of real GDP per head
- Strong inward FDI inflows, actively promoted by the local authorities
- External debt levels and ratios remain comfortable
- Relatively sound banking sector and supportive general business environment

Weaknesses

- Subject to adverse weather conditions (periodic cyclones)
- The small island state is dependent on external trade but vulnerable to external shocks (in terms of exports, from the adverse impact on the clothing sector following expiry of the MFA in January 2005 and from revised EU sugar quotas and, in terms of imports, from high oil prices as an energy consumer)
- Unemployment is high (currently estimated at around 8% of the labour force)
- Fiscal and current account deficits require careful economic management

Key Risks

- A protracted weakness in key EU markets coinciding with a reversal of investment flows (particularly from China and India) would increase deficits

Country Risk Assessment

| Ratings | Mauritius | | Median Grade BB | Bahrain | Peers Israel | India |
|---------------------------------|------------|------------|--------------------|------------|-----------------|------------|
| | Latest | Previous | | | | |
| Systemic Political Risk: | P2+ | P2+ | P2+ | P2- | P2- | P2- |
| Systemic Economic Risk: | E3 | E3 | E3 | E3 | E3 | E4 |
| ME rating: | ME3 | ME3 | ME3 | ME3 | ME3 | ME4 |
| <i>Structure</i> | 4.0 | 3.0 | 4.0 | 5.0 | 1.6 | 4.0 |
| <i>Policy</i> | 3.8 | 4.3 | 4.2 | 5.2 | 3.8 | 5.2 |
| <i>Solvency</i> | 1.0 | 1.9 | 1.3 | 1.9 | 2.8 | 1.9 |
| <i>External Liquidity</i> | 4.9 | 3.8 | 3.3 | 2.8 | 4.3 | 3.6 |
| SBE rating: | SBE2 | SBE2 | SBE2 | SBE2 | SBE2 | SBE4 |
| COUNTRY GRADE: | BB | BB | BB | BB | BB | B |

Nomenclature:

Political Risk Ratings are on a scale of P1 (lowest risk), P2+, P2-, P3+, P3-, P4 (highest risk).

Economic Risk Ratings are on a scale of E1 (lowest risk), E2, E3, E4, E5, E6 (highest risk).

ME (Macro-Economic) ratings are on a scale of ME1 (lowest risk), ME2, ME3, ME4, ME5, ME6 (highest risk).

The constituent parts of the ME rating are on a scale of 1.0 (best) to 6.0 (worst).

SBE (Structural Business Environment) ratings are on a scale of SBE1 (best), SBE2, SBE3, SBE4, SBE5, SBE6 (worst).

Country Grades are on a scale of AA, A, BB, B, C, D where AA is the lowest and D the highest country risk.

Source: Euler Hermes Country Risk Unit

ECONOMIC STRUCTURE

| Country Profile | |
|------------------------|--------------------------------|
| Capital city: | Port Louis |
| Population: | 1.29 mn (2009) |
| GDP: | USD 8667 mn (2009) |
| Currency: | Rupee (MUR) |
| Form of state: | Republic |
| Head of state: | President Sir Anerood Jugnauth |
| Head of government: | PM Navinchandra Ramgoolam |
| Next elections: | Parliamentary by May 2015 |

| Major Industries (% of GDP at market prices, 2009e) | Global Assumptions | 2010f | 2011f |
|--|----------------------------|--------------|--------------|
| Agriculture 4.0% | World GDP growth (% yr/yr) | 3.3 | 2.9 |
| Manufacturing 19.0% | Inflation (% , average) | 1.2 | 1.4 |
| Construction 7.0% | Oil: Dated Brent (USD/b) | 75.0 | 70.0 |
| Wholesale & retail trade 11.2% | | | |
| Finance 11.6% | | | |

| Main Exports (% of total, 2009) | | Main Imports (% of total, 2009) | |
|---|--|---|-------|
| Textiles 38.0% | | Machinery & transport equipment | 21.0% |
| Sugar 11.0% | | Fuels | 19.0% |
| Fish 11.0% | | | |
| Lead Export Markets (% of total exports, 2008) | | Lead Import Markets (% of total imports, 2008) | |
| UK 25.0% | | India | 23.0% |
| France 12.0% | | France | 11.0% |
| US 7.0% | | South Africa | 9.0% |
| Italy 5.0% | | China | 8.0% |

Basic indicators

| Selected economic indicators | 2007 | 2008 | 2009 | 2010f | 2011f |
|---|-------------|-------------|-------------|--------------|--------------|
| Nominal GDP (USD mn) | 7,521 | 9,326 | 8,668 | 9,460 | 9,848 |
| Population (mn) | 1.27 | 1.28 | 1.29 | 1.30 | 1.31 |
| GDP per capita (USD) | 5,922 | 7,286 | 6,719 | 7,290 | 7,544 |
| Real GDP growth (% yr/yr) | 5.6 | 10.2 | 1.6 | 3.5 | 5.0 |
| Inflation (% , average) | 8.8 | 9.8 | 2.5 | 3.0 | 4.5 |
| Fiscal balance (% of GDP) | -4.0 | -3.1 | -3.0 | -4.7 | -3.8 |
| Current account balance (% of GDP) | -5.8 | -10.5 | -7.8 | -7.7 | -5.6 |
| External debt/GDP (%) | 8.8 | 6.7 | 6.5 | 6.5 | 6.8 |
| External debt/Exports of goods & services (%) | 12.5 | 10.9 | 12.2 | 12.3 | 13.2 |
| Debt-service ratio (%) | 2.9 | 2.8 | 3.2 | 3.0 | 2.9 |
| Foreign exchange reserves (USD mn) | 1,740 | 1,693 | 2,002 | 2,100 | 2,200 |
| Import cover (months) | 3.6 | 2.9 | 4.4 | 4.2 | 4.3 |
| Exchange rate assumption, MUR:USD (av) | 31.3 | 28.5 | 32.0 | 31.5 | 33.0 |
| f: CRU central forecast | | | | | |

Sources: Central Bank, IMF, World Bank, Euler Hermes Country Risk Unit

Political Stability

Mauritius is a **politically stable and mature democracy** that is **characterised by regular peaceful transfers of power and consensus-based policymaking** that has underpinned more rapid economic development than in most of Sub-Saharan Africa. In parliamentary elections held in May 2010, the Labour Party (MLP) led by Navinchandra Ramgoolam won 31 out of 69 seats in the National Assembly and, in conjunction with the Mouvement socialiste militant (MSM) of Pravind Jugnauth and the PMSD, leads a coalition government that directly commands 45 parliamentary seats. The Mouvement militant mauricien (MMM) of Paul Bérénger appears set for five more years in opposition. The effective electoral process further underpinned the country's democratic credentials.

There is a **marked degree of consensus among political parties**. The new coalition under the premiership of Ramgoolam is unlikely to adopt a policy agenda that is significantly different from that evident in recent years, although Jugnauth (who is the son of the state president, Sir Anerood Jugnauth, as well as being a vice PM and finance minister) is expected to focus on increasing investments in areas that will alleviate poverty and improve living standards, including education and infrastructure. Nevertheless, Ramgoolam will oversee **continuation of overall policies that seek to increase competition and promote the private sector** as the engine of future growth.

Social tensions remain limited, despite relatively high unemployment (currently estimated at around 8% of the labour force) and a considerable **ethnic diversity** (68% of the population is of Indian origin and 27% is Creole and in terms of religion 48% is Hindu, 24% Roman Catholic, 17% Muslim and 9% other Christian). Bérénger, who had become premier in October 2003, was the first non-Hindu in that leading position.

The focus of foreign policy is development of trade, investment and other links, firstly with fellow members of regional economic communities, including the Common Market for Eastern and Southern Africa (COMESA) and the Southern African Development Community (SADC) and, secondly, with other major international trading blocs, such as the EU and North America. Business ties with India are significant (partly reflecting the country's geographic location and ethnicity) and growing preferential tax treatment is available to Indian entities registered on the island. Moreover, as elsewhere in Africa, China is becoming a leading trade partner and source of inward investments and sees Mauritius as a focal point for its expansion into the sub-Saharan region. **Given its track record of economic success, the country does not require a borrowing programme with the IMF**, but could rely on financial support from the IFIs and the international community in the event of a crisis.

Economic Stability

The economy—categorised as upper-middle income by the World Bank—has grown more rapidly than most others in the region as a result of **diversification away from dependence on sugar exports** through investment in the **textile, tourism and offshore and domestic financial sectors** from the 1970s onwards. Real GDP growth recorded an annual average 5.6% in the 1992-2001 period and 4.3% in 2002-2009. Indeed, long-term growth of real GDP per head averages around 3.2% per year, which is above the world average. The vibrancy and robustness of the economy has enabled the country to cope with **occasional external shocks** caused, in particular, by adverse weather conditions (Mauritius is particularly **prone to cyclones**) and, as recently, in downturns in the world economy and global trading environment. Even during a period of economic adjustment (2002-06), including determined attempts to diversify away from textiles and clothing and fishing, annual economic growth was 3.3% in real terms.

Real **GDP growth is forecast at 3.5% this year (following only 1.6% in 2009)**, partly reflecting private sector and government expenditure on tourism and general infrastructure and on telecommunications and IT. The traditional sectors of fishing, sugar and textiles and clothing are undergoing **rationalisation and refocusing on niche markets** but should add to the output gains from stronger sectors, such as tourism and finance. Partly as a result of tightness in the textile/clothing sector as low-cost producers in China, in particular, erode the competitiveness of domestic output and also the EU's decision mid-2006 to reduce sugar prices paid to African, Caribbean and Pacific (ACP) states, Mauritius has actively sought to diversify its economy. Economic management has yet again proved to be effective, aided by a measure of political consensus, and the outlook is favourable, with annual real GDP **growth likely to return to around 5% in 2011**, even if global uncertainties persist.

Nevertheless, there are some **structural rigidities** to be overcome if the economy is to remain dynamic. Although there is spare capacity—**unemployment is around 8% of the labour force**—worker immobility caused by skill mismatches and wage rigidities constrain prospects. It is difficult to reduce wage costs in the Export Processing Zones to levels that would enable clothing producers to compete with countries such as China. This has underpinned the government's desire for economic diversification into other areas, including tourism and financial services. However, in terms of **re-education towards a service-based economy**, corrective policies take several years to work through the system. Partly in response, the authorities are investing heavily in education and information and communications technology (ICT), particularly in its promotion of the country's Cybercity. A key part of overall policy is to enable the economy to act as **a regional centre for ICT**.

Monetary policy is focused on price stability, although **inflation targets are not announced publicly**. Inflation is strongly influenced by food and energy prices and therefore by prevailing weather conditions and agricultural output and by the costs of imported fuels. The food component in the overall consumer price index is 30%. Recent high international oil prices had a large impact on inflationary pressures and **annual average inflation was 8.8% and 9.8% in 2007 and 2008, respectively, but fell back to average around 2.5% in H1 2010**, reflecting weaker economic activity and subdued commodity prices. Exchange rate policy is non-interventionist, although the authorities are willing to intervene to smooth out ST volatilities in the FX market. Given the large deficit on the current account, the rupee is likely to depreciate against the USD in 2010-11, averaging MUR33:USD1 in 2011, compared with MUR28.5 in 2008.

The current account was in surplus from 2001 to 2003 but deficits since then reflect strong import growth. With oil prices forecast to ease but remain relatively high and limited potential growth in exports of manufactured goods (clothing) and sugar, the **current account balance is forecast to remain in large deficit, registering shortfalls equivalent to 7.7% and 5.6% of GDP in 2010 and 2011, respectively**. However, strong capital inflows will keep FX reserves at levels such that import cover will remain over four months. Other external liquidity indicators are relatively sound. Total external debt is currently equivalent to around 7% of GDP and 13% of export earnings, while the debt service ratio at only 3% of export earnings remains comfortable.

Structural Business Environment

The structural **business environment is sound and generally above the average** of the countries we assess. Indeed, a feature of the economy is its **well-developed commercial and legal infrastructure**, set against a stable political background and tradition of entrepreneurship. Mauritius generally ranks highly in international surveys of business and/or social development. For example, the Heritage Foundation's 2010 Index of Economic Freedom (IEF)—a proxy for the level of openness of an economy—categorises Mauritius as 'mostly free' and ranks it 12 out of 179 states assessed, below Denmark, Chile and the United Kingdom but above Bahrain, Luxembourg and the Netherlands. In the IEF, Mauritius scores above average in all ten areas measured and significantly above average in terms of investment, business regulations and fiscal freedoms and in protection of property rights and avoidance of corruption. According to the World Bank's Doing Business Survey 2010, Mauritius ranks 17 out of 183 countries in terms of overall ease of doing business. Enforcing contracts can take longer than the regional average but the cost of legal action is much lower and fewer procedures are required. Effectiveness of insolvency legislation is much better than the regional average in terms of costs, time and recovery rate, with the latter almost double the regional average. Mauritius is ranked 42 out of 180 countries ranked by Transparency International's Corruption Perception Index 2009, below Taiwan, Oman and South Korea but above Costa Rica, Malta and Bahrain.

The **domestic banking system** scores well in the Heritage Foundation's model and, despite continuing state involvement, is **"open, efficient and competitive"**; a view confirmed by the IMF's financial sector assessment programme, which notes a largely stable system, commitment to Basel guidelines and improving regulatory environment. Capitalisation and profitability in the financial system are generally high and this should cushion against rising NPLs as the economy adjusts under the reform process. Indeed, the **banking system has been largely unscathed by the global financial crisis**. However, the domestic banking sector remains concentrated, with four commercial banks accounting for approximately 70% of total assets. Although the offshore banking sector is relatively large, following the Banking Act of 2004 most distinctions between onshore and offshore have been eliminated.

Charts

