

THE TEPID YEAR ECONOMIC PERSPECTIVES FOR 2023

Prelude

"The end of the low interest rates era..."



As opposed to our 'HOT YEAR' expectations for 2022 at the time of writing last year, at this point of time, we expect the economy to soothe and so a relatively 'TEPID' 2023.

While authorities expect GDP at market prices to surge more than +7.2% this year, we prudently estimate that a +5.8% to +6.1% band may plausibly turn out as a more realistic figure (the IMF's estimates are at +6.1%); especially since the IMF has consistently been downgrading its global economic growth projections since the beginning of the year.

The Russo-Ukrainian conflict, sub-par growth associated with a debt and real estate crisis in China, weaker than expected growth in the US and Eurozone are all being cited as GDP dampening variables. In consequence, while global GDP growth has again been revised downwards to approximately +3.2% for 2022, 2023 projections are weaker at +2.7%.

As expected earlier during the year, the price shocks emanating from global supply chain disruptions have normalized and global commodities prices have weakened by -30% on average. International freight prices, as denoted by the Baltic Dry Freight index,

have weakened -60% since their November 2021 peaks. An easing of the global supply of semiconductors / microchips remains a good indication of the resumed but most importantly, normalized global economic output.

Despite the current strong dollar environment, we expect inflationary pressures to subside in 2023 from the higher mathematical base of 2022 but most importantly resulting from a rapid interest rate tightening to counter inflationary pressures in developed and leading emerging economies.

The tightening, coupled with unsustainably high prices have started to weaken domestic consumption in developed economies (we believe that this is a very short-term impact); which is cyclically good for imported cost push inflationary environment.

Considering the foregoing, Mauritius shall also invariably very likely feel these global pressures with weaker than expected economic growth in 2022. Our 2023 GDP growth, at this stage, is being projected at +5.1%; assuming a stronger recovery of the tourism and accommodation segment as well as sustained infrastructure investments; which are however, likely to abate in 2023 /24.



Revival of tourism likely to lead the economic recovery as travel is expected to surge in 2023.

As of September of 2022, 638,332 tourists had visited the island. This compares favourably and showcases an encouraging +12% growth as opposed to the 570,085 tourists' inflows for the corresponding period in 2019 (pre pandemic); which we expect to be maintained in 2023.

However, as rightly being prudently disclaimed by the IATA, "...inflation and higher interest rates may eventually begin to dampen the pent-up demand for air travel." As at the time of writing however, our discussions with relevant authorities and industry participants and research / monitoring of numerous lagging and leading indicators are pointing to a stronger 2023 / 24 in terms of travel cargo numbers; which shall likely be net-off positive for our local tourism industry and by extension; hopefully for our Rupee.

Earnings remain relatively weaker though

For the first 7 months of the year until July 2022, tourism earnings levelled at Rs 30.4 billion, circa -12% weaker than the Rs 36 billion tourism revenues registered in 2019. Adjusted for the circa -25% devaluation versus the USD since December 2019, our net tourism receipts remain therefore roughly -37% weaker than in 2019 in Rupee adjusted terms (yes, the revival of the profitability levels in the domestic tourism & accommodation industry, in Rupee terms – is misleading from an inflation / foreign currency translation net organic growth perspective).

This partly explains the tighter foreign exchange regime in the country, yet again this year (notwithstanding the fact of the matter that bankers' are naturally tightening the tap, hoarding their precious foreign currencies, and shorting the Rupee further). Unless the IMF recommendations are followed through; the Bank of Mauritius ('BOM') recapitalized and the Rupee stabilization mechanisms effectively reviewed, it is challenging to envision the BOM continuing to intervene to more significant extents (we had estimated a total intervention to clear our backlogs and stabilize the Rupee to the tune of USD 2.7 billion (and increasing) unless foreign exchange inflows improve materially (at this stage. We think they are indeed likely to). To that end, it is equally important for domestic local tourism groups to repatriate their FX held cross border(s).

All market interventions have until now, clearly been extremely 'temporary' in nature (but they did factually help alleviate the 'artificial' tight market, to a certain extent).

Considering the historically high US dollar, its significantly improved carry versus the Rupee (the delay in tightening monetary conditions domestically) and the backlog in the domestic FX

market, the tight FX regime is likely to remain intact until at most H223 (best case).

The above fundamentals signal that Net Revenues per room ('REV/PAR') in the industry still needs to recover and tick higher. Inflationary pressures have indeed been burdening disposable income in our main tourist markets. Most importantly both the psyche and propensity of spending by travellers were affected. *Ceteris Paribus*, it is very likely that REV/PAR numbers (in Rs terms only) actually improve in 2023 (notwithstanding tighter policy rates globally and domestically, weaker economic growth rates coupled with higher-than-average oil & gas prices internationally - resulting from the prolonged and unresolved Russo-Ukrainian conflict and strategically motivated production cuts by OPEC +).

Translated into tourism earnings, we are likely to therefore remain far from the record Rs 64 billion of revenues in 2018. For 2022, we expect a minimum of Rs 53.5 billion worth of revenues; which should slightly improve the domestically tight FX liquidity situation.

1st COVID-19 'Free' Xmas season: A Silver lining

Macau casino numbers have also been improving so far this year after a complicated start to the season with domestic lockdowns in China and international travel numbers (regional Asia Pacific) feeling Europe's geopolitical turmoil.

Forward booking rates for cruises and hotels worldwide seem healthier for year-end (in alignment to the forward booking trends domestically). It is also important, in support of our outlook for the industry, that we consider the fact that this Christmas will be the first true 'free' Christmas after the COVID-19 worldwide restrictions of 2020 / 21.

As of June 2022, Global air passenger demand had recovered + 76.2% year on year ("YOY") while still hanging roughly -18.6% weaker as opposed to pre pandemic levels; which is encouraging.

With China reopening and as Asia Pacific travel recovery gains traction, we expect numbers to sustain their recovering trajectory in 2023, notwithstanding increased US – China geopolitical divergences with regards to Taiwan.

It is important to note that the easing of travel & lockdown restrictions in China (as well as the easing of the previously disrupted global supply chains) are likely to equate to good news for world trade and air cargo volumes in the coming months.

However, the impact of a high inflation and rising interest rates will work against this expected recovery and here we need to closely monitor policy rate developments. Should the tightening be stubbornly aggressive, economic recovery is likely to be derailed; especially if the anticipated price decreases do not translate into a much weaker inflationary environment.



Prudently, a Stronger 2023 for tourism

Our base case for 2022 is slightly weaker than the 968,442 tourist arrivals we were anticipating last year. While still achievable, we believe that at base, tourist arrivals for 2022 shall likely hover around the 904,193 marker; surging past the million-marker post with in excess of Rs 60 billion of revenues hopefully in 2023.

From roughly 3.8% contribution to domestic GDP 2022, we expect GVA contribution of accommodation & tourism to have exceeded 11.25% in 2023.

Here we prudently assume a strong recovery from traditional European markets but most importantly, from China, India and Russia.

The Mauritius Financial services industry to deal with the normalization of rates & a worrying risk of Moody's junk downgrade

Following the much-anticipated exit of Mauritius from the Financial Action Task Force ('FATF') grey list in October 2021, the Mauritius Financial services industry now faces key fundamental issues; not least the normalization of monetary conditions in the economy and the risks of another sovereign credit rating downgrade (and therefore) pulling the sovereign credit rating of Mauritius further and deeper down into the infamous and catastrophic JUNK category.

As clearly and explicitly explained in numerous publications in 2022, we strongly believe that such a downgrade should be avoided at all costs. The risks of a 'Financial Tsunami' should not be played with; especially given the relatively 'weak' balance sheet of our Central Bank.

This key industry accounts for roughly 12% of GDP with industry growth rates of circa +6% expected in 2022, weakening to +4.1% in 2023. The projected weakening considers the heightened risks with an impending Moody's downgrade (and so higher GBC deposits outflows risks from the country).

'Weakening of institutions' is complicated to resolve in the short term

Alluding to the Moody's downgrade of our country's credit rating; the decision for the downgrade to Baa3 (stable) was primarily related to a 'weakening of institutions, amongst which the independence of the judiciary and public institutions, the central bank as well as on account of monetary and fiscal policy mismatches.

Now, while a credit worthiness motivated downgrade (of fiscal nature) can be dealt by showcasing fiscal discipline through a fiscal consolidation plan (and action) (supported by a 'mathematical' recovery of the debt ratios as the GDP recovers more than debt issuance growth); the 'quality of institutions' assessment metric is significantly more 'subjective' as we need to showcase a stronger commitment towards the improvement but especially the unquestionable independence of our country's key institutions.

Improving these institutional metrics as well as the subjective 'perception' is relatively more complicated and less straightforward.

This is where a clear commitment from the country's Executive, showcasing structural, judicial, and macroeconomic reforms shall likely hopefully help, but not only.

Growth in the GBC segment likely to stall

For 2022, we expect Financial and Insurance activities segment to progress by +4% (+4.6% in 2021) with weaker than expected growth in other financials, monetary intermediation and Insurance, reinsurance, and pensions.

As an impending Moody's downgrade loom onto our heads, several institutional funds shall likely place our jurisdiction on increased monitoring and red flags shall be raised as we unreasonably mess with the risks of a non-investment grade rating. To say the least, is worrying.

Hence, new number of funds creation is likely to stall. Risks of fund closures and GBC deposits outflows are real and palpable across the industry.

Furthermore, we should also understand that the tightening of monetary conditions throughout the developed world after years of loose to negative monetary conditions shall invariably result in tighter capital liquidity globally, including our main FDI markets (and so the essence of tightening money supply). In consequence, capital and investment outflows should normally be expected as global interest rates normalization gains traction.

This supports our weaker growth anticipations for the financial services industry in 2022 / 23.

What we most fear is that the leading developed central banks tighten in excess of what is needed; such that a delicate equilibrium between balancing out economic growth, low unemployment, healthy consumption, and the persistently high inflationary environment is hit.

Else, the bankers' risk deepening a recessionary cycle and derail an anaemic economic growth; which may be tricky to deal with.

At this stage, we see the rate hikes as on the right trajectory of 'normalisation' after all these years.

Further considering the global economic deceleration, price smoothening, we think is very likely to materialize in 2023 and so a certain pause of interest rates tightening; which shall clearly be positive as credit defaults risks abate to more reasonable levels. Else, in the case of prolonged and aggressive tightening, we fear these credit defaults gain traction; especially for highly indebted sovereigns and private companies.

The insurance segment to remain stable

The insurance sector typically generates about 19% of the financial services GVA, Rs 10.5 billion in 2020, as opposed to Rs 10.9 billion in 2019. We expect GVA to tilt towards Rs 11.1 billion in 2022, towards Rs 11.3 billion in 2023 / 24 (assuming an improvement of our Moody's credit rating).

Notwithstanding which, the numbers are likely to be weaker in alignment with the cautious outlook for financial services in 2022 / 23.

The general insurance industry continues to be highly motor insurance driven (34.4% of total Gross premiums in the general insurance segment), followed by the Accident & Health (29.3%) and Property & Casualty (13.5%). We expect the accident & health growth momentum experienced by the industry in 2021 to stabilize in 2022 / 23, with the Civil & Crime Liability Insurance and Guarantee segments to maintain positive growth. Life insurance is likely to maintain its growth trajectory in excess of 8% for 2022 while 2023, we expect a slightly +6.8% weaker industry growth. Pensions should remain healthy while the Linked Long-Term Insurance is the one segment in Long Term Insurance showcasing double digits growth numbers (+18% in 2021, +13.5% est. for 2022 and 11.8% in 2023).

Prudent outlook as Moody's risks loom

While the financial & insurance industries have historically been robust and so stable, the risks pertaining to another credit rating downgrade to the JUNK status is major, of great concern and the markets as well as GBC / Banking business activities are likely to price in the same, to a more palpable extent, over the next few months; and so, our prudent but still relatively positive note on the sector.

The Bankers' woes: normalization of interest rates & heightened credit default risks

Our banking sector and monetary outlook for 2022 have so far materialized this year with the normalization of interest rates finally under way.

At the time of writing, the REPO had already been tightened to 3% from a low of 1.85%. It did take recommendations from the IMF, Moody's et al and came absurdly late. We still remain far behind the curve. With GDP growth expected in excess of +6% (+7.2% estimated by the Bank of Mauritius - 'BOM') in 2022 (likely to settle around +5.6%) and a year on year ('YOY') CPI inflation at an uncontrolled 12% as at August 2022, real interest rates remain abnormally negative (and so impoverishment).

We maintain our recommendations that the Key Repo Rate ('KRR') should have already been at the 4.25% levels (pre pandemic as well) and at those KRR levels, the economic recovery shall certainly be tickled but healthy. Going forward and in light of the foregoing, we expect fast and aggressive tightening; plausibly another 75 Basis points, followed by a 50 Basis points hike (total 1.25%) before the end of the first quarter of 2023.

Thereon, weakened global economic growth, relatively weaker inflation numbers should incite the BOM to brake and assess. With this tightening and considering the still reasonable Rupee and Foreign Currency excess liquidity environment, the outlook for the banking sector points towards relatively higher net interest margins, higher non-income-based revenues; albeit amidst a 'slightly' heightened



credit default risk environment pressuring non-performing loans in-dustry numbers higher.

Credit growth to decelerate in 2023

As of August 2022, and in line with the historical low interest rates environment coupled with the MIC risks sterilization in the economy (and restart of economic activities), total credit growth (excluding GBCs) in the economy had surged + 8%. This compares favourably against a credit growth of +4% in 2021 and +2.7% for the corresponding period of the same year.

Of note that the significant improvement in credit growth was reasonably on the back of a higher extension of credit to private households (which now represents circa 38.5% of total credit allocation versus 37.8% in December 2021 and 36.3% in 2020) and more specifically the housing segment (which represents 70% of total private household credit. A clear progression from 66.6% as of December 2020).

We hence denote that the historically low interest rates environment, excess liquidity and heightened confidence has led to a surge in mortgages. This is substantiated by the +13.5% growth in housing credit allocation versus +10% growth in 2021 (+3.9% for the corresponding period in 2021); momentum much higher than the total credit growth to private households of +1.0% as of August 2022. We understand that relatively higher nominal savings resulting from the COVID-19 prudence mood and travel bans, low interest rates and investment opportunities fueled some mortgage refinancing at much lower rates in the economy as well.

Total credit extension likely to cool down in 2023

From these relatively higher mathematical bases of 2022, the global economic slowdown and considering the tighter interest rates environment in 2023, we expect total credit growth to cool off in 2023; hovering around the 6.5% marker; still in excess of GDP growth expectations for 2023.



Notwithstanding which, we expect net interest margins in the banking sector to improve as the excess domestic liquidity environment maintains a relatively competitive cost of funding (and savings / deposit rates) for the industry while the tightening of monetary policy and slightly heightened credit default risks pushes funding costs relatively higher.

GBC deposits to come under pressure as a Moody's downgrade looms over Mauritius

GBC deposits in the banking sector maintained its growth momentum as Mauritius exited the FATF grey list in 2022. As of December 2021, GBC deposits had grown +19.2% to reach circa USD 13.1 billion (Rs 574 billion) from USD 11 Billion (Rs 440 billion) as of December 2021.

These are systemically high levels for our country with GBC deposits representing roughly between 30%-40% of total banking deposits and circa 25% of total banking assets of our banking system (in excess of 110% of our GDP!). Its underlying impact on our balance of payments ('BOP') and international reserves is critical and so any major pressure should be monitored. The time series progression is likely to come under pressure as risks of a Moody's downgrade looms.

We reiterate that while fiscally (mathematically), our sovereign credit rating's outlook may be positive (in our humble view), demonstrating a clear improvement in the quality of our institutions and our macroeconomic policies remain overly subjective and therefore difficult to assess, improve and demonstrate in the very short term. For that we need clear commitments of structural as well as judicial changes in the system by the ruling executive and these, are yet to be seen; hopefully ahead of the next assessment.

Until such time that we remain Baa3; we remain on the 'Junk cliff' and fund managers / administrators are likely to face compliance and therefore heightened risks of outflows. This is a reality. Despite tightening, while a Rupee stabilization is warranted, a clear appreciation is still war afar under this credit downgrade risk econo-sphere. We reiterate that such a downgrade shall likely result in a 'financial tsunami' which Mauritius should avoid; AT ALL COST!

The Tourism pent up demand to cool off agricultural output

The 2021 agricultural output recovery aligned the economy restarting; especially with the uptick coming from a resumption of tourism and accommodation activities. 2021 saw growth in the sector to the tune of +7.1%; which should cool off towards circa +2.25% in 2022 and +1.75% in 2023 (notwithstanding any major climate related constraints).

We the industry continues to 'de-sugar' cultivation areas and monetize land assets on their free cash flow tight balance sheets, we expect production to maintain its downgrade spiral. While we expect total sugar production to hover around 238,000 tonnes in 2022, this number is more likely than not to hover weaker in 2023 with other produce to grow circa +3.2% in 2022 and +2.8% in 2023 (more on account of resumption of tourism activities and less so based on announced budgetary measures towards increasing agricultural output and increased agricultural 'sufficiency' – which from a realistically administrative and operations perspective remains complicated).

We humbly do reiterate that Credit allocation in the banking system should increasingly be focused on other Crops, animal production, hunting & related service activities but also fishing and aquaculture instead of sugarcane (and that the current credit allocation segregation is seemingly unsustainable – in that most (>68%) credit allocation in agriculture is weighted towards sugarcane while the same contribution to GVA is terribly and increasingly marginal).

Challenging 2023 on the horizon for Construction & Real Estate as inflationary constraints wean off amidst an increasingly bubbled up industry

While the construction industry had grown by circa +22.7% in 2021, we expect a flatter 2022 (+0.80%) growth in 2021; with a deceleration plausible in 2023 as the sector bubbles up and as major infrastructure spending decelerates; in a relatively tighter monetary environment.

With global freight prices cooling off in excess of -60% and global commodity prices -29%, we expect a short to medium term peaking of construction prices; a silver lining. Of note that of September 2022, the construction CPI had increased by yet another +9.5% (still weaker than the +12.4% registered in the 2021 calendar year). We expect the already observed momentum decline to gain traction going forward.

While more competitive building costs should be supportive to the entire industry, a lack of new enterprise and job creation, coupled with a tighter interest rate environment is likely to affect growth in 2023.

Total Credit extension to the construction industry has recovered so far this year (+5.3% as of August 2022 versus a slump of -18.1% for the same corresponding period in 2021). Credit extension to residential buildings maintains its downward trend with a decrease of -9.1% (-6% in 2021) while extension to non-residential segment has recovered from a -30% catastrophic decline in 2021 to +12% as of August 2022 (credit extension to hotels, stores, shopping malls, restaurants also recovering year to date ('YTD') by a commendable +24% (-35% for the corresponding period in 2021). The figures also showcase a net positive credit allocation growth of +8.4% for office



buildings (cooling off from the +23% recovery of 2021).

As we head into 2023, we maintain our positive outlook solely on the warehousing building constructions / renovations as our projections of the space need remains positive. On a prudent note, the global economic slowdown is likely to temper with the outlook and the entire industry shall again be overly dependent on central government financed infrastructure spending and budgetary incentives. Industry players are to monitor a certain tightening of credit extension (especially to space construction); going forward.

Net rental yields in Mauritius to remain under pressure

Total credit extension to real estate as opposed to a +25% recovery in 2021 and a +26.4% growth as of August 2021 had decelerated -13.2% in 2022 (and this despite the increase in mortgages). With inflation at +12% in September 2022, one can easily understand the challenging environment from an inflation adjusted net real yield perspective in the Real Estate Segment. We remain negative on office real estate and maintain our stable outlook for the residential and foreign sales (villas) driven real estate activities; especially in a context wherein we understand that a massive bubble continues to be fuelled in the office real estate segment. A number of empty buildings in Ebène and sub-par occupancy rates in Port Louis clearly demonstrates the same and is increasingly worrying.

On the high-end luxury villa segment, we note that vacancies and a sharp drop of resales are raising eyebrows. We understand that the 'high' prices practiced in our earlier 'IRS' years have rendered the 'high' resales market even more complex where a number of high-end investors have started to exit at an inflation and costs adjusted weaker NET sales price. With the Rupee's devaluation significantly dampening these initial investors' returns, certain mid to high end Phase - II & III, development. phases are increasingly being put

on hold (some developments being stalled, are further pressuring prices in certain gated communities turning more and more into 'ghost towns' and this is clearly worrying for the sector, as a whole).

The banking industry's entire credit (and collateral) allocation to office / smart city - construction and real estate is increasingly worrying and in our humble opinion an overweight which should be rebalanced. The budgetary impetus for residential real estate is supportive but to what extent; considering that more than 82% of the domestic population are already at least '1 house' owners. Actual commissioning and construction of mass market cheap residential housing is likely to gain traction and should be expedited by the executive; especially as the tighter interest rate environment

In light of the above, we remain prudent on the sector in 2023 and even 2024. We believe that Mauritius is undergoing a cyclical change in its real estate segment; which is likely to impact other ancillary sectors in 2023 and beyond.

Postlude

The normalization of rates in the global economy globally, after more than a decade of low to negative interest rates and sustaining economic recovery shall be the key considerations, in 2023.

Domestically, we expect a tepid and increasingly economic era starting to fold.

ANNEAU

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