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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 19/28-2

10:03 a.m., April 22, 2019

2. Mauritius—2019 Article IV Consultation

Documents: SM/19/75 and Correction 1; and Correction 2; and Supplement 1; SM/19/76

Staff: Qureshi, AFR, Fletcher, SPR

Length: 34 minutes

Executive Board Attendance

T. Zhang, Acting Chair

Executive Directors	Alternate Executive Directors
	I. Mannathoko (AE)
M. Raghani (AF)	
	E. Rojas Ulo (AG), Temporary
	G. Johnston (AP)
	P. Fachada (BR)
	P. Sun (CC)
	A. Arevalo Arroyo (CE), Temporary
L. Levonian (CO)	
	S. Benk (EC)
	A. Castets (FF)
S. Meyer (GR)	
	M. Siriwardana (IN)
	M. Psalidopoulos (IT)
	H. Mori (JA), Temporary
	M. Saadaoui (MD), Temporary
	M. Merhi (MI), Temporary
	R. Doornbosch (NE)
	K. Karjanlahti (NO), Temporary
	L. Palei (RU)
	F. Rawah (SA), Temporary
J. Agung (ST)	
P. Inderbinen (SZ)	
	S. Vitvitsky (US), Temporary

G. Tsibouris, Acting Secretary
P. Cirillo, Summing Up Officer
B. Zhao / E. Mannefred, Board Operations Officers
M. McKenzie, Verbatim Reporting Officer

Also Present
African Department: S. Dhungana, L. Erickson, R. Gupta, S. Issoufou, P. N'Diaye, D. Owen, M. Qureshi, D. Robinson, A. Selassie. Asia and Pacific Department: N. Feyzioglu. Legal Department: K. Kao. Executive Director: G. Lopetegui (AG), J. Mojarrad (MD), N. Ray (AP), A. Tombini (BR). Alternate Executive Director: K. Merk (GR), P. Moreno (CE), H. Razafindramanana (AF), J. Sigurgeirsson (NO), F. Sylla (AF), P. Trabinski (SZ). Senior Advisors to Executive Directors: Z. Abenoja (ST), M. Choueiri (MI), Y. Danenov (SZ),

Y.Liu (CC), Z.Mohammed (BR), O. Odonye (AE), T. Ozaki (JA), J. Shin (AP). Advisors to Executive Directors: E. Amor (AP), E. Boukpessi (AF), S. Buetzer (GR), K. Carvalho da Silveira (AF), S. David (AP), Z. Huang (CC), B. Jappah (AE), M. Josic (NE), G. Khurelbaatar (AP), G. Kim (AP), M. Sylvester (CO), L. Van Hoek (FF).

2. MAURITIUS—2019 ARTICLE IV CONSULTATION

Mr. Raghani, Mr. Nguema-Affane and Mr. Carvalho da Silveira submitted the following statement:

On behalf of the Mauritian authorities, we would like to thank Management and staff for the candid and constructive dialogue and invaluable technical assistance which have contributed to strengthen the authorities' policy framework and preserve macroeconomic stability and steady growth over the years. The authorities welcome the staff report which provides a balanced assessment of the macroeconomic situation, including progress achieved to date as well as challenges and policy priorities. They also found the focus of the Selected Issues paper on savings, the financial conditions index, and structural transformation in Mauritius to be particularly relevant and informative.

Mauritius has embarked on an ambitious journey of structural transformation of the economy in the context of their Mauritius Vision 2030. The vision aims to boost long-term inclusive growth and ultimately reach the high-income status by 2030 by updating the country's business model, which over the past decade focused on tourism and financial services and enabled to position Mauritius as a highly attractive and competitive touristic destination and financial hub. The new model seeks to strengthen the island's global competitiveness and develop its innovation capacity, building on the country's attractive traits including its political stability and strategic location between Africa and Asia.

The strategy underpinning this model revolves around three pillars: (i) economic diversification into high-value added services, (ii) public investment in urban and transport infrastructure, and (iii) promotion of private investment notably in new growth sectors such as ICT and the maritime or blue economy. This strategy should strengthen Mauritius' destination for FDI, enhance its position as a financial center, and improve its position as regional logistics and transport hub. The authorities remain determined to pursue these objectives while maintaining macroeconomic stability. In implementing the strategy, the authorities will manage no efforts to address key structural bottlenecks, including the aging population, skills mismatch and declining productivity.

Recent Developments and Outlook

The Mauritian economy continues to perform well, with real GDP growth estimated at around 3.8 percent in 2017 and 2018, driven mainly by tourism, construction, Information Technology and financial services sectors. The expansion in these sectors has led the unemployment to reach its lowest rate in a decade at about 6.9 percent in 2018. Inflation has fallen to 3.2 percent in 2018. Although the current account deficit widened in 2018 due to higher oil prices but large capital inflows kept the overall balance of payment (BOP) in surplus. Foreign exchange reserves increased from 8.2 months of imports in 2017 to 9.3 months in 2018. Fiscal policy in 2018 has been prudent and the deficit continued to decline despite a shortfall in non-tax revenues and external grants. Public debt decreased to 63.7 percent of GDP, still above the statutory 60-percent target, but is sustainable as underscored in the Debt Sustainability Analysis (DSA). Credit to the private sector continued to grow in 2018 and the banking sector remains sound.

Mauritius' economic outlook is positive. Real GDP growth is projected to remain strong at around 4.0 percent in the medium-term underpinned by a favorable performance in service sector. In the near-term, the materialization of key infrastructure projects will also support economic activity. Inflation is expected to decline further to 2.1 percent in 2019 and would remain relatively low in the medium term. As staff rightly noted, risks to the outlook could stem from domestic and external factors most notably (i) disruptions to the off-shore global business due to the expiration of tax treaty with India; (ii) tightening of global financial conditions; and (iii) rising protectionism. However, the Mauritian authorities are of the view that actions implemented to encourage greater female labor force participation, youth skill and small-scale entrepreneurs, could potentially surprise growth on the upside.

Policies Priorities for 2019 and the Medium-Term

Ensuring Fiscal Sustainability and Sound Fiscal Management

The authorities remain committed to fiscal and debt sustainability consistent with the country's fiscal rule. They agree with staff that given the debt vulnerability to macro-fiscal shocks in the medium-term, putting debt on a downward path in the medium-term will be important to maintain macroeconomic stability and help the country absorb shocks. They acknowledge that, under the current expansionary fiscal stance in FY2018/19 driven by higher public investment, the statutory public debt target of 60 percent of GDP will not be met by FY2020/21 as initially envisaged. The authorities are determined to meet the debt target but are considering extending the deadline by two years to allow a smoother fiscal adjustment in the near-term while carrying out their infrastructure projects. It is worth stressing that with regards to the aircrafts, no decision has so far been taken. However, Air Mauritius' favored option is leasing as it would not impact public sector debt.

Fiscal consolidation efforts will focus on both additional revenue-enhancing and expenditures-controlling measures but will need to be considered in view of the political cycle. In the Budget Circular issued in March 2019, it has been clearly stated that the 2019-2020 Budget would be formulated on the basis of the following four fundamental principles: (i) use the limited resources judiciously by right prioritizing of investment projects; (ii) eliminate wastage and unproductive expenditure in the public sector; (iii) ensure buoyancy in revenue collection; and (iv) adhere to the golden rule in public finance, that is, borrowing only to finance quality investment. Attention will also be paid to protecting the safety net for the most vulnerable.

Fiscal reforms are being implemented to enhance fiscal transparency and public investment management and help preserve fiscal and debt sustainability. In particular, the International Public Sector Accounting Standards (IPSAS) are currently being implemented, under the oversight of the newly created Ministry of Finance committee and several other project monitoring and coordinating commissions were created to support public investment efficiency. Steps are also underway to implement the remaining recommendations of the 2017 Public Investment Management Assessment (PIMA), including for public procurement process.

Maintaining Monetary Stability

The authorities concur that the current accommodative monetary policy stance continues to be appropriate considering subdued inflationary pressures. Bank of Mauritius (BOM) has made noteworthy efforts to improve the operational efficiency of its monetary policy. Through open market operations to address excess liquidity, the gap between the Key Repo Rate (KRR) and the money market rates narrowed. They will continue to monitor developments in both money market rates before formalizing the choice of the operational target. While efforts to mop up excess liquidity will continue, the high and increased cost associated with conducting monetary operations is a source of concern for BOM, as it has a serious bearing on the Bank's already thin balance sheet. At times, this limits the Bank from further mopping up the excess liquidity. They request the support of the Fund in the drafting of a cost-sharing agreement with MOFED to lessen the financial burden on BOM. In addition, BOM has requested the IMF's TA on asset and liability management, including reserve management to help support the high costs of absorbing liquidity.

The authorities are aware of the benefits that the establishment of a formal medium-term inflation target carry. Consideration will be given to this issue when the BOM finalizes its revised monetary policy framework.

Regaining External Competitiveness

The authorities share staff's concerns on external competitiveness and are aware that there is significant room for improvement. In this connection, measures are being taken to boost trade and investments. For instance, new bilateral and multilateral free trade agreements are being negotiated and new paths of economic diplomacy with the African States are being developed under the Government's Africa Strategy. The authorities also recognize the need to address the skill mismatch and promote innovation. Beside the focus on education and vocational systems, new tech-related courses are being introduced, the smart-city scheme is advancing and initiatives to facilitate access to finance, particularly for Small and Medium Enterprises (SMEs) were launched. Reflection is also ongoing on ways to further bolster female workforce participation. The authorities are confident that these measures, undertaken on several fronts, together with better coordination and monitoring will generate growth dividends in the coming years.

Strengthening Financial Stability and Integrity

Pursuing the strengthening of the AML/CFT framework ranks high in the authorities' policy priorities. At the recent Eastern and Southern Africa Anti-Money Laundering Group (ESSAMLG) Task Force Plenary meeting, the Mauritius Follow-up report and application for technical compliance re-ratings were considered by the Review Group. It is to be noted that significant progress has been made to comply, and therefore, Mauritius has been upgraded by ESSAMLG on 12 recommendations. Several AML laws and regulations have been amended, a dedicated unit for AML/CFT supervision was set up, and cooperation is actively ongoing with Financial Services Commission (FSC), Financial Intelligence Unit (FIU), Mauritius Revenue Authorities (MRA), Independent Commission Against Corruption (ICAC) and the Mauritius Police Force (MPF). Additionally, they have already conducted and are conducting more awareness and workshops on the subject across various target markets (The IMF AFRITAC is facilitating a week's training at the FSC on risk-based approach to AML/CFT supervision). Given the importance attached to capacity building, a number of targeted courses offered by the Chartered Institute of Bankers of Scotland are being rolled out to raise the standards of professionalism and conduct in the banking and financial service sector in Mauritius. Going forward, the authorities reiterate their commitment to implement the recommendations of the ESAAMLG report as well as the National Risk Assessment to ensure that Mauritius continues to develop an effective AML/CFT framework aligned with the highest international standards.

Regarding financial supervision, the "Mauritius Deposit Insurance Scheme" (DIS) bill was recently approved by the National Assembly. The BOM has requested technical assistance from the Fund to implement the DIS project.

Mauritius also made great strides in the regulatory landscape for Fintech. Following the publication of the Guidance Note on the "Recognition of Digital Assets as an asset-class for investment" in September 2018, they also established a regulatory framework for the licensing of Custodian Services for digital asset. This framework makes Mauritius the first jurisdiction globally to offer a regulated landscape for the custody of digital assets. Further to this, a Guidance Note on "Securities Token Offering" was also issued in April 2019. Licensees will equally have to comply with the applicable framework for AML/CFT, in line with international best practices.

Compliance with International Tax Initiatives

Compliance with international tax initiatives has improved and will be further strengthened. The latest Organization for Economic Co-operation and Development (OECD) report indicated that Mauritius meets all the international requirements of the Base Erosion and Profit Shifting Project (BEPS) Action 5 and consequently has no harmful tax practices in its tax regime. Notwithstanding these positive developments, the European Union (EU) still considers that further changes are needed to their tax regimes to bring them into line with international standards. Although they expressed their unease over the lack of coordination between different anti-tax avoidance initiatives, the authorities will continue to work in this area to ensure that the country upholds its adherence to international best practices.

Data Provision

Efforts to strengthen statistics continue. A revision policy on external sector statistics (ESS) has been posted on the Bank’s website early April 2019 when revised 2017 ESS data were disseminated.

Conclusion

The Mauritian authorities recognize the challenges and are mindful of the need to ensure fiscal consolidation to put public debt on a downward trajectory, regain external competitiveness and maintain financial integrity and stability. They are committed to continue to implement their reforms policies to sustain macroeconomic stability and boost long-term inclusive growth. Lastly, the authorities would like to express their appreciation to the Fund for its policy advice and invaluable technical support and look forward to continued cooperation.

Mr. Lopetegui and Mr. Rojas Ulo submitted the following statement:

We thank staff for a clear and candid report and Mr. Raghani, Mr. Nguema-Affane, and Mr. Carvalho da Silveira for their helpful buff statement.

Mauritius’ economy shows a positive and robust pace of growth and the outlook is favorable. The economy has recently achieved a remarkable transformation, led by the services sector, which is the most important contributor to employment. Economic growth is projected to increase by 3.9 percent in 2019 and stabilize at 4.0 percent in the medium term as performance of the construction and services sector remains strong. However, several risks linked to external and domestic shocks remain tilted to the downside.

Preserving a prudent fiscal policy remains import for consolidation, building buffers, and supporting economic growth in the long run. The consolidated fiscal balance is projected to deteriorate due to the expansionary fiscal policy and the fiscal deficit is set to widen from 2.9 percent of GDP in FY2018/19 to 3.0 percent of GDP in FY2019/20. Consequently, the debt target of 60 percent of GDP is likely to be missed, which may result in a loss of credibility for the authorities. Fiscal policies that both increase revenues and rationalize spending are necessary to support fiscal consolidation and keep public debt on a sustainable path. We concur on the need for the implementation of gradual fiscal consolidation which should come from the FY2019/20 budget to reach the debt target and enhance fiscal creditability.

The monetary policy stance has been appropriate, and the inflation rate is contained. The BOM should continue to monitor banking system conditions, improve the operational efficiency of monetary policy and inflation pressures, and stand ready to tighten the monetary stance if inflation pressures materialize. We support staff's recommendation on the modernization of the monetary policy moving toward a more formal framework with a clearly defined medium-term inflation objective to enhance credibility.

Further actions are needed to strengthen financial sector oversight and enhance inclusion. We commend the authorities for their endeavors to improve financial stability and note that the staff report shows that the sector remains liquid and capitalized under Basel III requirements. The authorities should continue monitoring banks and non-bank financial institutions' performance, including non-performing loans, and foster financial inclusion. The FSAP recommendations are to be implemented to consolidate supervision and the establishment of macroprudential authority. We encourage the authorities to continue efforts to implement the ESAAMLG recommendations to improve the effectiveness of the AML/CFT framework.

We support the implementation of structural reforms to improve the business climate and facilitate structural transformation. Mauritius' economy has made considerable progress along different dimensions of the Global Competitiveness Index but still lags in other areas, such as unfavorable productivity and a narrow production base. We concur with staff's recommendation to enhance external competitiveness and strengthen the external position, by improving productivity, labor market efficiency, and diversification. We support the implementation of measures to strengthen coordination of initiatives to enhance the effectiveness of reforms and support the business climate and innovation capacity.

With these comments, we wish Mauritius and its people success in their future endeavors.

Mr. Johnston and Mr. Kikiolo submitted the following statement:

We thank staff for their comprehensive reports and Messers. Raghani, Nguema-Affane and Carvalho da Silveira for the informative buff statement. Mauritius' economic outlook remains favorable and the authorities are working to address risks, including from the offshore global business sector. Nevertheless, macro-financial risks associated with the expiring Indian tax agreement and potential downswings in global financial conditions could affect growth. The authorities are urged to strengthen the supervisory framework, diversify the economy and improve productivity through implementation of structural reforms.

The authorities should be commended for maintaining fiscal prudence and sustaining debt at manageable levels. The smaller than expected fiscal deficit in 2017/18 was in part due to strong budget discipline, countering the underperformance in revenue collection. While we note the missed statutory debt target, we also recognize the tradeoff between faster debt reduction and supporting growth enhancing initiatives. The Mauritius Vision 2030 envisages large public infrastructure investments and other initiatives to boost growth. In this vein, we see the attraction of the gradual fiscal consolidation option that pushes out the debt target to 2022/23. At the same time, we agree with staff that the authorities should mobilize domestic revenue by broadening the tax base while improving spending efficiency through targeted social spending, wage reviews and pension reforms. We see the successful implementation of IPSAS as noted in the buff statement as a positive step in promoting fiscal transparency and we encourage the authorities to implement the remaining recommendations of the 2017 PIMA, including on procurement.

The accommodative monetary policy stance the authorities are undertaking is appropriate given the low inflation environment. While appreciating the Bank of Mauritius' (BOM) open market operations (OMO) to siphon excess liquidity from the banking system, we also note the cost of the OMO to BOM. We see the authorities are asking the Fund to assist with the drafting of the cost sharing agreement with MOFED and with asset and liability management. These are not in the list of capacity development priorities on page 53 but are they areas of TA the Fund can help with?

We welcome the authorities' perseverance to strengthen macroprudential and financial sector oversight. It is encouraging to note that most key FSAP recommendations contained in Annex V have either been fully or partially implemented. Also noteworthy is OECD's conclusion that Mauritius' tax regime contains no harmful features. However, more work is needed to align the AML/CFT framework with international standards. The authorities are encouraged to address the recommendations of the ESAAMLG report as well as the National Risk Assessment. Mauritius' work on Fintech, especially on the regulatory front, is innovative, but the authorities are urged to remain vigilant. Were staff able to evaluate Mauritius' Fintech experience to date and are there useful lessons to apply to other countries?

We encourage the authorities to continue ongoing reform programs to achieve long term inclusive growth. To enhance external competitiveness, we agree with staff that the authorities should implement labor market reforms, invest in infrastructure, and develop value-added sectors. The low female labor force participation rate is concerning and measures to raise this would pay long term dividends. We also see merit in the bilateral and multilateral free trade agreements the authorities are negotiating along with the authorities' Africa Strategy.

Mr. Guerra and Ms. Arevalo Arroyo submitted the following statement:

We thank staff for the comprehensive set of papers and Messrs. Raghani, Nguema-Affane, and Carvalho da Silveira for their helpful buff statement. Mauritius has performed well in the transition to a more service-oriented economy. The current strategy, in the context of the Mauritius Vision 2030, to continue with diversification, boost infrastructure investment and enhance the business climate will need to be put in place supported by fiscal prudence and measures to address structural issues in order to achieve strong and sustainable growth.

On fiscal policy, gradual fiscal consolidation is required to boost credibility of the government's fiscal plan to set public debt firmly in a downward path. We welcome the authorities' efforts to focus both on additional revenue enhancing and on expenditure controlling measures. Also, fiscal reforms to enhance fiscal transparency and the implementation of the International Public Sector Accounting Standards (IPSAS) are steps in the right direction. However, we agree with staff that the gradual fiscal consolidation should begin from the FY2019/20 to enhance fiscal credibility and bring the debt-to-GDP ratio on a declining path.

On monetary policy, we consider that the current stance appears appropriate and that moving toward a more formal inflation-targeting framework could enhance credibility and better anchor inflation expectations. While we agree with staff that efforts to contain excess liquidity should continue, we take note that the increased cost of monetary operations and their impact on the balance sheet of the central bank is a source of concern for Bank of Mauritius.

Efforts to support financial stability and integrity should continue. We welcome that the authorities have adopted several of the outstanding FSAP recommendations and that they will follow in the short term the adoption of the remaining ones. We note the substantial steps taken on AML/CFT recommendations and encourage the authorities to continue their commitment to strengthen the AML/CFT framework in line with FATF standards.

Improving external competitiveness will require additional efforts to improve the business climate, boost productivity and reform the labor market. We welcome the efforts taken by the authorities in this regard. Addressing the skill mismatch and bolstering female labor force participation will be important to reduce the economy's skill gap.

Ms. Mannathoko, Mr. Jappah and Mr. Nakunyada submitted the following statement:

We commend the Mauritian authorities for the country's strong policies and institutions that have delivered steady growth, low inflation, reduced unemployment, and strengthened economic resilience. We note their ambitious growth strategy anchored on significant public investments that should provide further growth impetus going forward. This notwithstanding, the outlook remains vulnerable to rising public debt, loss of competitiveness, and threats to financial integrity and stability. Accordingly, policy efforts should be directed towards fiscal consolidation, as well as accelerating structural and financial sector reforms.

We note the authorities' commitment to fiscal and debt sustainability in line with their fiscal rules and that public debt remains sustainable despite the possibility of missing the 60 percent of GDP public debt target in 2020. In this connection, prudent fiscal policy measures will be needed to meet the debt target going forward, while creating room to accommodate shocks and longer-term costs stemming from a rapidly aging population. Plans to meet the debt target in 2022 are commendable, and in that regard fiscal consolidation will be essential to build fiscal credibility, while preserving debt sustainability. We therefore support the authorities' efforts to intensify domestic revenue mobilization, exercise expenditure restraint, improve fiscal transparency, and enhance public investment management and efficiency. We also urge the authorities to remain vigilant in managing contingent fiscal risks emanating from SOE loans and note the need to preserve priority social and growth-friendly public investment spending. At the same time, we view a more gradual fiscal consolidation path as important to smooth adjustment, allow bridging of critical infrastructure gaps, and sustain strong growth performance.

In the external sector, while the overall balance has weakened over the past two years, it remains in surplus; therefore, staffs' repeated reference to a widening overall external imbalance in paragraphs 2, 18 and 51 requires clarification. The current account is more than adequately financed by surpluses in the capital and financial accounts, including growth-enhancing FDI. We also note, that the widening of the current account deficit is likely to be transitory – reflecting the impact of large intermediate and capital goods imports for mega-infrastructure investments underway. Moreover, the country is projected to continue realizing overall BOP surpluses, accumulate ample reserve buffers and maintain external debt at sustainable levels. In view of the foregoing, could staff clarify their assertion that Mauritius is experiencing widening external sector imbalances? If staff perceive risks to external balance going forward, perhaps these could instead be highlighted; for example, the risk of capital flow reversals, and potential BOP implications amplified by Mauritius' status as a financial hub.

We consider the current monetary policy stance to be appropriate, though adjustments may be required, should inflation risks materialize. The current monetary framework has served the country well, and in this regard, we note the effectiveness of ongoing measures to contain excess liquidity in the banking system. We therefore acknowledge the authorities' reluctance to move immediately to a formal inflation-targeting framework and would support the authorities taking a more gradual and considered approach to any changes to the monetary policy framework.

Reforms to the financial sector regulatory and supervisory framework are important given Mauritius' standing as a global financial services center; and should be advanced to ensure financial stability. To this end, we welcome the significant strides made by the authorities in addressing FSAP recommendations including the implementation of risk-based and consolidated supervision, as well as adoption of some Basel III instruments. Going forward, we encourage the authorities to address outstanding FSAP recommendations, including adoption of the remaining Basel III instruments. We also note the remarkable progress made in complying with international tax avoidance initiatives and in strengthening the AML/CFT framework. Further efforts will be essential to align with international standards to restore the country's status as a globally competitive financial center. Thus, going forward, the authorities should focus on addressing outstanding AML/CFT requirements and improving the integrity and transparency of the financial system in line with recommendations.

Given the importance of regaining external competitiveness, we agree that structural reforms should focus on enhancing productivity, labor market efficiency and economic diversification. In this vein, we welcome the authorities' initiatives to improve their doing business and global competitiveness rankings, as well as measures taken to support SMEs, youth skill development, female labour force participation, and private sector participation. That said, coordination and building of synergies, regular monitoring, and greater awareness across initiatives could be strengthened to enhance effectiveness and efficiency. Further efforts are also required to bridge existing skills mismatches and broaden labor market reforms needed to enhance cost competitiveness; including through the alignment of real wages with productivity. Further attention should also be accorded to the overvalued exchange rate as determined by staff in their external sector assessment.

With these few comments, we wish the Mauritius authorities success with ongoing reforms and in implementing their Vision 2030.

Mr. Benk and Mr. Harvan submitted the following statement:

We thank staff for the comprehensive set of papers, and Mr. Raghani, Mr. Nguema-Affane, and Mr. Carvalho da Silveira for the informative buff statement. Mauritius has made remarkable progress over the past decades with transforming its economy. However, reaching high-income status still requires tackling a few structural bottlenecks, such as diversifying the economy further and moving up the value chain that counterbalances the shortage of labor and the aging population, and speeding up compliance with international anti-tax avoidance initiatives and AML/CFT standards. We broadly agree with staff's assessment and recommendations subject to our specific comments below.

Mauritius' economy is performing well but risks remain in the short and medium term. The economy is expanding at a steady pace, close to potential, driven primarily by domestic demand. Can staff elaborate on the substantial and persistent contribution of statistical discrepancy and negative net exports to GDP? Workforce shortages, the decline in both human capital and physical capital accumulation are weighing on growth, and will moderate growth further unless the economy is able to generate continuously substantial productivity gains to counterbalance this trend. We welcome the selected issues paper on productivity and structural challenges. Overall, we agree with staff's assessment of risks, however, given the role of global business in supporting government revenues we highlight the significance of the impact of possible changes in international taxation regimes on public finances.

Like staff, we see fiscal adjustment necessary to reduce imbalances. The outturn in the last period was broadly in line with the budget, as shortfalls in nontax revenue were counterbalanced by restraints in current spending and delays in public investment. Can staff elaborate on the risk of future revenue shortfalls and its possible adverse impact on capital spending? Putting debt on a downward path and meeting the statutory debt target would increase the credibility of the fiscal framework. Staff's assessment could include the appropriateness of the statutory public debt target of 60 percent of GDP for a small and open economy like Mauritius with an aging population where fiscal risks have not been quantified. While the DSA deems public debt in Mauritius sustainable, vulnerability remains, stemming primarily from changes in the real interest rate and contingent liabilities.

We share staff's recommendations and concerns regarding the financial sector. Given the ESAAMLG findings of deficiencies, we urge the authorities to expeditiously implement the recommendations by the ESAAMLG to strengthen the AML/CFT framework, in particular pertaining to supervision. As Mauritius aims to become a regional fin tech hub the threats from money laundering and terrorism financing will increase. We also strongly encourage the authorities to implement the outstanding FSAP recommendations.

We welcome the steps taken to meet the international anti-tax avoidance initiatives. Significant reforms related to the global business sector were introduced in 2018 in line with OECD anti-tax avoidance initiatives and the authorities have indicated their commitment to address the EU tax transparency initiative by end-2019. Given the adopted and forthcoming changes in the tax code for international business and their role in the economy, we would support expanding the analysis of their impact on public finances in Mauritius as well as key partners. A box in the staff report looks at formal changes related to Global Business Company licenses, however, it remains to be seen to what extent this will affect the business model of these enterprises operating in Mauritius.

Mr. Palei submitted the following statement:

We thank staff for a set of insightful papers and Mr. Raghani, Mr. Nguema-Affane, and Mr. Carvalho da Silveira for their informative buff statement. We broadly concur with the thrust of the staff appraisal and would like to limit our comments to the following points.

The Mauritian economy demonstrates a steady moderate growth rate of about 3.8 percent driven by the construction and services sectors. Mild growth acceleration is a part of the baseline scenario. This positive outlook depends on maintaining sound macroeconomic frameworks and fiscal consolidation. At the same time, a higher economic potential calls for successful implementation of structural reforms.

We agree with staff that fiscal consolidation is among the policy priorities, given the need to strengthen credibility in this area and to set public debt on a declining path in the medium term. We note that the public debt-to-GDP ratio has declined by 1.3 percentage points, reaching the level of 63.7 percent by end-FY2017/18. However, the increased external borrowing by state-owned enterprises associated with their investment plans is likely to raise public debt to the level of 64.9 percent of GDP by end-FY2018/19, and to the level of 67.8 percent by end-FY2020/21. Given the vulnerabilities linked to the public debt level and fiscal accounts more generally, we believe that the authorities have to monitor the effectiveness of the SOE investments and be mindful of statutory public debt limit of 60 percent of GDP.

Inflation remains contained and current monetary stance is broadly appropriate. At the same time, given the economy's high exposure to global risks, the Bank of Mauritius should remain watchful of any emerging inflationary pressures. Given the role of Mauritius as a regional financial hub, with the financial sector of about 12 percent of GDP, one of the key elements of financial sector development should be the implementation of the recommendations by the Eastern and Southern Africa Anti-Money Laundering Group on how to further improve the AML/CFT framework.

The main challenges for the authorities include improving the supply of skilled workers, increasing productivity, and restoring competitiveness in a lasting manner. The authorities' track record of sound policy implementation bodes well for the good outcomes of their reforms.

Mr. Doornbosch and Mr. Josic submitted the following statement:

We thank staff for the excellent set of reports and Messrs. Raghani, Nguema-Affane, and Carvalho da Silveira for their helpful buff statement. We commend the authorities of Mauritius for implementing sound macroeconomic policies over the years that enabled them to achieve a remarkable transformation and for relying on a constructive dialogue and technical assistance from the Fund. This is a clear example of where strong ownership by the authorities and the role of the Fund as a trusted advisor can bring long-lasting benefits. We broadly agree with staff's appraisal and would like to emphasize the following points.

We are somewhat concerned about the delay in fiscal adjustments stipulated in the medium-term fiscal framework. While we take note that public debt is sustainable, we also share staff's view that risks have increased compared to the previous DSA (as evidenced by five upper-bound early warning thresholds that are now being crossed) and that the authorities' public debt targets are unlikely to be met without significant policy adjustments. In addition, potential contingent liabilities stemming from large financial sector and relatively inefficient SOEs, as well as an aging population pose medium-terms risks that require building fiscal buffers now, while the window of opportunity exists. In this context, we share staff's view that more can be done on the revenue mobilization side, particularly with streamlining the tax incentives framework, improving the tax auditing efficiency and increasing excise taxes. On the expenditure side, rationalizing current expenditures and better targeting of subsidies and social assistance through mean-tested solutions could bring further savings.

We commend the authorities for their notable efforts to comply with international anti-tax avoidance initiatives and AML/CFT standards. As a large financial center, Mauritius is prone to potential ML activities. However, preserving this status, crucially depends on its credibility. In this context recent measures to amend the AML law and introduce a risk-based plan of AML/CFT supervision, as emphasized in the buff statement, are welcomed steps. At the same time, further progress is warranted to meet the FATF and ESAAMLG recommendations, particularly on the implementation by reporting entities as well as information-sharing with foreign authorities.

We commend staff for the transparent and comprehensive coverage of the external sector assessment. All the model estimates have been clearly presented and we appreciated the CA gap and REER misalignments being presented in ranges. We see it as a transparent approach, considering structural characteristics and other uncertainties.

We encourage the authorities to make further progress with improving the data quality. This refers to improvements in national account and external sector statistics, as well as moving towards general government accounting. Additional attention could be paid to proper coverage of contingent liabilities stemming from SOEs (as evidenced in OECD 2014 Investment Policy Reviews).

Lastly, we are somewhat surprised about the lack of climate change considerations. The Fund's 2016 policy paper on small states' resilience to natural disasters and climate change has identified Mauritius as one of the three countries with extreme risk of climate change, based on the 2016 Maplecroft exposure index. However, these topics have not been covered in any of the Article IV reports since then. Staff's comments are welcome.

Mr. Mouminah, Mr. Alkhareif and Mr. Rawah submitted the following statement:

We thank staff for the well-focused set of reports and Mr. Raghani, Mr. Nguema-Affane, and Mr. Carvalho da Silveira for their helpful buff statement. We are in broad agreement with staff's analysis and policy recommendations and would limit our remarks to a few issues.

We see merit in pursuing fiscal consolidation. We note that the timeline to meet the public debt target could be extended from FY2020/2021 to FY2022/23 as the authorities plan to undertake major efforts to upgrade infrastructure and boost long-term growth. While public debt is sustainable, the economic outlook is vulnerable to a range of macro-fiscal shocks. Thus, pursuing fiscal consolidation is important, supported by a policy mix of revenue mobilization efforts and spending rationalization. This would help in putting the debt ratio firmly in a downward path and safeguarding fiscal sustainability. Separately, we welcome the authorities' efforts to improve public investment efficiency and look forward to addressing the remaining issues.

We echo staff's view on the importance of better coordination among the initiatives taken to improve external competitiveness. We take positive note of the important progress made in various aspects, including in enhancing labor productivity and business climate, and building innovation capacity, which could help in speeding up structural transformation. Here, well-coordinated initiatives could improve the synergies and the effectiveness of these reforms as rightly noted by staff. On the SIP paper regarding unlocking structural transformation in Mauritius, we concur with staff's recommendation to focus initially on value upgrading in the traditional sectors as a starting point, which could also help in better building infrastructure and technical expertise.

We welcome the progress made to improve AML/CFT framework and look forward to addressing the remaining deficiencies. It is encouraging to note that the progress made in this regard has led to several upgrades pertaining to the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG) recommendations. In this context, it will be important to sustain these efforts to address the remaining deficiencies to help strengthen financial stability and integrity, and possibly avoid potential listing.

Finally, we take positive note that financial soundness indicators point to continued financial sector stability. Indeed, banks are well-capitalized, supported by stress tests using severe scenarios, and NPLs are expected to continue to decline further. Separately, fostering financial inclusion is a step in the right direction and we encourage the authorities to further their efforts in this regard.

With these remarks, we wish the authorities further success.

Mr. de Villeroché, Mr. Meyer, Mr. Castets, Mr. Fragin and Mr. Rozan submitted the following joint statement:

We would like to thank staff for their detailed set of papers, as well as Mr. Raghani, Mr. Nguema-Affane, and Mr. Carvalho da Silveira for their informative buff statement. We broadly share staff analysis and views and wish to offer the following comments.

The outlook appears positive, with growth continuing to strengthen over the medium term, thanks to dynamic construction and services sectors, and productivity enhancing reforms. Mauritius has led a commendable economic transformation over the last few years, achieving upper middle-income status. This being said, several structural challenges weigh on the outlook over the medium term, and particularly the skill mismatch, the aging population as well as external competitiveness.

Over the medium term, fiscal adjustment will be needed to avoid putting pressure on public debt, as we understand that the statutory public debt target is projected to be missed. This being said, the authorities’ extension of the timeline to meet the debt target to FY2022/2023 appears warranted, so as to fund the necessary infrastructures and boost long term growth while protecting safety nets. We share staff assessment as to revenue and expenditure measures that can support this gradual consolidation. Given the under-execution of spending and under-collection of revenues for the last fiscal year, are there concerns by staff on the ability of the authorities to reach their fiscal targets, in terms of public finance management? Finally, we share staff’s recommendations to enhance fiscal transparency and public investment management (given the sizeable infrastructure financing needs) and welcome the authorities’ implementation plan. This will be important, in light of the slight deterioration seen in some institutional quality indicators.

Regarding monetary stability, we share staff assessment that the policy stance appears generally appropriate. Over the medium term, monetary policy targeting should be enhanced to gradually introduce formal inflation targeting, which will help enhance the credibility of the framework.

The rising role of Mauritius has a regional financial center and Fintech innovation hub is noteworthy. The current shift of the geographical focus from

India to Africa should help sustain this position over the medium term. To minimize any risks stemming from the financial activity, and potential spillovers to the real economy, we encourage authorities to resolve outstanding issues in the financial supervisory and regulatory framework, in line with the last FSAP assessment. In addition, while we note that progress has been done to address AML/CFT deficiencies, we encourage authorities to make significant progress in the effectiveness of the regime in line with ESAAMLG recommendations, to avoid being placed on the FATF gray list next October. Finally, we positively note that important steps have been taken to align with international anti-tax avoidance rules, importantly including adherence to the requirements under the Base Erosion and Profit Shifting initiative. However, we understand that the EU has concerns on the new, reformed tax regime, and we would welcome further details as to what these are, as well as authorities' plan to address them.

Finally, external competitiveness has been slipping recently, and it appears substantially weaker than implied by medium term fundamentals. We encourage authorities to implement the adequate reforms, to enhance technological readiness, innovation, enhance infrastructure, enhance skills adequacy and labor market efficiency. This will ensure that higher value products and services are exported. We note that the level of savings has been declining, which can be a concern in the face of a rapidly aging population. We would welcome staff assessment on reforms to be led to ensure that the demographic challenge is appropriately met.

Ms. Levonian, Ms. McKiernan and Mr. Sylvester submitted the following statement:

We thank staff for their well-written and comprehensive reports and Messrs. Raghani, Nguema-Affane, and Carvalho da Silveira for their insightful buff statement.

The Mauritian economy has demonstrated good resilience over many years and is still performing well. Looking ahead, the authorities are facing several risks and challenges in advancing their ambitious goal to reach high-income status by 2030, including from a less benign external environment. We are encouraged that they are taking decisive steps to boost competitiveness and growth, preserve fiscal and debt sustainability, and maintain financial integrity and stability of the financial system. As we broadly concur with the thrust of staff's appraisal and recommendations, we offer the following additional comments for emphasis.

We concur with staff’s recommendation on the need and timing of fiscal adjustment to enhance fiscal credibility, preserve debt sustainability, and reduce external imbalances. While we recommend continued focus on strong debt management and additional revenue mobilization, we can understand the authorities’ view on extending the debt target given their trade-off between a faster debt reduction and growth-supporting investment spending. Accordingly, we are encouraged by the authorities’ commitment to fiscal and debt sustainability consistent with the country’s fiscal rule, as highlighted in the buff. We welcome their efforts to explore options to mobilize domestic revenues as well as to rationalize and improve the efficiency of spending. Reforms to strengthen fiscal management are also welcome.

We welcome the authorities’ focus on implementing policies aimed at boosting growth and competitiveness in the context of their Mauritius Vision 2030 strategy. This strategic approach will build on past successes to further diversify the economy, invest in critical social and economic infrastructure, and promote private sector investments, including in new growth areas, such as ICT and the blue economy. In this context, we welcome continued efforts to improve the business climate, to build innovation capacity, and to address labor market constraints. We particularly urge the authorities to press ahead with addressing the infrastructure bottlenecks and skill mismatches. We also urge them to redouble their efforts to improve female workforce participation to further support inclusive growth.

We urge the authorities to further strengthen financial sector stability and integrity in line with staff’s recommendations. We acknowledge the significant progress made by the authorities in strengthening the financial sector, including to address AML/CFT deficiencies, strengthen financial supervision, and promote fintech development and financial inclusion. That said, much more needs to be done. We urge the authorities to vigorously implement remaining FSAP recommendations, the international anti-tax avoidance initiatives, and the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG) guidance.

Finally, on data provisions, we encourage the authorities to make further progress in strengthening statistical capacity, with Fund technical assistance.

Mr. Agung and Mr. Shaari submitted the following statement:

We thank staff for a concise set of reports, and to Mr. Raghani, Mr. Nguema-Affane and Mr. Carvalho da Silveira for their informative buff statement. We commend the Mauritian authorities for their sound macroeconomic management which has been instrumental in sustaining Mauritius' good economic performance in the recent period. To build on these achievements, successful implementation of measures to preserve macroeconomic stability and to address structural impediments are essential for the Mauritian economy progressing sustainably towards its aspiration to become a high-income country. Given this background, we welcome the authorities' commitment to continue pursuing reform efforts, among other areas, in strengthening the fiscal position, enhancing external competitiveness and boosting economic growth. We agree with the broad thrust of staff's recommendations and would like to offer the following points for emphasis.

Continued efforts to build fiscal buffers, reduce debt and strengthen fiscal management are crucial to attain long term fiscal sustainability. In this regard, we see merit in staff's recommendations for the authorities to pursue gradual fiscal consolidation by implementing measures to enhance domestic revenue and rationalize spending by better targeting social spending and subsidies. These should be complemented with efforts to strengthen fiscal transparency and public investment management which will enhance overall fiscal credibility.

Operation of a strong and credible monetary policy framework will help maintain price stability. We concur with staff's assessment that the current monetary stance is appropriate and authorities should remain vigilant against the emerging inflationary pressures. We also welcome the efforts taken by the Bank of Mauritius to strengthen its liquidity management framework and to improve the overall effectiveness of its monetary policy stance. Besides enhancing liquidity operations, an effective and credible monetary policy framework should be complemented with good policy signaling and communication practices. Thus, we encourage the authorities to continue building institutional capacity towards this end.

Advancing structural reforms is important to raise competitiveness and economic potential. We take positive note of the authorities' ongoing efforts to transform the economy. Given Mauritius' deteriorating external competitiveness, we encourage the authorities to press ahead with steady implementation of various initiatives to enhance productivity, labor market efficiency, and economic diversification. Improved coordination and systematic monitoring of the various reform initiatives will assist to accelerate progress and generate visible results in the transformation journey.

To further strengthened financial sector's stability and integrity, we support the call for the authorities meet the ESAAMLG recommendations on the AML/CFT areas. This should be complemented by efforts to implement the outstanding FSAP recommendations to enhance the supervisory and regulatory framework of the financial sector.

With these remarks, we wish the authorities every success in their future endeavors.

Mr. Inderbinen and Mr. Danenov submitted the following statement:

We thank staff for the valuable set of papers and Mr. Raghani, Mr. Nguema-Affane, and Mr. Carvalho da Silveira for their insightful buff statement. Mauritius' economy continues to grow at a steady pace and the outlook is positive. We take good note of the country's aspiration to become an inclusive high-income economy within the next decade. To achieve this goal, the authorities need to pursue an ambitious growth strategy aiming at economic diversification, fiscal sustainability, as well as improved infrastructure and the business environment.

We encourage the authorities to put the public debt on a downward path in the medium-term. We take note of the expected extension of the FY2020/21 statutory public debt target by two years, given the necessity to carry out large infrastructure projects within Mauritius' Vision 2030 Strategy. As outlined in the buff statement, the authorities' commitment to fiscal and debt sustainability that is consistent with the country's fiscal rule remains key. We also agree with staff's advice to mobilize domestic revenue by broadening the tax base while improving spending efficiency through targeted social spending, wage reviews and pension reform.

The monetary policy stance is appropriate given the low inflation environment. The Bank of Mauritius' progress in modernizing its monetary policy framework is welcome. At the same time, we agree that moving toward a more formal inflation targeting framework would enhance credibility and improve resilience to shocks. Moreover, there is a need to further improve the efficiency of monetary policy, including by aligning the money market rate with the policy rate. In this context, the Fund's ongoing technical assistance is warranted.

We welcome the efforts to strengthen financial sector oversight. While we welcome that many of the FSAP recommendations have been implemented, we encourage authorities to swiftly implement the outstanding measures. Moreover, efforts should be accelerated to address the recommendations of the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG), as well as to strengthen the AML/CFT framework.

Continuous progress on the structural front is important to achieve long term and inclusive growth. We agree with staff that the authorities should implement labor market reforms, invest in infrastructure and further develop value-added sectors. In this regard, the current and future development of Mauritius' International Financial Center goes in the right direction. Furthermore, efforts are also required to bridge existing skills mismatches and broaden labor market reforms, including by the increase of the female labor force participation rate.

Mr. Sun and Mr. Huang submitted the following statement:

We thank staff for the good papers and Messrs. Raghani, Nguema-Affane, and Carvalho da Silveira for their informative buff statement. The Mauritian economy continued to grow at a steady pace with unemployment rate at a decade low. The authorities' goals to achieve long-term inclusive growth and reach high-income by 2030 are ambitious. However, challenges, including elevated debt level, growing external imbalances, and structural impediments, remain. The authorities are encouraged to continue to diversify the economy, strengthen external competitiveness, and move up the value chain. We agree with the thrust of staff's appraisal and would limit our comments to the following for emphasis.

A gradual and growth-friendly approach is necessary to achieve the objectives of the fiscal consolidation. As a small and open economy, Mauritius is vulnerable to potential external shocks. We agree with staff that a decline in public debt over the medium term could create fiscal room to better preserve macroeconomic stability, but the fiscal consolidation should be pursued in a gradual and growth-friendly way. The most recent Debt Sustainability Analysis (DSA) shows that Mauritius' public debt remains sustainable. A sudden and sharp fiscal consolidation may dampen near-term growth and disrupt the authorities' efforts for infrastructure upgrade. As Mauritius lags behind its peers in information technology infrastructure, addressing this gap is essential to strengthen its competitiveness and move up the value chain. In this regard, we see merit for the authorities to extend the deadline of the public debt target by two years to minimize disruption. Meanwhile, the authorities should continue to improve public investment management, mobilize more private resources, and innovate financing approaches.

We concur with staff that the current accommodative monetary policy stance remains appropriate, given the relative low inflation environment. We take positive note of the central bank's effort to absorb excess liquidity in the banking sector through open market operations. Foreign exchange reserves continue to increase which have strengthened Mauritius' resilience to external shocks. Going forward, the authorities are encouraged to further modernize the monetary policy framework, including setting a clearer medium-term inflation target, with the Fund's technical assistances, where appropriate.

Preserving financial integrity and stability is key to strengthening Mauritius' role as an international financial center. We commend the authorities' recent efforts to comply with international anti-tax avoidance initiatives. The latest OECD report indicated that Mauritius meets all the requirements of the Base Erosion and Profit Shifting Projects (BEPS) Action 5 and has no harmful tax practices. Compliance with the international AML/CFT standards are of equal importance, and addressing the deficiencies in Mauritius' AML/CFT framework should be one of the top priorities. The authorities should step up their efforts to implement recommendations from international and regional anti-money laundering bodies. Noting the authorities' ambition to make Mauritius a regional fintech hub, with a focus on digital assets, we underscore the importance of ensuring that the needed policies and measures are in place to mitigate any related risks. Could staff elaborate more on the current developments of fintech in Mauritius, including the size of the digital asset market?

With these remarks, we wish the authorities every success in their policy endeavors.

The Acting Chair (Mr. Zhang) remarked that Directors had welcomed the authorities' efforts and the broadly positive macroeconomic outlook. However, they highlighted the rising fiscal and external sector vulnerabilities. They stressed the importance of the fiscal adjustment to ensure that debt was on a downward path; the need to bolster the financial sector reforms; and structural reforms to boost competitiveness and productivity.

Mr. Vitvitsky made the following statement:

We thank the staff for the Article IV report, and we broadly agree with the staff appraisal. I have a few comments.

On the debt vulnerabilities, while current public debt levels are considered sustainable, they are still quite high and rising. Furthermore, their vulnerability to shocks—in particular, exposure to contingent liabilities—is a bit concerning. As a result, we support the need for fiscal consolidation but also support greater transparency and improved management of state-owned enterprise (SOE) debt.

On Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) issues, while Mauritius has made progress in improving its AML/CFT regime, we note Box 3 on key deficiencies in the AML/CFT framework. We agree with the staff that the recommendations by the Eastern and Southern Africa Anti-Money Laundering Group (ESSAMLG) should be swiftly implemented.

Finally, we had a question on reserve adequacy and particularly the reserve adequacy metric. On page 48, there is a footnote that says that the reserve adequacy of Mauritius would fall to 29 percent of the metric if it is conducted and includes the external and other investment liabilities of the offshore sector. We would like the staff to elaborate on the difference between the assessing reserve adequacy (ARA) metric with this exclusion versus without this exclusion.

Mr. Fachada made the following statement:

I thank Mr. Raghani, Mr. Nguema-Affane, and Mr. Carvalho Da Silveira for their statement and the staff for the reports.

We commend the Mauritian authorities for maintaining a stable macroeconomic environment while seeking to achieve high-income status by 2030. The economy continues to grow at a steady pace due to robust performance in tourism, construction, and the service sector, spurred by infrastructure projects and improved private sector competitiveness.

We take note that a two-year extension of the deadline to meet the public debt target of 60 percent of GDP is being considered as this target may not be met without a significant policy adjustment. We agree with the extension but note that there is some room to pursue fiscal consolidation by containing current spending through better targeting social spending, controlling the wage bill, and by increasing domestic revenue mobilization.

The steps taken by the authorities to improve public investment efficiency with the implementation of International Public Sector Accounting

Standards (IPSAS) are welcome. However, we agree with staff that there is room for improvement in line with the 2017 Public Investment Management Assessment (PIMA) recommendations, particularly in the public procurement process.

Against the backdrop of subdued inflation and inflation expectations, Mauritius' monetary policy stance appears broadly appropriate. Nevertheless, we agree with the staff, that a more forward-looking monetary policy framework could be adopted to enhance policy credibility and better anchor inflation expectations.

Finally, we commend the authorities for the efforts in strengthening compliance with international tax initiatives and addressing the deficiencies in the AML/CFT framework. We are particularly encouraged by the statement of Mr. Raghani and colleagues, that the authorities will continue to work in this area to ensure that Mauritius upholds its adherence to international best practices.

Mr. Inderbinen made the following statement:

We thank the staff for the good documents and the responses they have provided, and Mr. Raghani and his colleagues for the comprehensive buff statement. I would just like to add one or two points to the gray statement that we put out last week.

First, on the fiscal policy, like others, we take good note of the authorities' commitment to prudence and sustainability, as emphasized in the buff statement, but at the same time note that there is consideration on extending the deadline to meet the country's statutory debt target. Like others, we do see a reason for such an extension but would, however, caution the authorities to preserve the credibility of the fiscal stance. We see great merit in the staff's recommendation to commence a gradual fiscal consolidation from the next budget onward in order to secure debt sustainability and put the trajectory on a downward path.

On the public financial management (PFM) side, we welcome the ongoing implementation of the IPSAS accrual accounting standard which, as noted by staff and echoed by Mr. Johnston and Kikiolo, will serve to improve fiscal transparency once implemented.

Finally, like Mr. Doornbosch and Mr. Josic, we appreciate the extensive discussion of the current account and the real effective exchange rate models in the annex on the external sector. We particularly appreciated the candidness of the uncertainties associated with the results in the case of Mauritius, which is highly open and highly integrated in global capital markets.

Mr. Castets made the following statement:

We thank the staff for the quality of the report and for their answers to our technical questions. We also thank Mr. Raghani for his helpful buff statement. We have issued a joint statement with Mr. Meyer, so I will just make a few points for emphasis, not repeating our point on the importance of continuing fiscal consolidation to put public debt on a downward path.

First, Mauritius is an example of a country that has been able to achieve upper middle-income status, thanks to strong institutions and the clear setting of the authorities' priorities. While we note that growth remains dynamic, sustaining Mauritius' progress and ensuring that the country reaches upper-income status will require new structural reforms, particularly investing in innovation, infrastructure, good governance, and addressing the skills mismatch—as noted by the staff.

Second, the country will need to build buffers to address two structural challenges: first, to be able to adapt and to withstand large-scale climate-related events; and second, to address issues related to the rapidly aging population in the country.

Third, we know that Mauritius wants to position itself as a world-class financial sector. Their financial sector has already achieved a significant overall size. Nevertheless, as also mentioned by our American colleagues, we call on the authorities to maintain the highest standards in terms of financial regulation and supervision, AML/CFT, and also tax cooperation with other jurisdictions. While progress has been made, we note in the report that the country still lags on the Financial Action Task Force (FATF) recommendations, so we encourage them to swiftly adapt the regulatory framework.

Mr. Doornbosch made the following statement:

I thank the staff for the good report and interesting selected issues paper. I would like to thank Mr. Raghani and his colleagues for the buff statement. I have just one point that I would like to come back to.

In our gray statement, we asked a question on climate change because Mauritius was identified in the 2016 paper from the Fund as a country being more vulnerable than average to the effects of climate change. In the answers to technical questions, the staff notes that the risk of natural disasters is included in the global risk assessment matrix (G-RAM). That is helpful, but that was not really what we intended. We were asking, given the possible macro-critical impact of climate change on Mauritius, whether it would be helpful for the authorities if more emphasis was placed on this topic in future Article IV consultations.

Ms. Mannathoko made the following statement:

We thank the staff for the report and Mr. Raghani for the helpful buff statement. We wanted to indicate that we recognize the strong track record that Mauritius has had. We recognize its prudent macroeconomic policies. It has managed to achieve some degree of structural transformation over time. Even the path that the authorities are on now, in trying to raise it to the next income level, the different significant investments and the policy reforms are all moving in a very positive direction. Our view was generally positive.

One quick question that I have for staff, which we did not touch on in our gray statement, was whether the staff could elaborate on what may be the strategy or what plans are in place with respect to addressing the aging population issue.

The staff representative from the African Department (Ms. Qureshi), in response to questions and comments from Executive Directors, made the following statement:[1]

I thank Directors for their helpful comments and the authorities for their cooperation. We have provided written answers to all the questions raised by the Directors in their gray statements.

In my remarks, I will update the Board on some key recent economic developments, as well as touch upon some of the broad policy issues discussed by Directors. I will then turn to addressing the additional questions posed by the Directors during today's meeting.

In terms of economic developments, since the beginning of the year, macroeconomic conditions in Mauritius have remained broadly stable.

[1] Prior to the Board meeting, SEC circulated the staff's additional responses by email. For information, these are included in an annex to these minutes.

Inflation has remained subdued, averaging about 2 percent in the first quarter of 2019, which has led the Monetary Policy Committee of the Bank of Mauritius to keep the policy rate unchanged. Preliminary data for the external sector accounts for the last quarter of 2018 and early 2019 show that the trade balance continues to be in deficit, while financial inflows have stayed strong and international reserves have increased by about US$200 million in the first quarter of 2019, reaching about US$6.6 billion by the end of March 2019. Overall, the broad economic outlook remains in line with the projections by the staff in the report.

On public sector debt, while the debt profile appears to be sustainable, fiscal risks have increased since the last Article IV consultation. As noted by Directors, a gradual fiscal consolidation will help to preserve debt sustainability while supporting the authorities' objective of boosting long-term economic growth.

The staff would like to reiterate, however, that fiscal consolidation should begin from the forthcoming budget to enhance fiscal credibility and to put public debt firmly on a declining path.

Fiscal consolidation will also help the growing current account deficit, which is a cause for concern, especially in the face of the looming demographic challenge.

The authorities have undertaken a range of steps to enhance external competitiveness by boosting productivity and diversification through initiatives to improve the business climate and innovation capacity, as well as to support skills development, female labor force participation, and small- and medium-sized enterprises (SMEs). There is, however, room to increase the traction of these initiatives, and the authorities agree with this and intend to enhance the focus on increasing the effectiveness and the efficiency of their reforms, including through better monitoring and data collection.

As highlighted by Directors, compliance with the international standards for AML/CFT and anti-tax avoidance is crucial for the global business and financial sectors to continue thriving in Mauritius. In line with the recommendations of the Financial Action Task Force (FATF)-style regional body, the ESSAMLG, the authorities have introduced significant changes to the national AML laws in a short span of time. This, as mentioned by Mr. Raghani in his buff statement, has recently resulted in ESSAMLG's agreement to revise upward Mauritius' technical compliance ratings in several key areas. The authorities are committed to meeting the remaining deficiencies, and the staff is fully supporting them in their efforts.

Turning to the questions raised by Directors this morning, on the issue of reserve adequacy, in line with a past assessment, the way the reserve adequacy metric is computed for Mauritius is that it is adjusted to exclude the large other external liabilities of the offshore sector, which tend to be matched by their external asset holdings. However, to take into account the foreign exchange liquidity risks, the metric adjusts for the foreign exchange deposits in small- and medium-sized banks that are net of their liquid assets.

However, with this adjusted metric, the reserve adequacy is around 120 percent. Nevertheless, taking into account other liabilities of the offshore sector, what would be the reserve adequacy? This indicates the range and the uncertainties, and this flags the large and complex global financial sector and the need to continue strengthening the reserve buffer.

On the issue of climate change, we share the concern by Mr. Doornbosch. As mentioned in our written responses, the focus of this year's Article IV consultation was decided with the authorities during the staff visit in July 2018, where it was discussed and agreed that, given the increase in the fiscal and the external vulnerabilities, as well as the identified deficiencies by ESSAMLG in the AML/CFT framework, the focus for this Article IV consultation would be on fiscal and external competitiveness and financial integrity issues. We, however, take note of this; and in setting the agenda for the next Article IV consultation with the authorities, we will definitely take climate change into account.

On the issue of the authorities' plans to address the aging population, they are taking a multifaceted approach to address this issue. On the one hand, boosting fiscal national savings is very important, so fiscal consolidation will help in this regard. The authorities have also suggested undertaking pension reforms in the coming years to help improve private savings.

Given the projected shrinking population and the increase in the old age dependency ratio, boosting productivity is important. The authorities are undertaking a range of steps to boost productivity and improve diversification. In this regard, their steps on skills development and also boosting the internet, communications, and telecom infrastructure are critical.

Mr. Raghani made the following concluding statement:

On behalf of my Mauritian authorities, I would like to thank Directors and management for supporting the conclusion of the 2019 Article IV consultation. Their valuable comments will be faithfully conveyed to my authorities.

I also would like to express the authorities' appreciation to the mission chief, Ms. Qureshi, and her team for their hard work and for the open and cooperative discussions during the consultation. I share the responses provided by the staff to the questions raised by Directors and will limit myself to a few remarks.

First, I welcome Directors' recognition of Mauritius' solid economic performance and sound policies over the years, as well as their continued commitment to address existing vulnerabilities.

Second, Directors stressed the importance of continued fiscal consolidation to strengthen governance policy credibility and to set public debt on a firm downward path into the medium term. The Mauritian authorities fully share this view, as we already indicated in our buff statement. The authorities are determined to stay on course with fiscal consolidation through policies aimed at containing expenditures, as well as improving domestic revenue mobilization. This also includes leasing the aircraft so that it would not impact public sector debt.

Third, Directors called for continued efforts to support financial stability and integrity. In this connection, major inroads have been made to strengthen the AML/CFT framework; and as a result, Mauritius has recently been upgraded by ESSAMLG. Going forward, the authorities reiterate their commitment to implement the remaining recommendations of ESSAMLG to ensure that Mauritius continues to develop an effective AML/CFT framework aligned with the highest international standards.

Fourth, Directors also encouraged the authorities to comply with international tax initiatives. Important steps have been taken to align with international anti-tax avoidance standards, including the Base Erosion and Profit Shifting Project (BEPS) Action 5. The authorities will continue to work in this area to ensure that the country upholds its adherence to international best practices. It is worth stressing the importance of continued technical assistance from the Fund and other multinational institutions in supporting the implementation of these reforms of the tax system in Mauritius.

Fifth, my authorities agree with the Directors on the need to enhance external competitiveness, notably, through structural reforms aimed at improving the business climate, boosting productivity, and enhancing labor market efficiency. As indicated in our buff statement, several measures are being undertaken: New bilateral and multilateral free trade agreements are being negotiated, including with African states and governments. Vocational training and innovation are being promoted. Many initiatives were launched to support female labor force participation as well as to facilitate access to finance for SMEs.

Finally, I would like to echo the concerns expressed by some Directors on the coverage of the climate change issue. Given Mauritius' external vulnerability to natural disasters and their potential large and adverse impacts on the economy, I welcome the staff's intent to provide adequate attention to this critical issue in the next Article IV consultation.

To conclude, let me reiterate the Mauritian authorities' commitment to continue to implement their reforms to sustain macroeconomic stability and boost long-term inclusive growth.

I thank the Board again for its continued support.

The Acting Chair (Mr. Zhang) noted that Mauritius is an Article VIII member, and no decision was proposed.

The following summing up was issued:

Executive Directors agreed with the thrust of the staff appraisal. They welcomed Mauritius' steady economic growth momentum and broadly positive macroeconomic outlook. Noting the rising fiscal and external sector vulnerabilities, Directors encouraged the authorities to pursue prudent policies to strengthen macroeconomic and financial resilience and to continue reforms to boost productivity and competitiveness.

Directors underscored the need for fiscal adjustment to enhance fiscal credibility, preserve debt sustainability, and reduce the external imbalance. Given the public investment needs, the authorities' debt target of 60 percent of GDP for FY2020/21 is unlikely to be met without a significant policy adjustment. While the authorities are considering extending the target by two years, Directors urged a gradual fiscal consolidation beginning with the next budget for FY2019/20 to enhance fiscal credibility and to put public debt on a declining path.

Directors agreed that the monetary policy stance is broadly appropriate at the current juncture. They encouraged the authorities to continue their efforts to contain excess liquidity in the banking system. Further modernizing the monetary policy framework by building the necessary capacity to announce and track a medium-term inflation objective would help to enhance policy credibility and improve resilience to shocks.

Directors highlighted the widening external imbalance. While international reserves have improved significantly on the back of strong financial inflows, given the large size of the offshore sector, Directors agreed that the foreign exchange intervention policy should continue to build reserves buffers as conditions permit, to strengthen resilience to shocks.

Directors appreciated the authorities' efforts to bolster competitiveness by introducing effective and efficient initiatives to improve the business climate, build innovation capacity, reduce the skill mismatch, and increase female workforce participation. Maintaining strong and independent institutions is essential to ensure the country remains an attractive investment and employment destination.

Directors stressed the importance of implementing the outstanding FSAP recommendations for further strengthening financial stability. They also welcomed the steps taken to comply with the international anti-tax avoidance initiatives and the efforts to strengthen the AML/CFT framework. In this context, they underscored the need to expeditiously implement the remaining recommendations of the Eastern and Southern African Anti Money Laundering Group (ESAAMLG). Directors also encouraged the authorities to continue to improve data quality.

It is expected that the next Article IV consultation with Mauritius will be held on the standard 12-month cycle.

APPROVAL: April 15, 2020

JIANHAI LIN
Secretary

Annex

The staff circulated the following written answers, in response to technical and factual questions from Executive Directors, prior to the Executive Board meeting:

Fiscal Sector

1. ***Can staff elaborate on the risk of future revenue shortfalls and its possible adverse impact on capital spending?***

- Staff sees limited risk to capital spending from revenue shortfalls. Tax revenue shortfalls have been modest, well under ½ percent of GDP in recent years. The Mauritian Revenue Authority (MRA) is technically strong and over the years has made significant improvements in tax efficiency and administration. Further progress in improving tax auditing and compliance is being made with the help of IMF TA. Shortfall in non-tax revenue has also been generally modest, around ½ percent of GDP. Going forward, given the need for fiscal consolidation, maintaining adequate capital spending will require increasing fiscal revenue in line with the measures suggested in the Staff Report.

2. ***Given the under-execution of spending and under-collection of revenues for the last fiscal year, are there concerns by staff on the ability of the authorities to reach their fiscal targets, in terms of public finance management?***

- Staff does not view public finance management as a significant threat to achieving the authorities' fiscal targets. As noted above, revenue shortfalls have been modest, and Mauritius generally performs well against Public Expenditure and Financial Accountability (PEFA) benchmarks. Moreover, the under execution of spending tends to offset the effect of the revenue shortfalls on fiscal balances. Thus, performance on the consolidated balances have exceeded budgeted targets.

Monetary Sector

3. ***While appreciating the Bank of Mauritius' (BOM) open market operations (OMO) to siphon excess liquidity from the banking system, we also note the cost of the OMO to BOM. We see the authorities are asking the Fund to assist with the drafting of the cost sharing agreement with MOFED and with asset and liability management. These are not in the list of capacity development priorities on page 53 but are they areas of TA the Fund can help with***?

- The authorities made a request for TA on managing central bank assets and liabilities very recently during the Spring Meetings. MCM and the authorities have begun discussions on the scope and modalities of this TA. Regarding the cost-sharing agreement with MOFED, this is a long-standing issue between the BoM and MOFED. The BOM has not requested formal TA but has requested support in the form of providing examples of cost-sharing practices in other countries as it tries to work out an arrangement with MOFED. Staff will continue to engage with the authorities on this issue and provide other relevant examples and background material.

Financial Sector

4. ***Mauritius' work on Fintech, especially on the regulatory front, is innovative, but the authorities are urged to remain vigilant. Were staff able to evaluate Mauritius' Fintech experience to date and are there useful lessons to apply to other countries?***

5. ***Noting the authorities' ambition to make Mauritius a regional fintech hub, with a focus on digital assets, we underscore the importance of ensuring that the needed policies and measures are in place to mitigate any related risks. Could staff elaborate more on the current developments of fintech in Mauritius, including the size of the digital asset market?***

- Fintech activity in Mauritius is still in its infancy—the size of the digital asset market is unknown, though it is likely to be small—and banks have recently started to promote the use of mobile money and payment platforms.

- The authorities are taking an appropriately cautious approach to Fintech adoption and are selectively adopting components from the Fintech development strategies of global Fintech frontrunners as applicable to the Mauritian economy. For example, the authorities introduced a Regulatory Sandbox Regime early on and fashioned it in large measure after other established sandbox regimes (e.g. U.K., India, Singapore), thereby establishing a clear playing field for Fintech startups. They have been carefully reviewing and selecting applications to the sandbox, rejecting proposed activities for which the regulatory framework had not yet been elaborated. In addition, the authorities solicited expert advice for drafting regulation or guidance notes on Fintech activities (custodian services for digital assets and securities token offerings, respectively) that also address AML-CFT concerns. The regulation for custodian services in digital assets and a guidance note on securities token offerings were issued recently in February and April 2019, respectively.

6. ***We positively note that important steps have been taken to align with international anti-tax avoidance rules, importantly including adherence to the requirements under the Base Erosion and Profit Shifting initiative. However, we understand that***

the EU has concerns on the new, reformed tax regime, and we would welcome further details as to what these are, as well as authorities' plan to address them.

- The EU Council, in a letter dated February 1, 2019, notified the Mauritian authorities that the new Partial Exemption system had been deemed to have similar harmful effects as the harmful regime that Mauritius had effectively abolished at the end of 2018. The EU Council thus requested that this new regime be amended or abolished by end of 2019. The Mauritian authorities intend to comply with the EU's request, notably by (i) introducing a specific requirement for any outsourcing of the core income generating activities of a firm to be within Mauritius and not overseas in order to avail itself of the partial exemption system; (ii) passing regulation to prevent multiple use of the same resources of the outsourcing provider; and (iii) reinforcing the anti-abuse mechanism by introducing Controlled Foreign Company (CFC) rules that deter profit shifting to no- or low-tax jurisdictions.

- The authorities are currently discussing with the EU the intended changes to the Mauritian tax laws and plan to introduce these changes at the earliest opportunity, but no later than by August 2019 in the next Finance Act.

External Sector

7. ***Could staff clarify their assertion that Mauritius is experiencing widening external sector imbalances?***

- Mauritius' current account deficit has deteriorated from about 4 percent in 2015–16 to an estimated 6 percent in 2018. Staff's external sector assessment presented in the Staff Report (Annex IV) shows that Mauritius' current account gap has also increased and stood at -5.8 percent of GDP in 2017, indicating that Mauritius' external position was substantially weaker than implied by medium-term fundamentals and desirable policy settings. While the current account is being financed with financial flows, as noted in Staff Report (para 18 and Annex I), a significant reduction in these flows could have serious implications for domestic macro-financial stability.

8. ***External competitiveness has been slipping recently, and it appears substantially weaker than implied by medium term fundamentals. We encourage authorities to implement the adequate reforms, to enhance technological readiness, innovation, enhance infrastructure, enhance skills adequacy and labor market efficiency. This will ensure that higher value products and services are exported. We note that the level of savings has been declining, which can be a concern in the face of a rapidly aging population. We would welcome staff assessment on reforms to be led to ensure that the demographic challenge is appropriately met.***

- The need to address the long-term challenges arising from Mauritius' aging population is the backdrop for much of staff's policy advice. As discussed in the Staff Report (paras 23, 37, 52), in the face of the ongoing demographic shift, the need to improve national savings is imperative. Fiscal consolidation will help to improve public sector savings. Reforms to the pension system (e.g., increasing contribution rates) would both help to make the system more sustainable and stimulate greater private savings.

- With a shrinking labor force and higher dependency ratio, raising productivity growth will be essential to maintain the growth momentum. The authorities are cognizant of these challenges and efforts to improve the business climate, build innovation capacity, and lower skill mismatches are underway. In addition, steps are being undertaken to improve female labor force participation, which would help to boost labor supply. As discussed in the Staff Report, regular monitoring and evaluation of government's initiatives is key towards improving economic productivity and meeting the demographic challenge.

Climate Change

9. ***We are somewhat surprised about the lack of climate change considerations. The Fund's 2016 policy paper on small states' resilience to natural disasters and climate change has identified Mauritius as one of the three countries with extreme risk of climate change, based on the 2016 Maplecroft exposure index. However, these topics have not been covered in any of the Article IV reports since then. Staff's comments are welcome.***

- Staff shares concern by the Executive Director about the importance of climate change issues for the economy. This potential risk to the economy is flagged in the Risk Assessment Matrix in the Staff Report (Annex I). Following discussions with the authorities during the Staff Visit in July 2018, the focus of this year's AIV consultation was on fiscal policy, competitiveness, and financial integrity issues given the increase in fiscal and external vulnerabilities, as well as the identified deficiencies in the AML/CFT framework by the regional-style FATF body.

Statistical Issues

10. ***Can staff elaborate on the substantial and persistent contribution of statistical discrepancy and negative net exports to GDP?***

- The authorities are working towards resolving the substantial statistical discrepancy in the national accounts with the help of Fund TA. As discussed in the Staff Report (paras 46-47, Annex VI), this is a priority area for capacity development in Mauritius.

Preliminary findings of the TA suggest that the discrepancy is a result of problems in measuring the contribution of the global business sector. On the negative contribution of net exports to GDP growth, this trend is consistent with the declining net exports of goods and services and the deteriorating external competitiveness as highlighted in the Staff Report.