

# Economic outlook for 2012: Mind the deceleration spiral

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2012 is yet another year of challenged economic conditions and poor visibility for Mauritius as Europe, our main trading partner, battles with its sovereign debt crisis and the ensuing austerity. The Central Statistics Office (CSO) projected growth rate of 4 percent for the year is already being revised downwards. The World Bank is projecting a 3.3 percent growth rate, and even the Vice-Prime Minister and Minister of Finance, Xavier Duval, is admitting that growth will be weaker this year.

The world is entering in a new dangerous zone, with renewed risks of slowdowns in the industrialized world. A sluggish activity in Europe and the United States will also hurt the large emerging economies that trade with them. The fallout from the sovereign debt crisis is hitting the real economy as biting austerity, tighter credit conditions and weaker than expected growth hit confidence. It will be some time before we can expect to see a sharp rebound in the Eurozone economy.

The January 2012 consensus of forecasts for this year is lower than it was in January 2011 for all the world's significant economies, including even fast-growing China and India. The cuts for eurozone countries are striking: eurozone growth is now forecast at -0.3 percent this year, against 1.6 per cent a year earlier; German growth is forecast at 0.5 per cent, down from 1.8 percent; French growth is forecast at zero, down from 1.7 per cent; and Italian growth is forecast at -1.3 percent, down from 1.1 percent.

US growth in 2012 is now forecast at 2.2 per cent, a small improvement on the October consensus of 1.9 per cent, but still well below last January's 3.3 per cent. Japan's forecast has fallen least, from 2 per cent to 1.9 per cent, though that is largely because of the recovery from the impact of the tsunami.

Even as emerging and developing countries are in reasonably robust condition, they are vulnerable to an intensification of the crisis, which could hit them via several channels: trade, finance and remittances. Many countries – both high-income and developing – are in a weaker condition than they were in 2008 and would, accordingly, find it harder to respond effectively.

Back home, growth for 2011 is estimated at 4.1 percent, which is a very decent performance against a backdrop of deteriorating global economic outlook. The economy will still continue to grow, but we must guard ourselves against the danger of a deceleration spiral taking hold.

There are some worrying signs already, especially in industries that are highly exposed to European economies. The garments industry is expected to stagnate next year, whilst the wider manufacturing will only grow by a modest 1.5 percent.

Growth in the tourism sector will be sluggish with a projected 3 percent, even as we will be crossing the 1 million-mark tourist arrivals for the first time ever. European travelers will opt for short-haul travel at the detriment of far-away places like Mauritius. In addition, major sport events like the London Olympics and the Euro 2012 will contribute to retain holidaymakers on the Old Continent.

Besides the difficult trading conditions, hotels, garments companies and business process outsourcing (BPO) companies that are selling mainly to the eurozone are also affected by an adverse exchange rate context with the euro trading in the Rs 38 – 39 region.

Even the financial services industry is set to expand at a slower pace compare with recent years trend.

A better performance is anticipated though in the construction sector, especially with the boost to low-cost housing, ongoing large scale works in road expansion, airport and the start of some large-scale water projects.

The labour market will remain tight with an unemployment rate of around 8 percent as firms are wary about hiring new staffs and expanding production because of economic uncertainties. Private sector investment declined by 0.5 percent in 2011 after stagnation in 2010. This does not augur well for future growth and job creation prospects. To sustain job creation at a fairly steady pace, we need a growth rate of at least 6 percent which itself requires a private sector investment rate (business investment as a share of GDP) of 24 percent at least. We are currently at 18 percent, suggesting that we are still far from a dynamic business activity model.

Meanwhile, we expect public sector investment in infrastructure works to play a big role in supporting economic growth and jobs. Yet, efforts must be maintained to stimulate business investment and reverse a kind of private sector austerity, especially as large-scale private projects are coming to an end. Government is putting a lot of emphasis on developing the small and medium enterprises (SME) sector so that there is a greater trickle down effects of business capex on growth and on the labour market.

Policymakers should strive to improve business climate and stimulate the development of new activities and projects in the various sectors of the economy. Turbulent times demand strong leadership as major downside risks weigh on growth prospects for 2012 and beyond. Fragile firms should be protected and fairly resilient ones must be encouraged to develop new capacity and invest in new growth activities in anticipation of a solid rekindling of the economic machinery.

Policymakers should constantly monitor the evolution of the economy, especially in a context of lack of visibility. The Finance Minister has indicated to the press lately that Government stands ready to deploy additional and targeted measures to vulnerable industries in view to protect jobs. Funds from the National Resilience Fund will be used to bail out crisis-hit companies if necessary. One of the priorities of the Minister is to rekindle private sector investment, especially in the SME sector. The 2012 National Budget has introduced many pro-growth policies. Their timely implementation is vital so that there is a real impact on business activity.

At the same time, the Minister must devise new reform policies to address the long-term structural deficiencies of the economy like poor productivity, resources and skills limitations, a narrow industry base, weak infrastructure, sub-standard public services and inferior broadband connectivity.