

Interview

with

Eric Ng

Economist



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Eric Ng, economist and ex-Chairman of the Development Bank of Mauritius (DBM), gives his views on the precarious state of the Mauritian economy and the measures the government is introducing in an attempt to keep damage to a minimum. He comments in particular on the crisis affecting the euro.

■ **What is the philosophy behind the Economic Restructuring and Competitiveness Programme (ERCP)?**

To encourage deleveraging among firms that are heavily indebted to banks.

■ **And why are some companies so heavily indebted?**

Many choose to finance their investments through bank loans rather than raising money on the capital markets.

■ **Which, I suppose, is not a bad idea when interest rates are low...**

Yes, but even when lending rates are high, enterprises keep having recourse to borrowing when the cost of capital on the stock market is more appealing.

■ **But is this strategy sustainable?**

Yes, as long as they get a reasonable return on investment that allows them to repay their debts without putting stress on the cash flow. But today, we are deep in an economic crisis. Our enterprises are not getting sufficient business and are unable to achieve the same level of profitability as before. Excessive borrowing has led to a situation where finance costs represent a big chunk of the expenses of the company. When the gearing ratio is high, a company should reduce its debts and find other ways of raising finance rather than borrowing from banks. For instance, it can sell debentures or increase its capital through public floating on the stock market.

■ **But the ERCP sounds very much like the Additional Stimulus Package. Is there a difference?**

The ERCP is not so different from the Additional Stimulus Package (ASP). Some adjustments have been brought to the schemes related to the mechanism for transitional support to make them more workable. Many of the schemes have been extended for one year to December 2011, in line with the expectations of the private sector.

■ **What is the urgency of presenting an economic programme three months prior to the national budget? Is it to cater for the most urgent issues?**

That's what I would have expected but in fact it is not the case. I would qualify the ERCP document as a sort of pre-budget report indicating the policy direction of the government in the forthcoming budget.

■ **We have been hearing a lot about the Repo rate. How exactly does it affect the consumer?**

The Repo rate is the key interest rate by which the Bank of Mauritius indicates its monetary stance. When the monetary policy committee brings a change to the Repo rate, all commercial banks are called upon to follow suit by adjusting their Prime Lending Rate (PLR) accordingly. Since all interest rates are linked to the PLR, the whole interest rate structure is affected by a variation in the key Repo rate. If the latter increases, the deposit interest rates go up, which encourages saving.

■ **And the private sector is lobbying for the Repo rate to go down to lower their financial costs?**

Yes, when the Repo rate goes up, the lending interest rates also rise. And, as we said, companies live on borrowed money.

■ **But it is not only companies which are affected by a high repo rate, is it?**

No, consumers who live on debt through credit cards or personal loans will pay more interest charges too.

■ **Is the Repo rate entirely the responsibility of the Bank of Mauritius?**

The Repo rate is determined on a quarterly basis by a Monetary Policy Committee (MPC).

■ **Talking about the MPC, there has been a lot of criticism of some of its members. Nita Deerpalsing, for example, criticized the presence of**

Jacque Li Wan Po, who she claims has vested interests.

Yes, the committee should not comprise businessmen. You cannot have people in the MPC who are judge and party. If they are players, they cannot arbitrate. And we have seen instances in the past where the management of the Bank of Mauritius was found in minority and the management of the Bank of Mauritius has to take responsibility for every decision taken by the MPC.

Rather unfair, isn't it?

Well, this is why Mr. Bheenick wants to review the structure of the MPC to make its members more accountable and to give more transparency to the decision-making process. I subscribe to his proposals because monetary policy is today crucial to the state of the Mauritian economy. Although the monetary transmission mechanism is not yet as effective as it should be, monetary decisions have a real impact on our economic variables.

There is no sign at the present time that the Repo rate will go down and the Joint Economic Council (JEC) is, predictably, not happy. Do you sympathize with them?

I do and I share their view that it would be less painful for companies to deleverage if interest rates were lower. However, a reduction in the Repo rate, which is currently at 5.75%, should not be construed as an incentive to leverage further... Banks can help debtors to repay their debts but they should remain prudent in expanding their credit.

But can the BoM afford to lower the Repo rate without increasing the inflation rate?

Let me tell you something: I am known to be an inflation hawk. Nonetheless, I must be honest: the Bank of Mauritius (BoM) has some room to lower the key Repo rate by at least 50 basis points. I said so three months ago in this newspaper. Since then, the headline inflation rate has remained persistently below 2%. Market expectations are that it will move to 3% by the end of the year, a rate which is still manageable. It might go further up to 4% by the third quarter of 2011, at which time the BoM could tighten its policy.

"Après la mort, la tisanane?"

No, there will be no death. On the other hand, the longer the BoM stays put, the more difficult it will be for it to justify a loosening of its policy and the less likely it will be to do so. It is now or never.

Why now?



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Because the euro is undergoing its worst crisis since its launch on 1st January 1999. True, the euro was at its lowest level in October 2000 when it was exchanged at the rate of Rs 23. However, at that time, the hotels could compensate the loss in foreign exchange with an increase in their occupancy rate. Today, they are losing both on price, with heavy discount pricing, and on volume, with a dramatic fall in tourist arrivals. Furthermore, as Mauritius has been diversifying its economy, it has become more dependent on European markets.

Must we, as Pravind Jugnauth predicts, expect a worsening of the situation?

Absolutely! The figures published by the ERDC document speak volumes. The single currency accounts for 95% of our sugar receipts. Tourists from euro-based countries represent 60% of total arrivals and tourists from the United Kingdom 12%. Out of ten export-oriented enterprises, seven are paid in euros, and four receive all their earnings in euros. Also, around 65% of the export revenues of the ICT/BPO sector are in this currency.

The local operators predict that the euro crisis may last between 5 and 7 years. Do you share this pessimism?

Allow me to have a cynical view of the euro: will the single currency still exist in 7 years?

You really think the euro will disappear?

I may be wrong but for me, the sovereign debt crisis in the PIGS economies (Portugal, Italy, Greece, Spain) is a bad omen for the existence of the euro. I predict that sooner or later some members of the eurozone will dump the euro. When the public debt of a member country is such that it cannot make use of its fiscal policy tool to stimulate its economy, the only thing it can do is to free itself from the shackles of the monetary union. In other words, it will get rid of the single currency and take back its monetary sovereignty by giving legal tender to its national currency.

The other alternative is to implement structural economic reforms...

Yes, but these can only come with a heavy political price which no representative government in a democracy would accept to pay. I believe that even France will question the legitimacy of the euro because its population does not like supporting economic reforms.

What would be the result for Mauritian operators if that scenario happened?

I think they should start right now to diversify their exports

into dollar-based countries. As the euro-based economies are slowing down, the International Monetary Fund is forecasting a paltry growth rate of 1% this year. I don't expect them to recover before 2013. And I don't see the euro shooting above Rs 45 in the near future and staying there for a long time.

Is the devaluation of the rupee an option. Pravind Jugnauth thinks devaluation is unfair and I am afraid I tend to agree with him.

It is indeed unfair to favour one category of operators, the exporters, against others, the importers and the consumers. A central bank should always work in the national interest so as to earn credibility. Besides, a forceful depreciation (devaluation) of the rupee is no panacea for our economic woes. Deliberately manipulating the exchange rates is like playing with fire. It becomes uncontrollable.

Talking about fairness, is this programme intended to give more help to the SMEs?

I really don't see many benefits for the small and medium enterprises in this programme. We tend to associate the difficulties of SMEs strictly with a problem of finance. In fact, there is plenty of money available at the commercial banks but not enough viable projects to finance. What SMEs need is access to markets and promotion of their products both locally and overseas. I doubt that the Small and Medium Enterprises Development Authority (SMEDA) is well equipped to help them in these areas. Government should lay more emphasis on the aspects of support, mentoring and marketing for SMEs in the next budget.

As ex-chairman of the Development Bank of Mauritius, you must be familiar with the Amnesty Scheme that was set up two years ago. What do you think of its amended version of loans written off as "hardship cases"?

I can tell you that many borrowers who fell under this scheme could not take advantage of its benefits in spite of the fact that all interests were waived. At DBM, I was the one who proposed to the ministry of Finance to write off all loans for which the capital balance did not exceed Rs 10,000, and also for borrowers facing extreme hardship. For sure, the bank should examine the hardship cases very carefully, the more so as there would be political interference. But as a caring society, we should give vulnerable people a second chance in life.