Rate of interest in mauritius analysis

Chapter 1. 0: Introduction

1. Introduction:

The study aims to assess the various methods to determine the Mauritian rate of interest. Moreover, we shall also try to implement a method which is suitable for the economy of Mauritius.

The rate of interest is merely remuneration for the lender with a point of view of rewarding him for the interval of lending money (Edward, P.). As per Edward, a bigger meal can be attributed to those who wait. From the perspective of the borrower, the rate of interest is defined as the price of durability. The latter is expensive when the rate of interest is high.

In an article, Ross and Szeliski(1942, p. 501) further defined the rate of interest as being a preference of sacrificing the cash in hand in order to obtain deferred cash at a later date.

A few examples of the rate of interests cited from the book of Amarcher and Ulbrich are as follows:

- Interest on loans (general loans),
- Interest rates on home mortgages and car loans (specific loans),
- Interest rates on bonds,
- Interest rates that commercial banks pay to the Bank of Mauritius.

The rate of interest depends on the nature of a loan. Since the rate of interest is equally the price of taking up a loan, the interest rate is expensive when the risk is high in addition if it is a long term one and vice versa.

According to Amarcher and Ulbrich, the interest rate is made up of the real interest rate, the risk premium and the inflation adjustment. The real interest rate reflects the purchasing power of an individual while the risk premium is simply a probability that the loan may default and the inflation adjustment refers to the expected inflation over the lifetime of the loan.

1. 2: Importance of the Subject Matter:

Despite being only a figure, the rate of interest carries much importance. It determines the decisions of disparate stakeholders ranging from investors to consumers.

Furthermore, the rate of interest is also relevant for the implementation of policies in an economy. The right rate of interest will lead to appropriate decisions and policies, thus experiencing a stable economic condition whereas an unsuitable rate of interest will only cause turmoil in an economy.

Moreover, the determination of interest rate has an effect on inflation and unemployment which in turn impact on the economy of Mauritius.

1. 3: Statement of Problem:

The primary aim behind this study is to solve the ongoing dispute between the Ministry of Finance [MOF] and the governor of the Bank of Mauritius [BOM].

The MOF and the BOM are administered with their respective instruments to regulate the economy. While the MOF is in charge of fiscal policy, the BOM is responsible of modulating the monetary policy. For instance, controlling the interest rates and credit ratios are their main tools.

Despite the fact that the MOF and BOM should act independently, the behavior of the MOF completely overruled this fact. For example; the MOF was supposed to buy 100 million dollars and this will affect the money supply. In other words, the MOF is pooping his nose into someone else business.

The situation worsens even more when the governor of BOM and MOF does not agree on the same grounds regarding the rate of interest.

A repo rate of 4. 65% does not fit the actual economy according to Rundheersing Bheenick (governor of the BOM). The latter confirms that if the rate of interest does not increase we will be facing a troublesome situation in controlling inflation as Money Supply is high. However, the MOF does not seem to be worried about inflation as it met a lowest record in 2013. Thus, maintaining the same level of interest from his standpoint is valuable. Furthermore, MOF asserts that increasing the level of interest will only decrease demand for new loans, consequently, deteriorating the problem of excess liquidity. The MOF referred the situation to a scenario where we are increasing the prices of tomatoes to clear the surplus on the market.

Rundheersing Bheenick justifies that maintaining the same level of interest rate will make the economy vulnerable to shocks as it reduces savings. As a result, the economy becomes dependent on external funding. The MOF defends himself by stating that there is no relationship between savings and the rate of interest and this statement of his is based on the saying of Martin Petri being the head of the International Monetary Fund (IMF).

The faceoff between two strong financial leaders can proves to be disastrous for the economy as a whole leaving consumers among others to be a victim of their wrath. Without any hesitation, their debate is also being termed as " The Financial War of Ego" where decisions are no longer implemented for the benefit of the economy but to hurt the ego of their opponent.

Moreover, Mauritius is not the sole one to be experiencing this crucial situation. Among others, Maldives is also a victim of disputes between the governor of Maldives Monetary Authority (MMA) and the Minister of Finance. On one hand the MMA aimed at increasing the rate of interest to reduce government deficits, the MOF on the other hand maintained the same level of interest rates (Miadhu, 2013).

However, this conflict did not arise for Seychelles. The MOF and the governor of Central Bank of Seychelles (CBS) worked cooperatively with one another. While the governor of CBS increased the rate of interests in order to reduce demand of foreign exchange rates, the MOF was thinking to freeze imports of certain products for a limited period (Seychelles News Agency, 2014).

Thus, in this study we will aim at setting a neutral rate of interest to solve the ongoing dispute as well as to protect the various stakeholders involved in this scenario. In addition, by setting up a neutral rate of interest, we expect everything to be back to normal where no dispute will spoil the image of Mauritius and encouraging Foreign Direct Investment (FDI).

1. 4: Research Question:

Has the interest rate been appropriately determined?

1. 5: Research objectives:

A study of the above mentioned title would focus on the following aims and objectives:

- An assessment of different theories determining the rate of interests.

Under this objective, we will be assessing the different theories under which the rate of interest is determined and we will be determining which theories best suit the Mauritian economy.

- Determination of the neutral rate of interest.

In this context, a neutral rate of interest will be set to solve the dispute of the two financial leaders and which is appropriate for the present economics condition of Mauritius.

- Assessing the independence of BOM and MOF.

Here, we will be studying whether the BOM and MOF act independently while making decisions as per the rule.

- A study of the economic factors affecting the rate of interest.

This objective will go through the different economic factors that influence the rate of interest in Mauritius.

- A forecast of the interest rates for Mauritius.

Forecasting the interest rates involves predicting the interest rates in the coming future.

1. 6: Hypothesis Testing:

1. 7: Research Methodology:

1. 8: Format of Study:

Chapter 1: Introduction

Chapter 1 includes a definition of the rate of interest and its importance to the economy of Mauritius. It gives a further explanation of the problem and a brief description of what will be covered in the following chapters.

Chapter 2: Literature review

In the context of Literature Review, we will go through theoretical and empirical evidence of determining the rate of interest. The different theories about determining the rate of interest will be analyzed and discussed.

Chapter 3: Research Methodology

Research Methodology puts forward the model that will be used in determining the rate of interest for Mauritius. The variables will be defined in this context and the test that will be used is described and analyzed.

Chapter 4: Data Presentation and Analysis.

Chapter 4 will convert raw data into meaningful data which will be in turn analyzed and conclusions can be drawn.

Chapter 5: Recommendations and Conclusions

This chapter aims at suggesting suitable policies for the economy to recover from the given problem and giving a conclusion about what has been studied.

1. 9: Summary:

In this chapter we gave an introduction about the topic that will be studied, the importance of the subject, the problem behind it and a brief explanation of what will be covered in the following respective chapters.