BANK OF MAURITIUS

FINANCIAL STABILITY REPORT

December 2021

Contents

FOREWORD

The Bank of Mauritius (hereafter referred to as the "Bank") is issuing the second edition of its Financial Stability Report for 2021 which covers the period April to September 2021, unless otherwise stated.

This Report is published pursuant to section 33(2)(b) of the Bank of Mauritius Act that stipulates that the Bank shall publish at least twice a year a report on financial stability. The Report includes a review of financial stability and an assessment of policies of the Bank in relation thereto.

In line with its mandate to ensure the stability and soundness of the financial system of Mauritius as per section 4(2)(b) of the Bank of Mauritius Act, the Bank makes an overall assessment of the risks that can threaten the stability of the financial system and the measures taken to mitigate these risks. It evaluates the resilience of the system to the risks as a stable and sound financial system is a prerequisite for financial intermediation in the economy and for creating conducive conditions for economic and financial development.

This Report is available on the Bank's website at https://www.bom.mu/publications-and-statistics/publications/financial-stability-report.

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Financial Stability Report December 2021

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Executive Summary

The global economy is rebounding in 2021 bolstered by improved business confidence and investors' risk appetite, amid broadly accommodative monetary and fiscal policies. The pandemic continues to spread at varying rates globally, while vaccination campaigns are being reinforced. The International Monetary Fund (IMF) estimated that advanced economies could reach pre-pandemic output levels by 2022 while emerging and developing economies would do so later. The IMF, in its October 2021 World Economic Outlook, projected global economic growth for 2021 at 5.9 per cent, falling to 4.9 per cent in 2022. Uncertainty persists as to the strength of the economic recovery and the impact on financial markets subsequent to the emergence of new COVID-19 variants, which could heighten volatility and risks.

The global financial markets were well supported as from the first quarter of 2021. Equity prices improved as the monetary policy stance in many large economies remained accommodative. Global long-term yields went up by the end of September 2021, after declining earlier, reflecting a rise in measures of interest rate risk and inflation compensation. Capital flows improved during the ongoing economic recovery sustained by global risk appetite. Going forward, as high inflation persists, a tightening of monetary policy in many economies could disrupt these flows.

Fiscal and monetary support in many countries moderated financial strains on the household and corporate sectors. Low interest rates, income support measures and loan moratoria have improved financial conditions, containing defaults on debts and preserving stability of the financial system. The resilience of the global banking industry to the pandemic-induced shocks enabled it to sustain the flow of credit facilities in most economies. Nevertheless, credit growth remained subdued, as banks were cautious given risks to the economic outlook, particularly in emerging economies.

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In the midst of nascent economic recovery, risks to global financial stability have remained well contained. Policymakers are facing tighter policy space as they are confronted with various challenges. Besides pandemic-induced ones, climate change threats require more than ever pressing measures and actions, as they are increasing financial sector vulnerabilities. To safeguard financial stability, policymakers should lay greater emphasis on climate-related financial sector policies that will encourage an orderly transition.

The Mauritian economy rallied in the second quarter of 2021, with a real growth rate of 19.3 per cent. This growth momentum was projected to be sustained in the third quarter of 2021. Continued policy support from the monetary and fiscal authorities, progress in the vaccination campaign, as well as buoyancy of some major sectors propelled the recovery process. Moreover, the revival of the tourism sector, with the partial reopening of the borders as from mid-July 2021 and full reopening on 1 October 2021, is anticipated to bolster economic activity including in related sectors as tourist arrivals gradually gain momentum. The rebound in economic activity, helped to moderate risks to financial stability, as financial conditions of the household and corporate sectors began improving.

While optimism on economic prospects gained ground in the third quarter of 2021, the emergence of the new COVID-19 variant could potentially trigger disruptions to international travel and external demand which may give rise to downside risks to the economic outlook. These risks could become subdued, however, depending *inter alia* on the efficacy of the vaccines against new variants. In the light of these developments, the Bank revised its growth projection for 2021 to around 5.0 per cent.

The domestic stock market recovered as economic prospects brightened spurring investor appetite, though key stock market indices were still below pre-pandemic levels. Another positive factor propelling the stock market was the resumption of dividend payments by some blue-chip companies and continued support by the authorities to the economy. However, the performance of the stock market was under pressure from the continuous disinvestment by foreigners in search of risk-adjusted returns.

The conditions on the foreign exchange market broadly stabilised, as evidenced by lower volatility in the market demand-supply gap. Economic dynamism and the gradual revival of the tourism sector were expected to bolster activity on the foreign exchange market. The Bank continued to intervene to supply foreign exchange to the market. These interventions, conducted at market exchange rates, have suppressed excessive volatility and sharp adjustment to the exchange rate that could have heightened economic and financial vulnerabilities. From 1 April to 30 September 2021, the weighted average selling dealt rate of the Rupee depreciated by 4.9 per cent against the US dollar (US$). The external value of the Rupee continued to reflect conditions on the domestic FX market as well as international currency movements.

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The country's foreign exchange reserves buffer was adequate to protect the economy against external vulnerabilities. The reserves remained at a level that satisfied various stringent adequacy assessment metrics. The Gross Official International Reserves of US$7.8 billion as at end-September 2021 provided an import cover of 19.6 months, based on imports of goods and services for 2020.

The Bank maintained its accommodative monetary policy stance to support economic recovery. The policy rate was kept unchanged at 1.85 per cent at the Monetary Policy Committee meeting held on 4 August 2021 as inflationary pressures, triggered by pandemic-induced transitory supply shocks, were expected to subside. The Bank intensified its monetary operations to bring down the level of Rupee excess liquidity in the banking system, as economic activity gathered pace. Further, risk to financial stability arising from possible liquidity constraints had also abated with ongoing economic recovery.

Economic activities resumed rapidly following the second lockdown in March 2021, with the prompt roll-out of work access permits and easing of sanitary restrictions. This speedy resumption helped the household and corporate sectors to withstand the economic impact of the second wave of the pandemic, preventing further build-up of vulnerabilities. The annual growth of bank credit to the private sector generally trended upwards, rising from 4.4 per cent in March 2021 to 4.7 per cent in June 2021 and further to 8.6 per cent in September 2021, with increasing growth rates for both the household and corporate sectors.

To accompany the recovery process and contain risks to financial stability, the Bank extended some of the measures under its COVID-19 Support Programme to continue providing assistance to households and corporates during the recovery phase. These measures contributed to cushion the impact on the asset quality of banks, as evidenced by the decline in the ratio of non-performing loans to total loans to 4.5 per cent as at end-September 2021, from 5.0 per cent as at end-March 2021. The Bank has already started work on the unwinding of the COVID-19 measures, which are under discussion at the level of the Task Force on Banking Sector Resilience.

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The resilience of the banking sector improved in September, relative to March 2021. The capital and liquidity buffers held by banks allowed them to sustain the stresses of the pandemic-induced economic shocks and thus preserved financial stability. The Capital Adequacy Ratio went up to 19.6 per cent in September, from 18.7 per cent in March 2021, with improving profitability and a contraction in risk-weighted assets. The Liquidity Coverage Ratio improved to 259 per cent from 250.6 per cent during the same period. Profitability in the banking sector started picking up in 2021, impacting positively on returns on assets and equity. Other key financial soundness indicators of banks remained comfortably within prudential limits.

The Bank evaluated the resilience of these capital and liquidity buffers to various hypothetical but plausible shocks using its stress testing framework. The results of the stress tests, using September 2021 data, showed that banks generally held resilient buffers enabling them to absorb greater shocks – such as shocks to economic growth, credit portfolios and liquidity – though a few banks exhibited some vulnerabilities. Of importance, the findings depicted an improvement in the resilience of the banking sector compared to March 2021, indicating the sector has stronger buffers to withstand risks to financial stability.

The Bank conducted a Survey on Economic Perspectives and Financial Stability Implications with the banking industry in October/November 2021. The main findings pointed to rising optimism among banks as to a pick-up in economic activity over the next year accompanied by improving profitability. Most banks anticipated expected credit losses to stabilise, with even an improvement in asset stage classification. They projected favourable liquidity position for the upcoming year. Almost half of the banks indicated that the main challenges going forward are climate-related risks that could impact income and credit portfolio, and operational risks arising from cybersecurity vulnerabilities. They indicated that they have put in place various risk mitigating strategies, including higher investment in IT infrastructure and systems.

The Bank recognised that climate change and environmental degradation can have economic consequences which can pose major risks to the financial system. To prepare the financial system to better face these challenges, the Bank launched its Climate Change Centre on 14 October 2021 to affirm its response to climate-related risks.

Furthermore, cognisant of downside risks from advancing digitalisation, the Bank has taken several initiatives to further enhance efficiency, safety and resilience in the payment ecosystem. The National Payment Systems Act was amended in August 2021 to provide for the establishment of the National Payment Systems Committee that will act as an advisory body to the Bank in the exercise of its oversight function in respect of the national payment systems. The Committee will also serve as a forum for cooperation, thereby supporting the achievement of sound and efficient payment systems in Mauritius.

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The Bank has, in August 2021, been assigned the function of the macroprudential authority of Mauritius in terms of section 5(1)(ba) of the Bank of Mauritius Act 2004 (Act). This new responsibility complements its mandate to ensure the stability and soundness of the financial system of Mauritius, as laid down in section 4(2)(b) of the Act. The main objectives of macroprudential policy are to prevent the build-up of systemic risks in the financial system and reinforce the resilience of the financial system to shocks so as to preserve financial stability.

While macroprudential policy is certainly not new to the Bank, this statutory mandate requires the design and deployment of a robust macroprudential policy framework to assess and monitor systemic risks in the whole financial system. To that effect, the Bank is currently reviewing its macroprudential policy framework as well as consolidating its structure to manage risks to financial stability in line with international standards.

The non-bank financial services industry broadly recovered its growth momentum. Amid economic uncertainties, the Non-Bank Deposit-Taking Institutions adopted a prudent approach and redeployed their funds towards less risky assets. They were assessed to be sound and adequately capitalised, complemented by prudent risk management policies.

The long-term insurance industry has shown better resilience to the effects of the pandemic so far in 2021, after growing at a slower rate in 2020. The pandemic had moderate impact on the total gross premium earned by life insurers. The overall performance of the general insurance business was relatively undeterred. The value of assets in the pension scheme industry kept a general upward trend, despite market volatility and historically low interest rates. The performance of financial markets since the first quarter of 2021 amplified the growth in pensions assets whilst vulnerabilities in the pension industry remained well contained.

The global business sector maintained its growth momentum. This progress was achieved despite risks stemming from the effects of the pandemic worldwide and the listing of Mauritius by the Financial Action Task Force (FATF) in its list of jurisdictions under increased monitoring and by the European Union and the United Kingdom in their list of high-risk countries. The global business sector is projected to expand by 5.0 per cent in 2021, a significant rebound from the contraction of 10.3 per cent in 2020.

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Mauritius successfully exited the FATF list of jurisdictions under increased monitoring in October 2021, after completing its Action Plan well ahead of the set timeline. As from November 2021, the United Kingdom also removed Mauritius from its list of high-risk countries under its UK Money Laundering and Terrorist Financing (Amendment) (No. 3) (high-risk countries) Regulations 2021. It is expected that Mauritius will be removed from the European Union List of high-risk countries in the near future. These developments uphold the reputation of the Mauritius International Financial Centre as a robust and credible jurisdiction and reinforce the integrity of the financial services sector of Mauritius including its global business sector. The delistings are important milestones for the Mauritius International Financial Centre.

Macrofinancial Environment

The global economic recovery is ongoing and the domestic economy is rebounding, amid well-contained risks to financial stability but with lingering uncertainty and risks to the economic outlook due to the pandemic. Optimism on domestic economic prospects gained further ground in the third quarter of 2021 with the reopening of the borders, accompanied by improving financial conditions. Conditions on the foreign exchange market improved and the reserves buffer remained adequate to shield the country from external vulnerabilities.

Improving global economic and financial conditions

The global economy recovered in 2021, with enhanced investors' confidence and improved risk appetite, supported by broadly accommodative monetary and fiscal policy measures. The pandemic continued to spread at varying rates globally, while vaccination campaigns were reinforced. In its October 2021 World Economic Outlook, the International Monetary Fund (IMF) estimated global economic growth for 2021 at 5.9 per cent, moderating to 4.9 per cent in 2022. However, uncertainty persists as to the strength of economic recovery with the emergence of new COVID-19 variants, which could further disrupt economic activity, particularly in emerging and developing economies.

Economic recovery across countries diverged due to the uneven evolution of the pandemic. Growth in advanced economies improved during the first three quarters of 2021 supported by easing financial conditions and increased optimism. However, recovery in emerging and developing countries was hampered by high unemployment rates, rising international commodity prices, pandemic-induced shocks on human capital and climate change. The IMF projected that advanced economies would reach pre-pandemic economic output levels by 2022, earlier than emerging and developing economies.

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Inflationary pressures gathered pace during 2021, with pandemic-induced shocks exacerbating demand-supply gaps. As a result, many central banks – mostly in emerging market economies – resorted to interest rate hikes to roll back accommodative monetary policy to fight inflationary pressures. The latter is expected to subside in 2022, but inflation is forecast to remain higher for emerging and developing economies than for advanced economies.

The monetary authorities in emerging and developing economies are anticipated to resort to further interest rate hikes that could lead to tighter financial conditions. While capital flows improved through the ongoing economic recovery, sustained by global risk appetite, potential tightening of monetary policy could disrupt capital flows and worsen debt sustainability of vulnerable economies.

Fiscal and monetary support alleviated financial strains on the household and corporate sectors. The low interest rate environment, complemented by income support measures and loan moratoria, improved the financial positions of households and corporate entities, curbing defaults on debts and preserving stability in the financial system. In the midst of economic recovery, policymakers are facing tighter policy space as they are confronted with various pandemic-induced challenges.

Risks to global financial stability remained well contained, reflecting the resilience of the financial world supported by timely policy actions, as elaborated by the IMF in its October 2021 Global Financial Stability Report. The resilience of the banking industry to the pandemic-induced shocks allowed it to sustain the flow of credit to the economy, owing to the consolidation of capital buffers that reflect the regulatory reforms post the Global Financial Crisis of 2008. Nevertheless, credit growth continued to be subdued, as banks remain cautious given risks to the economic outlook, particularly in emerging economies.

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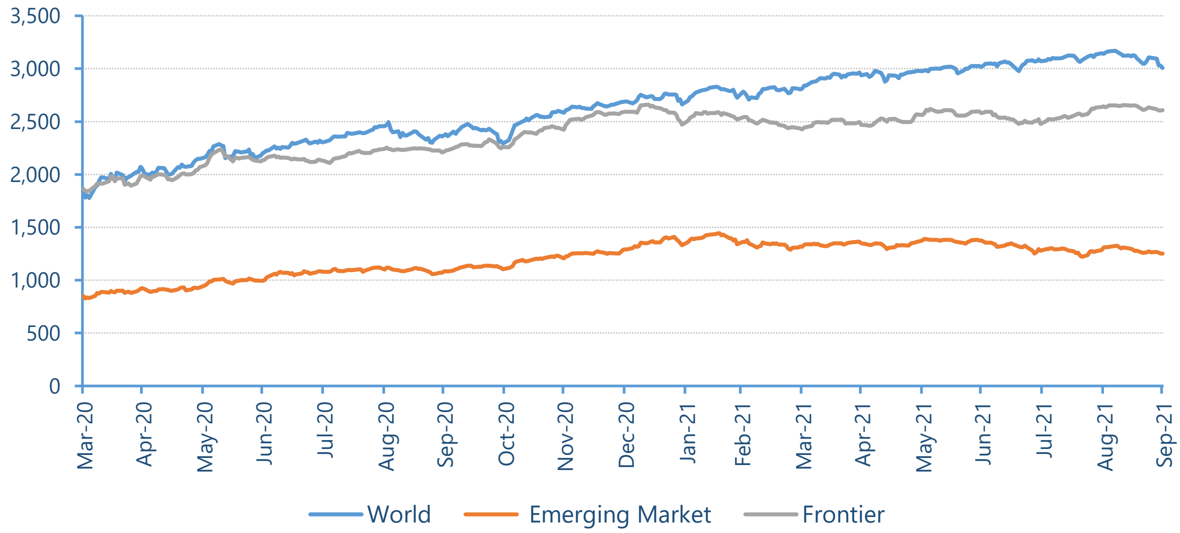
Equity prices registered a net improvement as the monetary policy stance in many large economies continued to be accommodative. The Morgan Stanley Capital International (MSCI) World index and MSCI Frontier index rose by approximately 7 per cent and 8 per cent, respectively, from end-March 2021 to September 2021. In contrast, the MSCI Emerging Market index contracted by 5 per cent over the same period (Chart 1.1).

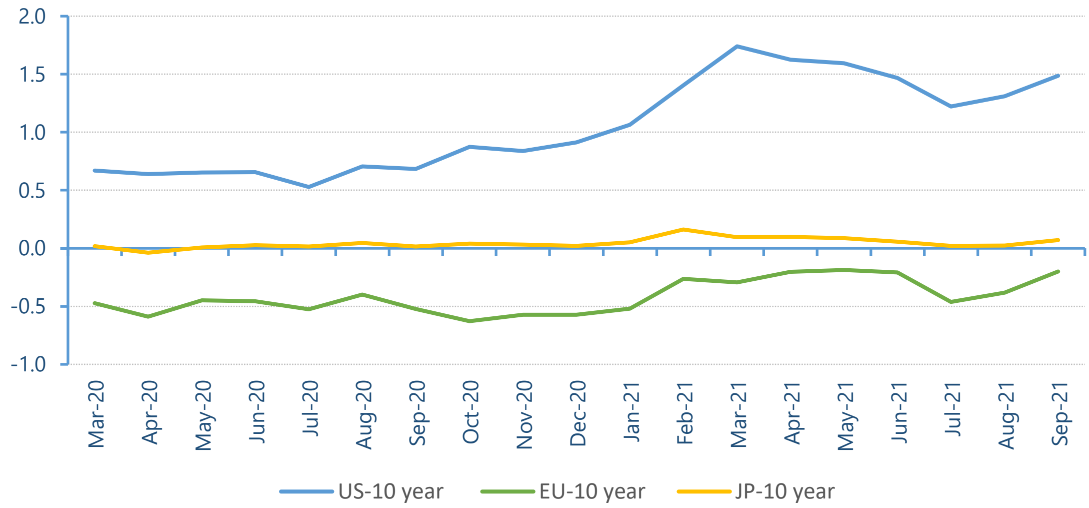
Chart 1.1: MSCI indices



Source: Bloomberg

Global long-term yields went up by the end of September 2021 following a noticeable decline earlier. The US 10-year yield went up in the third quarter of 2021, reversing its downward trend over the previous quarter. Nevertheless, the US 10-year yield was 25 basis points lower as at end-September 2021 than its peak level as at end-March 2021. A similar trend was noted for the EU 10-year yield, despite remaining in negative territory. This reflected the increase in market measures of interest rate risk and inflation compensation (Chart 1.2).

Chart 1.2: Selected government bond yields



Source: Bloomberg

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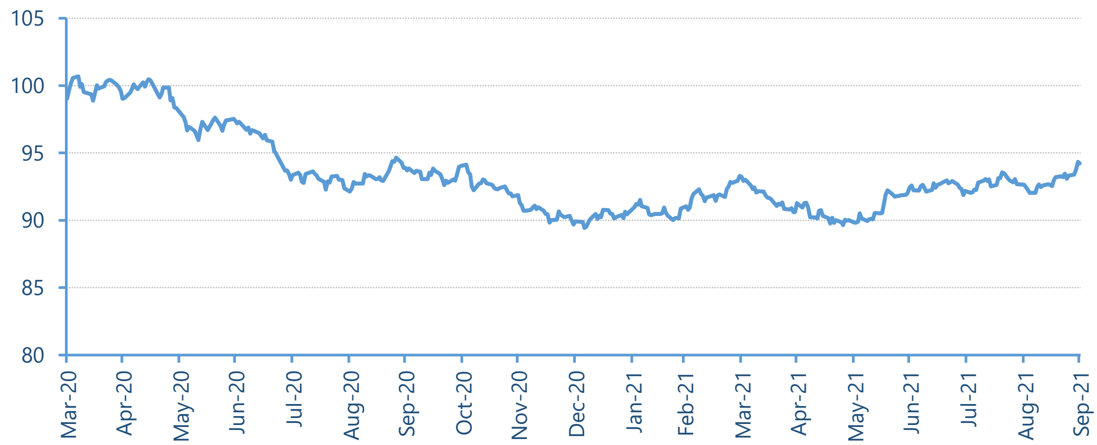
In currency markets, the US Dollar (US$) Index reached a new high at around 94, as at end-September 2021, reflecting a marginal improvement of 1 basis point compared to end-March 2021. The US$ Index initially followed a downward trend from end-March 2021 to 89 as at end-May 2021, and subsequently recovered till end-September 2021. This indicated that US economic recovery regained momentum as risk appetite and investors' confidence strengthened (Chart 1.3).

Chart 1.3: US Dollar Index



Source: Bloomberg

Domestic macrofinancial conditions recovering

The domestic economy rebounded in the second quarter of 2021. Real output expanded by 19.3 per cent due to progress in the vaccination campaign, continued policy support from the monetary and fiscal authorities as well as buoyancy of some major sectors that supported the economy during the second wave of the pandemic. The unemployment rate is estimated at 9.2 per cent in 2021, a 2.5 percentage point increase from the previous year. Importantly, the pickup in activity helped to moderate risks as financial conditions of the household and corporate sectors began improving.

Inflation rose to 3.2 per cent in September 2021, from 1.9 per cent in March, mainly driven by pandemic-induced supply-side shocks. Rising international commodity prices, higher freight costs coupled with a weaker exchange rate contributed to the pick-up in inflation. As the rise in consumer prices and producer prices in Mauritius have been prompted by supply-side bottlenecks, it does not suggest a deterioration in macroeconomic conditions. As such, even though inflation expectations are skewed to the upside, they do not represent a major source of risk to financial stability.

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With the partial reopening of the borders as from mid-July, there has been a revival in the number of tourist arrivals and tourism earnings (Chart 1.4). The tourism sector is expected to pick up further momentum, with the full reopening of the borders as from 1 October 2021. The recovery of various related sectors will be bolstered as tourist arrivals rise further.

Chart 1.4: Tourist arrivals and tourism earnings

Source: Bank of Mauritius and Statistics Mauritius

With the ongoing COVID-19 vaccination campaign, 63.2 per cent of the Mauritian population was fully vaccinated as at end-September 2021, rising to 72.3 per cent in November 2021. This notable progress in vaccination is likely to uplift consumer and business confidence while boosting economic activities.

While optimism on economic prospects gained ground in the third quarter of 2021, the spread of the new COVID-19 variant with potential disruptions to international travel as well as external demand may give rise to downside risks to the economic outlook. These risks could become subdued, however, depending *inter alia* on the efficacy of the vaccines against the new variant and development and commercialisation of medication to treat COVID-19. In the light thereof, the Bank revised its growth projection for 2021 to around 5.0 per cent.

Domestic markets gaining momentum

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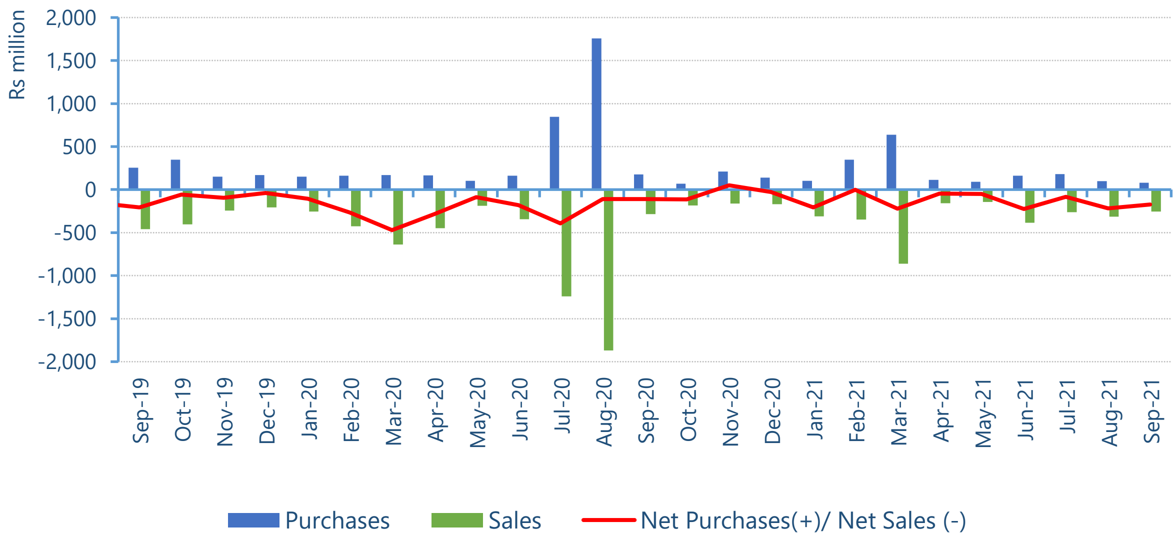
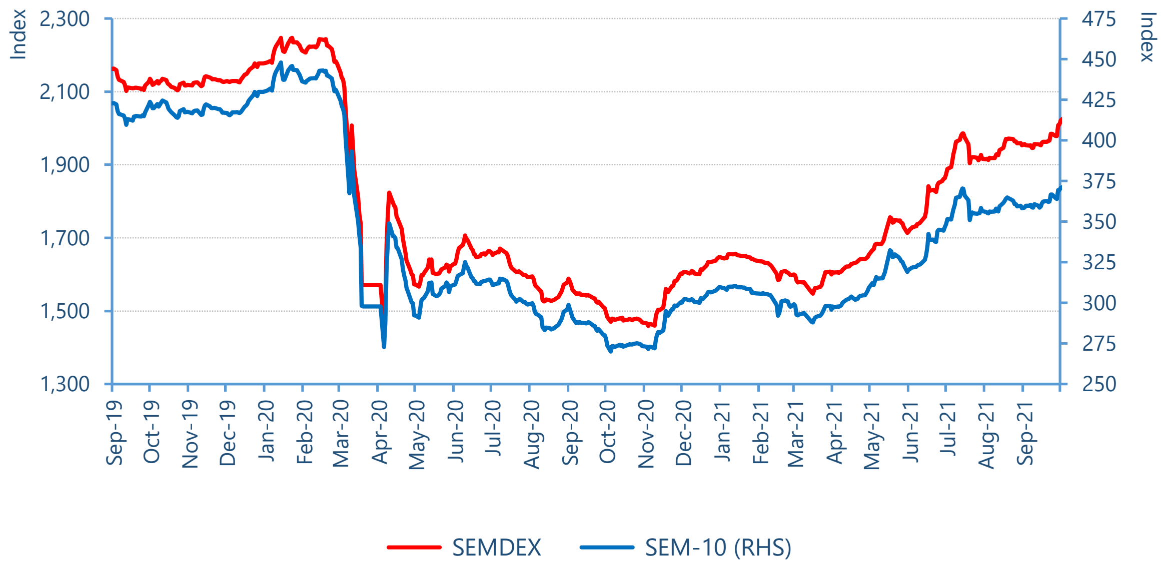
The domestic stock market continued to recover during the period under review as brighter economic prospects spurred investors' appetite, though key stock market indices were still below pre-pandemic levels. Besides economic recovery propelling gains on the stock market, another positive factor was the resumption of dividend payments by some blue-chip companies and continued support by the authorities to the economy, including the corporate sector. The performance of the domestic stock market was also under pressure from the continuous disinvestment by foreigners in search of risk-adjusted returns (Chart 1.5). Overall, the SEMDEX closed the third quarter of 2021 at 2,011 points compared to 1,600 for the first quarter of 2021 (Chart 1.6).

Chart 1.5: Investment by non-residents on the SEM and DEM



Source: Stock Exchange of Mauritius

Chart 1.6: Stock market indices (base: June 2017)



Source: Stock Exchange of Mauritius

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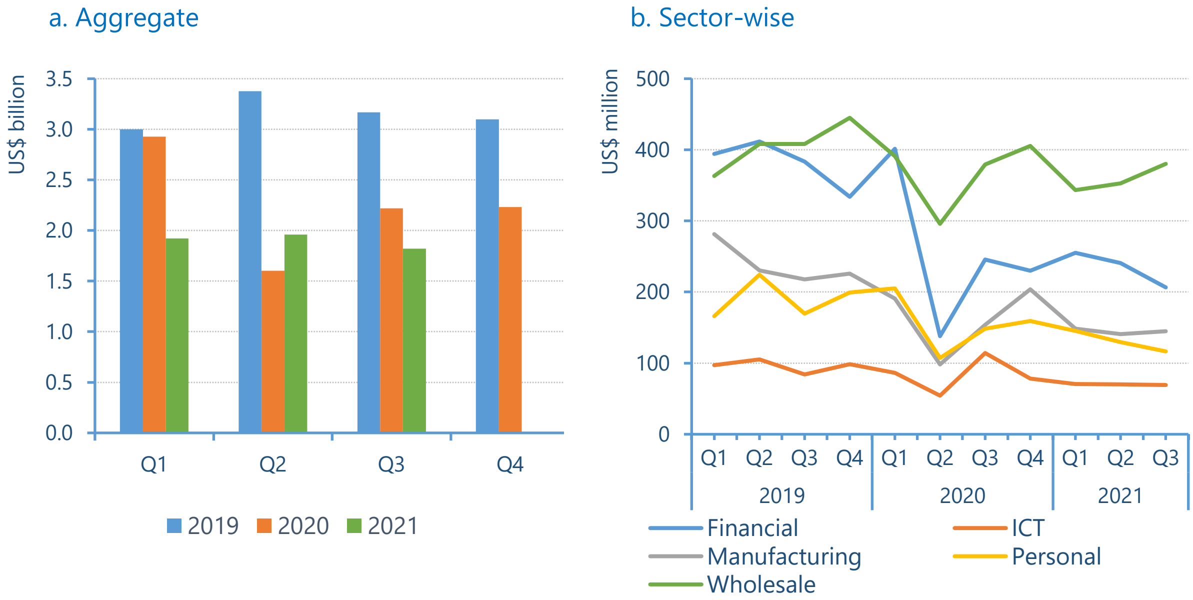
Conditions on the foreign exchange (FX) market broadly stabilised during the two quarters ended September 2021, with reduced volatility in the gap between market demand and supply of FX. Turnover was slightly up by 2 per cent in the second quarter of 2021 compared to the first quarter of 2021 as a result of the easing of the second lockdown in phases as from end-April 2021. However, this trend did not carry through to the third quarter, when FX turnover fell by 7 per cent from the second quarter of 2021 (Chart 1.7a). This drop was mostly caused by a lower volume of transactions in the '*Financial and insurance activities*' sector, which fell by 14 per cent in the third quarter of 2021 compared to the second quarter of 2021. Concurrently, turnover in the '*Wholesale and retail trade*' sector expanded by 8 per cent from the second quarter of 2021 to the third quarter of 2021. FX turnover in other main sectors was mostly unchanged (Chart 1.7b). The revival of the tourism sector and heightened economic activity are expected to bolster the FX market, though downside risks still prevail.

Chart 1.7: Foreign exchange turnover



Source: Bank of Mauritius

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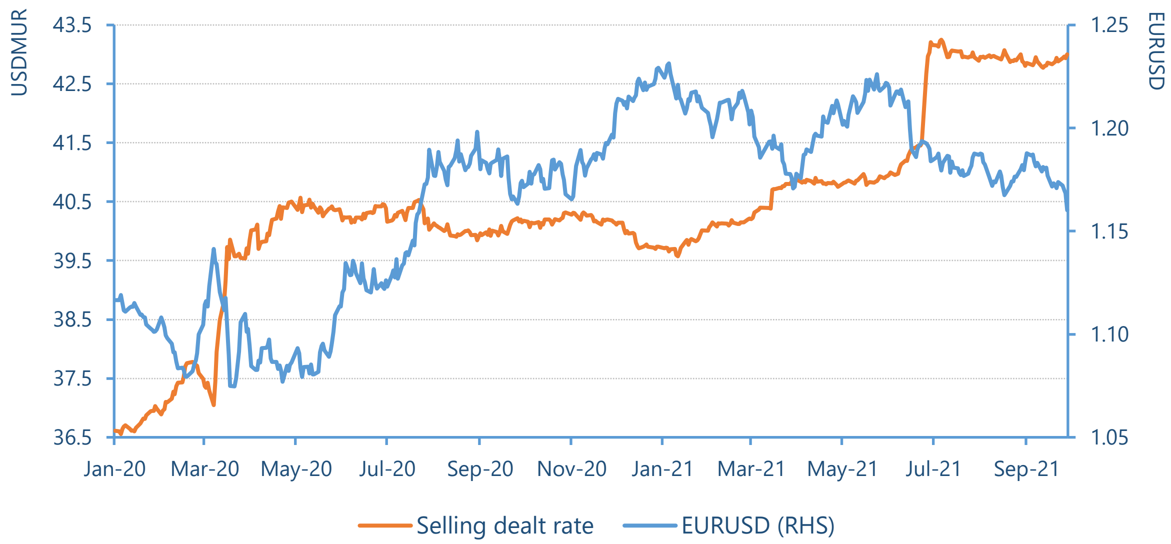
The Bank continued intervening to supply FX to the market and support the economic recovery in the absence of adequate FX inflows, in particular from the tourism sector. During the second and third quarters of 2021, the Bank intervened and sold a total amount of US$510 million to banks and foreign exchange dealers. The Bank also sold a total amount of US$280 million directly to the State Trading Corporation to fund the import of essential goods.

These FX interventions, conducted consistently within prevailing market exchange rates, contained excessive exchange rate volatility and unwarranted adjustment to the exchange rate that could have amplified economic and financial vulnerabilities. The exchange rate of the Rupee continued to reflect conditions on the domestic FX market as well as international currency movements. From 1 April to 30 September 2021, the weighted average selling dealt rate of the Rupee (Rs) depreciated by 4.9 per cent against the US dollar (Chart 1.8).

Chart 1.8: Evolution of EURUSD and USDMUR selling dealt rate



Source: Bank of Mauritius

The Bank pursued its accommodative monetary policy stance to support economic recovery. The Monetary Policy Committee kept the policy rate unchanged at 1.85 per cent at its meeting of 4 August 2021, as inflationary pressures triggered by pandemic-induced transitory supply shocks were expected to subside in the short term.

As recovery gathered momentum in the second quarter of 2021, the Bank intensified its monetary operations to bring down the level of Rupee excess liquidity in the banking system and sustain monetary policy effectiveness. Further, risk to financial stability arising from possible liquidity constraints had also abated with the ongoing recovery. As a result of its monetary operations, the Bank brought down the average Rupee excess liquidity to Rs26 billion from April to September 2021, from an average of Rs36.5 billion in the first quarter of 2021.

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The combination of issuance of securities by the Bank and its FX interventions contributed to bring down the level of excess reserves. The Bank issued securities for an aggregate amount of Rs50.5 billion against maturing securities of Rs60.9 billion, including the 3-Year Golden Jubilee Bonds for an amount of Rs4.9 billion. In addition, the Bank mopped up around Rs32.8 billion through FX operations conducted with banks, foreign exchange dealers and the State Trading Corporation. Net Issuance of Government securities for the period amounted to Rs42.6 billion, with an aggregate issuance of Rs24.6 billion in June 2021.

The liquidity impact of disbursements made under the various lines of credit extended by the Bank was neutralised through heightened liquidity operations. Lines of credit made available to the Development Bank of Mauritius Ltd and State Investment Corporation Ltd were meant to support enterprises operating in specific sectors and SMEs. These lines were initially valid up to 31

December 2020 but were extended up to June 2021. An aggregate amount of Rs3.1 billion was disbursed under various schemes up to 30 June 2021.

Money market yields gradually firmed up as the level of excess liquidity dropped. A gradual pick up in short-term yields was noted as from April 2021, with the 91-Day Bills yield rising from 0.25 per cent to 0.62 per cent by last week of September 2021. Yields in the 182-Day tenor ranged between 0.33 per cent to 1.32 per cent and that of the 364-Day tenor between 0.41 per cent to 1.59 per cent. Interbank interest rates went up as well, hovering in the range 0.12-2.00 per cent, compared to 0.12-0.64 per cent in the previous two quarters. Banks' weighted average savings deposit rate fell by 4 basis points to 0.42 per cent while their weighted average lending rate dropped by 11 basis points to 4.58 per cent (Chart 1.9).

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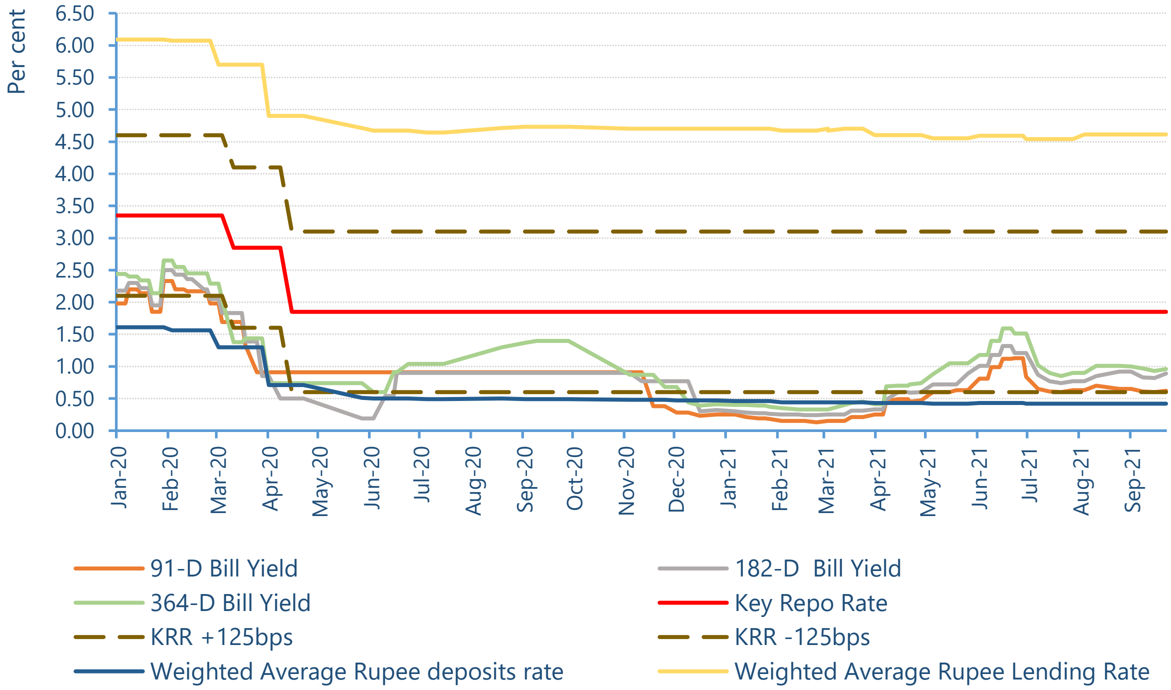
Chart 1.9: Evolution of market interest rates



Source: Bank of Mauritius

International reserves remained adequate

The Gross Official International Reserves (GOIR) remained at a level that satisfied various adequacy assessment metrics. The GOIR rose to US$7.8 billion as at end-September 2021, from US$7.3 billion as at end-March 2021. The level of the reserves was assessed to determine whether it was adequate to protect the country against potential external vulnerabilities, such as to meet import obligations, servicing short-term external debt and unexpected outflows from the global business (GB) sector. The assessment was carried out using latest available data as well as projections for the third quarter of 2021.

The conventional reserve adequacy metrics indicate that the reserves were broadly adequate. Based on imports of goods and services for calendar year 2020, the GOIR provided an import cover of 19.6 months as at end-September 2021. Similarly, the reserves to broad money ratio stood at 44 per cent – well above the 5-20 per cent range advocated by the IMF – while the ratio of reserves to short-term external debt stood at 101 per cent, above though close to the threshold of 100 per cent (Greenspan-Guidotti rule).

The Bank also monitors reserve adequacy following the IMF Assessing Reserve Adequacy (ARA) methodology.[1] This methodology, adapted to the Mauritian context, evaluates the adequacy of reserves from the perspective of potential shocks to the balance of payments. The IMF ARA metric takes into account exports of goods and services, short-term debt, broad money liabilities, external liabilities and deposits of the GB sector given the size of the sector, when assessing the resilience of the reserves. The ratio of reserves to the IMF ARA metric as at end-September 2021 stood at 114 per cent, well within the 100 to 150 per cent range advocated by the IMF (Chart 1.10).

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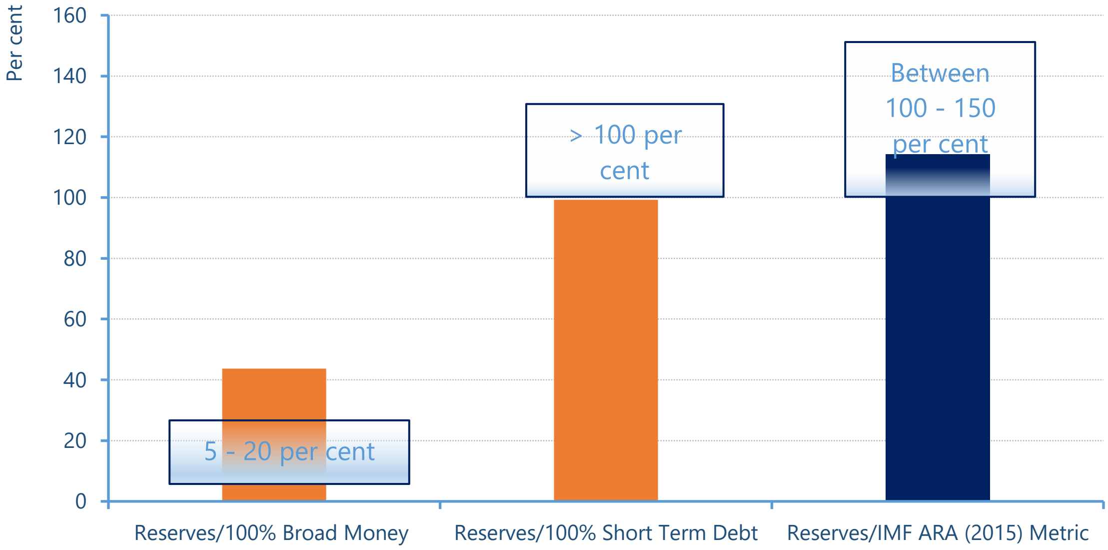
Chart 1.10: Reserves adequacy metrics



Source: Bank of Mauritius

Systemic Risk Indicator rose due to greater uncertainty

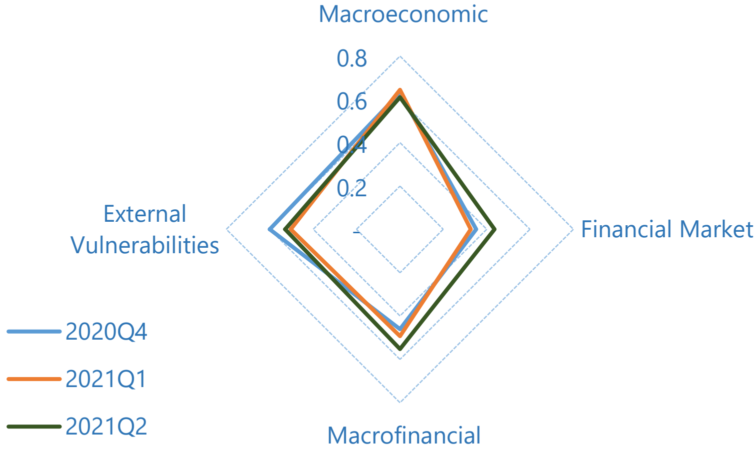
The level of risk, as measured by the Systemic Risk Indicator (SRI), went up in June as compared to March 2021. This higher level was caused by greater volatility in domestic financial markets and a rise in macrofinancial risk, likely stemming from still high uncertainty about the path of economic

[1] *Mauritius: Staff Report for the 2021 Article IV Consultation. (https://www.imf.org/en/Publications/CR/Issues/2021/06/28/Mauritius-2021-Article-IV-Consultation-Press-Release-Staff-Report-and-Statement-by-the-461296)*

recovery with possible implications for the financial sector. On the other hand, vulnerabilities arising from the macroeconomic conditions and external threats subsided to some extent, as business and consumer confidence improved with the gradual reopening of the borders as from mid-July 2021 (Chart 1.11). The rise in the SRI appeared to be driven by the level of uncertainty in current circumstances rather than by the fundamental build-up of systemic risks.

Chart 1:11: Systemic risk indicator

a. Risk map



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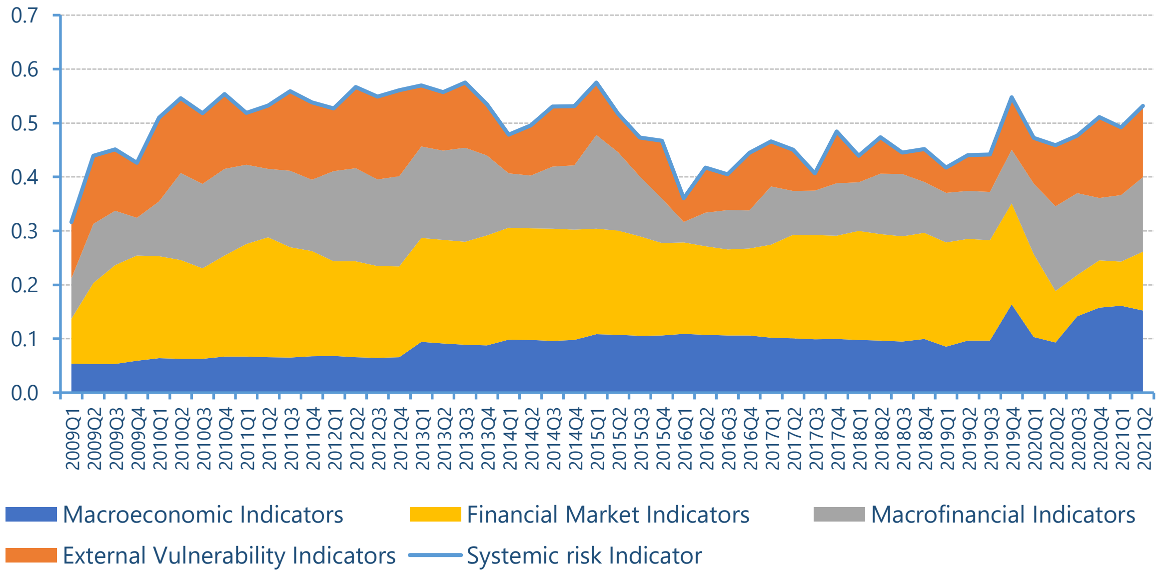
b. Systemic risk indicator



Note: The Systemic Risk Indicator provides an indication of an overall assessment of changes in the underlying risk indicators relevant to the macro stability of the banking sector. It covers the period from the first quarter of 2009 to the second quarter of 2021. As the indicators move further from the centre (approach a score of 1), the level of risk increases.

Source: Bank of Mauritius

Box 1: Mauritius successfully exits the FATF list

Mauritius was placed on the Financial Action Task Force (FATF) list of countries under increased monitoring in February 2020. In the light thereof, the country committed to resolve swiftly the strategic deficiencies identified by FATF in its Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) system, within an agreed timeframe.

The five strategic deficiencies identified were namely:

1. demonstrating that the supervisors of its global business sector and Designated Non-Financial Business and Professions implement Risk-Based Supervision (RBS);
2. ensuring access to accurate basic and beneficial ownership information by competent authorities in a timely manner;
3. demonstrating that Law Enforcement Agencies have the capacity to conduct money laundering investigations, including parallel financial investigations and complex cases;
4. implementing a risk-based approach for supervision of its Non-Profit Organisation sector to prevent abuse for terrorist financing purposes, and
5. demonstrating the adequate implementation of targeted financial sanctions through outreach and supervision.

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In February 2020, Mauritius made a high-level political commitment to work with the FATF and the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG) to strengthen the effectiveness of its AML/CFT regime and to implement its Action Plan within the timeline agreed with the FATF.

In June 2021, the FATF made the initial determination that Mauritius had substantially completed its Action Plan, which warranted an on-site assessment to confirm that the implementation of Mauritius' AML/CFT reforms had begun and was being sustained, and that the necessary political commitment was in place to sustain such implementation over the long-term.

The Africa/Middle East Joint Group of the FATF undertook the onsite visit of Mauritius in September 2021 and confirmed that all the action items had been addressed by Mauritius, and that the requisite conditions were in place to ensure sustainability of the reforms.

At its October 2021 Plenary, the FATF concluded that Mauritius would no longer be subject to increased monitoring by the FATF. The FATF welcomed the significant progress made by Mauritius in improving its AML/CFT regime by strengthening the effectiveness of its AML/CFT regime and meeting the commitments in its action plan regarding the strategic deficiencies that the FATF identified in February 2020. The FATF concluded that Mauritius would therefore no longer be subject to the FATF's increased monitoring process but the country should continue to work with ESAAMLG to improve further its AML/CFT system.

Consequently, Mauritius exited the FATF list of jurisdictions under increased monitoring in October 2021, after completing its Action Plan well ahead of the set timelines. As from November 2021, the United Kingdom (UK) has removed Mauritius from its list of high-risk countries under the UK Money Laundering and Terrorist Financing (Amendment) (No. 3) (high-risk countries) Regulations 2021. Mauritius will eventually be removed from the EU List. These developments uphold the reputation of the Mauritius International Financial Centre (MIFC) as a robust and credible jurisdiction and reinforce the integrity of the financial services sector including its global business sector.

The fight against money laundering and terrorism financing is an ongoing process and Mauritius, through its National Strategy, ensures the sustainability and continuity of the AML/CFT reforms over both the medium and long term. Mauritius will ensure that appropriate actions are taken at all times so that it is at par with the evolving international standards, both for technical compliance and effectiveness. The overall objective is to address new and emerging AML/CFT risk.

Box 2: The Bank is assigned the mandate of the macroprudential authority of Mauritius

The Bank has been assigned the function of the macroprudential authority of Mauritius in August 2021, in terms of section 5(1)(ba) of the Bank of Mauritius Act 2004 (Act). This new responsibility complements its mandate to ensure the stability and soundness of the financial system of Mauritius, as laid down at section 4(2)(b) of the Act. The primary objective of macroprudential policy is to prevent the build-up of systemic risks in the financial system and ultimately preserve financial stability.

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Macroprudential policy is certainly not new to the Bank, as it has been conducting macroprudential analysis and using macroprudential tools since 2013. However, with this statutory mandate, it becomes imperative to design and deploy a systematic and robust macroprudential policy framework to assess and monitor systemic risks in the whole financial system. To that effect, the Bank is currently redesigning its macroprudential policy framework as well as consolidating its structure for the surveillance of risks to financial stability in line with international standards. The key prerequisites to effective macroprudential policy are a strong institutional framework, clear mandate and objectives, authority and powers to act, and accountability and transparency.

The Financial Services Commission (FSC), as the regulator for non-bank financial services, will share its analyses on systemic risks and financial stability issues with the Bank. The well-established effective collaboration between the FSC and the Bank will facilitate the coordination of financial sector assessment to enable timely identification of threats to financial stability and fast-track policy responses.

Macroprudential policy is about systemic risks. Specifically, the Bank has to identify, assess, mitigate and monitor those risks to preserve financial stability in Mauritius. Some key aspects of macroprudential policy are outlined below.

Rationale for macroprudential policy

The consequences of disruptions to the financial system have led international standard setters to focus greater attention on macroprudential policy since the Global Financial Crisis in 2008, as systemic risks were generally underplayed prior to that event. Many central banks and regulatory authorities rapidly formalised macroprudential policy and adopted a series of policy measures to tackle those risks. These measures rely on prudential tools primarily to limit those risks in the financial system, as compared to microprudential policy which focuses on the soundness of individual financial institutions.

The ultimate objective of macroprudential policy is to safeguard the stability of the financial system by containing those risks and reinforcing the resilience of the financial system to shocks to ensure sustained contribution of the financial sector to economic growth. Recognising the importance to manage systemic risks, the Bank introduced a set of macroprudential tools in 2013, such as loan-to-value and debt-service-to-income ratios, and has recalibrated these tools to address changes in the level of the risks.

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Interlinkages in the financial system

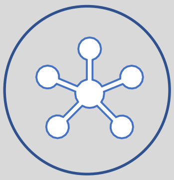
The high degree of interconnectedness within the financial sector and between the financial sector and the real economy are potential sources of systemic risks that can threaten financial stability. For instance, the connection between Global Business Companies (GBCs) and the banking sector is intricate and strong, with GBCs assets and liabilities to the banks representing an important component of banking operations. While banks have their own internal risk mitigation system when it comes to exposures to GBCs, a system-wide approach has to complement the management of such risks.

The size and complexity of the financial sector in Mauritius have expanded considerably in the last two decades and is set to magnify further. The banking sector represented around 420 per cent of GDP in September 2021. It is essential for the macroprudential authority to address vulnerabilities in the financial system and those that could emerge from macrofinancial linkages.

Tools and indicators

The macroprudential policy framework being developed will consist of a series of models, indicators and tools targeting the broad financial system as well as specific segments of the real economy to which the financial system is exposed. It will enhance the Bank`s internal capacity for the timely identification and management of systemic risks to foster resilience against structural and exogenous shocks.

The tools will also comprise capital flow management measures (CFMs) that are specifically intended to manage capital flows during crises. CFMs can foster resilience to external vulnerabilities. They would supplement the new macroprudential and financial stability setup and safeguard the stability of the financial system against external shocks.



Interaction between macroprudential measures and other policies

The implementation of macroprudential measures (MPMs) entail various implications for monetary policy, fiscal policy, microprudential policy, crisis management, and resolution planning amongst others. The purposes of macroeconomic policies may complement or conflict with macroprudential policy. The policies have, however, the same focus: to preserve and sustain economic stability to maximise long-term economic growth.

Fiscal and monetary policy are more concerned about business or economic cycles, while macroprudential policy tend to focalise more on financial cycles. For instance, a monetary policy stance geared towards maintaining price stability may contribute to the build-up of pressures in the financial system and the economy. The execution of MPMs would, therefore, necessitate careful assessment of conflicts or synergies with other relevant policies to ensure their effectiveness.

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Accountability and transparency

Effective communication is a crucial element of the financial stability and macroprudential set up. It allows stakeholders to understand the objectives, the strategy and the policy process and to put any warnings or measures into the right context. The ultimate objective is to build confidence in the financial system.

The Bank is already transparent in its assessment of risks to financial stability, in particular in its biannual Financial Stability Report (FSR). As the macroprudential authority of Mauritius, more specific coverage of macroprudential assessments and policies will be required and these will be elaborated in the FSR going forward. The institutional setup, objectives, assessments and policy responses will be further clarified in the FSR as well as in dedicated sections of the Bank's website.

Financial Soundness of Households and Corporates

The ongoing recovery is well supported by the expansion of bank credit to economic operators and is moderating risks in the banking sector. The host of monetary and fiscal measures, including the extension on loan moratoria to 30 June 2022, has aided to cushion the impact of the pandemic on the credit portfolio of banks. Household credit grew at a strong pace, against the backdrop of a low ratio of non-performing loans. The corporate sector is progressively recovering from the pandemic, accompanied by subsiding financial risks, and was the major contributor to the growth of bank credit. As the economy is still operating below its pre-pandemic capacity and the pandemic continues to linger, potential risks from the household and corporate sectors are closely monitored for the timely deployment of measures to avert the build-up of vulnerabilities.

Economic recovery is well on track, with the gradual reopening of national borders as from mid-July 2021 and continued support measures extended by the monetary and fiscal authorities. The swift resumption of economic activities following the second lockdown in March 2021, with the prompt roll-out of work access permits and easing of sanitary restrictions, helped households and corporates to walk through the second wave of the pandemic. Understandably, this prevented further build-up of vulnerabilities, while keeping risks to financial stability contained. The Bank has further extended some of the measures under its COVID-19 Support Programme to continue providing assistance to the household and corporate sectors during the recovery phase.

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Bank credit growth sustains optimism

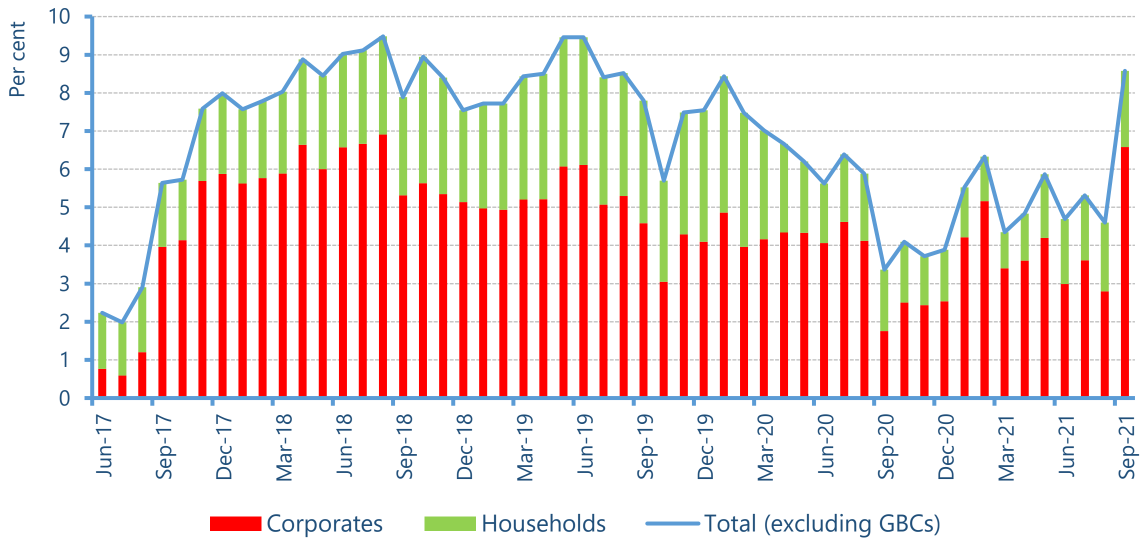
Recent trends in bank credit to the private sector (excluding GBCs) added some optimism to economic prospects.[2] Prompt actions taken by the authorities played a major role in cushioning the blow to economic activity from the second wave of the pandemic in early 2021, whilst measures rolled out by the Bank proved effective in maintaining the flow of credit to the economy. These measures also contributed to cushion the impact on the asset quality of banks, in particular the ratio of non-performing loans (NPL) to total loans which dropped to 4.5 per cent as at end-September 2021 from 5.0 per cent as at end-March 2021.

The annual growth of bank credit to the private sector has been generally trending upwards despite some volatility. A sustained expansion in credit facilities availed by both households and corporates could be noted, with the annual growth rising to 8.6 per cent as at end-September 2021, from 4.4

[2] *Private sector includes Other Nonfinancial Corporations, Other Financial Corporations, Public Nonfinancial Corporations and households.*

per cent as at end-March 2021 (Chart 2.1). Nevertheless, given that the impact of favourable base effects on output shadowed the expansion in credit, the private sector credit-to-Gross Domestic Product (GDP) ratio went down modestly from 89.4 per cent as at end-March 2021 to 89.2 per cent as at end-September 2021.

Chart 2.1: Year-on-Year growth of credit to the private sector



Source: Bank of Mauritius

Household credit growing soundly

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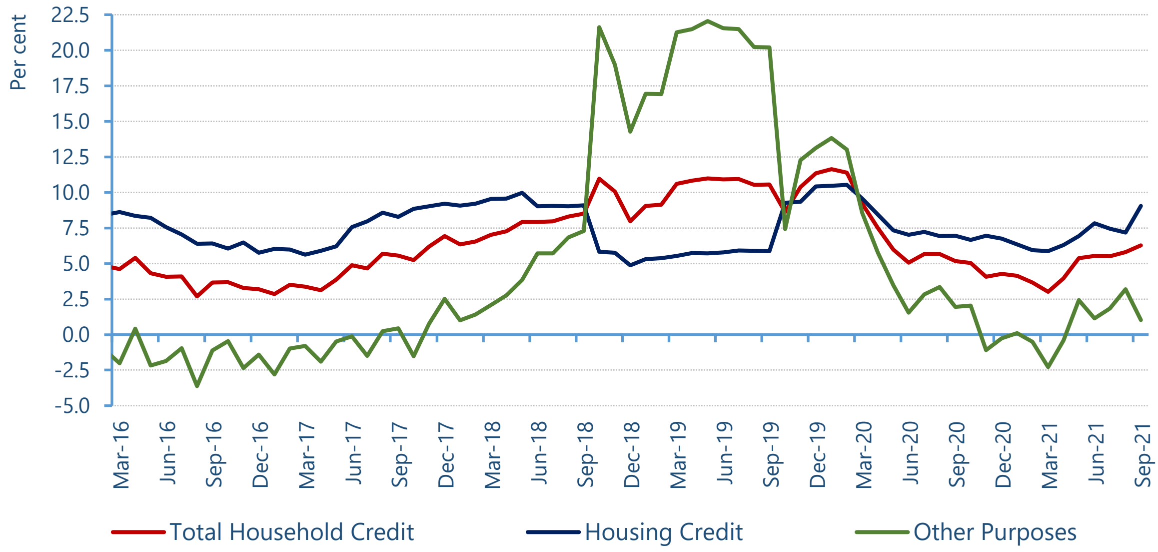
Household credit expanded at a strong pace, partly reflecting confidence in economic perspectives and moderation of risks due to the rebound in economic activity. The annual growth rate went up to 6.3 per cent as at end-September 2021, from 3.0 per cent as at end-March 2021. Household credit was driven primarily by housing credit.

The growing share of housing credit, reaching 67.3 per cent of total household credit in September 2021, underscored its relevance in the composition of total household credit. In contrast, the share of credit directed to households for other purposes declined. The low interest rate environment remained favourable to housing credit, with its growth picking up to 9.0 per cent as at end-September 2021 from 5.9 per cent as at end-March 2021.

Household credit granted for purposes other than housing depicted greater correlation with the economic cycle, plummeting as quarterly output contracted and picking up with economic recovery. From a contraction of 2.3 per cent as at end-March 2021, household credit for other purposes resumed with positive growth of around 1.0 per cent as at end-June and end-September 2021 (Chart 2.2).

Chart 2.2: Year-on-year growth of credit to households



Source: Bank of Mauritius

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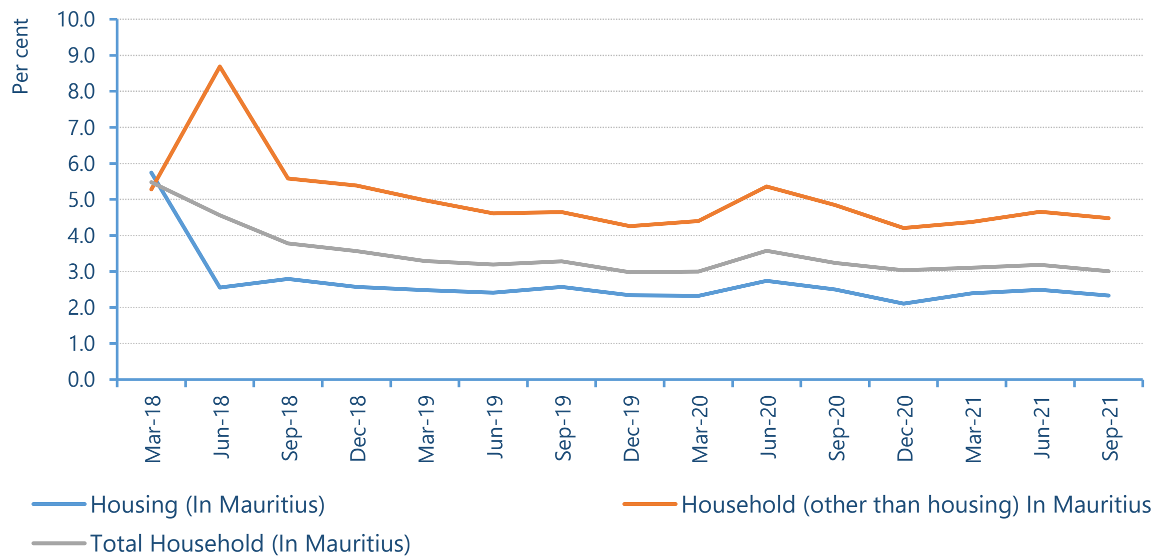
The quality of household credit was not significantly impacted by the economic downturn, given the set of support measures launched by the authorities to protect households financially, such as loan moratoria, restructuring of loans, and wage assistance schemes. The NPL ratio for households hovered around 3.0 per cent as at end-September 2021, compared to 3.1 per cent as at end-March 2021. For housing credit, the share of NPL stood at 2.3 per cent as at end-September 2021, marginally down from 2.4 per cent as at end-March 2021. In contrast, the NPL ratio for household credit granted for other purposes went up slightly to 4.5 per cent as at end-September 2021, from 4.4 per cent as at end-March 2021 (Chart 2.3).

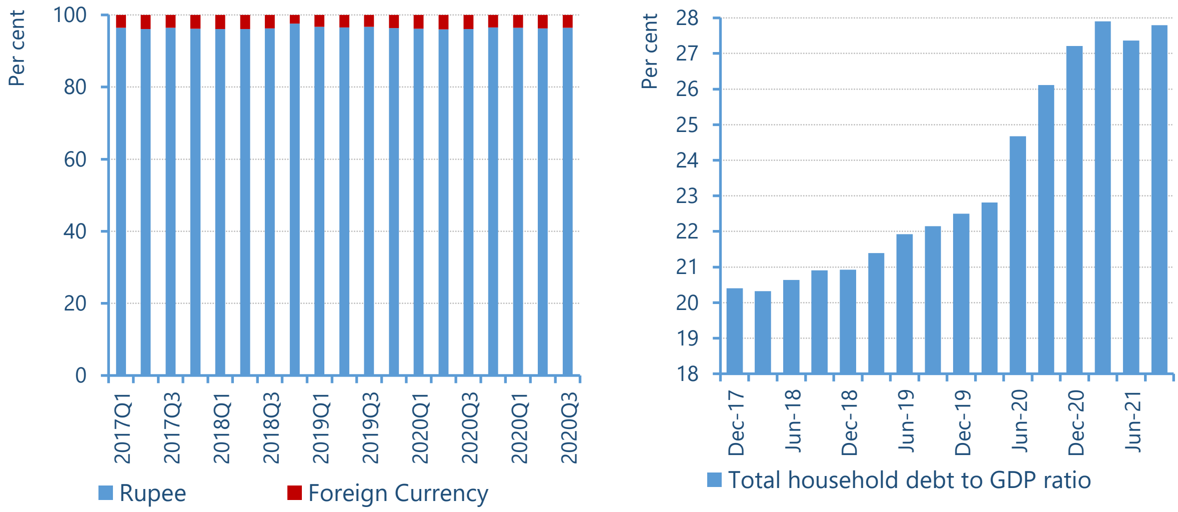
Chart 2.3: NPL ratio for households in Mauritius



Source: Bank of Mauritius

Household indebtedness to banks as a ratio to GDP was relatively unchanged at around 28 per cent in September 2021, compared to March 2021 (Chart 2.4). However, a broader measure of household indebtedness – that sums up household credit from banks, Non-Bank Deposit-Taking Institutions (NBDTIs), insurance and leasing companies – fell to 40.9 per cent of GDP in the third quarter of 2021, from 41.6 per cent of GDP in the first quarter of 2021.

Chart 2.4: Indicators of Household Indebtedness



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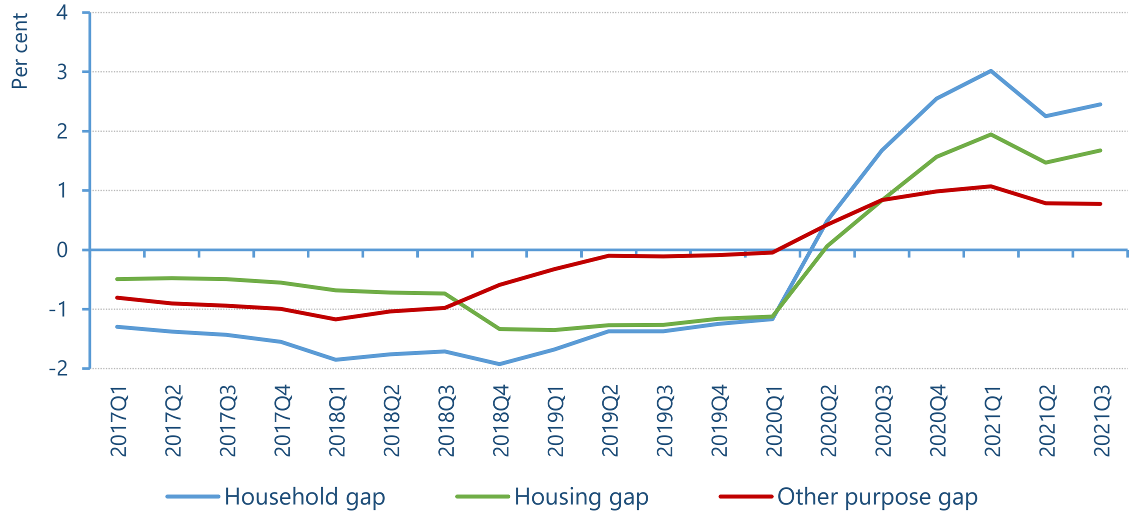
Source: Bank of Mauritius

As household credit expanded, the household credit-to-GDP gap narrowed to 2.5 per cent in September 2021, from 3.0 per cent in March 2021 (Chart 2.5).[3] The household debt service ratio – computed as a ratio of household debt service cost to GDP – also indicated better ability of households to repay their debt, as the ratio dropped to 6.9 per cent as at end-September 2021 from 7.1 per cent as at end-March 2021 (Chart 2.6).

[3] *Credit-to-GDP gap is the percentage deviation between the credit-to-GDP ratio and an estimate of its trend. The trend in the credit-to-GDP ratio is estimated by using the HP filter.*

Chart 2.5: Household Credit-to-GDP Gap



Source: Bank of Mauritius

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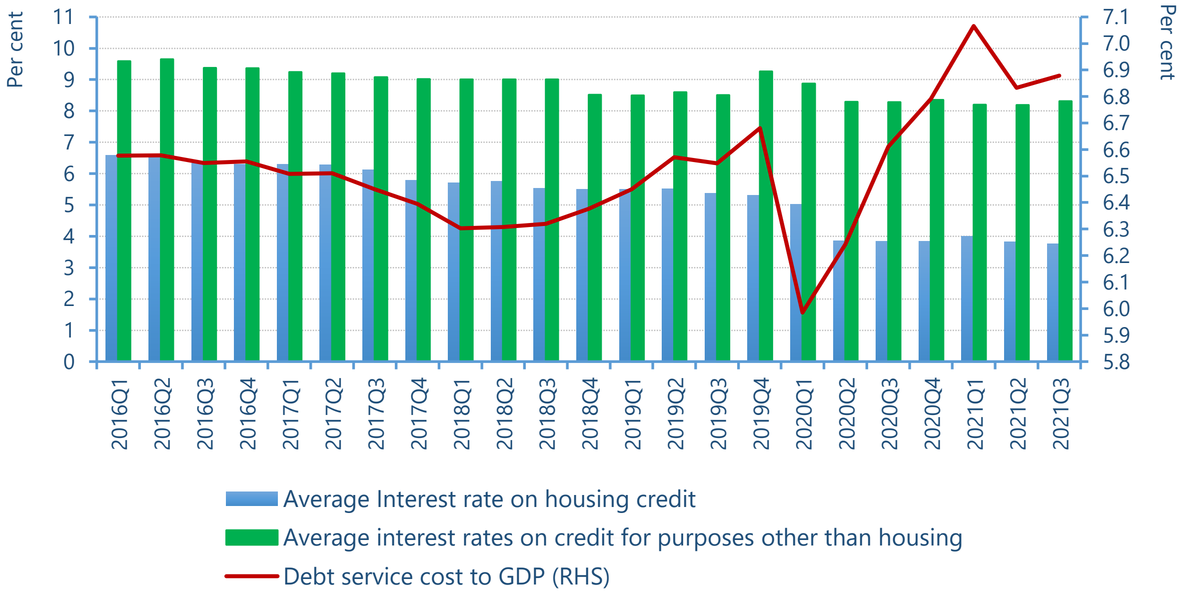
Chart 2.6: Household Debt Service Cost and Interest Rates



Source: Bank of Mauritius

The key metrics used to assess the level of indebtedness and borrowing capacity of households are primarily driven by output developments, as they are dependent on GDP level. Hence, these measures are portraying a rather optimistic picture pertaining to household debt developments, in consonance with the recovery in activity associated with favourable base effects.

Overall, financial risks from the household sector have stayed broadly stable. There are indications that household debt vulnerabilities have not worsened, mainly due to the range of COVID-19 support measures launched by the authorities. The improvement in household debt service ratio may partly accrue to efforts made by the Bank to assist distressed households in the form of moratoria and loans restructuring while keeping monetary policy broadly accommodative. In addition, initiatives by the government also contributed to preserve revenue of households, through wage or income assistance schemes. These measures have averted a dimmer scenario for the household sector and contained risks to financial stability that could have potentially emerged with the prolonged pandemic. However, as the pandemic continues to linger with the outbreak of new variants, concerns over the debt repayment capacity of the household sector persist.

Risks from corporate credit expansion remain contained

The corporate sector has progressively recovered from the pandemic as economic recovery became entrenched, accompanied by subsiding financial risks. The performance of the sector also improved with the gradual resumption of tourism-related activities and positive momentum in other sectors, such as the *'Manufacturing'* and *'Construction'* sectors. The host of measures extended by the fiscal and monetary authorities continued to provide the necessary support to corporates, aiding them to endure the brutal economic downturn in 2020 and subsequently ascend through the recovery process. The historically low interest rate environment is maintaining financing costs low, allowing corporates to allocate resources towards preserving their operations.

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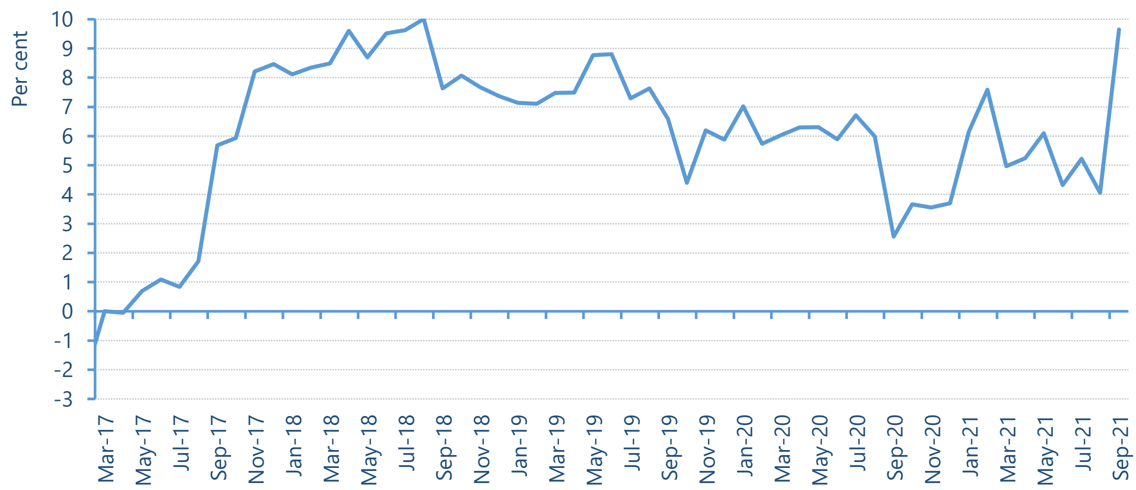
The corporate sector remained by far the dominant contributor to banks' total private sector credit, with a share close to 70 per cent. In keeping with prudent lending standards similar to the pre-pandemic period, bank lending to corporates grew at an annual rate of 9.7 per cent as at end-September 2021, higher than the growth of 5.0 per cent as at end-March 2021 amidst improved optimism amongst businesses and with economic activity gaining traction (Chart 2.7). The corporate credit-to-GDP ratio declined slightly from 60.7 per cent in March 2021 to 60.3 per cent in September 2021, mainly reflecting the rise in output.

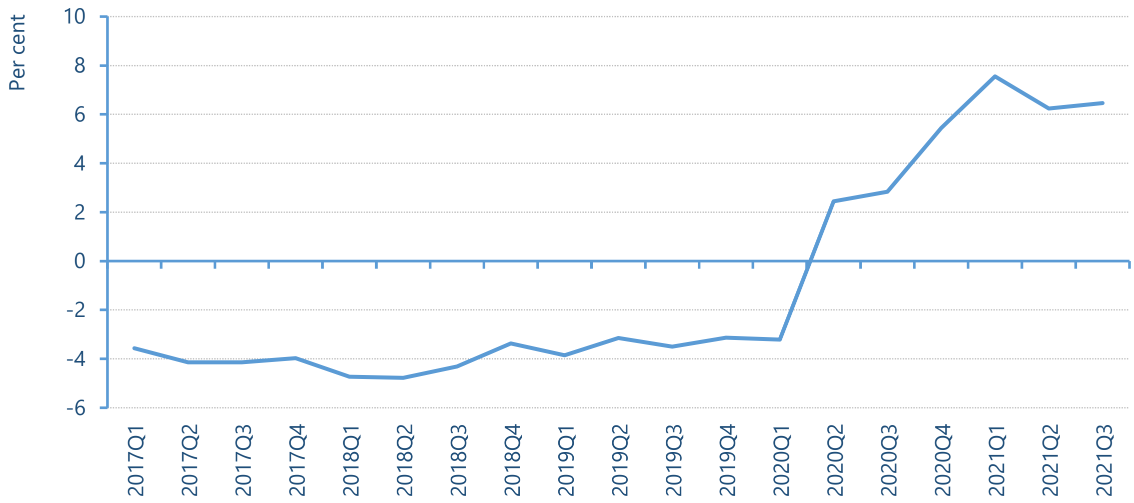
Chart 2.7: Corporate credit y-o-y growth



Source: Bank of Mauritius

The corporate credit-to-GDP gap suggests that risks to financial stability from the expansion of corporate credit are not significant. The gap narrowed from 7.6 per cent to 6.5 per cent, confirming that the surge in the gap was transitory in the wake of the negative impact of COVID-19 on output and is likely to normalise with the recovery in economic activity (Chart 2.8).

Chart 2.8: Corporate credit-to-GDP gap



Source: Bank of Mauritius

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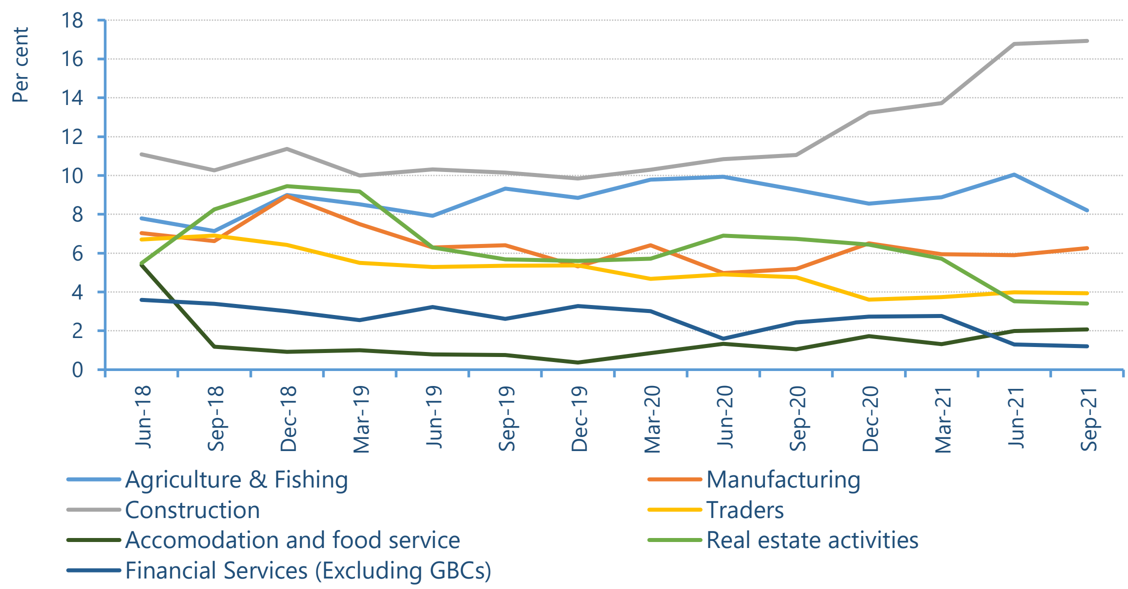
Similar to households, the repayment capacity of the corporate sector has been sustained with the support measures. As a result, the NPL ratio in key sectors had not deteriorated much and even improved for some sectors such as the '*Agriculture and fishing*', '*Real estate*', and '*Financial services (excluding GBCs)*', between end-March and end-September 2021 (Chart 2.9).

Chart 2.9: Sector-wise NPL ratio for selected key sectors in Mauritius



Source: Bank of Mauritius

Total corporate debt grew at an annual rate of 8.9 per cent as at end-September 2021 compared to a rise of 5.4 per cent as at end-March 2021, reflecting an increase in both domestic and external debt. Domestic corporate debt, accounting for around 92 per cent of total corporate debt, expanded at an annual rate of 9.1 per cent as at end-September 2021, higher compared to 5.6 per cent as at end-March 2021. This was mainly driven by credit to key sectors of the economy notably, the '*Accommodation and food service activities*', '*Wholesale and retail trade*' and '*Real estate activities*' sectors (Chart 2.10). Total external debt of the corporate sector went up by 7.0 per cent as at end-September 2021, compared to a growth of 2.9 per cent as at end-March 2021 as a result of a substantial increase in short-term borrowings.

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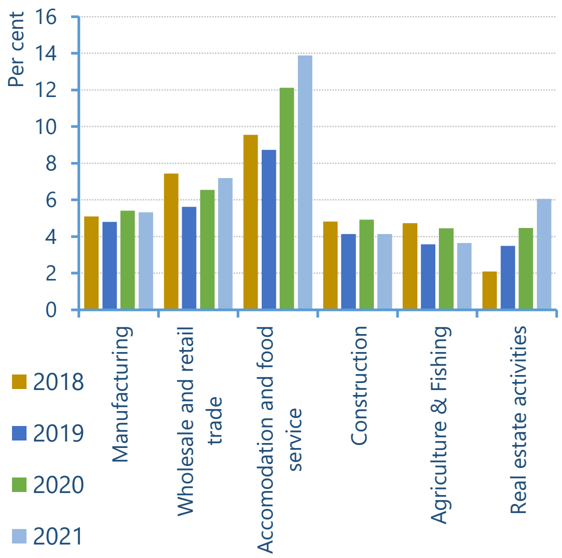
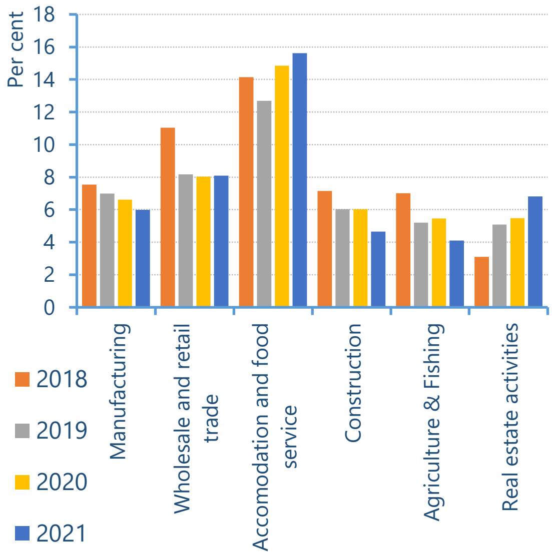
Chart 2.10: Sectoral distribution of corporate credit

a. Share in GDP



b. Share in total bank credit to the private sector



Note: Data refer to end-September.
Source: Bank of Mauritius

Incoming data indicate that the outlook for the corporate sector has brightened. Corporates are, however, at an early stage of their recovery path as the economy is still operating below its pre-pandemic capacity and some support measures are still in place. The cash flow of corporates, though improving, still remains fragile and vulnerable to adverse effects from the protracted pandemic. Should the risks unfold, the repayment capacity of the corporate sector may ultimately be impacted. As the COVID-19 pandemic continues to loom, downside risks to the health of corporates remain a concern and are closely monitored for the timely deployment of pre-emptive measures to avert the build-up in vulnerabilities.

Box 3: Extension of COVID-19 policy measures to June 2022

Since the outset of the COVID-19 pandemic, the Bank has taken several measures to ensure that the banking system remains resilient. Among others, some regulatory requirements were relaxed to ensure continuous supply of credit to the economy, as highlighted in the July 2021 FSR. On the other hand, additional guidance was provided on the classification and provisioning of assets in the context of COVID-19 as well as in the conduct of stress testing. The Bank also rolled out new reporting requirements and surveys for an enhanced oversight of the potential impact of the pandemic on the banking sector.

During the period under review, the Bank has adjusted the loan-to-value and debt-service-to-income ratios. The Bank also waived the annual licence fees due by cash dealers impacted by the COVID-19 pandemic for the financial year 2020-2021 to provide cash flow relief to these institutions.

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Arrangements for unwinding of COVID-19 measures

The accommodative measures adopted so far to contain the negative impact of the pandemic may have adverse effects in the long run. Hence, it is important that these measures be unwound in a time-bound manner, while at the same time ensuring that they are not prematurely removed.

The Bank has already started work on arrangements for the unwinding of the COVID-19 measures which have been discussed at the level of the Task Force on Banking Sector Resilience.

Accordingly, while the Bank has extended the moratorium on loans granted to economic operators, SMEs, households and individuals impacted by COVID-19 to 30 June 2022, banks have been required to examine the requests on an individual basis. Further, the Bank is now considering the payment of dividends on a case-to-case basis. However, banks are required to strictly comply with the requirements of the Guideline on Payment of Dividend, if they intend to pay dividend. The Guideline was recently amended to, amongst others, require submission of banks' financial forecasts, including those under stressed scenarios, and assumptions when seeking the Bank's approval.

Box 4: Decline in restructured loans as economic conditions improve

The extension on moratoria has cushioned financial stability risks within the economy. The magnitude of potential default among COVID-19 impacted borrowers on banks' balance sheet is a matter of concern. Accordingly, it becomes mandatory for banks to keep in view these loans along with proper monitoring of affected borrowers' financial position.

Total restructured loans followed a downward trajectory from Rs106 billion as at end-March 2021 to Rs88 billion as at end-June 2021, to then reach Rs82 billion as at end-September 2021. This decline by 22.6 per cent from the first quarter to the third quarter of 2021 is explained by a slump in demand for restructured loans. COVID-19 related restructured loans accounted for 77.0 per cent of total restructured loans as at end-September 2021 (Chart I).

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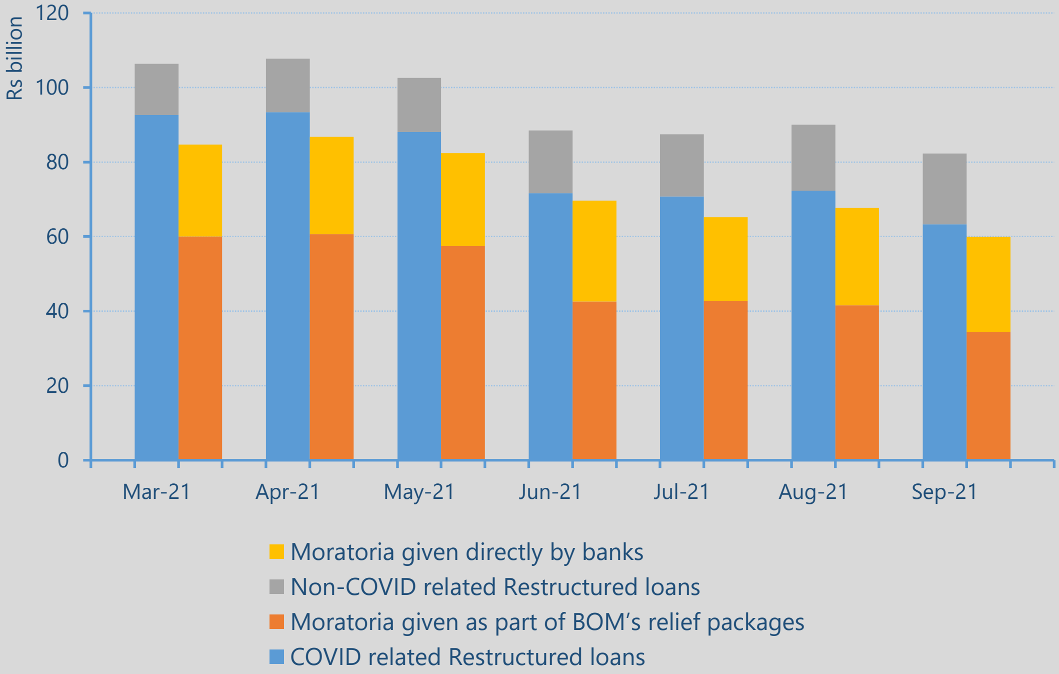
Chart I: Restructured loans and moratoria

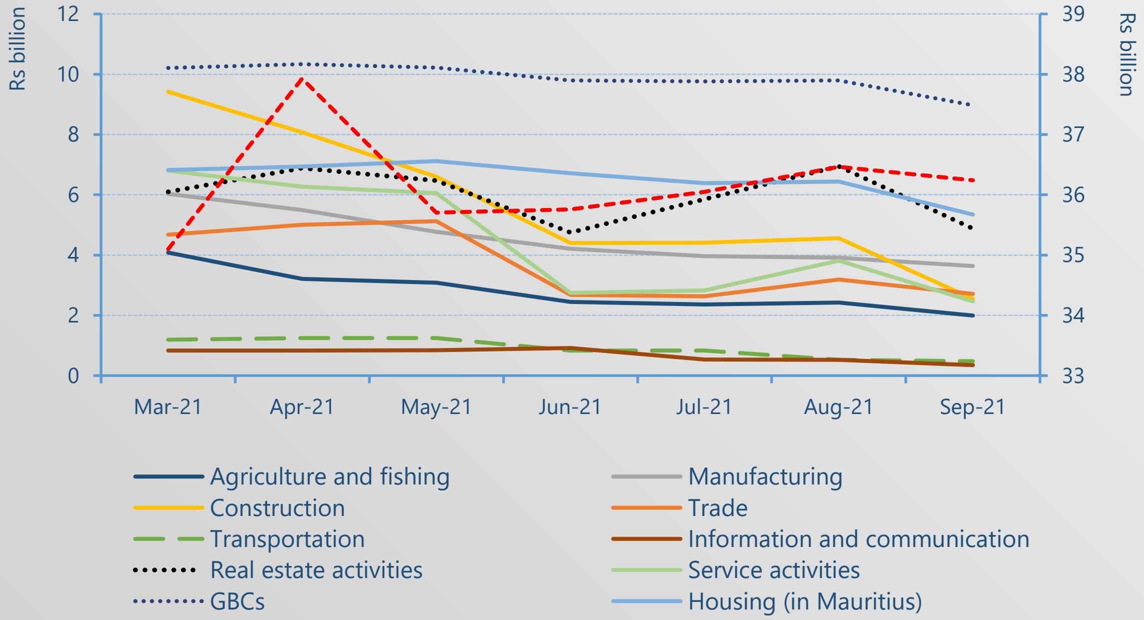


Source: Bank of Mauritius

Restructured loans in the form of moratoria hover around 73 per cent for the same period. The Bank's relief packages on moratoria amounted to Rs34 billion as at end-September 2021, down from Rs60 billion as at end-March 2021, due to the unwinding of the exposures under moratorium as well as repayments since the beginning of 2021. With the gradual phasing out of the support measures amid the economic recovery gaining momentum, the Bank will closely monitor banks to ensure a smooth exit from these support measures.

Reflective of the severity of the pandemic, '*Accommodation and food services*' remained the sector which has been mostly affected, with restructured loans amounting to Rs36 billion as at end-September 2021. This was followed by the 'GBC', 'housing' and 'real estate activities' sectors with restructured loans standing at Rs8 billion, Rs5 billion and Rs4 billion, respectively. On the other hand, restructured loans for the '*Construction*' and '*Manufacturing*' sectors fell during the period under review (Chart II).

Chart II: Sectorwise restructured loans



Source: Bank of Mauritius

More than 65 per cent of the restructured exposures were under Stage 1 followed by a lower proportion of 28 per cent under Stage 2 and the lowest proportion of 7 per cent were under Stage 3. In contrast, the bulk of provision made by the banking sector on restructured facilities, notably 46 per cent, was allocated under Stage 2.

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Financial Soundness of Deposit-Taking Institutions

Deposit-taking institutions (DTIs) remained resilient, supported by strong capital and liquidity positions as well as sound asset quality, despite significant headwinds from the pandemic. Key financial soundness indicators of DTIs were comfortably within prudential limits. Profitability levels improved as economic activity gathered momentum. Besides the monetary and fiscal measures, regulatory measures supported the resilience of the banking sector. Altogether these measures and the comfortable buffers held by the banking system contributed to preserve stability in the financial system.

Structure of the deposit-taking financial sector broadly unchanged

The composition of the sector has stayed unchanged. As at end-September 2021, nineteen banks were licensed to carry on banking business in Mauritius, of which eight were domestic-owned, eight were foreign-owned subsidiaries and three were branches of foreign banks. One bank, under conservatorship since 1 April 2020, was acquired and recapitalised by a new shareholder on 15 October 2021. A new banking licence was issued to the bank on 11 November 2021 following a change of name under section 7 of the Banking Act 2004.

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The banking sector continued to expand. Total assets of the sector rose to 420 per cent of GDP in September 2021, from 397 per cent in March 2021, primarily driven by the expansion in bank credit that was funded by an increase in deposits. The banking landscape remained relatively concentrated, with the two largest banks accounting for roughly 46 per cent of market shares for total deposits, advances and assets.

As part of its systemic risk monitoring, the Bank carried out an assessment in June 2021 to measure the systemic importance of banks and the resultant capital surcharge to be maintained by them. It determined the same five banks – namely, The Mauritius Commercial Bank Limited, SBM Bank (Mauritius) Ltd, Absa Bank (Mauritius) Limited, The Hongkong and Shanghai Banking Corporation Limited (Branch) and AfrAsia Bank Limited – as systemically important for the jurisdiction. These Domestic Systemically Important Banks (D-SIBs) maintained adequate capital buffers, inclusive of their respective D-SIB capital surcharges. Despite the COVID-19 impact, the D-SIBs maintained sound asset quality and remained profitable as at end-September 2021. They were also sufficiently funded, with LCR well above the regulatory requirement of 100 per cent.

As with banks, NBDTIs have shown resilience during the pandemic. There were six NBDTIs as at end-September 2021, which include leasing companies and finance companies. They mobilise deposits from the public and grant leasing and loan facilities to individuals and corporates. Total assets of NBDTIs represent around 14.3 per cent of GDP as at end-September, compared to 14.5 per cent as at end-March 2021, making up a relatively smaller part of the domestic financial ecosystem. A lack of business opportunities, given the uncertainty prevailing in the economic environment, hindered the growth momentum of NBDTIs. However, with the reopening of the borders and the revival of the tourism industry, the business landscape is expected to improve.

Banking sector overview

Strengthened balance sheet

Banking sector assets increased by 5.9 per cent over the six months ended September 2021 (Chart 3.1). This is mostly driven by growth in the business of the domestic-owned banks and subsidiaries of foreign banks. This expansion occurred during difficult times, in particular when the country faced the economic impact of the pandemic and the jurisdiction being on the FATF list of jurisdictions under increased monitoring, as well as on the list of high-risk countries of the European Union (EU) and the United Kingdom. The robust prudential framework combined with the trust of operators, both domestic and foreign, in the jurisdiction have contributed to this achievement.

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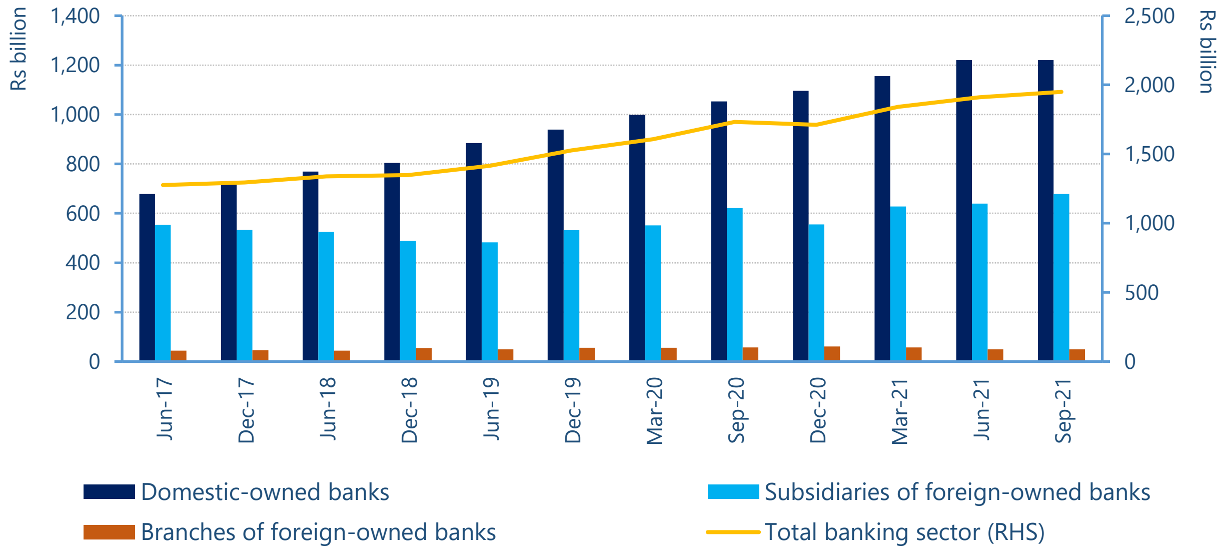
The pattern of distribution of assets and of liabilities have remained relatively unchanged (Chart 3.2). Deposits continued to be the main source of funds of the banking system. Global Business Corporations (GBCs) deposits accounted for about 28 per cent of total liabilities of banks.

Since the start of the pandemic, banks' assets grew principally from additional investments in less risky assets, such as Government and central bank securities, as well as placements rather than riskier loans. This lower risk appetite was primarily due to the elevated credit risk profile of corporate and retail customers in the context of the pandemic. Accordingly, the share of loans in total assets decreased to 45.3 per cent as at end-September 2021, from 46.1 per cent as at end-March 2021.

Chart 3.1: Banking sector assets



Source: Bank of Mauritius

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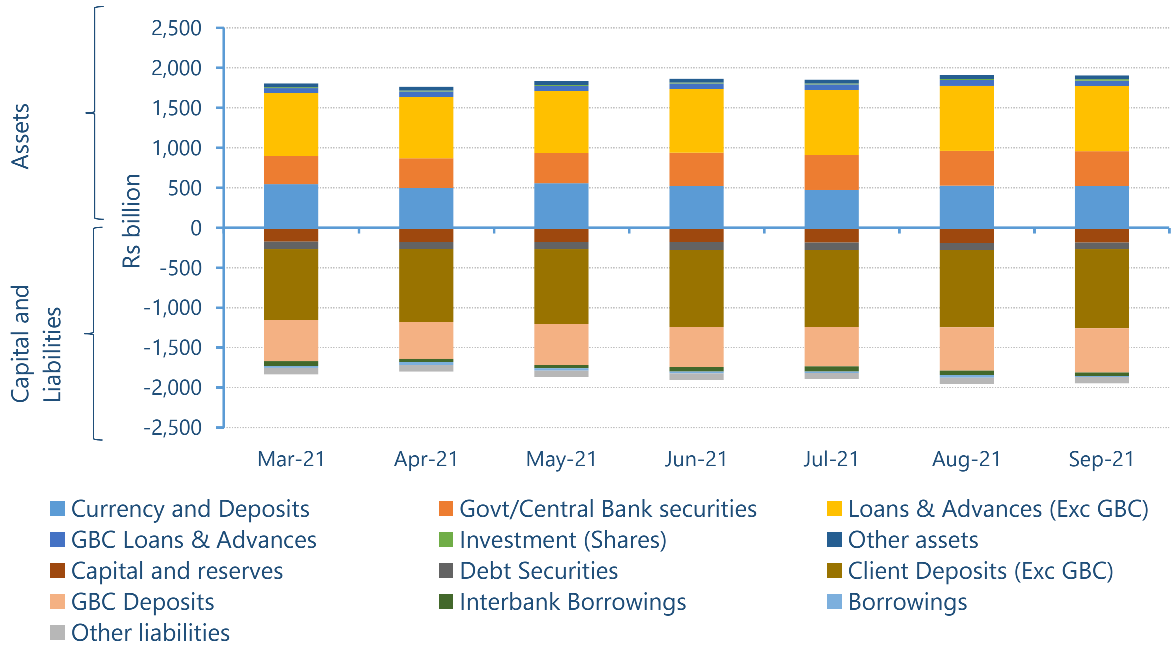
Chart 3.2: Distribution of assets and liabilities



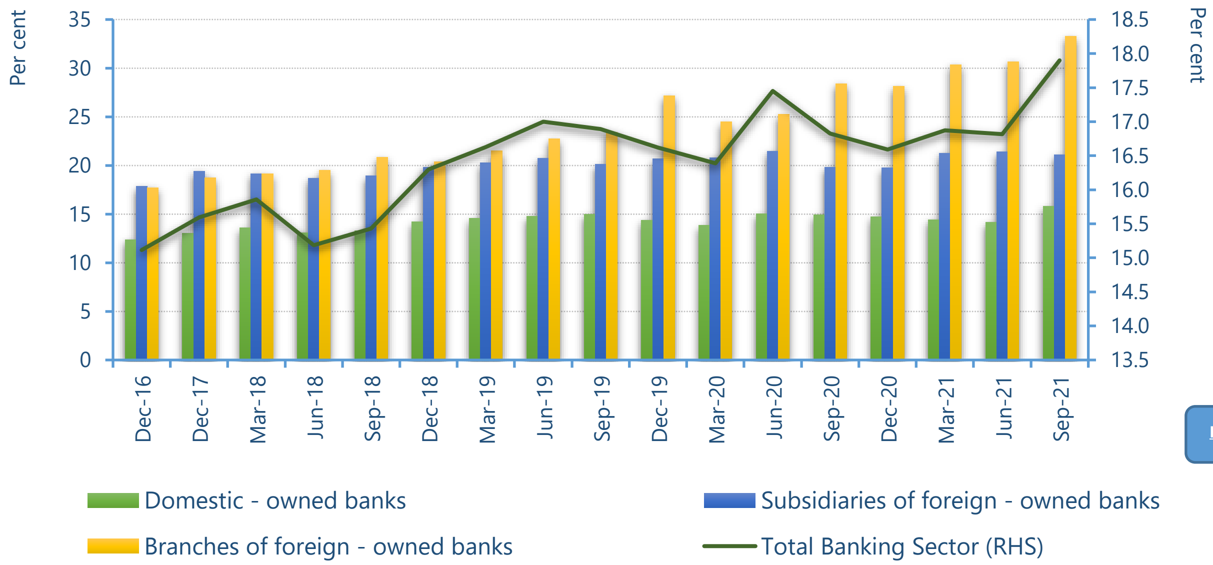
Source: Bank of Mauritius

Higher capital buffers sustaining credit flows

The capital position of the banking sector was robust in 2021, as capital buffers were consolidated through improving retained earnings and dividend pay-out restrictions. The strong capital adequacy ratio (CAR) was also the result of a contraction of 0.1 per cent in risk-weighted assets (RWAs), following the deployment of banking assets in the lower risk buckets, such as the 20 per cent bucket. The decline in RWAs signalled risk diversification and prudent risk management practices by banks in an uncertain environment. Improving CAR positions gave banks enough buffers to sustain credit flow to the economy and absorb shocks from economic downturns.

The aggregate CAR of the banking sector rose by around 1.0 percentage point to stand at 19.6 per cent as at end-September 2021, compared to end-March 2021. Similarly, Common Equity Tier 1 (CET1) ratio, indicative of the strength of banks' core capital structure, increased to 17.9 per cent from 16.9 per cent (Chart 3.3). Overall, the CAR of banks was above their respective regulatory minimum, inclusive of the Capital Conservation Buffer and D-SIB charges, where applicable.

Chart 3.3: CET1 capital ratios



Source: Bank of Mauritius

Improved asset quality supported by monetary and fiscal measures

Banks' asset quality continued to improve during 2021. The COVID-19 support measures – such as the loan moratoria and wage assistance schemes – significantly helped to stabilise the financial conditions of households and the corporate sector. Robust credit risk management measures adopted by banks also aided to sustain asset quality.

The NPL ratio for banks' credit portfolio improved to 4.5 per cent as at end-September 2021, from 5.0 per cent as at end-March 2021, as banks wrote-off more non-performing loans for loans extended outside Mauritius. The NPL ratio for credit extended outside Mauritius declined to 4.1 per cent as at end-September 2021, from 4.8 per cent at end-March 2021. This favourable development in the NPL ratio was also noted for credit extended within Mauritius, which declined to 4.9 per cent as at end-September 2021, from 5.2 per cent as at end-March 2021. This drop was mainly on account of an increase in the amount of loans extended to the resident sector, which

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outweighed the rise in its NPL. Loans have been rising as economic activity started to strengthen since March 2021, indicative of a boost to consumer and business confidence.

The level of provision set aside suggests that banks are adequately protected against risk of credit losses. The total specific provisions on NPL decreased by Rs800 million or 3.2 per cent, during the period under review to stand at Rs24.4 billion as at end-September 2021. Nevertheless, the coverage ratio – that is, specific provisions as a percentage of non-performing loans – improved to 65.7 per cent as at end-September 2021, from 62.5 per cent as at end-March 2021. Specific provisions on NPL within Mauritius rose by 6.9 per cent, between end-March and end-September 2021. In contrast, specific provisions for NPL outside Mauritius fell by 12.1 per cent mainly due to write-offs. This indicates that banks were setting aside higher levels of provisions for their non-performing advances.

Stages 1 and 2 provisions, which are funds set aside by banks in a pre-emptive manner for anticipated future losses, have been rising as banks consolidated their buffers against credit risk between March and September 2021. Stage 1 provisions rose to Rs5.8 billion from Rs4.9 billion, while Stage 2 provisions went up to Rs8.0 billion from Rs7.4 billion. Banks generally expect movements across stages in Expected Credit Loss to stabilise over the next year (see Box 6: Survey on Economic Perspectives and Financial Stability Implications).

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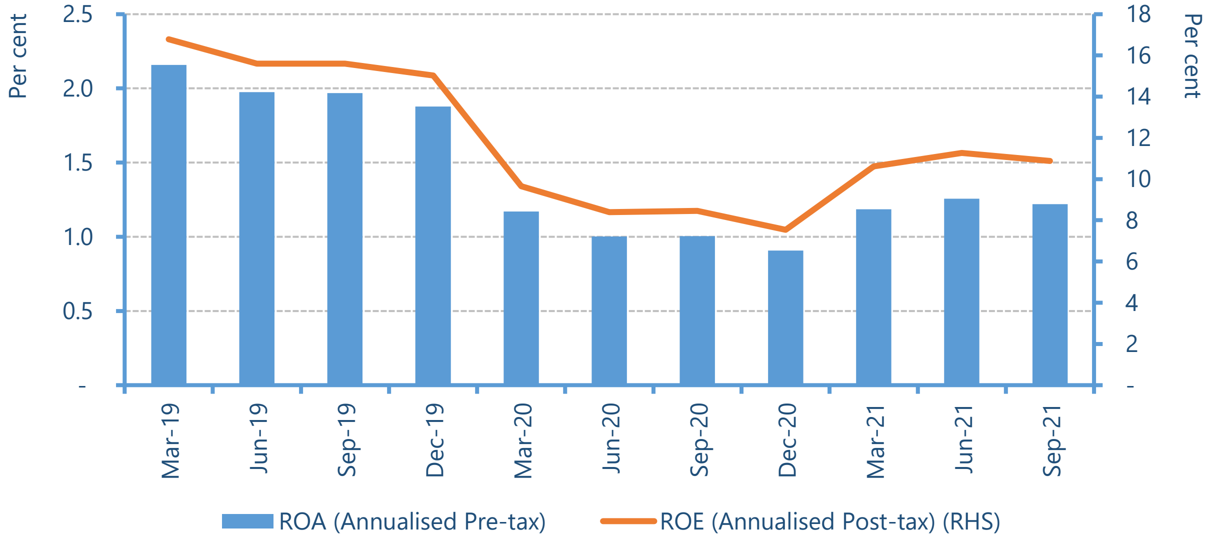
Stimulated profitability level

The profitability of the banking sector has been recovering – though still below pre-pandemic level – as economic recovery picked up pace. Annualised pre-tax profit of banks went up mainly on account of an increase in net interest income and net fee and commission income, as well as a contraction in net impairment loss charges. Banks' profitability levels were inhibited by a reduction in their net income on financial derivatives held at fair value through profit and loss.

Consequently, the pre-tax return on average assets (ROA) for the banking sector continued to hover around 1.2 per cent in the two quarters under review, whilst the post-tax return on equity (ROE) improved slightly by 0.3 percentage point to stand at 10.9 per cent for 2021Q3 (Chart 3.4).

Chart 3.4: Profitability ratios



Source: Bank of Mauritius

The cost-to-income ratio for the banking sector deteriorated to 44.6 per cent during the third quarter of 2021, from 42.9 per cent during the first quarter of 2021, mainly on account of a higher increase in non-interest expense relative to growth in operating income.

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Ample liquidity buffers

Banks have adopted prudent liquidity risk management, primarily by maintaining strong liquidity buffers. The Liquidity Coverage Ratio (LCR) for the banking sector improved to 259.0 per cent in September 2021, from 250.6 per cent in March 2021. The rise in the LCR was on account of a healthy expansion of 25.0 per cent in the level of banks' high-quality liquid assets (HQLA), which outweighed the increase of 20.9 per cent in their net cash outflows over the period under review. Taken together, the consolidated LCR of banks, in both rupees and other major currencies, stayed above the regulatory requirement of 100 per cent. Although banks held liquidity buffers well above requirement, their ability to sustain lending to the private sector was not constrained as evidenced by the steady growth in credit.

Credit concentration and FX exposures stay within prescribed limits

With regard to other prudential ratios, banks maintained FX exposures as a percentage of Tier 1 Capital, as well as, Credit Concentration Ratios well within the prescribed regulatory limits. This again demonstrates the application of prudent risk management practices by banks.

Unfazed cross-border exposures

Banks in Mauritius have relatively large cross-border exposures as funds from abroad are channelled through the financial system to other destinations and this can pose potential risks to the banking sector. Both the source as well as the destination countries can represent a risk conduit for banks. For instance, the banking system remained a net recipient of funds from South Africa and China during the period under review, and is thus vulnerable on the funding side to any adverse developments in these countries. In terms of destinations of the funds, the banking sector is a net supplier of funds to countries such as the United States, UK, Europe and India (Chart 3.5). Any unfavourable developments in these countries could impact the quality of banks' assets held in those destinations.

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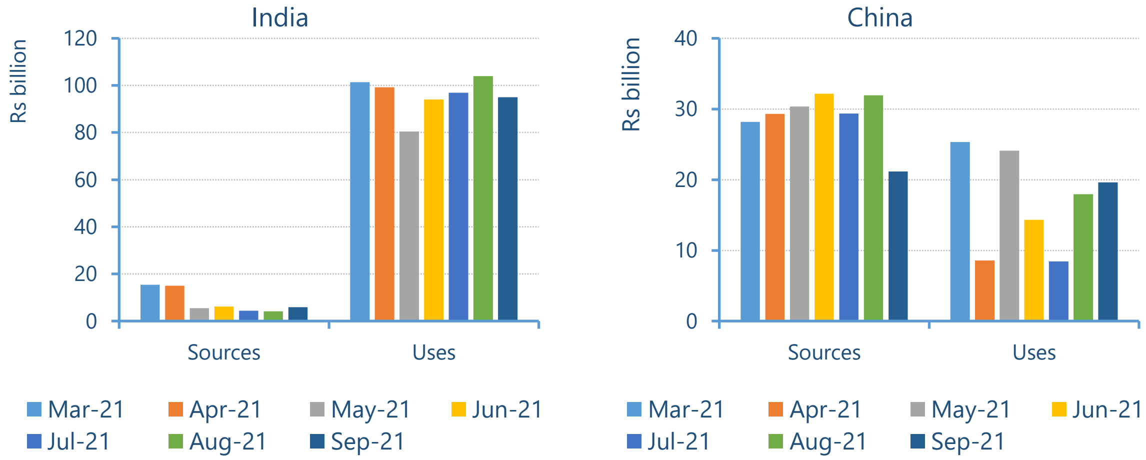
The Bank revised its Guideline on Cross-Border Exposure in March 2021 to provide a set of additional minimum standards that banks have to follow in respect of their cross-border exposures. These minimum standards provide a risk-based management framework to mitigate the main cross-border banking risks.

Chart 3.5: Evolution of cross-country exposure



Source: Bank of Mauritius

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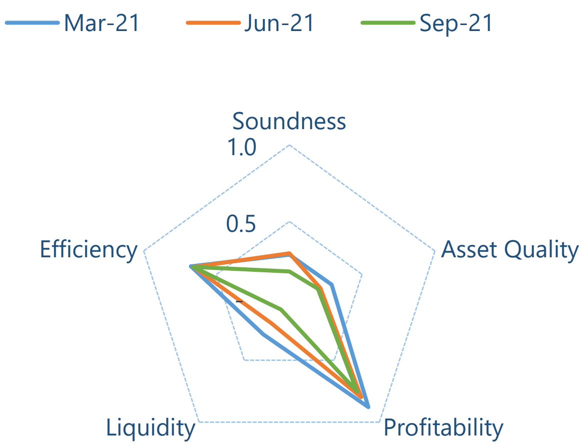
The Banking Sector Stability Indicator improved

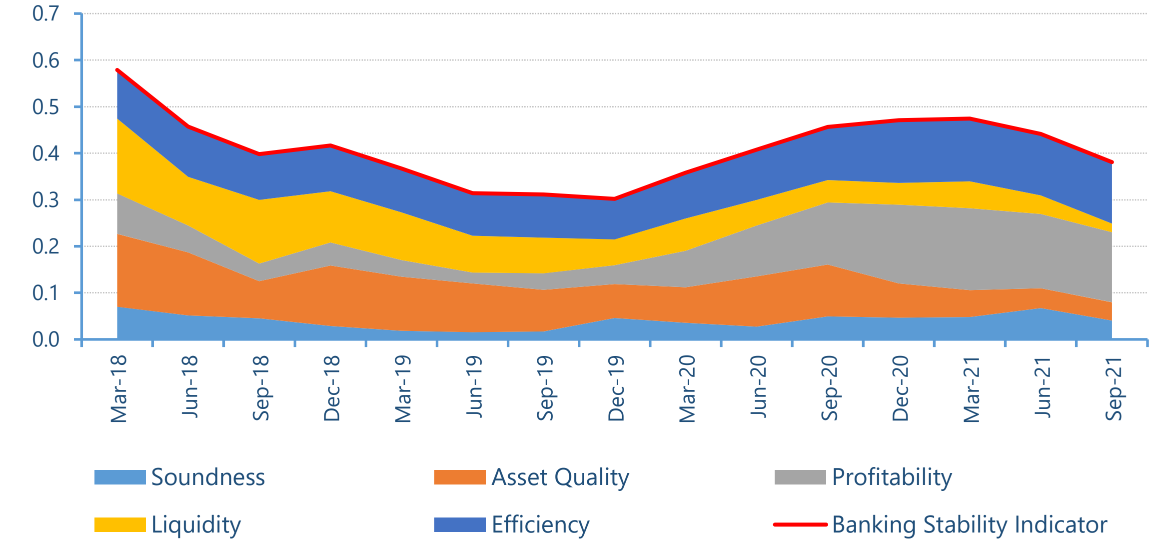
The Banking Stability Indicator – a composite index of five indicators namely, soundness, asset quality, profitability, liquidity and efficiency – improved between the first and the third quarters of 2021. As the five risk indicators move further away from the centre (approach a score of 1), the composite measure of riskiness increases. The favourable movement of the index is primarily led by significant enhancement in the liquidity, profitability and asset quality indicators (Chart 3.6).

Chart 3.6: Banking stability indicator

a. Banking stability map



b. Banking stability index



Source: Bank of Mauritius

Non-Bank Deposit-Taking Sector

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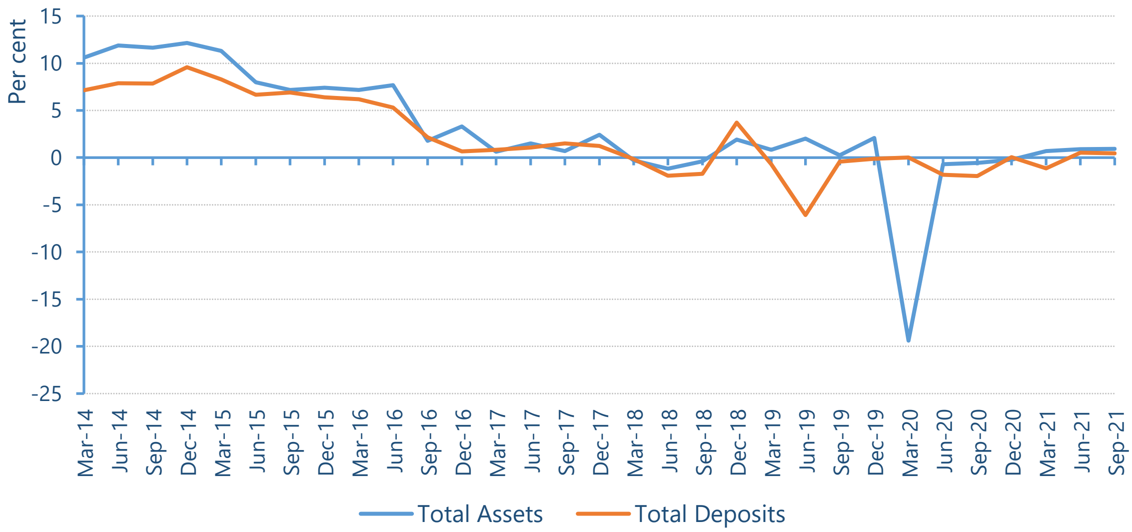
Resilience of NBDTIs

The balance sheet of NBDTIs recovered and expanded from the first quarter of 2021 to the third quarter of 2021, after being hit by the economic impact of the pandemic (Chart 3.7). Total assets grew by 1.9 per cent to stand at Rs67.4 billion as at end-September 2021. Similarly, total deposits held at NBDTIs registered a slight growth of 0.9 per cent to stand at Rs42.6 billion as at end-September 2021.

Chart 3.7 Balance sheet growth of NBDTIs



Source: Bank of Mauritius

Given the economic context, NBDTIs adopted more prudent risk management policies and practices and invested in relatively less risky liquid assets. The increase in total assets of NBDTIs was mainly due to higher investments in less risky assets, such as Treasury bills and Government securities. This outweighed the increase in riskier assets, notably loans and finance leases.

NBDTIs were found to be sound and adequately capitalised. Their CAR increased to 49.1 per cent as at end-September, from 48.6 per cent as at end-March 2021. Total capital base increased at a higher rate than RWAs on account of investments in less risky assets.

All NBDTIs maintained liquidity ratios above the statutory minimum of 10 per cent. The liquid assets of NBDTIs went up by 5.5 per cent over from end-March to end-September 2021, to reach Rs9.6 billion. The ratio of liquid assets to total deposits, which stood at 21.5 per cent as at end-March, rose to 22.6 per cent as at end-September 2021.

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Financial Soundness Indicators[4]

DTIs were well supported by a strong capital position. The aggregate CAR rose to 20.7 per cent as at end-September, from 19.8 per cent as at end-March 2021, reflective of a rise in total regulatory capital of 5.0 per cent countered by a marginal increase in RWAs of 0.2 per cent. The Tier 1 capital of DTIs increased to Rs183 billion as at end-September, compared to Rs173 billion as at end-March 2021.

The asset quality of DTIs improved significantly over the first three quarters of 2021, with the NPL ratio hovering at 5.3 per cent as at end-September 2021, from 6.2 per cent as at end-March 2021. Similarly, NPLs net of provisions to capital dropped by 3.0 percentage points to 7.6 per cent as at end-September 2021. This improvement was prompted by accommodative support measures from authorities, cushioning the effects of the pandemic.

The profitability levels of DTIs have been rising during the period under review. This reflected improving net-interest income and a reduction in net impairment loss charges. The drop in non-interest income slightly offset the rise in profitability. Annualised profits stood at Rs24.3 billion as at end-September 2021, up from Rs21.6 billion as at end-March 2021. Pre-tax ROA was stable at 1.3 per cent. On the other hand, pre-tax ROE recorded an increase of 1.0 percentage point to reach 12.4 per cent.

[4] *FSIs are calculated on a domestic consolidation basis using the Financial Soundness Indicators Compilation Guide (2006) of the International Monetary Fund. Figures in this section may not match those provided in other sections.*

A slight contraction in liquid assets was noted during the two quarters under review.[5] Liquid assets as a ratio of total assets declined to 26.5 per cent as at end-September 2021, from 29.4 per cent as at end-March 2021. Nonetheless, liquid assets to short-term liabilities rose by 1.5 percentage points to stand at 34.3 per cent.

The distribution of sectoral loans experienced a slight shift from 'Non-Financial Corporations' to 'Deposit Takers'. Asia and Africa remained the major cross-border destinations for credit facilities from Mauritius, with a share of 31.1 per cent and 15.1 per cent, respectively, as at end-September 2021.

Chart 3.8 illustrates the Financial Soundness Indicators (FSIs) grouped in five distinct categories with each colour-coded line indicating the position of these indicators over the quarters under review.

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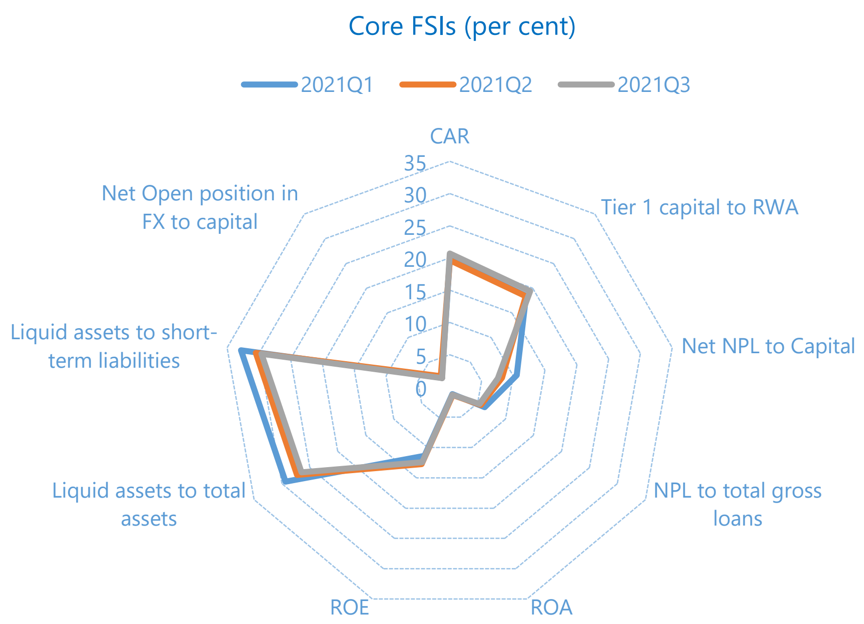
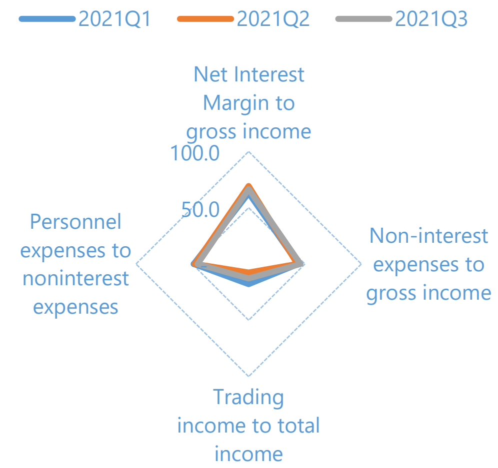
Chart 3.8: FSI radar panel

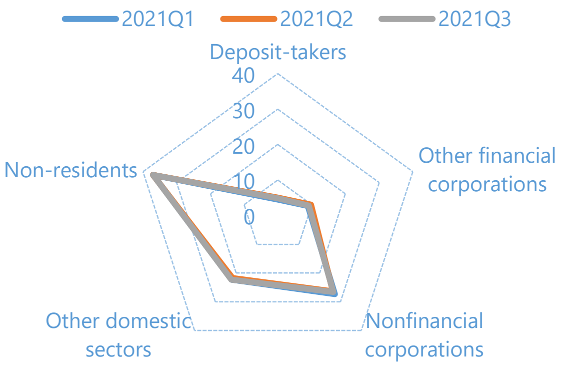


[5] *Based on the Financial Soundness Indicators (FSI) compilation guide definition of liquid assets of the IMF, core liquid assets comprise currency, deposits and other financial assets that are available either on demand or within three months or less (although deposits of DTIs and other nontraded claims with other deposit-takers included in the reporting population are excluded) that can be readily converted into cash, with insignificant risk of change in value under normal business conditions.*

Encouraged profitability ratios (per cent)



Sectoral distribution of loans (per cent)



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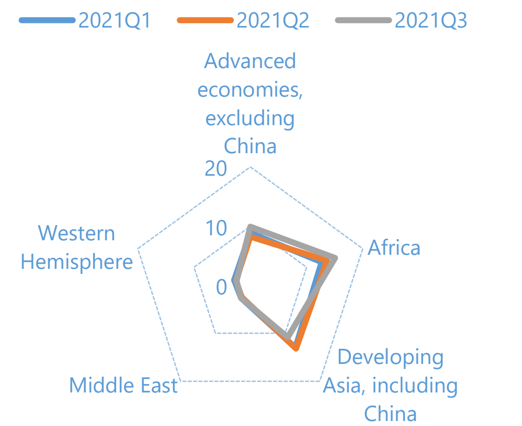
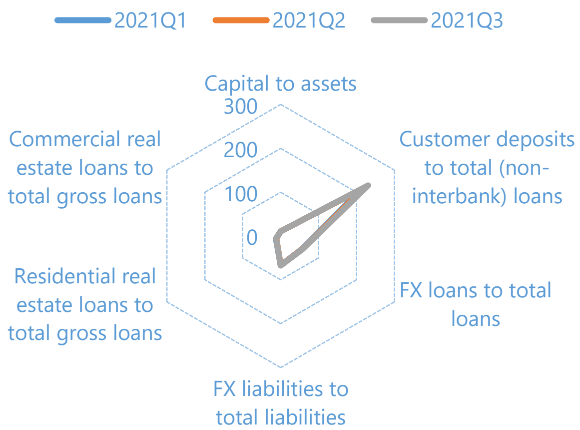
Geographical distribution of loans (per cent)



Selected encouraged FSIs (per cent)



Source: Bank of Mauritius

Box 5: Consolidating the ecosystem for innovations in digital payments and fintech

Payment systems play a crucial role in the economic development and financial stability of a country, as they are the most reliable network through which funds and securities are channelled. Cognisant of the criticality of payment systems, the Bank has taken several initiatives to further enhance efficiency, safety and resilience of the payment ecosystem.

The Bank operates the Mauritius Automated Payment and Settlement System (MACSS), a real-time gross payment and settlement system of systemic importance. Over the past decade, the Bank has constantly invested in the digitalisation of the payment ecosystem to keep pace with technological developments and international evolution in the payments space. One of the key objectives is to provide alternative payment facilities for low-value retail payments to reduce systemic risk of the MACSS. MACSS is the centrepiece of the payment ecosystem in Mauritius, enabling settlement of retail payment systems in central bank money in line with Principle 9 of the BIS CPMI-IOSCO Core Principles for Financial Market Infrastructures (PFMIs) to mitigate credit and liquidity risk in the financial sector.

Moreover, until recently, only banks had direct access to MACSS and central bank money for payment settlement and alternative payment service providers had to route through these banks. With growing demand for anywhere anytime payment services and pressing need for real-time transaction, a need was felt for fintechs to have direct access to this infrastructure. Since 2019, this is a reality. Fintechs can now hold accounts on MACSS. The Bank is also taking the initiative to upgrade the MACSS to support the ISO 20022 which is regarded as a richer, better structured and more granular end-to-end payment message.

With mobile phones becoming an integral part of our life, it is without doubt that many developments in the payments space are taking place using this channel. However, in the absence of a central platform, service providers operated their private schemes in a silo model that did not have the expected outcome. To bridge this gap, the Bank established a National Payment Switch, known as the Mauritius Central Automated Switch branded as MauCAS, that operates a 24/7 digital payment system based on novel state-of-the-art technology.

This innovative digital platform makes banking, e-commerce and mobile payments interoperable and encourages cashless means of payment. Fintech firms can leverage on this platform to offer value-added services and provide banks with opportunities to collaborate with providers of emerging technologies. This synergy will bring more efficiency in the system and act as a catalyst in the digital transformation of the economy.

The MauCAS is also an enabler for the Bank to support government agencies and online services to accept electronic forms of payments. In 2020, the Bank took the initiative to set up a Government Payment Portal to boost instant digital forms of payments for e-government services.

The Bank has continued to enhance the services available on the MauCAS platform to give further impetus to the digitalisation of the payment ecosystem. One of the main achievements is the implementation, in September 2021, of a national QR Code, the MauCAS QR Code, an important instrument in payments and a low-cost enabler of payment interoperability. In addition, the national QR code will also be an enabler to facilitate the digitalisation of Government payment services.

The various initiatives taken by the Bank has allowed Mauritius to keep pace with technological developments and international trends in the payment space. Principle 1 of the PFMIs advocates that a sound legal basis is essential for the safety, soundness and efficiency of the payment systems. In keeping with the Principles, a comprehensive legislation, the National Payment Systems Act 2018, was promulgated in January 2019. In addition, to ensuring safe and sound operations of payment systems in Mauritius, this legislation also makes provision for irrevocability and finality of payments. It also provides an enabling framework for the development of digital payments and fair and equitable access to the payment system infrastructure to new players, such as Fintechs and TechFins.

To support its objective of ensuring the stability and soundness of the financial system of Mauritius, the Bank provides the safest money to households, businesses and the financial system. This money is currently available only in the form of banknotes and reserves held by banks with the Bank.

Currently, households and businesses do not have direct access to central bank money to make electronic payments and have to rely on money held with banks. The Bank has engaged in a process for the potential introduction of a Central Bank Digital Currency (CBDC) in Mauritius. The CBDC will provide a digital payment instrument that will enhance digitalisation in the payment ecosystem, while providing households and businesses a safe form of digital money.

Non-bank players can also bring innovation and foster competition in the payment domain. However, these developments raise new challenges and need a solid central bank foundation to thrive. The National Payment Systems (Authorisation and Licencing) Regulations, published on 31 May 2021, provides a competitive level playing field while setting out standards to ensure a fair and uniform operating environment.

The ongoing digital revolution is disrupting traditional ways of payment and ushering new risks. The Bank is gearing up its oversight capacity in the face of growing challenges. The National Payment Systems Act was amended in August 2021 to provide for the establishment of the National Payment Systems Committee which will act as an advisory body to the Bank in the exercise of its oversight function in respect of the national payment systems. The Committee will also serve as a forum for cooperation, thereby supporting the achievement of sound and efficient payment systems in Mauritius.

Emerging technologies, such as Artificial Intelligence, Robotics, Internet of things, Fintech and Big Data, are becoming an integral part of our daily life. Technological innovation in the financial sector is changing consumer behaviour and the way financial institutions conduct business. Cognisant of the fact that emerging technologies will be the pivot of the digital transformation process of Mauritius, a Fintech Committee – drawing its membership from the Financial Services Commission, the Mauritius Bankers Association, the Mauritius Africa Fintech Hub, Payment service Providers and ICT Companies, among others – was established in November 2020 to develop a roadmap for fintech developments. Some of the elements being considered by the Fintech Committee is the distributed ledger technology, central bank digital currencies, big data, open banking, as well as related regulatory and policy matters.

Based on the Committee's recommendations, the Banking Act was amended to provide for an enabling framework for the implementation up of a digital lab and a regulatory sandbox by the Bank. The principal objective of setting up the lab is to accelerate the development of fintech and support the Government's Digital Mauritius 2030 Strategic Plan, to make Mauritius a regional fintech hub.

Box 6: Survey on Economic Perspectives and Financial Stability Implications

The Bank conducted the "Survey on Economic Perspectives and Financial Stability Implications" in October/November 2021 with the banking industry. The main findings of the survey are summarised below. It is noteworthy that the survey refers to information available prior to the discovery of the new COVID-19 variant, Omicron, in late November 2021.

Economic Outlook

Banks are generally anticipating an improvement in the global and domestic economic performances. They expect key global metrics to improve over the next 12 months and support the global growth momentum. The domestic economic recovery is expected to foster household consumption and stabilise, even decrease, the unemployment rate. Nevertheless, inflationary pressures, both globally and domestically, remain a concern, mostly as a consequence of the supply-chain shock induced by the pandemic.

Domestic economic recovery is mostly expected to follow a U-shape over the next year. Banks viewed that it may take at least up to 2023 for output to reach pre-pandemic level, as the economy still faces pandemic-induced challenges. The general consensus is that uncertainty remains in the face of threats of the Delta variant and possible emergence of new variants of COVID-19.

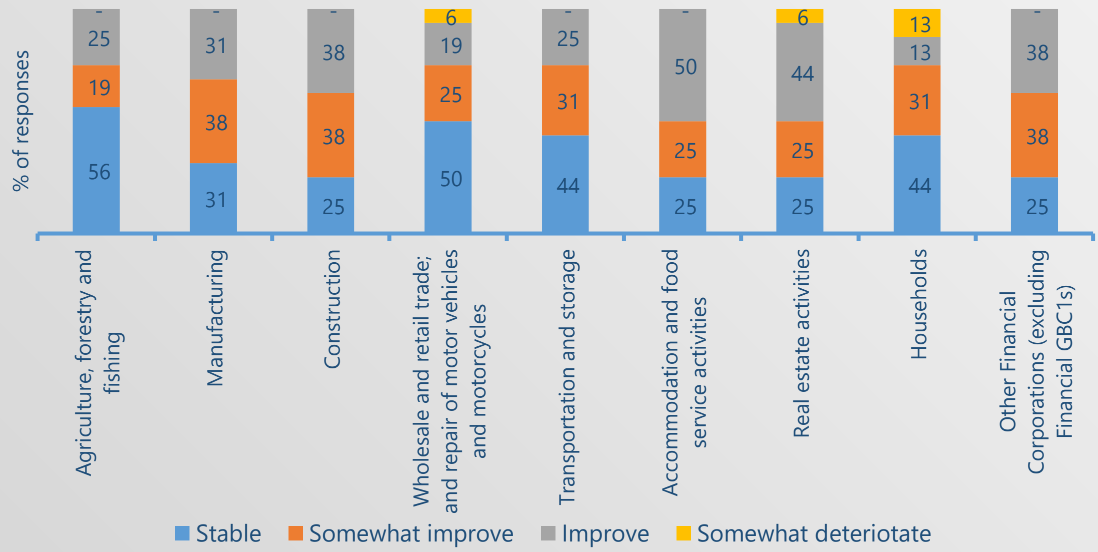
Other major sources of risk that could potentially hamper global recovery comprise: (i) climate-related risks leading to environmental degradation and human health threats from new diseases; and (ii) cybersecurity risks leading to logistics challenges and heightened costs, amongst others.

Stress testing

Most banks conducted stress tests using various scenarios to assess their respective institution's solvency and liquidity resilience, mostly to potential impact of the pandemic and the expiration of support measures currently in place.

Banks expect activity in most sectors to improve in the coming year. The '*Accommodation and food services activities*' sector is expected to recover. They have similar expectations for other key sectors (Chart I).

Chart I: Sector wise performance over the next 12 months



Source: Bank of Mauritius

Profitability and strategy

Most banks expect an improvement in profitability over the coming months with an estimated ROE ranging between 6 to 12 per cent, and plan to boost profitability through an increase in net fees and commission income, trading income, and other operating income.

Banks have highlighted that pandemic-induced shocks remain the main threats to profitability. A slower economic recovery, below mean expectations, could trigger a rise in expected credit losses and higher impairment charges.

Liquidity and funding

Most banks projected a favourable liquidity position for the upcoming 12 months, expecting no liquidity constraints from non-performing loans in both domestic and foreign currency. They will focus mainly on wholesale and retail deposits for their funding needs, as they expect a pick-up in deposits from these segments. Interest rates on deposits have been revised downwards and are expected to stabilise over the next 12 months, given the low deployment rates and interest income margins of banks.

Asset quality and capital adequacy

Most banks anticipated their expected credit losses (ECL) to stabilise, with a slight improvement in asset stage classification, over the next 12 months. The majority of banks expects less than 10 per cent of these movements to be induced by the pandemic. This reflects growing optimism in the banking sector on the asset quality front, mainly underpinned by a more favourable sanitary and economic outlook.

The responses further suggested that the NPL portfolio of most banks are adequately covered as banks indicated stable movement in their provisioning levels over the next 12 months.

Additionally, most respondents expect an increase in excess of 5 per cent of their banks` RWAs over the next year. This could reflect an increase in risk-taking behaviour along with sustained growth in banks' balance sheet.

Operational Risk

Almost half of the respondents revealed that they anticipated an increase in operational risks. 'Cyber risks and Data security' ranked as the highest threat to banks' institutional resilience going forward. Banks have planned varying strategies to mitigate operational risk, consisting mainly of an increase in investment in IT infrastructure and system, amongst others.

Digitalisation

Most banks have reported an improvement in their business with the advent of Fintech firms. Those firms are viewed as positively impacting the operational income of banks, while also reducing costs. Banks revealed a significant improvement in operational resilience with digital innovation during the pandemic.

Climate-related risk

Most banks are of the view that climate change will impact their income and credit portfolio the most, followed by liquidity. Sustainable products/services are currently either being offered and/or planned and/or developed by some banks. Almost 50 per cent of respondents have reported to be currently offering green products/services to customers in the form of green financing, sustainable deposits, and sustainability-linked loans.

Banks are yet to develop a stress test framework for climate-related risks. Nevertheless, a noteworthy point is that most banks have established various contingency strategies to mitigate physical and transition risks that may arise from climate change.

Others and mitigating measures

The majority of responses indicated that no new trends or challenges, particularly in relation to AML/CFT, have been registered.

Overall, banks have considered various risk mitigating strategies, the salient ones being forward-looking risk assessments, risk appetite review, increased automation, cybersecurity measures, enhanced climate-friendly measures, intensified AML/CFT awareness, more atomisation and work-from-home measures, and continued targeted support to impacted clients.

Box 7: The Bank launches its Climate Change Centre

Climate change threats require more than ever pressing measures and actions, as they can amplify financial sector vulnerabilities. The financial industry has to become a critical enabler to promote and influence efforts and decisions by the real economic sectors. Large and abrupt transition risk shocks could be disruptive to the financial industry. The 2021 United Nations Climate Change Conference (COP26) is seen as a crucial forum to stimulate the transition to low greenhouse gas emission. To uphold financial stability, policymakers should lay greater emphasis on climate policies that will encourage an orderly transition.

Against this backdrop, on 14 October 2021, the Bank launched its Climate Change Centre to affirm its response to climate change and environmental degradation. The objectives of the Climate Change Centre include *inter alia*:

1. To integrate climate-related and environmental financial risks into the Bank's regulatory, supervisory and monetary policy frameworks;
2. To review the Bank's internal operations in view of reducing its carbon footprint and becoming a more sustainable organisation;
3. To look into enhancing disclosures on climate-related and environmental financial risks;
4. To support the development of sustainable finance;
5. To build capacity and raise awareness for climate-related and environmental financial risks; and
6. To bridge data gaps in relation to climate-related and environmental financial risks.

The Climate Change Centre comprises a main committee with four Task Forces focusing on the following aspects in respect of climate-related and environmental financial risks: (i) regulation and supervision; (ii) monetary policy; (iii) sustainable finance; and (iv) the Bank's internal operations.

Non-Bank Financial Services Sector[6]

The non-bank financial services sector has been recovering as economic activity gathered pace. The sector was also supported by commendable performance of financial markets. The shift from fixed income instruments to equity continued in the insurance and pension industries, attributed mainly to the search for higher returns. The long-term insurance industry seems to show resilience so far as the impact of the pandemic is concerned. Vulnerabilities in the non-bank financial services sector still persist, but close monitoring and timely regulatory measures are curbing the accumulation of risks.

The effects of the pandemic on the economy were felt on the financial services sector as well, but the sector is recovering fast after a downturn in 2020. The non-bank financial services industry, in particular the life insurance, general insurance and pension scheme industries, have broadly recovered their growth momentum.

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The FSC has been and will continue to closely monitor the non-bank financial services sector and the GB sector. Since March 2021, the FSC has taken several key initiatives to improve the resilience of the non-bank financial system, such as the supervision of financial conglomerates, enhanced monitoring of Systemically Important Financial Institutions and development of FSIs for the "*Other Financial Corporations*" sector (refer to Box 8 on Financial Soundness Indicators for Other Financial Corporations).

Life insurance industry

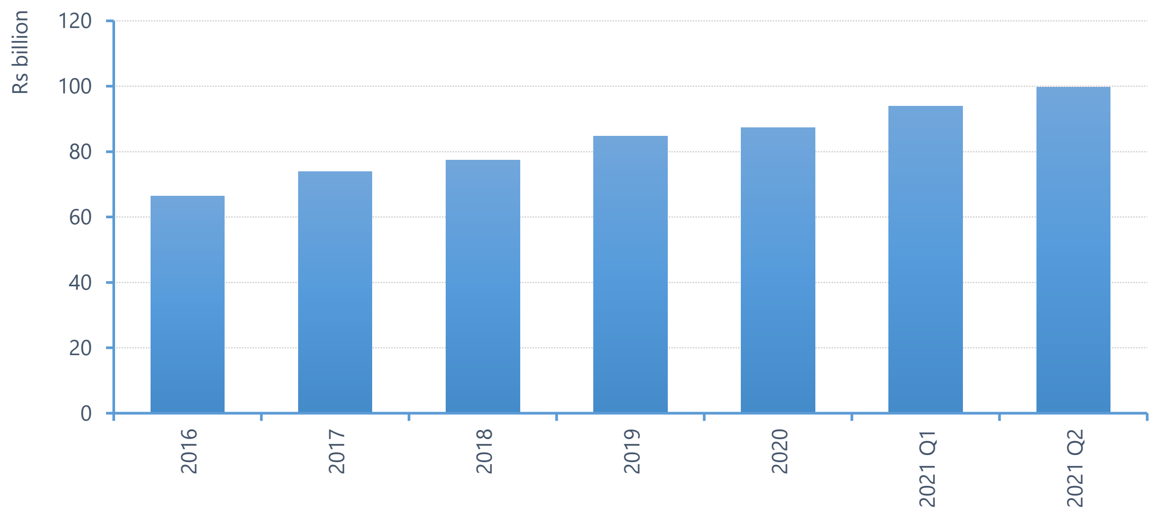
Improved performance of life insurance business

The long-term insurance industry showed better resilience to the effects of the pandemic in 2021, after growing at a slower rate in 2020. Assets of life insurers rose by 6 per cent to reach Rs99.7 billion as at end-June 2021 compared to the previous quarter (Chart 4.1).[7]

[6] *This chapter is a contribution from the FSC to the Report.*

[7] *Based on value of assets of the 7 life insurers operating in the domestic regime.*

Chart 4.1: Long-term insurance assets value



Source: Financial Services Commission

Growth in long-term insurances' assets has mostly been driven by the good performance in equity investment that expanded by 14 per cent as at end-June 2021, compared to end-March 2021, roughly matching the trend of SEMDEX (Chart 4.2). The shift from fixed income instruments to equity by the insurance industry has continued, likely due to the industry searching for higher yielding assets given the low interest rate environment. In contrast, assets in the form of currency and deposits dropped to Rs9.1 billion as at end-June 2021, recording a contraction of 15 per cent.

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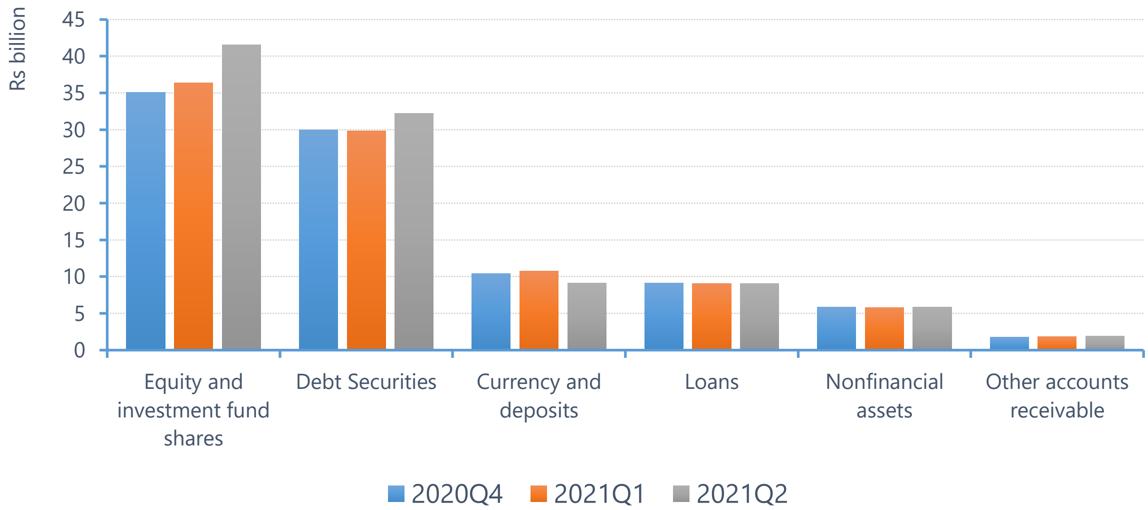
Chart 4.2: Distribution of assets by class

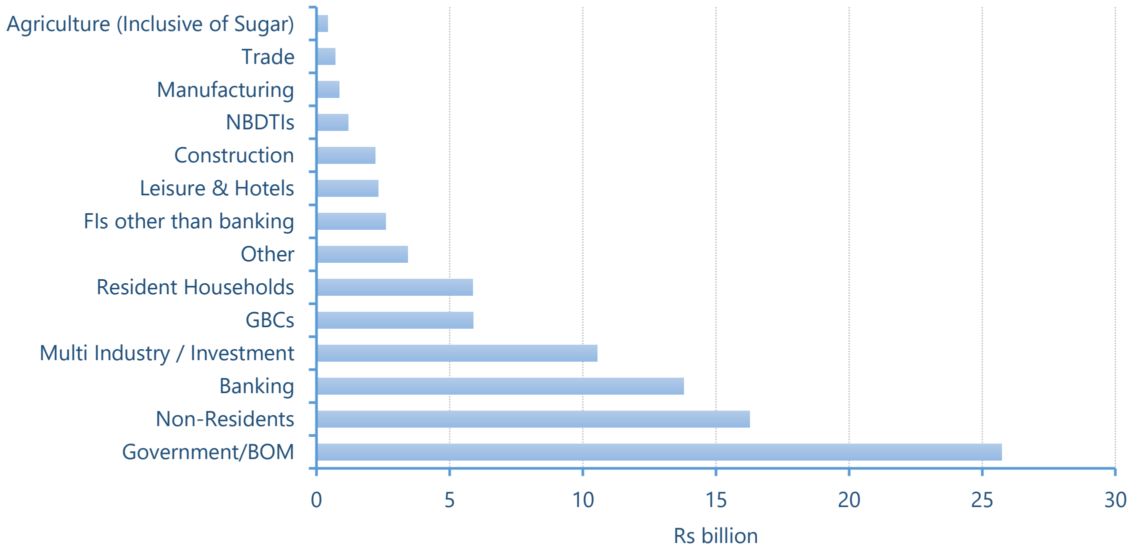


Source: Financial Services Commission

Interconnectedness with other institutional sectors and industries of the economy

Investments in Government and Bank of Mauritius securities remained the largest exposure of life insurers (Chart 4.3). However, the exposure to central bank securities had dropped to 28.0 per cent in the second quarter of 2021 from 32.6 per cent in the first quarter of 2021, in line with the observed shift from fixed income instruments to equity. The non-resident and banking sectors have been the largest recipients of equity investment, with 18 per cent and 15 per cent of life insurers' monetary and financial assets for the period under review, respectively.

Chart 4.3: Distribution of monetary and financial assets by industry as at 30 June 2021



Source: Financial Services Commission

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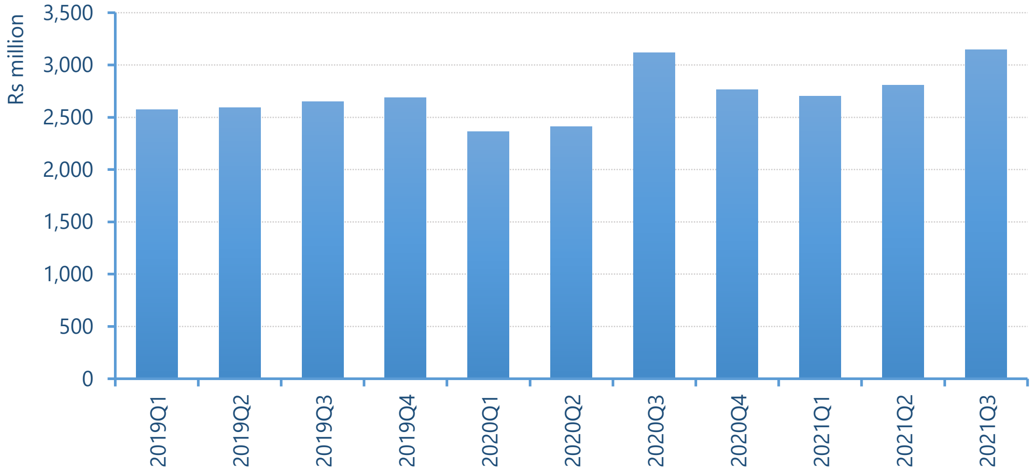
Moderate impact of the pandemic on gross insurance premium

On the income side, the pandemic has had moderate impact on the total gross premium earned by life insurers. However, it seems that the quarterly volatility on gross premium was mostly due to operational disruptions than a drop-in business. When smoothing out these short-term fluctuations, the slight upward linear trend remains almost unchanged compared to the pre-pandemic period (Chart 4.4).

Chart 4.4: Total Gross Premium



Source: Financial Services Commission

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Generally solvent long-term insurance industry

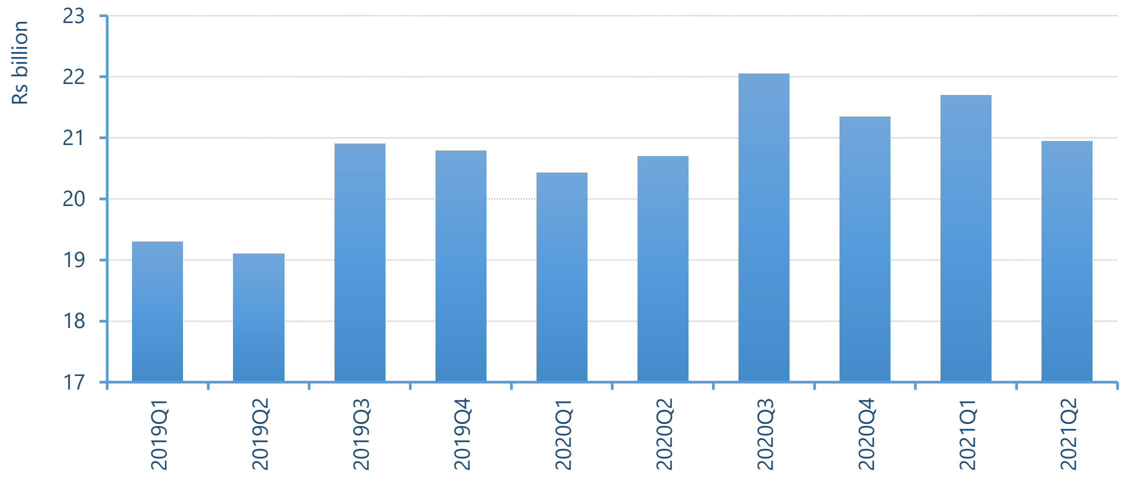
While the long-term insurance industry seems to show resilience so far as the impact of the pandemic is concerned, it is undeniable that the capacity of life insurers to maintain their statutory solvency level has become vulnerable. According to the Insurance (Long-Term Insurance Business Solvency) Rules 2007, life insurers are required to uphold a solvency margin at least equal to their minimum capital requirement. Given the current circumstances, the FSC has been closely monitoring these financial institutions. Life insurers had a solvency margin exceeding their minimum requirement during the period under review, except for two medium to small sized insurers which remain subject to enhanced monitoring. It is, however, worth noting that capital injections have been made to restore and maintain their solvency position.

Even though an actuarial computation of solvency remains an essential tool to monitor the financial health of insurers, the current exceptional circumstances warrant more frequent and timely set of indicators. In that respect, the FSC has initiated an exercise with the objective to collect data and compile FSIs for insurance companies. FSIs consist of a set of indicators that will allow enhanced macroprudential oversight on the long-term insurance sector during this period.

General insurance industry

The general insurance industry consisted of 15 insurers at the end of September 2021. The effects of the pandemic had marginal adverse effects on the assets of general insurance companies (Chart 4.5).

Chart 4.5: General insurance asset's value



Source: Financial Services Commission

The evolution of the number of policies in force in the motor and non-motor segments of the general insurance business is indicative of an upward trajectory for both segments of class of policies since the first lockdown in March 2020 until the third quarter of 2021 (Chart 4.6).

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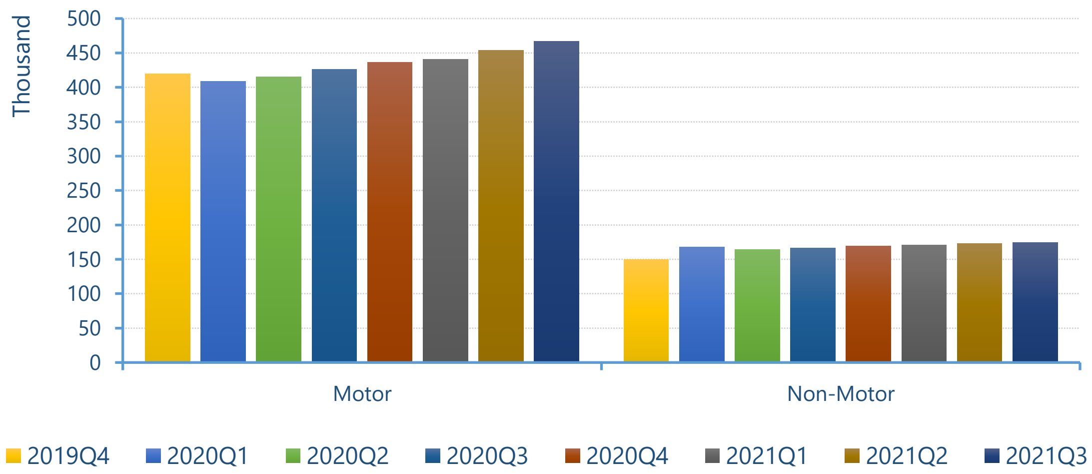
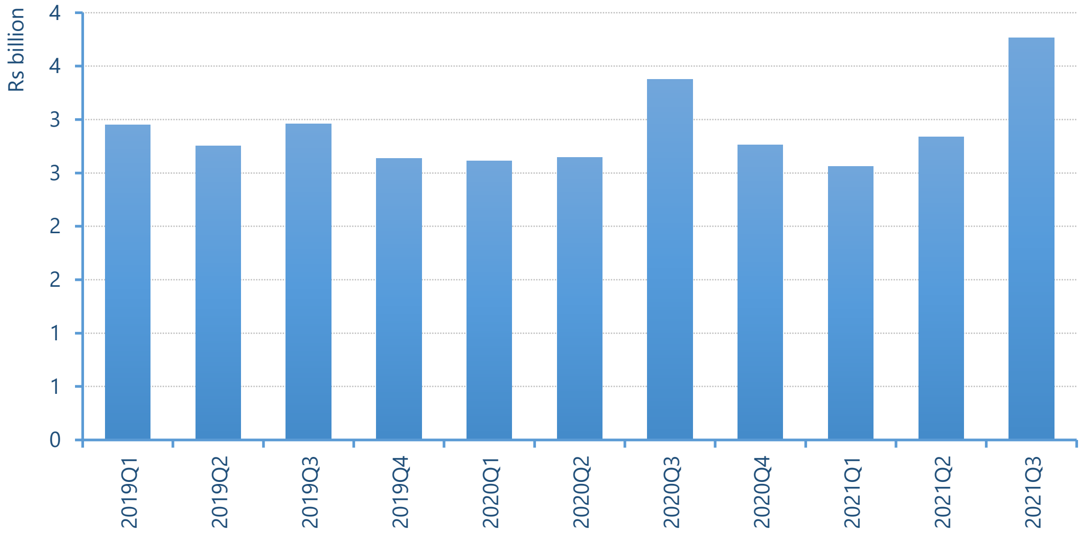
Chart 4.6: General insurance – number of policies in force



Source: Financial Services Commission

Similar to the pattern observed for long-term insurance business, gross premium collected for non-life insurance have registered short-term fluctuations during periods of lockdown (Chart 4.7). Likewise, peaks are observed after the relaxation of sanitary restrictions. During the period under review, the overall performance of the general insurance business remained relatively undeterred despite the impact of COVID-19 on the economy.

Chart 4.7: General insurance – total gross premium



Source: Financial Services Commission

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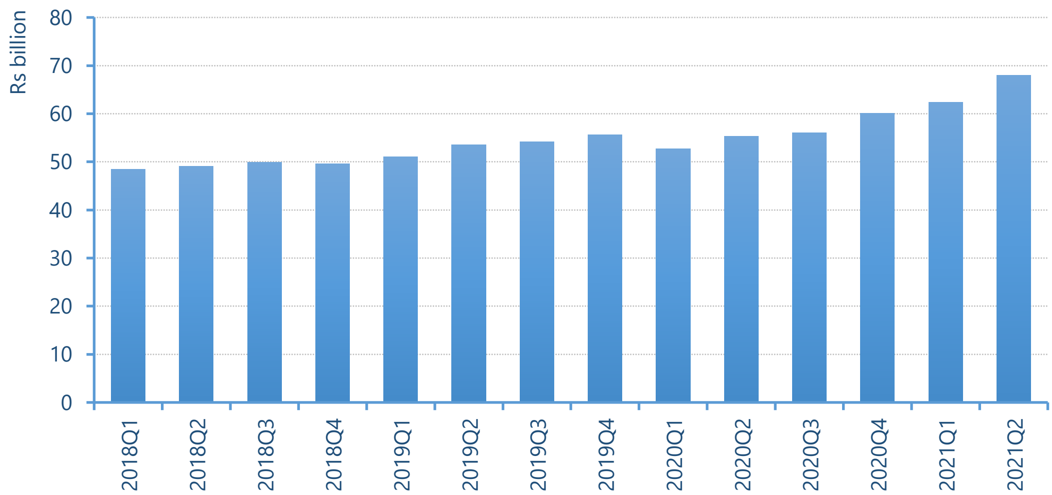
Pension scheme industry

Strong assets growth

Despite market volatility and historic low interest rates during this period, the value of assets in the pension scheme industry has maintained a general upward trend. The domestic pension industry comprised of 57 pension schemes at end of the first semester of 2021. The value of assets of pension schemes witnessed a growth of 23 per cent as at 30 June 2021, compared to 30 June 2020 (Chart 4.8). The good performance of financial markets has accentuated the rapid growth observed in the latest quarters.

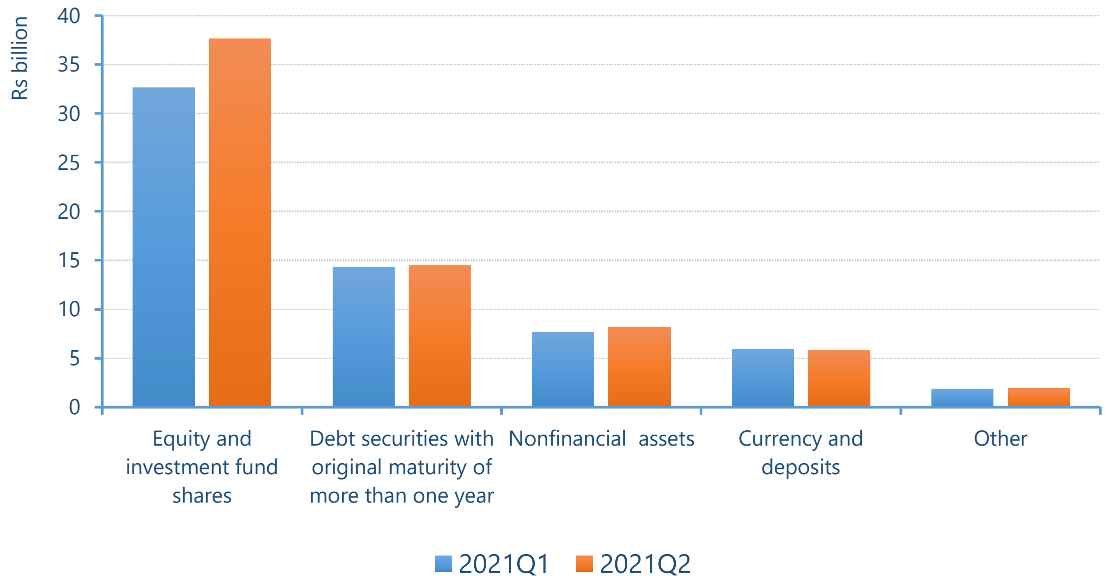
Chart 4.8: Pension schemes – value of assets



Source: Financial Services Commission

In terms of assets allocation, investment in equity accounted for 55 per cent, followed by debt instruments having long-term maturities and non-financial assets at 21 per cent and 12 per cent, respectively, in June 2021. A similar trend was observed for the general insurance and long-term insurance business investment in equity, attributed mainly to the search for higher returns. Investment in equity by pension schemes grew by 15 per cent to reach Rs37.7 billion in June 2021 compared to the first quarter of 2021 (Chart 4.9).

Chart 4.9: Distribution of assets by class



Source: Financial Services Commission

Interconnectedness with other industries

Investment in non-resident enterprises accounted for the largest share at 30 per cent of the total financial assets of pension schemes as at 30 June 2021. Investment in financial instruments issued by local banks (or holding companies of local banks) and by the Government and the Bank followed with shares at 18 per cent and 16 per cent, respectively (Chart 4.10).

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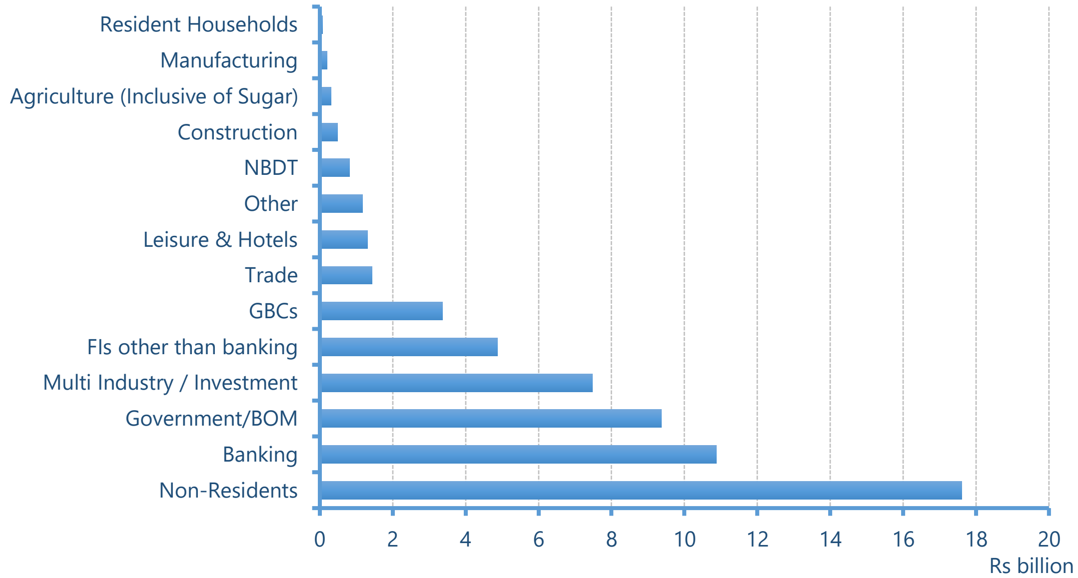
Chart 4:10: Monetary and financial assets by industry



Source: Financial Services Commission

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Overall, the outlook for the pension scheme industry seems positive. While the COVID-19 pandemic has brought many challenges and uncertainties, assets growth has maintained the momentum and vulnerabilities have remained well contained.

Box 8: Financial Soundness Indicators for Other Financial Corporations

The potential for spill-over effects from industries significantly impacted by the on-going COVID-19 crisis to the financial services sector has prompted the need for enhanced monitoring tool to gauge the financial soundness of financial institutions. In addition, given the high degree of interconnectedness between banks and other financial corporations, the FSC has initiated an exercise to compute FSIs for insurance companies and Pension Schemes. FSIs consist of a set of early-warning quantitative risk indicators developed by the IMF in the late 1990s and are being used globally to strengthen macroprudential surveillance by monitoring the financial health of financial institutions through the identification of actual or potential financial sector fragilities.

Consultation is currently being carried out with industry representatives and a data collection instrument is expected to be finalised early next year for the computation of FSIs.

Global Business Sector[8]

The challenges facing the GB sector began easing during the period under review, with a rebound in activity and the decision of the FATF in June 2021 to conduct an onsite visit in Mauritius. Activity in the GB sector is projected to pick up firmly in 2021, after contracting in 2020. The GB sector continued to target India and Africa, with a larger volume of investment flows channelled to the former. GBC deposits held with banks expanded further. The asset quality of the GB sector held in the books of banks has deteriorated reflecting the effects of the pandemic, but banks have set aside provisions. The delisting of the jurisdiction from the FATF list in October 2021 is a major milestone and would give a boost to global business activities. The GB sector has undergone major changes in its regulatory framework in order to enhance its competitiveness while adhering to the highest international norms. Concurrently risks are expected to subside, in particular to the banking sector.

The GB sector maintained its growth momentum, despite risks coming from the effects of the pandemic worldwide and the listing of Mauritius by the FATF in its list of jurisdictions under increased monitoring and by the EU and the United Kingdom in their list of high-risk countries. During its plenary session held in October 2021, the FATF announced the exit of Mauritius from its list. The UK subsequently removed Mauritius from its list as well. These positive developments are expected to significantly alleviate risks to the financial system coming from the GB sector.

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Mauritius has a large GB sector with aggregated assets valued at around US$640 billion. The majority of these assets are in the form of equity investments held in non-resident enterprises. The sector's interconnectedness with the financial services sector and other local industries is well-recognised, notably its contribution to employment and economic growth. Direct employment in the GB sector is estimated at around 7,000 and more indirectly through the services contracted from banks, audit firms and legal advisers.

The GB sector is projected to expand by 5.0 per cent in 2021, a significant rebound from the contraction of 10.3 per cent in 2020. The growth rate for 2021 could potentially be further supported by the positive developments for this sector. The delistings are important milestones in reinforcing the reputation of Mauritius as a robust and credible jurisdiction for cross-border investment.

[8] This chapter is a contribution from the FSC. The section on "Linkages between GB sector and Banking Sector" was prepared jointly by the FSC and the Bank.

Global Business sector developments

The GB sector has undergone major changes in its regulatory framework in order to enhance its competitiveness while adhering to the highest international norms to combat tax abuse. As from 1 July 2021, companies holding a Global Business Licence Category 1 were deemed to be holders of a Global Business Licence while the Category 2 Global Business Licence (GBC2s) was phased out. Prior to that date, existing GBC2s had the option to continue business in Mauritius notably by converting to an Authorised Company or a GBC. It is estimated that around 600 GBC2s have been converted into GBC and almost 3,400 to ACs.

The allocation of GBC activity is such that 65 per cent and 20 per cent of GBCs conduct investment holding activities and non-financial activities other than investment holding, respectively. The remaining portion is almost equally distributed between funds and financial activities other than GB Funds, such as investment dealers, investment advisers or CIS Managers.

Rising licensing trend for live GBCs

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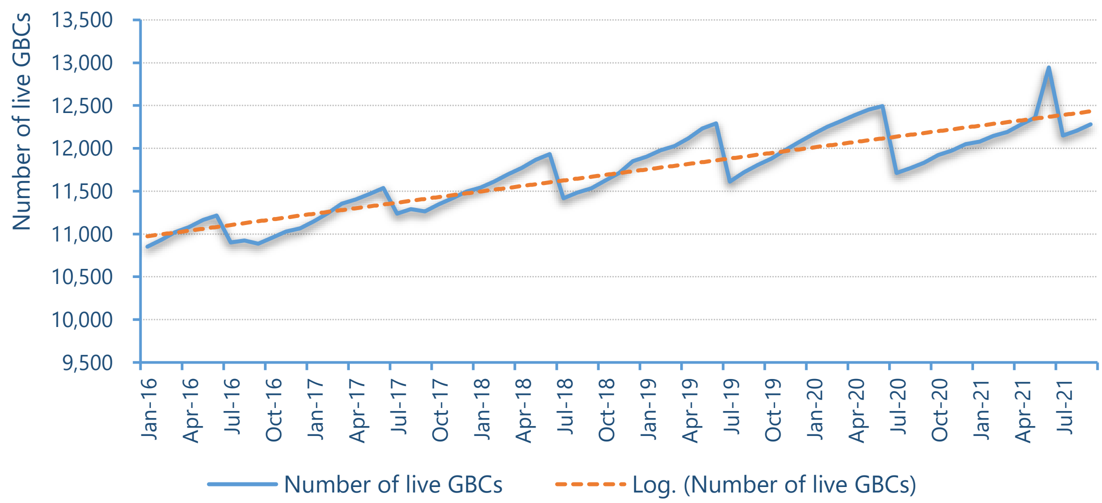
The number of live GBCs stood at 12,282 as at end-September 2021, compared to 11,831 a year earlier, representing an increase of 4 per cent. A peak was observed in June 2021 reflecting the number of GBC2s converting to GBCs, which was 577 (Chart 5.1). The drop in July 2021 is explained by the non-renewal of the GB licence of a number of companies, which occurs annually at the same period.

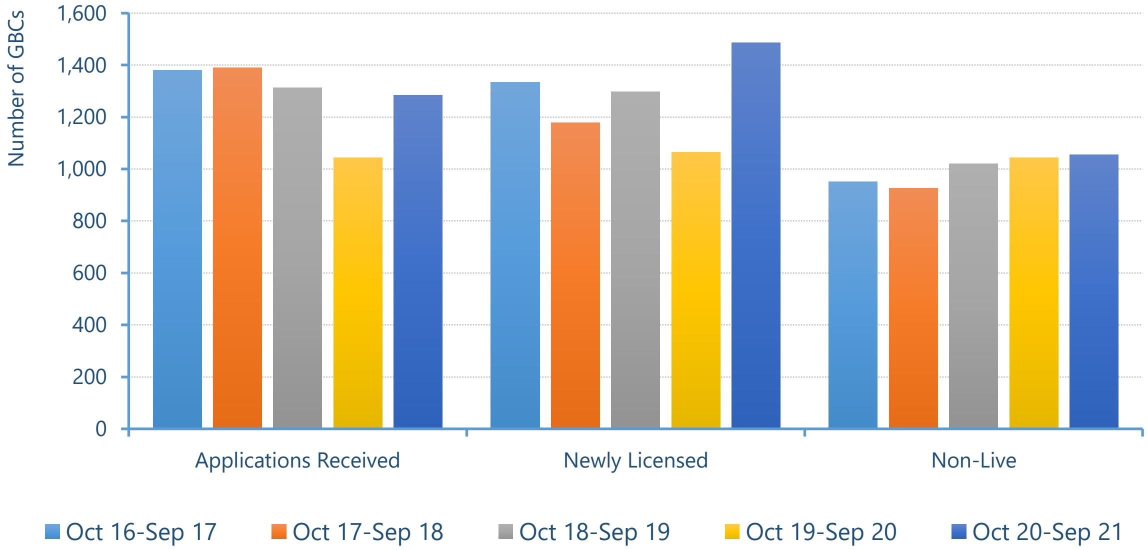
Chart 5.1: Evolution of live GBCs



Source: Financial Services Commission

The number of new GB licences issued for the year ended September 2021 increased by 40 per cent to reach 1,486, comprising the 577 conversion cases from the GBC2 regime. Exclusive of these cases, the number of newly licensed GBCs for the six months ended September 2021 has remained at par with the corresponding period in 2020. Likewise, the number of GBCs turning non-live has remained almost unchanged compared to a year before. (Chart 5.2)

Chart 5.2: Evolution of applications, newly licensed and non-live GBCs



Source: Financial Services Commission

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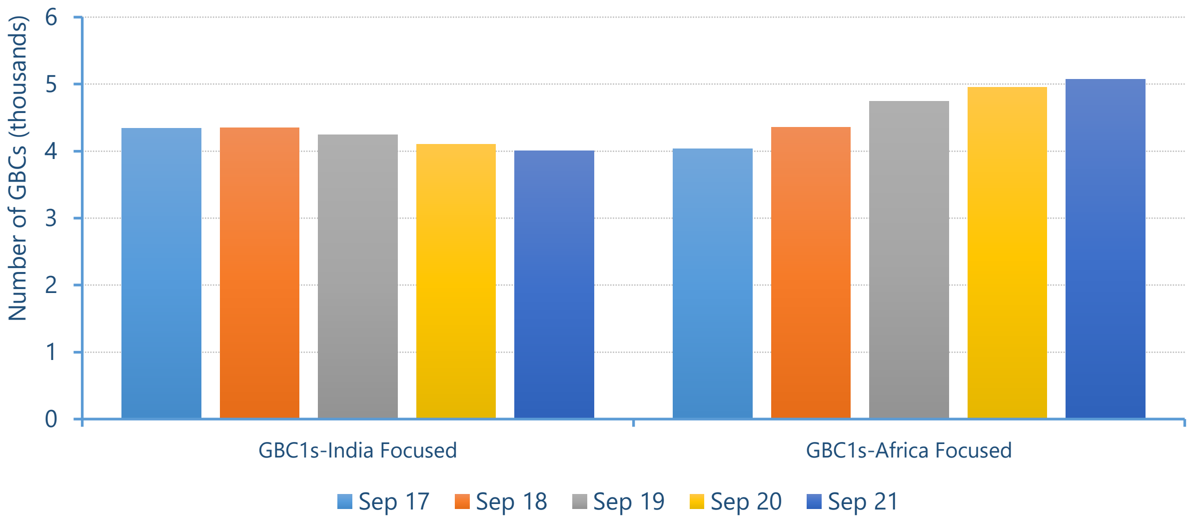
Africa has become the main investment target in terms of the number of GBCs, replacing India in 2019, and has since maintained that trend (Chart 5.3). However, the fund segment of the GB sector, still predominantly targets India representing around 69 per cent of the total schemes, whilst Africa-focused GB funds represent only 19 per cent (Chart 5.4). Funds are likely to be portfolio investors investing in listed instruments on stock markets. The relatively low number of advanced and liquid exchange markets in Africa may explain the small percentage of GB funds targeting this region. Investment in African countries through Mauritius is mainly in the form of private equity by way of direct investment.

Chart 5.3: Live GBCs Targeting India vs Africa



Source: Financial Services Commission

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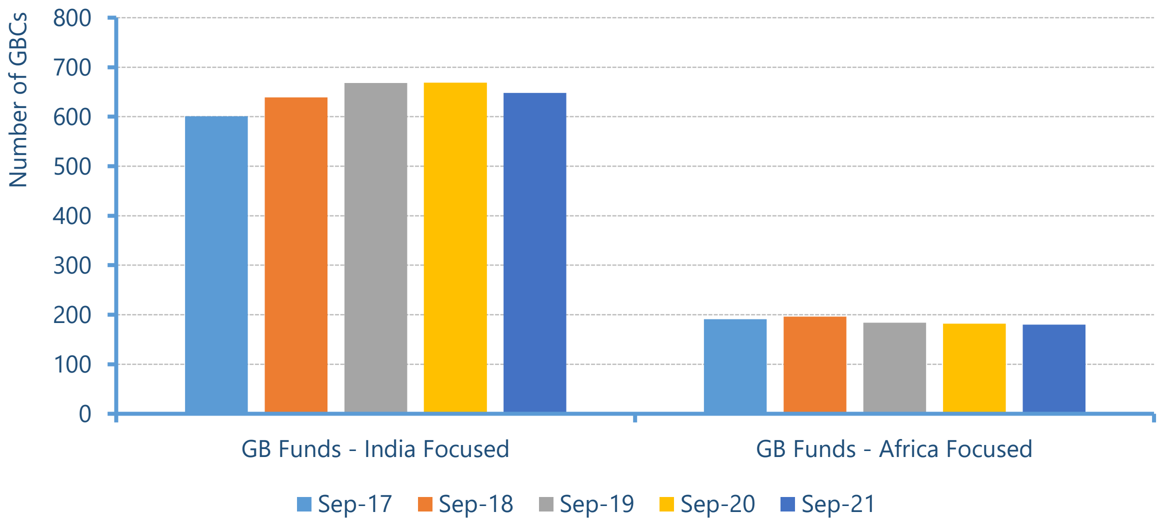
Chart 5.4: GB Funds targeting India vs Africa

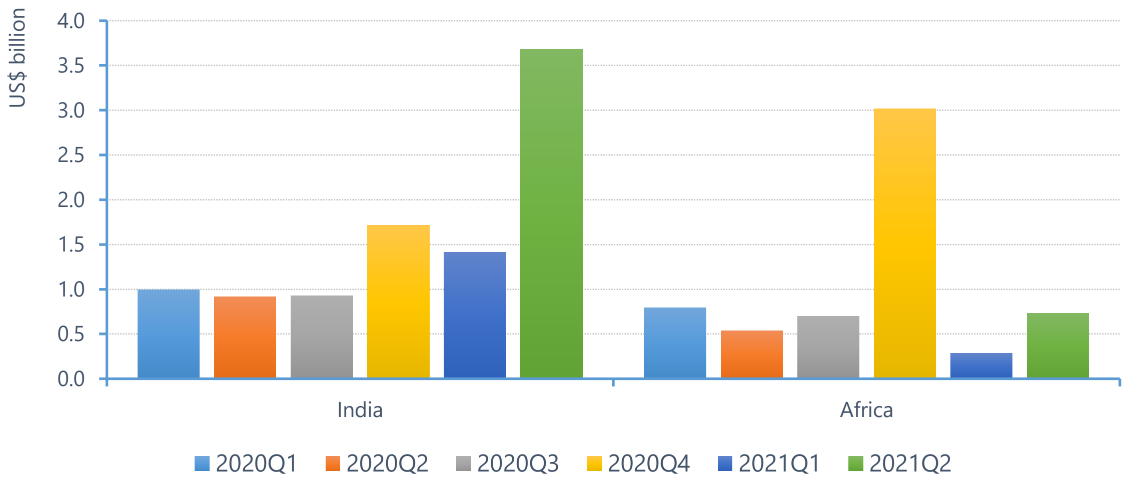


Source: Financial Services Commission

Investment trending upwards

Gross investment flows are inherently volatile when analysed over a short period. However, the pick-up in economic activity globally in 2021 is reflected in both foreign direct investment (FDI) and foreign portfolio investment (FPI) flows into India through the GB sector of Mauritius. During the first semester of 2021, total investment (both FDI and FPI) amounted to US$26.3 billion, as compared to US$18.9 billion during the first semester of 2020. For the same period, flows into Africa from Mauritius have registered a year-on-year increase of 7 per cent, to reach US$2.9 billion during first semester of 2021 (Charts 5.5 and 5.6).

Chart 5.5: Gross Flows of Foreign Direct Investment



Source: Financial Services Commission

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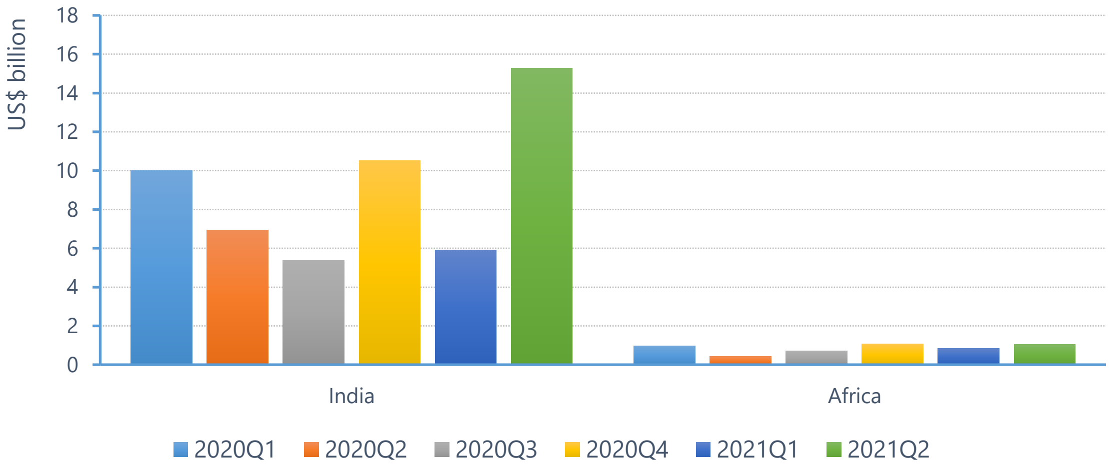
Chart 5.6: Gross Flows of Portfolio Investment



Source: Financial Services Commission

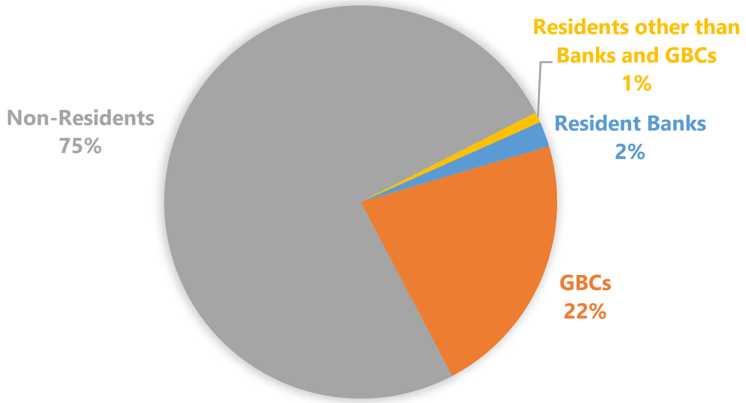
India represents a larger volume of flows of investment especially in terms of portfolio investment. This is consistent with the observation that GB funds, mostly portfolio investors, largely target India rather than the African region (Chart 5.4). On the other hand, the difference in magnitude of gross FDI flows is smaller between the two main investment targets of GBCs.

Linkages between the global business and banking sectors

The MIFC is largely used as a gateway to channel investments towards the Asian and African regions. The breakdown of the monetary and financial assets of GBCs by institutional sectors as at end-September 2021 clearly depicts this structural trend (Chart 5.7). The largest asset exposure of GBCs is with non-residents representing 75 per cent, followed by cross-exposures between GBCs at 22 per cent, indicating the prevalence of GBC group structures operating in the sector. In terms of exposure with residents other than GBCs, it is principally in the form of deposits held with banks. These GB deposits amounted to US$12.8 billion as at end-September 2021, almost equivalent to the GDP of Mauritius. The GB sector is a source of FX, supplementing the insufficient FX inflows from other key sources including the tourism sector. These inflows contributed to mitigating excessive exchange rate volatility.

However, as the GB sector is highly exposed to vulnerabilities, an abrupt and significant exodus of GBCs or GBC deposits could exert significant strains on the liquidity position of the banking system and, ultimately, on financial stability. The Bank has deployed, over the years, a comprehensive framework to monitor risks to the banking system emanating from the GB sector. For instance, it regularly conducts stress tests on the exposure of banks to the GB sector so as to identify vulnerabilities and take appropriate microprudential measures.

Chart 5.7: Exposure of monetary and financial assets of GBCs by institutional sectors



Source: Financial Services Commission

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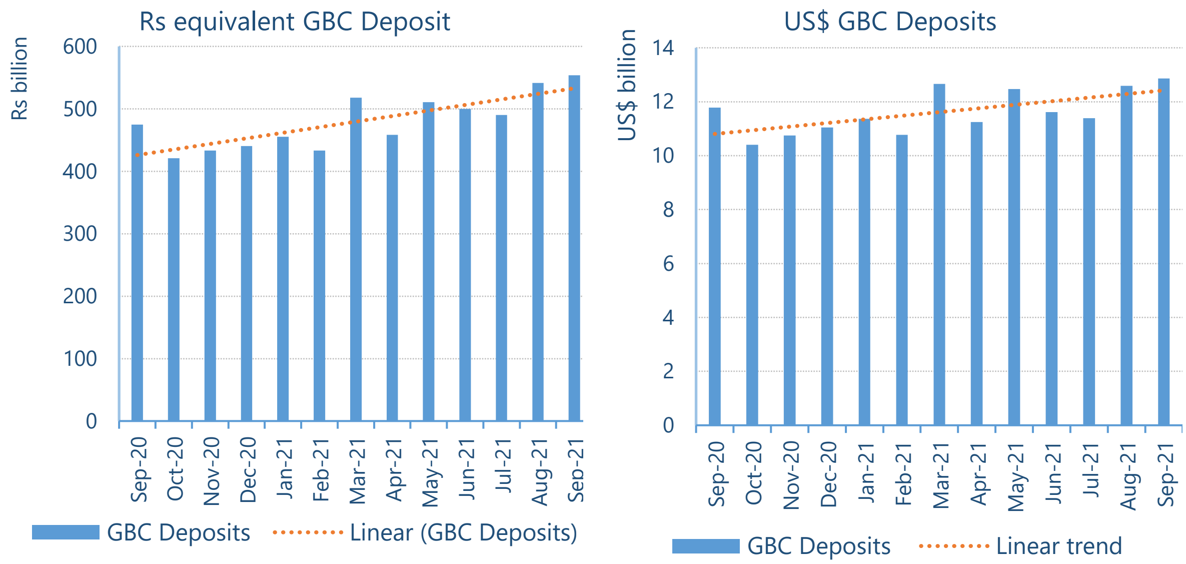
GBC deposits with banks accounted for approximately one-quarter of the total banking assets and one-third of the total banking deposits. Despite the severity of the pandemic and the recent developments in the GB sector, GBC deposits remained buoyant. GBC deposits rose by 7.0 per cent to reach a high of Rs554 billion (approximately US$13 billion) as at end-September 2021, from Rs518 billion (approximately US$12 billion) as at end-March 2021 (Chart 5.8).

Chart 5.8: Evolution of GBC deposits



Source: Bank of Mauritius

Loans to GBCs accounted for approximately 4 per cent of total assets of the banking sector and 8 per cent of total loans extended by banks. As at end-September 2021, GBC loans stood at Rs69 billion (approximately US$1.6 billion), compared to Rs59 billion (approximately US$1.4 billion) as at end-March 2021 (Chart 5.9).

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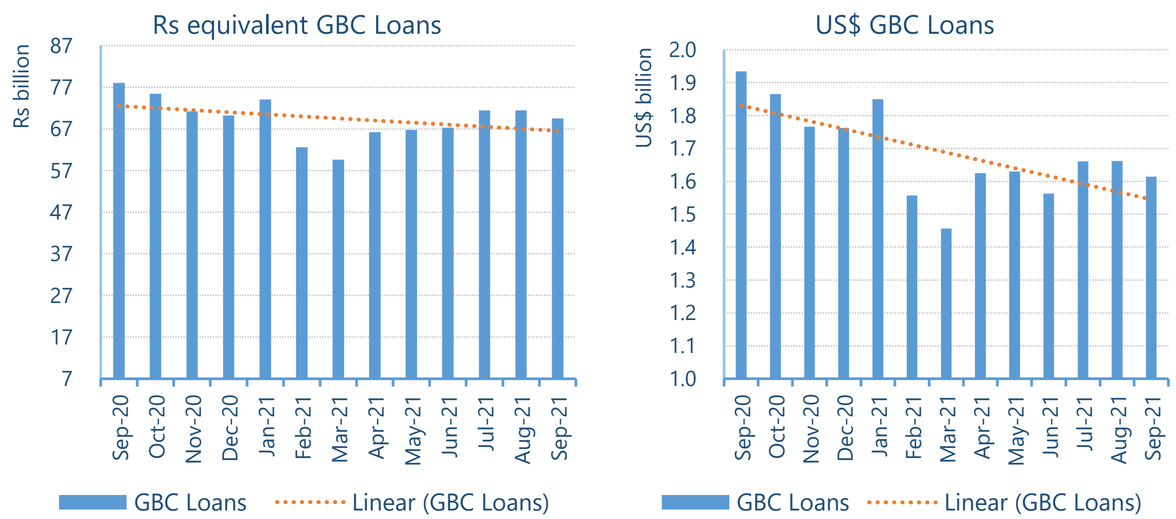
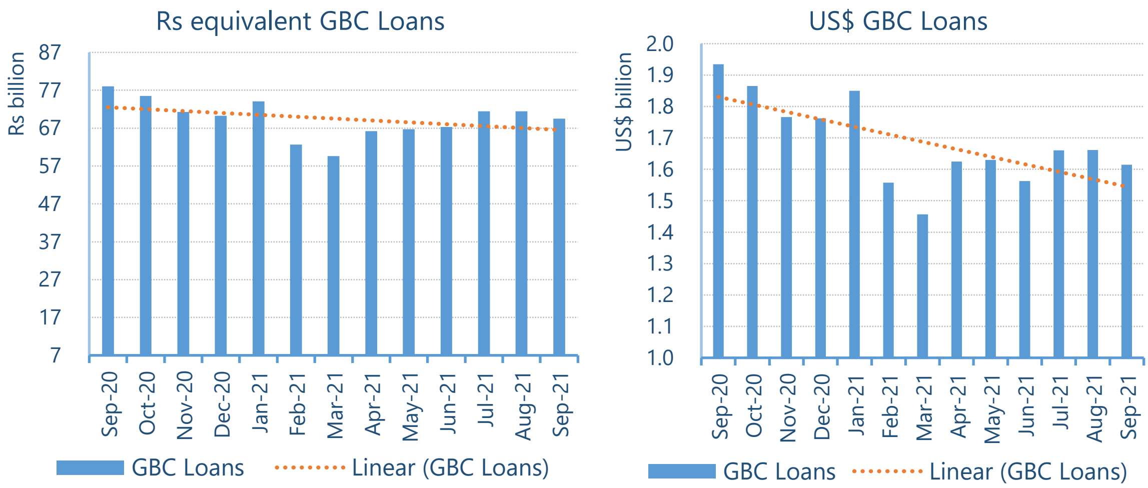
The asset quality of the GB sector in the books of banks has not weakened significantly. Reflective of the global pandemic impact, GBC NPLs rose to 9.5 per cent as at end-September 2021, from 8.9 per cent as at end-March 2021. Specific provisions to NPLs in the GB sector stood at 63.9 per cent as at end-September 2021 (Chart 5.10). The NPLs represented around 17 per cent of the total banking sector's impaired credit.

Chart 5.9: Evolution of GBC loans





Source: Bank of Mauritius

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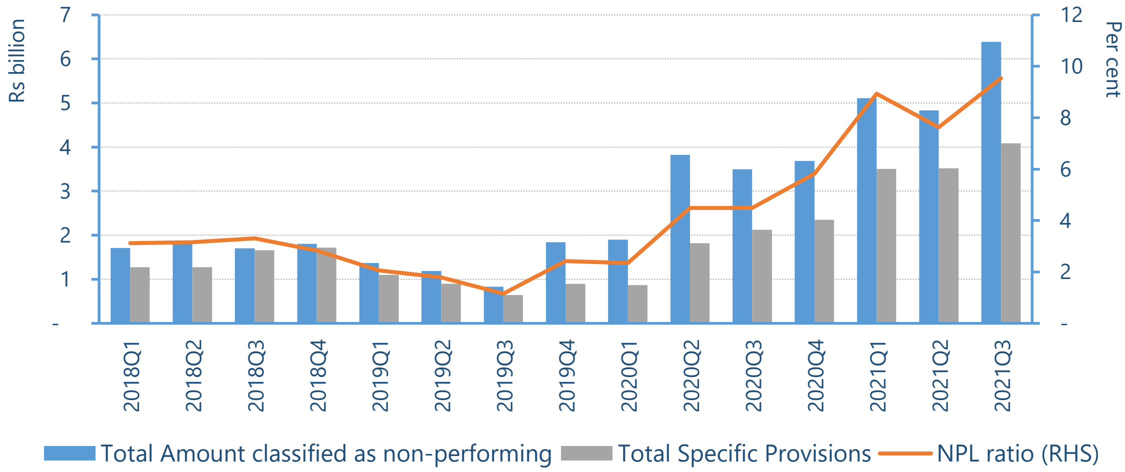
Chart 5.10: Evolution of GBC NPLs



Source: Bank of Mauritius

To have a better assessment of the exposure of the banking sector to the GB sector, a risk map was developed by the FSC to estimate the likelihood of GBCs leaving the jurisdiction and another rating to measure its impact on the banking sector. Based on data as at end-September 2021, it is noted that between 2 to 15 per cent of the GBC deposits have been classified under the higher (high and medium-high) risk and impact categories (Table 5.1). A risk map was devised for the banking sector to measure its exposures to a sudden withdrawal of GB deposits.

Table 5.1: Risk map – per cent of total GBC deposits

Risk Score		Sub-Total Risk scores					
	High Risk	11.4	0.0	3.4	4.4	1.7	1.9
	Medium-High Risk	22.1	0.1	4.6	6.0	2.7	8.7
	Medium-Low Risk	12.0	0.0	3.7	2.9	1.8	3.6
	Low Risk	54.4	0.3	20.7	15.2	7.1	11.1
		Sub-Total Impact Score	0.4	32.4	28.5	13.3	25.3
			Low Impact	Medium-Low Impact	Medium Impact	Medium-High Impact	High Impact
			Impact Score				

Source : Financial Services Commission

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Stress Testing the Mauritian Banking Sector

The results of the stress test for the banking system showed greater resilience of the sector in September compared to March 2021, as banks have built stronger capital and liquidity buffers. The resilience was tested through various hypothetical but plausible scenarios. While the findings demonstrated the capacity of the banking sector to absorb additional shocks, a few banks displayed signs of vulnerabilities and the Bank has been addressing these vulnerabilities as necessary. Overall, with ongoing economic recovery and consolidation of financial buffers, the risks to financial stability have been moderating. However, the level of uncertainty about the duration of the pandemic has gone up with new variants emerging. As such, the Bank views that the risks to financial stability, though moderating with the ongoing recovery, remained persistent and required careful assessment and monitoring.

Overall, banks held comfortable capital and liquidity buffers during the period under review, well above the regulatory limits. The Bank evaluated the resilience of these buffers against various hypothetical but plausible shocks using its stress testing framework. These scenarios are based on hypothetical adverse conditions, such as shocks to the credit portfolios, interest rate, exchange rate and liquidity. These scenarios and their outcomes should not be considered as forecasts.

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Based on the results of the stress tests conducted using September 2021 data, banks generally held resilient capital and liquidity buffers enabling them to absorb greater shocks, though a few banks exhibited some vulnerabilities. Moreover, the results showed an improvement in the resilience of the banking sector given that a lower number of banks demonstrated vulnerabilities, as compared to the findings of the similar exercise conducted using March 2021 data for the previous FSR. Stronger resilience is mostly attributed to increasing buffers in the banking sector, such as rising profitability. Thus, as economic recovery continues, the risks to financial stability are moderating.

However, with the emergence of new variants of COVID-19 and the likelihood of additional adverse shocks to the economy, there is still uncertainty about the magnitude of potential risks to financial stability.

Scenario analysis

The Bank constructed three hypothetical scenarios to assess the resilience of banks to macroeconomic shocks, namely: a baseline, a moderate and a severe risk scenario. The scenarios are based on three different sets of assumptions on macroeconomic shocks, in particular on adverse shocks to economic growth.

The "baseline" scenario assumes that the economy will perform in line with the Bank's growth forecast. The gradual reopening of the borders culminating into full reopening as from 1 October 2021, the roll out of the vaccination programme, the revival of the tourism industry with favourable ripples effects on other segments of the economy with brighter global economic outlook, are together expected to improve the domestic economic performance in the second half of 2021 and in 2022.

The second "moderate" scenario assumes that the economy does not grow in 2021 as the tourism industry struggles to recover and external demand for manufactured goods remains subdued. In addition, the main competitors in the region are benefitting from first-mover advantage which is impacting tourist arrivals in Mauritius. Furthermore, the current health situation is assumed to dampen the enthusiasm of tourists planning to travel to Mauritius for vacation, thereby delaying the complete resumption of economic activity in all economic sectors.

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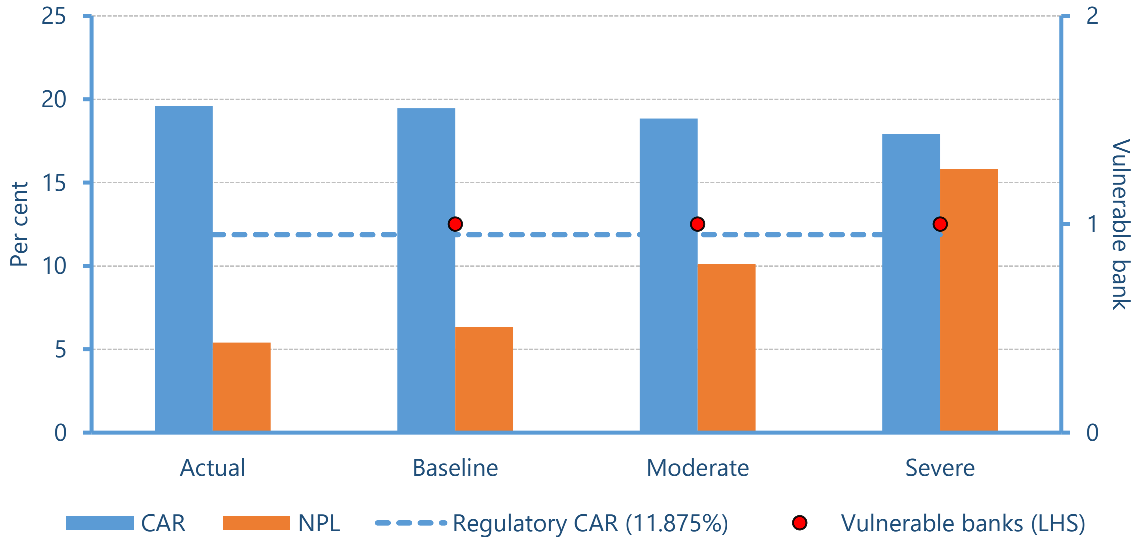
For the "severe" scenario, it is assumed that the new variants compel main markets to close their borders to control the rapidly deteriorating sanitary situation, thus leading to depressed global economic conditions until the second half of 2022. Given the heavy reliance of the domestic economy on external demand for goods and services, including the linkages between the tourism sector and other segments of the economy, the recovery phase is significantly obstructed. As a result, the domestic economy is assumed to contract in 2021 and to resume recovery in the second half of 2022. At the same time, the debt repayment capacity of households and businesses could be hampered.

The results of the stress tests showed that the banking sector is able to sustain the pressure as the macroeconomic scenarios became harsher. The CARs of almost all banks would remain above the standard regulatory limit of 11.875 per cent with the exception of one bank (Chart 6.1).

Chart 6.1: Scenarios results



Source: Bank of Mauritius

Sensitivity analysis

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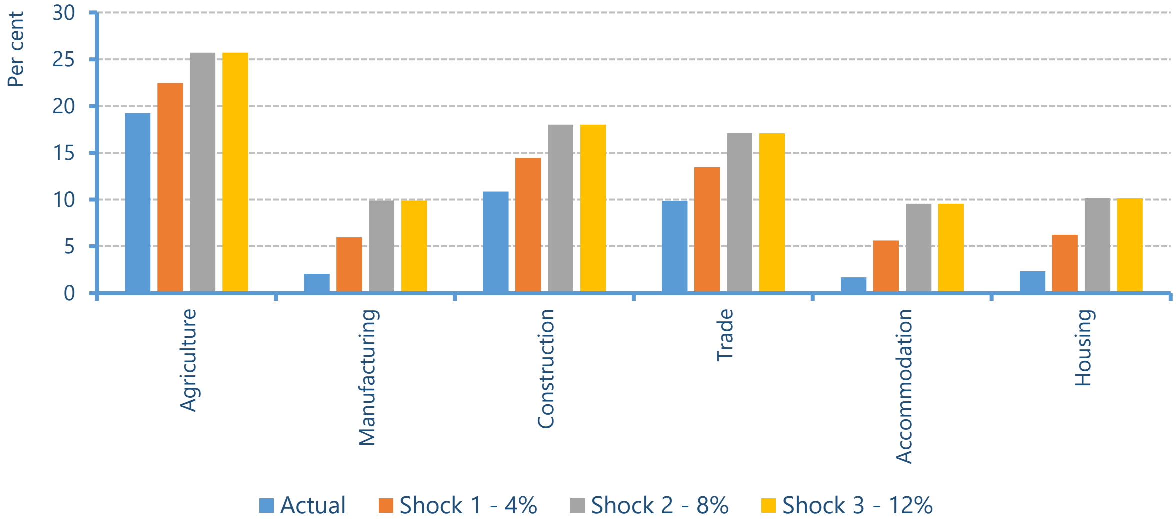
Several single-factor sensitivity stress tests were carried out on banks based on September 2021 data to assess their vulnerabilities and resilience under various scenarios. The sensitivity analysis covered: (i) sectoral credit risk, (ii) credit concentration risk, (iii) liquidity risk, and (iv) reverse stress test.

Sectoral credit risk

Sensitivity stress tests were conducted on banks' sectoral credit portfolio as at end-September 2021 to determine their resilience to shocks. The key sectors identified for the exercise comprise the *'Agriculture'*, *'Manufacturing'*, *'Construction'*, *'Trade'*, *'Accommodation and food services'*, and '*Housing'* sectors. These sectors represent the largest credit portfolios of banks. The sensitivity analysis assumes that a proportion of the performing credit portfolio becomes impaired, with this proportion rising as the exercise is performed under the baseline scenario (4 per cent of performing portfolio is impaired) to the moderate (8 per cent of performing portfolio is impaired) and severe scenarios (12 per cent of performing portfolio is impaired).

The results showed that the *'Accommodation and food services'* sector recorded the highest increase in the NPL ratio, followed by the *'Manufacturing'* and *'Housing'* sectors. The *'Agriculture'* sector would have the highest post-shock NPL ratio, building on its already high actual NPL ratio (Chart 6.2.a). The overall results suggest that all banks would be able to sustain the shocks under the three scenarios (Chart 6.2.b).

Chart 6.2.a: Sector-wise NPL ratio sensitivity results



Source: Bank of Mauritius

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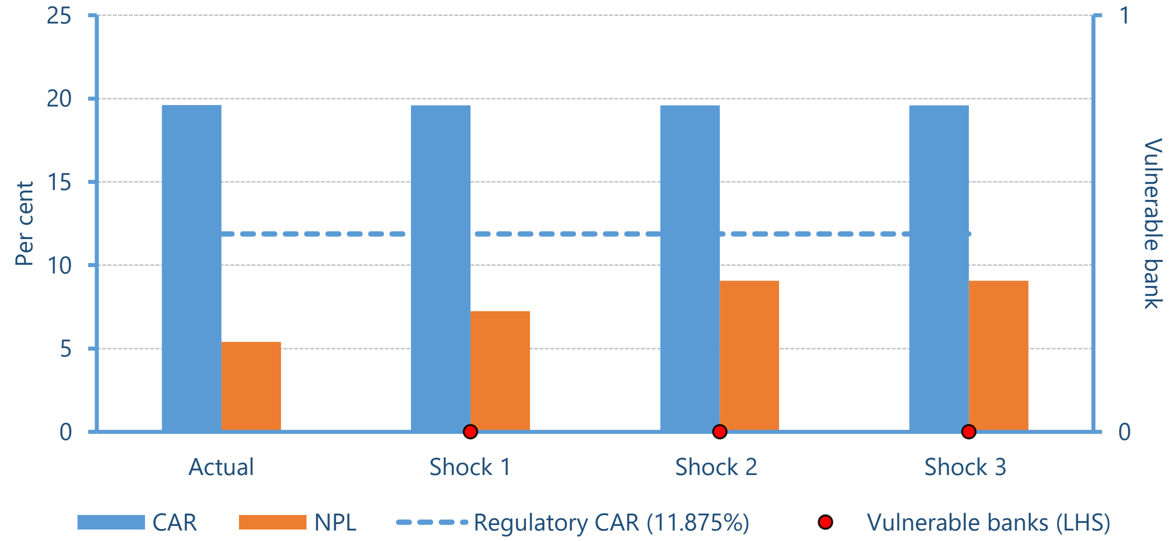
Chart 6.2.b: Sensitivity results



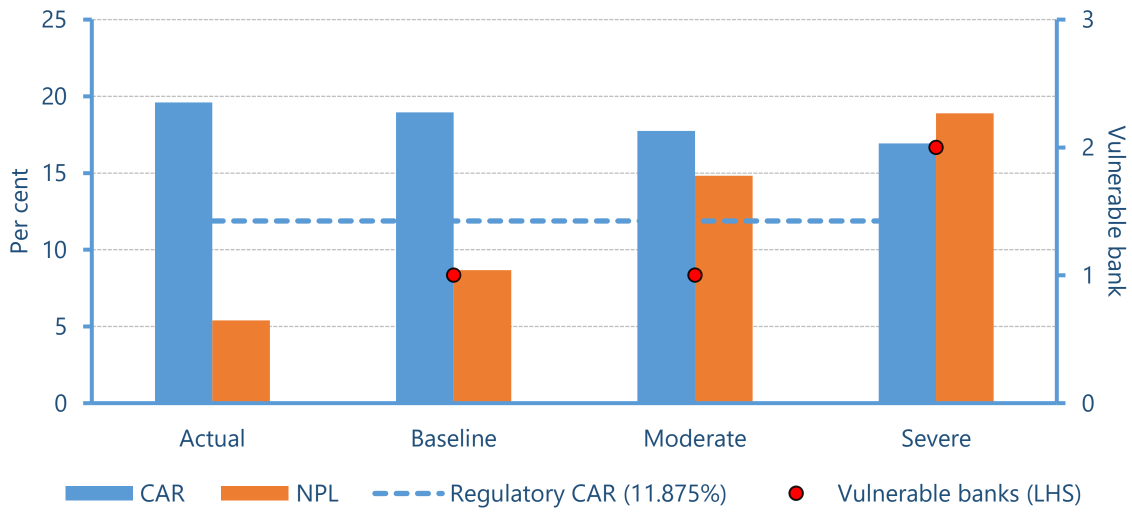
Source: Bank of Mauritius

Credit concentration risk

The impact of credit concentration risk was investigated by considering the hypothetical impairment of the top ten single borrowers, based on their performing advances, for the respective banks. Three shock scenarios were applied: (a) the first scenario assumes that the top single borrower of each bank defaults; (b) the second scenario assumes that the top five borrowers of each bank default; and (c) the third scenario assumes that the top ten borrowers of each bank default. These borrowers comprise the top entities that are unlisted and/or non-governmental bodies. They mainly operate in the *'Agriculture'*, *'Manufacturing'*, *'Construction'*, *'Trade, Transportation and storage'*, and *'Accommodation and food services'* sectors.

The stress test exercise showed that the banks' aggregate post-shock CAR would decline from 19.6 per cent (actual) to: (a) 19.0 per cent (first scenario), (b) 17.7 per cent (second scenario) and, (c) 16.9 per cent (severe scenario) (Chart 6.3). Banks were able to withstand the shocks derived from these scenarios, with exception of one bank in the first two scenarios and two banks in the last scenario.

Chart 6.3: Credit concentration risk



Source: Bank of Mauritius

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Liquidity risk

Liquidity stress tests have been performed to assess the liquidity position of all banks operating in Mauritius, based on five shock scenarios (Table 6.1). The sensitivity analysis focusses more on the impact of withdrawal of GBC deposits, as banks have varying proportions of GBC deposits on their balance sheets with foreign banks having higher shares.

Table 6.1: Liquidity risk – foreign currency deposit withdrawals

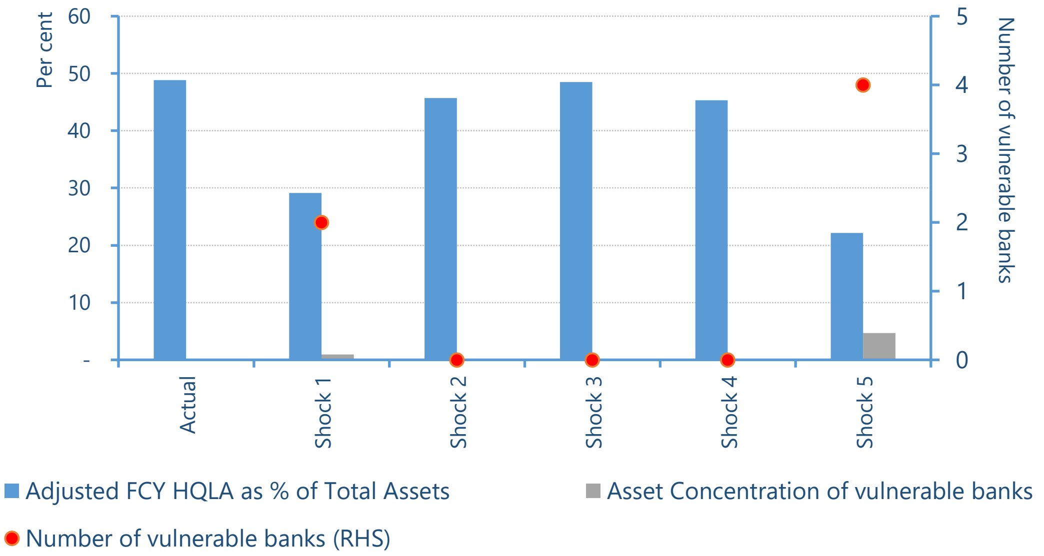
Shocks	Description
1	Assume 35 per cent one-off foreign currency deposit withdrawal
2	Assume largest GBC depositor withdrawal
3	Assume riskiest GBC depositor withdrawal
4	Aggregate of Shocks 2 and 3 (provided largest GBC depositor is not the riskiest one as well)
5	Aggregate of Shocks 1, 2 and 3

Source: Bank of Mauritius

These five scenarios have been designed to investigate the ability of the banks in Mauritius to withstand increasing foreign currency deposit withdrawals against their Adjusted Foreign Currency High Quality Liquid Assets (Adjusted HQLA). The latter is derived by combining (1) the foreign currency HQLA (as per LCR definition) and (2) foreign currency interbank placements held. In these tests, a bank was considered as 'vulnerable' if its Adjusted HQLA turned negative under stressed conditions.

Results showed that two banks would show signs of vulnerability when Shock 1 is applied. As for Shocks 2, 3 and 4, the Adjusted HQLA of all banks would remain resilient. However, four banks would show signs of vulnerability should Shock 5 be applied (Chart 6.4).

Chart 6.4: Liquidity risk – adjusted FCY HQLA



Source: Bank of Mauritius

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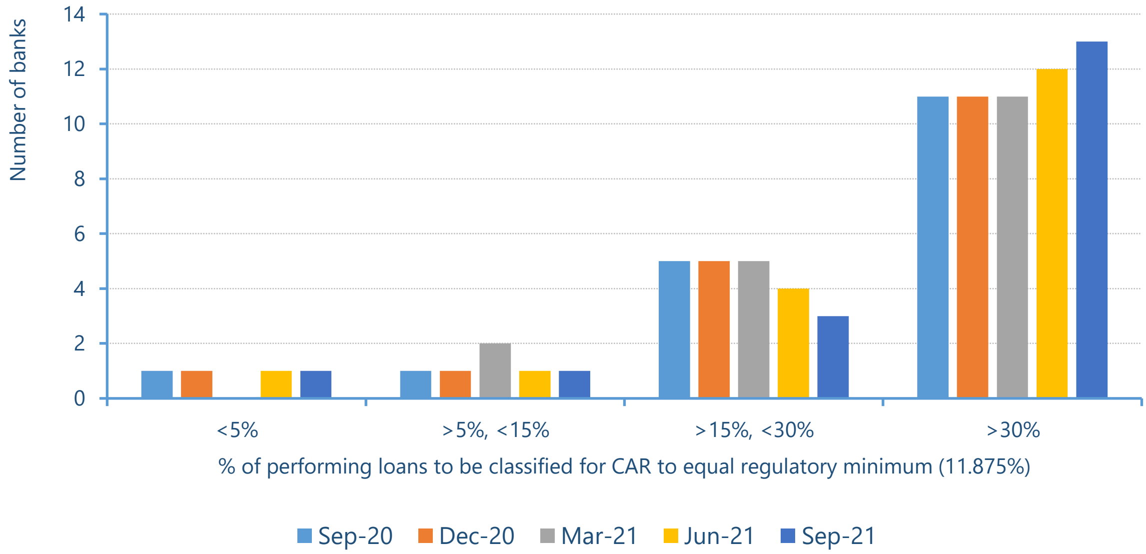
Reverse stress test

The reverse stress test measures the maximum amount of additional NPLs that banks would be able to absorb for their CAR to fall to the minimum regulatory CAR. The additional NPLs is taken as a proportion of the existing performing loans of each bank.

The distribution of the proportion of performing loans to be classified as impaired denotes greater resilience to potential shocks. Banks' capital buffers would be able to absorb shocks to their performing loans portfolio ranging from 1.0 per cent (8.5 per cent as at end-March 2021) to 398.5 per cent (257.6 per cent as at end-March 2021) (Chart 6.5).

The reverse stress testing results suggest that most banks would need dispersed and larger proportion (above 20 per cent) of loans turning impaired for their CAR to reach their respective minimum regulatory limit. Overall, banks' capital buffers have strengthened, reflecting their ability to absorb potentially higher shocks to their credit portfolio.

Chart 6.5: Implied percentage of performing loans to be classified as non-performing



Source: Bank of Mauritius

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Annex A: Financial Soundness Indicators

Financial Soundness Indicators[a] of Other Depository Corporations[b]

Per cent

(Core)	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21
Capital-based								
Regulatory capital to risk-weighted assets	19.6	19.3	20.4	19.9	19.7	19.8	19.7	20.7
Regulatory Tier 1 capital to risk-weighted assets	18.2	18.0	19.0	18.5	18.3	18.4	18.3	19.4
Non-performing loans net of provisions to capital	10.4	11.5	12.2	11.1	10.2	10.6	8.2	7.6
Asset Quality								
Non-performing loans to total loans[c]	4.9	5.3	5.8*	6.1*	6.2	6.2	5.6	5.3
Sectoral distribution[d] of loans to total loans[c]:								
Interbank loans	2.5	4.4	4.6	2.8	4.3	4.5	5.0	4.9
Other financial corporations	12.1	11.7	11.4	9.8	9.6	8.9	9.8	9.1
Non-financial corporations	26.4	25.9	27.1	28.3	27.8	27.3	26.4	26.6
Other domestic	23.4	21.1	20.9	22.0	22	22.3	21.7	22.3
Non-residents	35.6	36.8	35.9	37.1	36.3	36.9	37	37
Earnings and Profitability								
Return on assets[e]	1.9	1.2	1.1	1.1	1	1.2	1.3	1.3
Return on equity[e]	16.7	11	9.5	9.7	8.9	11.4	12.7	12.4
Interest margin to gross income	69.3	71.7	65.9	68.2	69	63.1	69.3	66.6
Non-interest expenses to gross income	41.1	41.8	40.0	43.3	44.1	44	43.2	45.9
Liquidity								
Liquid assets to total assets	25.3	24.5	26.4	27.7	26	29.4	27.3	26.5
Liquid assets to short-term liabilities	28.5	27.7	29.7	31.1	29.3	32.8	30.5	29.6
Sensitivity to Market Risk								
Net open position in foreign exchange to capital	2.1	1.7	1.7	1.6	1.6	1.9	2.2	1.8
(Encouraged)	**Dec-19**	**Mar-20**	**Jun-20**	**Sep-20**	**Dec-20**	**Mar-21**	**Jun-21**	**Sep-21**
Capital to assets	11.3	11.2	11.0	10.6	10.8	10.2	10.3	10.3
Value of large exposures to capital	237.3	244.8	258.5	257.7	242.3	237.5	253.1	236.5
Customer deposits to total (non-interbank) loans	174.7	179.4	182.7	194.8	197.4	213	219.2	230.8

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Residential real estate loans to total loans[c]	10.8	10.6	10.6	11.3	11.5	12.5	11.3	11.7
Commercial real estate loans to total loans[c]	5	4.7	5.0	5.1	5.4	5.5	5.5	5.5
Trading income to total income	11.7	13.0	16.4	13.3	11	17.9	7.6	12.8
Personnel expenses to non-interest expenses	45.4	46.5	48.0	45.6	51.1	48.7	47.6	45.3

[a] *FSIs are calculated on a domestic consolidation basis using the Financial Soundness Indicators Compilation Guide (2006) of the International Monetary Fund.*

[b] *Other Depository Corporations refer to Banks and NBDTIs that are all licensed by the Bank.*

[c] *Total gross loans include commercial loans, instalment loans, hire-purchase credit, loans to finance trade credit and advances, finance leases, repurchase agreements not classified as deposits, and overdrafts.*

[d] *With the emergence of new types of economic activities, the return on sector-wise distribution of credit to the private sector has been replaced by a new template based on the United Nations International Standard Industrial Classification (ISIC) of all economic activities, Rev. 4, built on a set of internationally agreed concepts, definitions, principles and classification rules. Hence, data are not strictly comparable with those prior to December 2018.*

[e] *Return on asset and Return on equity are based on Annualised Profit before Tax, which is in accordance with the Financial Soundness Indicators Compilation Guide (2006) of the International Monetary Fund.*

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Note: Figures may not add up to totals due to rounding.
Source: Bank of Mauritius

List of Charts, Tables and Boxes

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Tables

Boxes

Acronyms

AML/CFT	Anti-Money Laundering and Combatting the Financing of Terrorism
Bank	Bank of Mauritius
CAR	Capital Adequacy Ratio
CBDC	Central Bank Digital Currency
CET1	Common Equity Tier 1
D-SIBs	Domestic Systemically Important Banks
DTIs	Deposit-taking institutions
ESAAMLG	Eastern and Southern Africa Anti-Money Laundering Group
EU	European Union
FATF	Financial Action Task Force
FDI	Foreign direct investment
FPI	Foreign portfolio investment
FSC	Financial Services Commission
FSI	Financial Soundness Indicators
FSR	Financial Stability Report
GB	Global Business
GBC1	Global Business Category 1
GBC2	Global Business Category 2
GBCs	Global Business Corporations
GBL	Global Business Licence
GDP	Gross Domestic Product
GOIR	Gross Official International Reserves
HQLA	High Quality Liquid Assets
IMF	International Monetary Fund
LCR	Liquidity Coverage Ratio
MACSS	Mauritius Automated Payment and Settlement System
MauCAS	Mauritius Central Automated Switch branded
MIFC	Mauritius International Financial Centre
MSCI	Morgan Stanley Capital International
NBDTIs	Non-Bank Deposit-Taking Institutions
NPL	Non-Performing Loan
ROA	Return on Assets
ROE	Return on Equity
RBS	Risk-Based Supervision
Rs	Mauritian Rupees
RWAs	Risk-Weighted Assets
UK	United Kingdom
US$	US dollar

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Glossary

Corporate credit is defined as credit extended to corporates by banks.

Corporate debt refers to aggregate credit to corporates extended by banks as well as NBDTIs, leasing and insurance companies.

Credit-to-GDP gap is the percentage deviation between the credit to GDP ratio and an estimate of its trend.

GBCs are resident corporations, which conduct business outside Mauritius. GBCs are regulated by the Financial Services Commission (FSC) under the Financial Services Act 2007.

Household credit is defined as credit extended to households by banks.

Household debt refers to aggregate credit to household extended by banks as well as NBDTIs, leasing and insurance companies.

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ROA is the annualised pre-tax return on assets and is measured by the ratio of pre-tax profit to average assets.

ROE is the annualised pre-tax return on equity and is measured by the ratio of pre-tax profit to average equity.

Percentage point is the arithmetic difference of two percentages.

SEMDEX is an index of prices of all listed shares on the Stock Exchange of Mauritius wherein each stock is weighted according to its share in the total market capitalisation.

Tier 1 capital is a term used to qualify eligible capital of a bank and is constituted of the components having the highest loss absorbing capacity.

Annual or y-o-y change compares the value of a variable at one period in time with the same period of the previous year.