BANK OF MAURITIUS

Financial Stability Report

June 2022

Foreword

The Bank of Mauritius (hereafter referred to as the "Bank") is issuing the first edition of its Financial Stability Report for 2022, covering the period September to December 2021, unless otherwise stated.

This Report is published pursuant to section 33(2)(b) of the Bank of Mauritius Act which stipulates 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 in terms of section 4(2)(b) of the Bank of Mauritius Act, the Bank makes an overall assessment in this report 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.

The Bank welcomes feedback from readers. Comments and suggestions should be forwarded to communications@bom.mu.

Financial Stability Report June 2022

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Executive summary

Global developments

The global economic outlook had improved towards the end of 2021 but the lingering effects of the pandemic continued to weigh on global economic prospects. The divergence between economic recovery in advanced economies and emerging and developing economies persisted, partly due to the disproportionate access to vaccines.

Besides setting policies to stimulate economic recovery, policymakers also had to tackle rising inflation. A growing number of central banks resorted to monetary policy tightening to curb inflation, some more aggressively than others, as an upsurge in inflation could raise inflation expectations and disrupt the pace of economic recovery. Inflation dynamics in the last quarter of 2021 was persistently exacerbated by protracted supply chain disruptions.

Higher interest rate was a challenge for fiscal consolidation, compounded by elevated social expenditures related to the pandemic and to support economic recovery. Moreover, Emerging Market and Developing Economies (EMDEs) were vulnerable to interest rate increases, worsening many of these economies' debt metrics. Concurrently, financial markets showed some volatility. The Morgan Stanley Capital International (MSCI) World index rose by 6.9 per cent in the last quarter of 2021 and global long-term yields increased.

Risks to financial stability remained well contained in the last quarter of 2021, supported by economic recovery across most economies. The emergence of the Omicron variant around November 2021 dampened prospects to some extent, but its effects were not protracted. While financial conditions were broadly loose in 2021, the interest rate hikes in many economies started tightening financial markets. The loose financial conditions, in particular low interest rates, had benefitted both the corporate and the household sectors. However, rising interest rates could herald macrofinancial vulnerabilities going forward.

In early 2022, the Russia-Ukraine war heightened uncertainty about economic prospects and added to the pandemic-led demand-supply imbalances. Inflationary pressures mounted. The inflation outlook posed serious risks to economic prospects and financial stability. Many central banks, including in advanced economies, tightened monetary policy at a faster pace to prevent un-anchoring of inflation expectations. The International Monetary Fund (IMF) revised downward its growth forecast for 2022 to 3.6 per cent.

Risks to global financial stability went up against this backdrop at the beginning of 2022. Altogether, pandemic-led vulnerabilities, policy tightening to curb intensifying inflationary pressures, the adverse economic implications of the war, and downward revision to economic growth have heightened challenges to maintain the stability of the financial system.

Domestic developments

With the full opening of the borders in Mauritius as from 1 October 2021, economic prospects brightened, propelled by the revival of the tourism industry and spill-over effects on related sectors. The economy grew, in real terms, by 6.2 per cent in the last quarter of 2021 compared to the same quarter in 2020. Growth was broad-based across most sectors of the economy and, as a result, many sectors attained pre-pandemic levels of economic activity. The temporary setback caused by the Omicron variant of COVID-19 did not disrupt the outlook significantly, as the tourism sector was still expected to recover strongly in 2022. The unemployment rate declined to 8.1 per cent in December 2021, from 9.4 per cent in September 2021, sustaining faster recovery in income in the corporate and household sectors. Monetary policy remained supportive of economic recovery.

Improving investors' confidence in the last quarter of 2021 infused greater buoyancy in the stock market. The foreign exchange (FX) market started recovering with the revival of tourism and greater dynamism in the export sector. The pick-up in FX inflows caused the Bank to scale down the frequency and size of its interventions on the FX market as from November 2021. These FX interventions continued to focus on containing excessive fluctuations in the exchange rate, while ensuring broadly sustainable demand-supply conditions on the FX market.

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The country held adequate FX reserves buffer to face external vulnerabilities. The Gross Official International Reserves (GOIR) hovered around levels that continued to meet various reserves adequacy metrics, as it rose to US$8.6 billion as at end-December 2021 from US$7.8 billion as at end-September 2021. Also, as FX inflows increased, drawdowns of reserves were of lower magnitude.

Inflation picked up in the last quarter of 2021, mainly due to persisting pandemic-induced supply-side shocks. Headline inflation rose to 4.0 per cent in December 2021. Although the inflationary pressures are expected to subside over the medium term, the rise in consumer prices is expected to adversely influence consumer and business sentiment.

To avoid inflation from disrupting growth prospects, the Monetary Policy Committee (MPC) of the Bank started withdrawing the accommodative monetary policy stance in March 2022 with an increase in the policy rate. Further hikes will depend on the assessment of the inflation and growth outlook over the policy horizon. The withdrawal of the accommodative monetary policy stance could induce risk to financial stability, primarily due to the impact of higher interest rates on the debt servicing capacity of borrowers, asset prices and the economic outlook.

The household and corporate sectors benefitted from the sustained economic recovery, contributing towards containing risks to the stability of the financial system. The extension of some of the COVID-19 support measures by the Bank up to June 2022 provided these sectors additional financial flexibility, while also boosting faster recovery in consumer and business confidence. Private sector activities have been picking up, well supported by bank credit.

Bank credit to the household sector grew strongly but contracted for the corporate sector, as some key economic sectors reduced their exposures to banks. The overall capacity of the household sector to service their debt obligations was assessed to be adequate, though those households having a high debt service-to-income ratio could face difficulties. Aggregate household debt service – which includes debt servicing to banks and other financial institutions – was at 6.7 per cent of Gross Domestic Product (GDP) and 17.2 per cent of household aggregate income. The contraction of corporate credit, together with a declining share of corporate credit to operating surplus, is expected to improve the ability of businesses to fulfil their financial obligations to banks.

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Bank credit to businesses and households were performing, with a share of 4.9 per cent assessed to be non-performing as at end-December 2021, slightly higher than in September 2021. Profitability metrics were broadly stable and could rise as the business environment improves. The robust regulatory framework and the adequate capital and liquidity buffers held by the banking system contributed to maintaining stability in the financial system.

The Global Business (GB) sector showed noticeable resilience in 2021, with deposits continuing its growth trajectory. The exit of Mauritius from the list of jurisdictions under increased monitoring of the Financial Action Task Force (FATF) and the United Kingdom (UK) list of High-Risk Third Countries towards the end of 2021 improved the outlook of the sector. The withdrawal of Mauritius in the European Union (EU) List of High-Risk Third Countries in February 2022 added further positive impetus to the performance of the sector. Favourable economic outlook, bolstered by a surge in investor sentiment during 2021, led to a rise of both Foreign Direct Investment (FDI) and Foreign Portfolio Investment (FPI) flows, which remained India-focused. Altogether, the linkages of the GB sector to the banking sector did not represent a source of risk to financial stability.

There was a marginal uptick in the Systemic Risk Indicator (SRI), largely driven by risk-taking behaviour in financial markets and a rise in external vulnerabilities. The increase in the current account deficit and higher exchange rate volatility were the main triggers of the rise in external vulnerabilities. These sources of risk are expected to subside as tourism recovers and inflows of FX improve further. Also, the GOIR was assessed to be adequate in December 2021, mitigating the risks implied by the rise in the SRI.

The banking sector was resilient to a range of macroeconomic and other idiosyncratic shocks applied under various stress test scenarios. Strong capital and liquidity buffers supported this resilience. The scenarios comprised shocks to the credit portfolios, interest rate, exchange rate and liquidity, which were calibrated to reflect the plausible developments due to the pandemic as well as the Russia-Ukraine war. A few banks showed signs of vulnerabilities in specific areas. The Bank is addressing these weaknesses, as appropriate.

More broadly, as economic recovery gathered momentum, the banking sector continued to consolidate its financial buffers and, consequently, risks to financial stability were well contained. However, with the frequency and severity of shocks in recent years, the Bank maintains its prudent approach by closely assessing and monitoring risks to financial stability. An increase in risks to financial stability was noted in the early months of 2022, amid rising inflation and interest rates as well as a downgrade in the global economic outlook.

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The Bank continued to engage with the banking industry on the unwinding of COVID-19 support measures, through regular interactions at the level of the Task Force on Banking Sector Resilience. The moratoria on loans continued a downward trajectory in the last quarter of 2021. This decline is a positive indication of economic recovery. Subsequently, the Capital Conservation Buffer was restored to 2.5 per cent with effect from 1 April 2022, from 1.875 per cent.

Non-Bank Deposit-Taking institutions (NBDTIs), as well as other financial institutions (comprising life insurances, general insurances and pension funds), demonstrated healthy performance in the last quarter of 2021. The capital level in these financial segments was well above regulatory limits. The long-term insurance industry registered relatively healthy solvency margins in terms of gross premiums. Since the onset of the pandemic, life insurers have demonstrated resilience by re-allocating their investment mix to safer assets at the peak of the pandemic and to riskier assets during the recovery phase. Similarly, general insurance also held strong solvency margins.

Longer term challenges – such as geopolitical tensions, protectionism and the tightening of monetary policy – have changed the landscape of the insurance sector. The Financial Services Commission (FSC) has accordingly brought forward several amendments to the insurance sector legislation.

The Bank continued to upgrade its prudential framework. It issued the revamped Guideline on Private Banking and a new Guideline for Digital Banks on 6 December 2021, with the objective of providing a conducive environment for private banking and digital banks. The revised Guideline on Standardised Approach to Credit Risk and the Additional Macroprudential Measures for the Banking Sector became effective on 1 April 2022.

Climate change continues to be a priority for the Bank. The Guideline on Climate-related and Environmental Financial Risk Management was introduced with effect from 1 April 2022. Its purpose is to assist financial institutions in embedding sound governance and risk management frameworks for climate-related and environmental financial risks within their risk management frameworks. This new prudential standard sets out expectations in terms of governance and risk management framework.

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1. Macrofinancial environment

The global economy continued to recover from the effects of the pandemic towards the end of 2021 whilst fiscal and monetary stances remained largely accommodative. In Mauritius, growing optimism among economic stakeholders following the full opening of the borders on 1 October 2021, along with the successful vaccination campaign, bolstered domestic economic activity and the outlook. The temporary setback from the emergence of the Omicron variant underscored the vulnerability of growth prospects. The drop in the unemployment rate favourably impacted the financial position of the household sector. The marginal pick up in the SRI was largely driven by the rise in the current account deficit and higher exchange rate volatility. These sources of risk are expected to subside as tourism recovers and inflows of FX improve further. The GOIR was assessed to be adequate in December 2021. Risks from the macrofinancial environment remained well contained, but geo-political tensions will likely test the resilience of both the global and domestic financial systems in 2022.

Global economic and financial conditions remained vulnerable

The global economic outlook had improved towards the end of 2021. However, the lingering effects of the pandemic continued to weigh on global economic prospects, though to a lesser extent than before given the series of measures taken around the world to reign in the pandemic. Output growth divergences between advanced economies and EMDEs indicated that the former could reach pre-pandemic output level in 2022 while the latter would only do so around 2024.[1] The disproportionate access to vaccines was one of the main causes of the uneven economic recovery.

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Policymakers worldwide had to respond to growing inflationary pressures in the second half of 2021, though economic activity was generally still lagging pre-pandemic levels. Monetary authorities were faced with the trade-off between continuing to support economic recovery and curbing inflation. Further, inflationary pressures were exacerbated by persisting supply chain disruptions. Consequently, many central banks embarked on interest rate hikes, some more aggressively than others. The surge in inflation towards the end of 2021, that intensified in early 2022, heightened risks of un-anchoring inflation expectations and disrupting the recovery momentum.

On the fiscal side, large-scale expansion in governments' budget to mitigate the economic fallouts of the pandemic had worsened many economies' debt metrics. EMDEs had become increasingly vulnerable to increases in interest rates. At the same time, higher interest rate

[1] *IMF April 2022 World Economic Outlook.*

posed a challenge for governments to consolidate their fiscal position, compounded by pressures for social expenditure that remained elevated.

Risks to financial stability were well contained in the last quarter of 2021, sustained by economic recovery across economies and continued policy support, despite the emergence of the Omicron variant around November 2021. Financial conditions were broadly loose in 2021 but started to tighten as more central banks resorted to interest rate hikes in the fourth quarter of 2021. While both the corporate and the household sectors benefitted financially from very low interest rates and support measures, the prolonged accommodative policies could become potential sources of financial vulnerabilities.

The economic outlook deteriorated significantly following the outbreak of the Russia-Ukraine war in February 2022. The war and the resurgence of the COVID-19 cases in China further disrupted the supply chain in early 2022. Soaring food and commodity prices and tightening of monetary policy heightened risks. The geo-political tensions had amplified the pandemic-led demand-supply imbalances, resulting in higher oil and commodity prices which were expected to remain elevated over the medium term amid an array of financial sanctions imposed on Russia. In light of these developments, the IMF in its April 2022 World Economic Outlook (WEO) revised downwards its global growth projections by 1.3 percentage point to 3.6 per cent for 2022, relative to its October 2021 projection.

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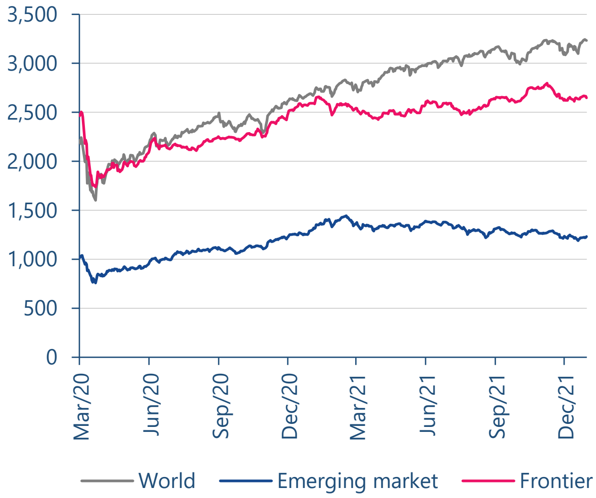
As a result, the risks to global financial stability went up in the early months of 2022, as extensively covered in the IMF's April 2022 Global Financial Stability Report. The combination of vulnerabilities built up during the pandemic, monetary policy tightening as inflationary pressures intensified, the spill-over effects of the war, dimmer economic prospects and a drop in risk appetite, altogether exerted strains on the resilience of the financial system and exacerbated financial stability challenges.

Equity prices remained broadly stable across the world market in the last quarter of 2021, albeit a slight drop noted in November 2021 on account of the outbreak of the Omicron variant. An increase of 6.9 per cent was registered in the MSCI World Index, whilst the MSCI Frontier Index rose by 1.5 per cent. Conversely, the MSCI Emerging Market index fell by 1.2 per cent (Chart 1.1).

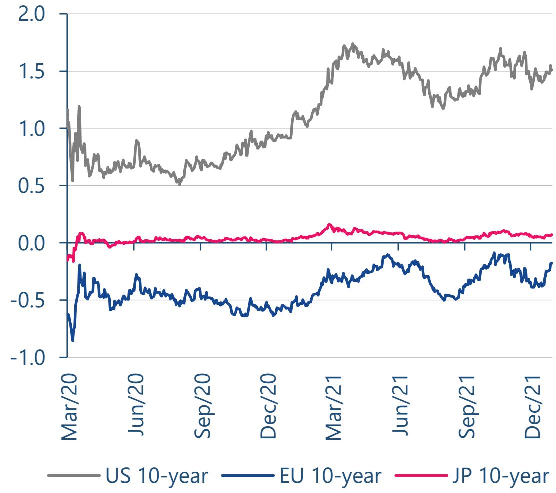
Global long-term yields improved towards the end of 2021, with further indication of interest rate hikes from monetary authorities to curb inflation. The US 10-year yield averaged 1.5 per cent for the quarter ended December 2021, a slight increase from 1.4 per cent in the preceding quarter. Moreover, the EU 10-year yield remained in negative territory with an average yield of -0.2 per cent during the last quarter of 2021. The long-term yields are expected to maintain an upward trend in the medium term in the light of the accelerated monetary policy tightening by central banks to thwart inflationary pressures (Chart 1.2).

Chart 1.1: MSCI indices



Source: Bloomberg

Chart 1.2: Selected government bond yields



Source: Bloomberg

The US$ Index maintained an upward trend since end-September 2021 to reach 95.7 as at end-December 2021. This trend reflected the United States (US) Federal Reserve's intention to curb inflationary pressures whilst the US economy recovered from the pandemic (Chart 1.3).

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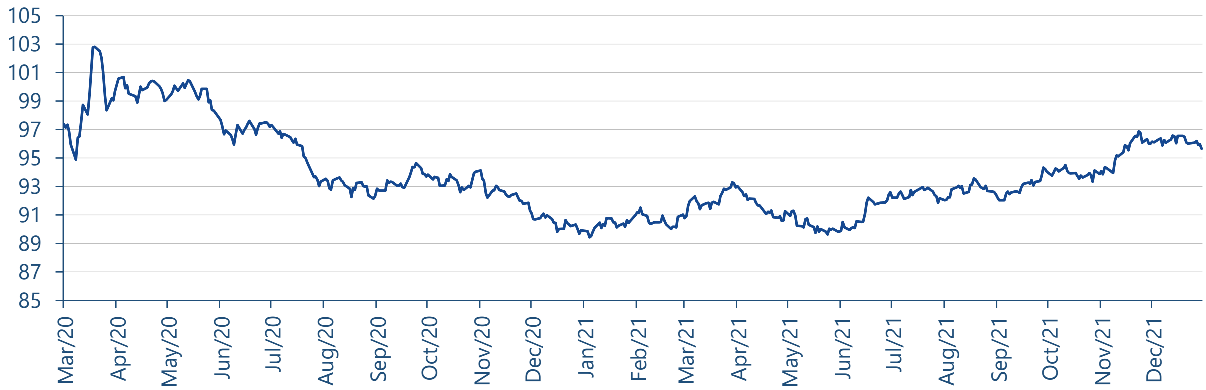
Chart 1.3: US dollar index



Source: Bloomberg

Domestic macro conditions improved amid rising inflation

The recovery momentum of the domestic economy was sustained in the fourth quarter of 2021. The economy expanded by 6.2 per cent in real terms compared to the same quarter of 2020, with broad-based growth across most sectors of the economy and with the large majority of them having reached pre-pandemic levels of economic activity. Following the full reopening of the borders on 1 October 2021, the revival of the tourism sector was well on track with spill-over effects to related sectors, despite a temporary setback from the resurgence of new COVID-19 variants. Labour market conditions improved, with the unemployment rate falling to 8.1 per cent in December 2021, from 9.4 per cent in September. The successful vaccination campaign, easing of COVID-19 restrictions and opening of the borders have enabled key sectors of the economy to resume gradually normal operations as from the second half of 2021. Growth prospects for 2022 remained upbeat, accompanied by expected strong recovery of the tourism and manufacturing sectors. Downside risks to the economic outlook prevailed, however.

Inflationary pressures caused by pandemic-induced supply-side shocks persisted in the last quarter of 2021, with headline inflation rising to 4.0 per cent in December 2021. The Russia-Ukraine war as from February 2022 exacerbated upward price pressures by prompting further supply-side disturbances resulting in a surge in commodity and food prices. Although inflationary pressures are expected to subside over the medium term, the rise in consumer prices is expected to adversely impact consumer and business sentiment, with potential implications for growth prospects. Timely policy responses, however, are expected to mitigate risk to financial stability.

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On the positive side, the full opening of the borders provided a much-needed impetus to the tourism sector. Tourist arrivals in November 2021 surpassed the figures recorded in March 2020 (Chart 1.4). The emergence of the Omicron variant towards the end of 2021, however, led to a slight drop of tourist arrivals in December 2021. The outlook of the tourism sector remained positive and the authorities targeted tourist arrivals of 1 million in 2022. Tourism earnings surged sharply in the last quarter of 2021 and are projected to rise steadily in 2022.

Chart 1.4: Tourist arrivals and tourism earnings

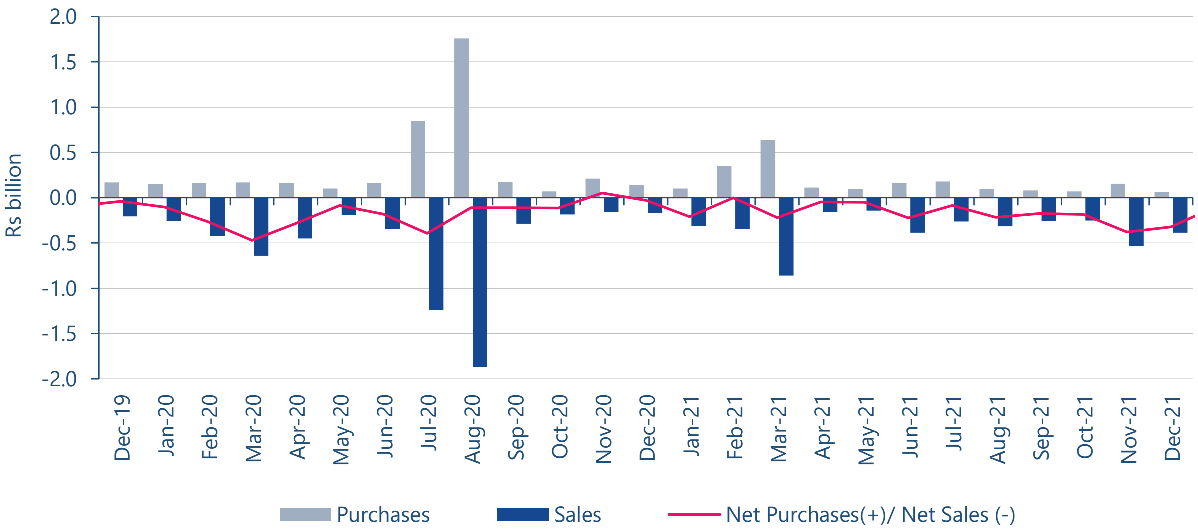
Source: Bank of Mauritius and Statistics Mauritius

Domestic markets

Stock market pick up after Omicron setback

Improving investors' confidence infused greater buoyancy on the stock market in the last quarter of 2021. The re-opening of the borders increased optimism and led to a surge in hotel stock prices as well as for the broader market. The emergence of the Omicron variant, however, momentarily induced risk aversion among investors, even triggering an abrupt flow of disinvestment by non-residents (Chart 1.5). Net disinvestment by non-residents peaked at Rs378 million in November 2021. Towards the end of December 2021, stock prices recovered as the risks stemming from the Omicron variant progressively subsided and also as some large corporates declared and paid dividends. The SEMDEX closed the year higher at 2,098 points, compared to 2,011 points on 30 September 2021 (Chart 1.6).

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



Source: Stock Exchange of Mauritius

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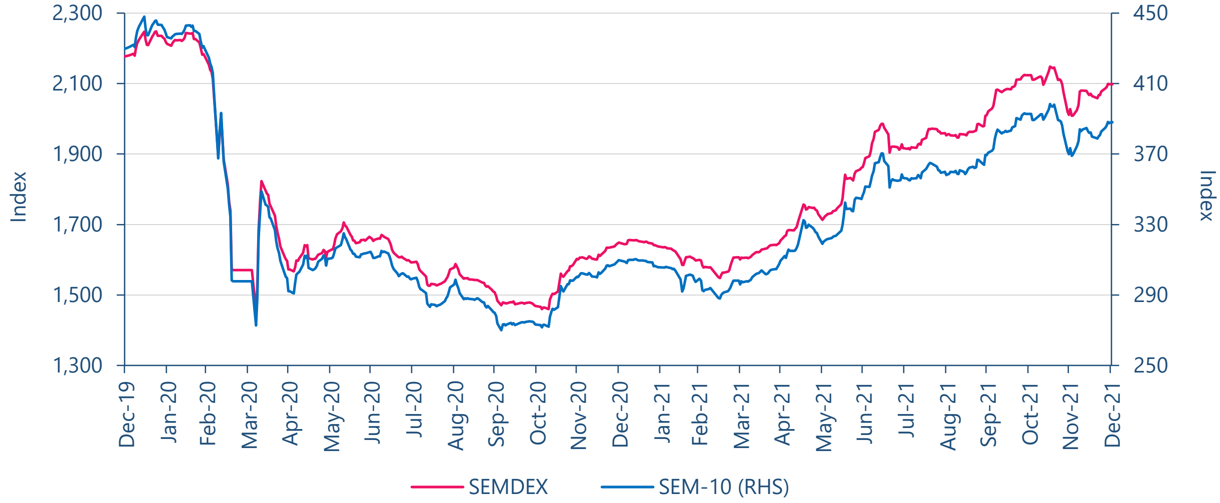
Chart 1.6: Domestic stock market



Source: Stock Exchange of Mauritius

Foreign exchange market recovered further

The FX market showed signs of improvement with the full opening of the borders. FX turnover grew by 19 per cent to US$2.16 billion in the last quarter of 2021, from US$1.82 billion in the third quarter. Altogether, banks and FX dealers purchased a total amount of US$985 million from the market, compared to US$750 million in the third quarter of 2021. The revival of the tourism industry clearly bolstered activity on the FX market. Simultaneously, a 75 per cent rise in FX turnover was noted from the '*Transportation and storage*' sector, primarily on account of recovery in the travel industry. FX turnover in the main sectors of the economy expanded in the last quarter of 2021 (Chart 1.7).

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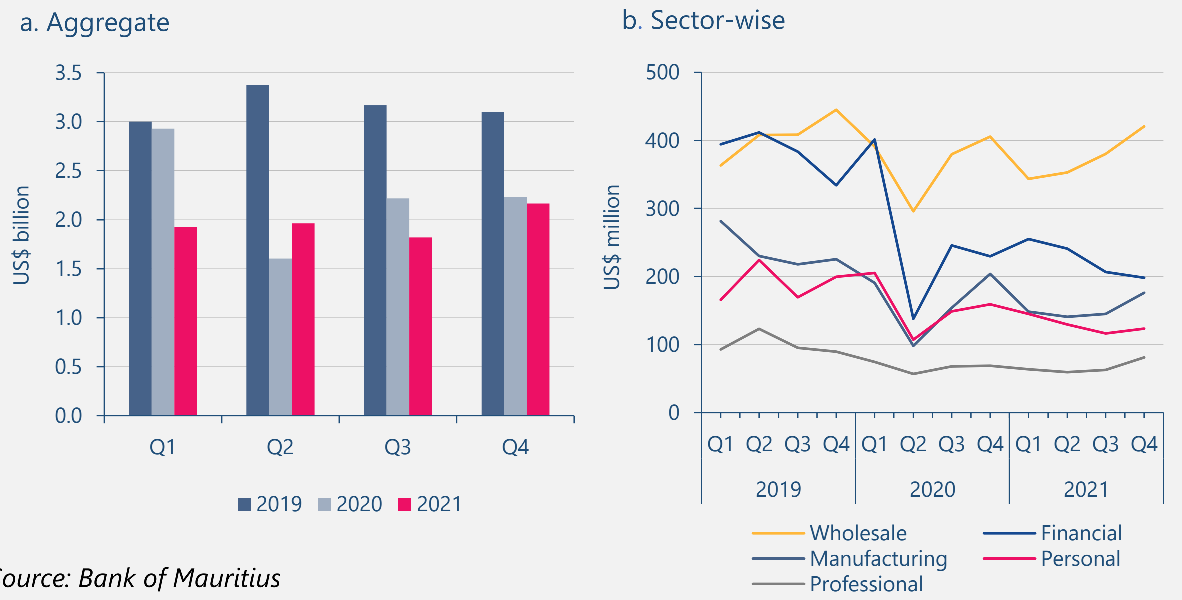
The first quarter of 2022 experienced a more or less similar level of FX inflows as the last quarter of 2021. This is a clear indication that activity on the FX market remained strong and could rise further as the tourism sector recovers. Improving FX market conditions and inflows are expected to reduce risks to financial stability from FX market dynamics.

Chart 1.7: Foreign exchange turnover



Source: Bank of Mauritius

With the improvement in FX inflows, the Bank scaled down the frequency and size of its interventions on the market as from November 2021. In the fourth quarter of 2021, the Bank sold US$180 million to banks and FX dealers, 23 per cent lower than the amount sold in the preceding quarter. Concurrently, the Bank continued to sell Foreign Currency (FCY) to the State Trading Corporation for the import of essential goods, which reached US$86.4 million in the last quarter of 2021.

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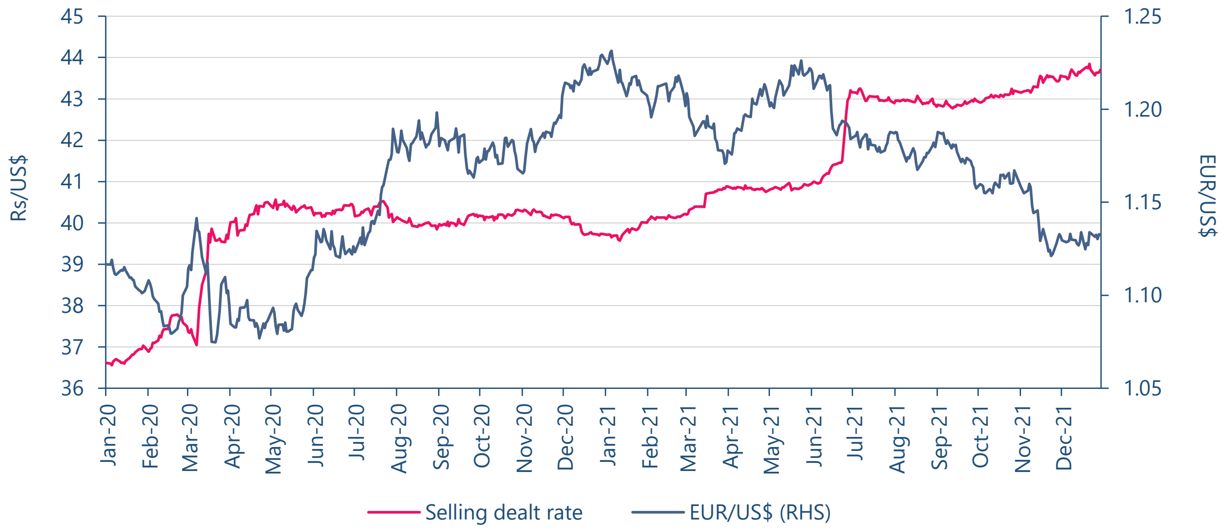
The FX interventions by the Bank continued to focus on containing excessive fluctuations in the exchange rate, while ensuring broadly sustainable demand-supply conditions on the FX market. Excessive exchange rate fluctuations could have amplified financial vulnerabilities in the economy. The FX interventions have also helped to mitigate inflationary pressures that could have emerged from a sharp adjustment of the exchange rate to temporary economic conditions. In line with the well-established practice, the Bank conducted all FX interventions within prevailing market exchange rates.

The exchange rate continued to be driven by domestic demand and supply FX conditions as well as international currency movements. From 1 October to 31 December 2021, the weighted average selling dealt rate of the rupee depreciated by 1.7 per cent against the US dollar (Chart 1.8). In the first few months of 2022, global currency markets were shaken by the Russia-Ukraine war. The safe-haven US dollar soared against riskier assets and impacted the Rs/US$ exchange rate.

Chart 1.8: Evolution of EUR/US$ and Rs/US$ selling dealt rate



Source: Bank of Mauritius

Monetary policy supportive of economic recovery

The Bank maintained its accommodative monetary policy stance to continue supporting economic recovery. The MPC kept the policy rate unchanged at 1.85 per cent at its two consecutive meetings held on 20 October and 15 December 2021, whilst inflationary pressures caused by demand-supply imbalances were expected to be transitory.

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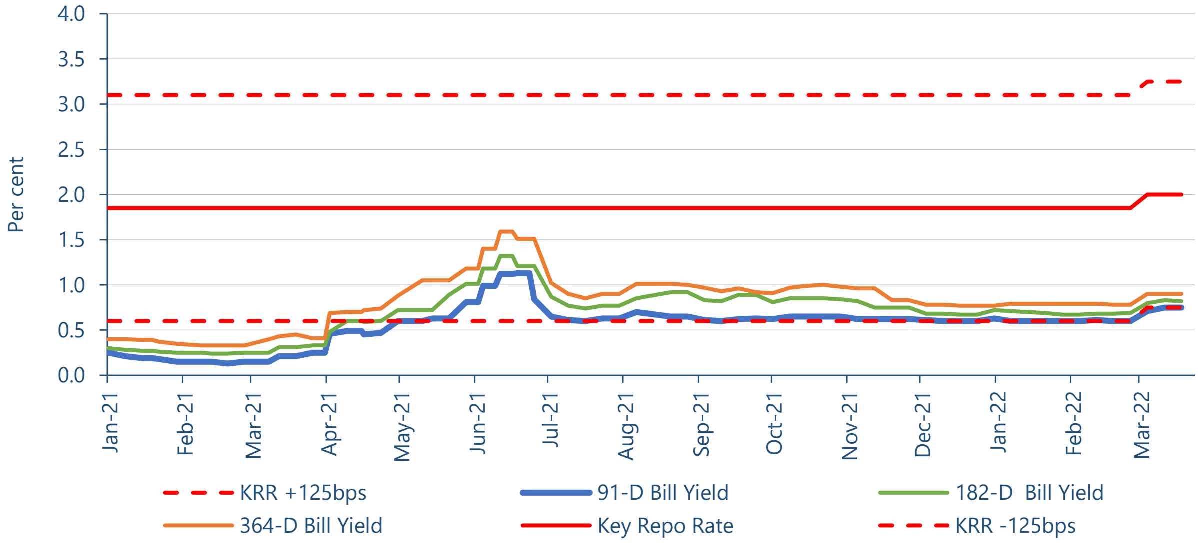
The Bank conducted monetary operations to bring down the level of Rupee excess liquidity on the money market in order to improve the monetary policy transmission mechanism. As a result of the Bank`s operations, the average Rupee excess liquidity fell to around Rs31 billion in fourth quarter of 2021, compared to an average of Rs42 billion for the corresponding period in 2020. It must be highlighted that, in line with the seasonal pattern, banks usually maintain higher excess liquidity around December to cater for demand for liquidity.

The Bank issued securities for an aggregate amount of Rs48.1 billion, against maturing securities of Rs24 billion, from October to December 2021, resulting in a net issuance of Rs24.1 billion. During the same period, net issuances of government securities amounted to Rs13.3 billion. In addition, the Bank mopped up around Rs15.7 billion through its FX operations conducted with banks, FX dealers and other market participants.

As economic recovery gathered pace, operators in the tourism and exports sectors impacted by the pandemic were less reliant on the credit facilities made available by the Bank. However, Small and Medium Enterprises (SMEs) availed of Rs600 million in the second quarter of 2021, disbursed through the special line of credit for the Budgetary Loan Scheme to the Development Bank of Mauritius Ltd.

The level of excess liquidity helped to maintain some stability in market yields. Short-term yields remained within the interest rate corridor set for monetary policy, though closer to the lower bound. Yields on 91-Day Bills hovered between 0.60 per cent and 0.65 per cent. Yields in the 182-Day tenor ranged between 0.67 per cent and 0.89 per cent and that of the 364-Day tenor ranged from 0.77 per cent to 1.00 per cent (Chart 1.9). The overnight interbank rate trended generally between 0.12 per cent to 0.50 per cent, except on a few occasions where one bank was short of rupee liquidity and borrowed significantly on the market at exceptionally high rates of around 1.5 per cent.

Chart 1.9: Evolution of market interest rates



Source: Bank of Mauritius

Many central banks resorted to successive interest rate hikes to stem inflationary pressures and an un-anchoring of inflation expectations. The Russia-Ukraine war and pandemic-related supply-side factors caused inflationary pressures in many countries, including Mauritius, to escalate in the first few months of 2022. The MPC of the Bank also viewed that the risk to the inflation outlook called for a gradual normalisation of monetary policy to foster price stability and anchor inflation expectations over the medium term. Consequently, the MPC raised the policy rate by 15 basis points to 2.00 per cent per annum in March 2022. The timing and pace of further monetary policy tightening is subject to the assessment of the inflation and growth outlook over the policy horizon. The withdrawal of the accommodative monetary policy stance may entail risks to financial stability. The implications of interest rate hikes in Mauritius on risks to financial stability are assessed in the sections on household and corporate sectors and on stress testing of this Report.

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Adequate international reserves

The GOIR hovered around levels that continued to meet various reserves adequacy metrics, as it rose to US$8.6 billion as at end-December 2021 from US$7.8 billion as at end-September 2021. The level of the reserves was assessed using several methodologies to determine whether it was adequate to protect the country against external vulnerabilities.

The conventional reserves adequacy metrics showed that the level of the GOIR satisfied different coverage criteria. Based on imports of goods and services for calendar year 2021, the GOIR level provided an import cover of 17.6 months. The reserves-to-broad money ratio stood at 49 per cent – well above the 5-20 per cent range advocated by the IMF. The ratio of reserves-to-short-term external debt stood at 119 per cent, comfortably above the 100 per cent threshold (Greenspan-Guidotti rule).

The Bank monitors reserves adequacy using the more stringent IMF Assessing Reserve Adequacy (ARA) methodology (2015).[2] The ARA considers exports of goods and services, short-term external debt, broad money liabilities, non-Global Business Corporation (GBC) portfolio and other investment liabilities position, as well as deposits of non-Domestic Systemically Important Banks (D-SIBs) GBCs when evaluating the extent to which the reserves can withstand potential adverse shocks to the balance of payments.[3] The ratio of reserves to the ARA metric was estimated at 122 per cent in December 2021 – i.e., within the desired 100 to 150 per cent range advocated by the IMF (Chart 1.10).[4]

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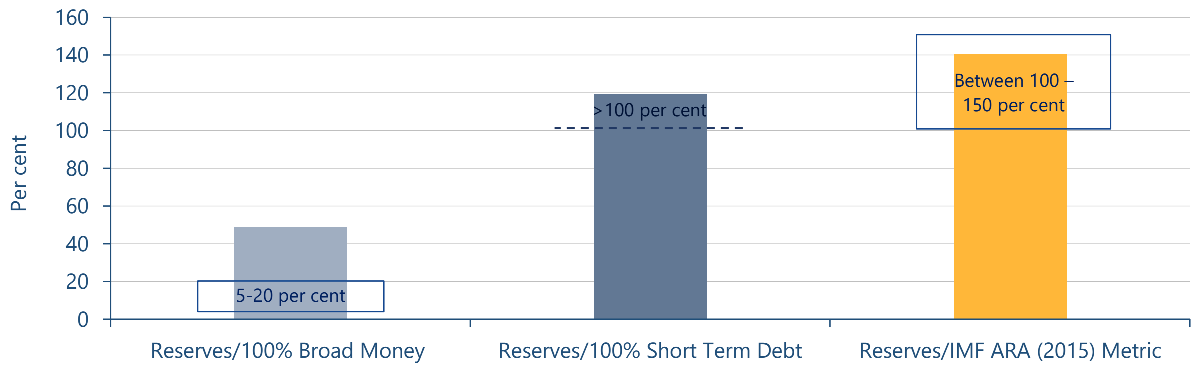
Chart 1.10: Reserves adequacy metrics



Source: Bank of Mauritius

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[2] *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)*

[3] *IMF Policy Paper, Assessing Reserve Adequacy--Specific Proposals (https://www.imf.org/-/media/Files/Publications/CR/2019/1MUSEA2019001.ashx).*

[4] *The reserves to ARA metric ratio for end-December 2021 was derived using actual data for non-GBC portfolio and other investment liabilities position.*

Systemic risk rose

The SRI suggested a slight build-up of systemic risk in the last quarter of 2021, compared to end-September 2021 (Chart 1.11). This marginal increase emanated primarily from risk-taking behaviour in financial markets, due to rising inflationary pressures and the search for yield, and a rise in external vulnerabilities. A widening of the deficit on the current account of the balance of payments and a rise in exchange rate volatility worsened external vulnerabilities to some extent. On a positive note, broad-based economic recovery sustained business and consumer confidence, contributing towards stabilising macroeconomic and macrofinancial conditions. Banking activities expanded as credit to the private sector continued growing. Credit risk went up but remained within acceptable bounds.

Although a rise in external vulnerabilities could be noted, the country`s GOIR increased by more than 10 per cent during the last quarter of 2021, complemented by an import cover of 17.6 months. Importantly, the GOIR continues to meet several reserves adequacy metrics, demonstrating its ability to protect the country against external vulnerabilities. External vulnerabilities are expected to subside as tourism recovers and inflows of FX improve further.

Chart 1.11: Systemic risk indicator[5]

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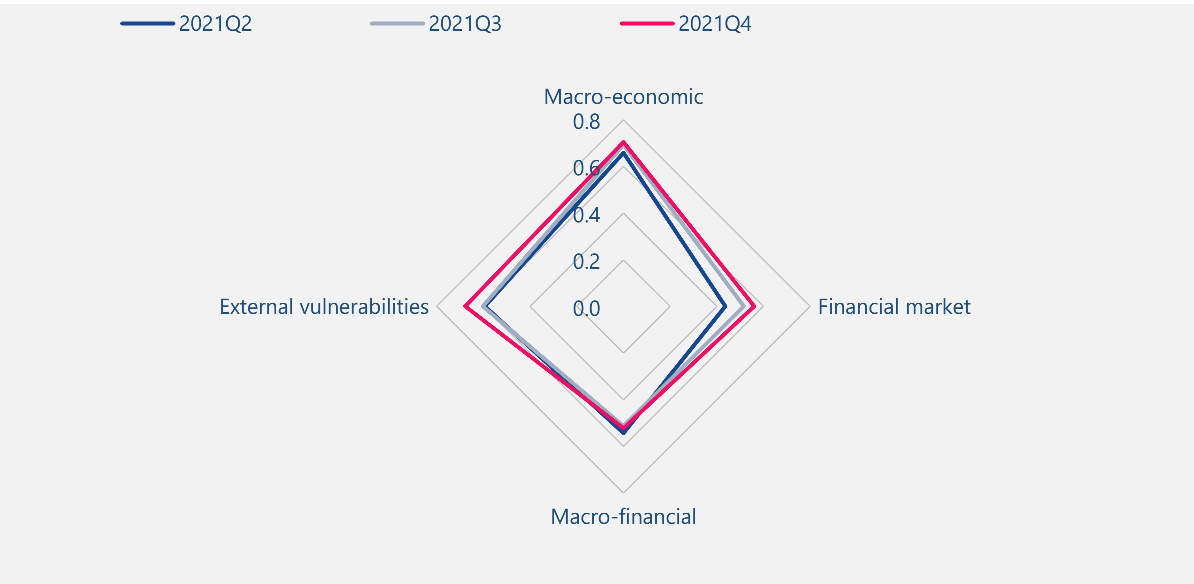
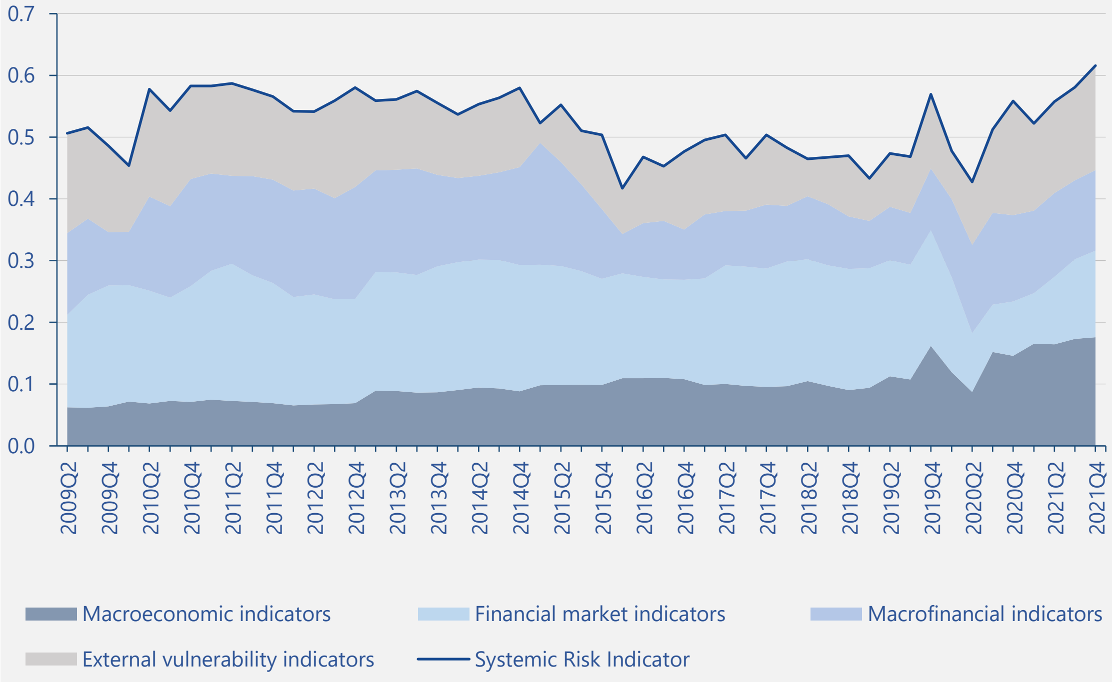


[5] *The SRI gives an indication of an overall assessment of changes in the underlying systemic risk indicators relevant to the macro stability of the banking sector. It covers the period from the second quarter of 2009 to the last quarter of 2021. As the indicators move further from the centre (i.e., approach a score of 1), the level of risk increases.*



Source: Bank of Mauritius

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2. Financial soundness of households and corporates

Private sector activities gained momentum towards the last quarter of 2021, bolstered by stronger economic dynamism. The household and corporate sectors maintained steady recovery, supported by the flow of bank credit. Household credit grew at a strong pace, housing credit in particular. The elevated growth rate does not represent a source of systemic risk to the financial system at this stage. The quality of bank credit extended to households and corporates remained broadly sound. The corporate sector continued its post-pandemic recovery, underpinned by positive performance from key sectors of the economy namely 'Accommodation and food service activities', 'Manufacturing', and 'Wholesale and retail trade'. Some key industries in the corporate sector reduced their exposures to banks. Risks to financial stability from developments in the household and corporate sectors have been well-contained in the fourth quarter of 2021.

Both the household and corporate sectors benefitted from the sustained economic recovery in the last quarter of 2021, contributing towards containing risks to the stability of the financial system. The extension of some of the COVID-19 support measures by the Bank provided these sectors additional financial flexibility that helped to mitigate the adverse effects of the pandemic, while also boosting faster recovery in consumer and business confidence. Alongside these measures, the successful vaccination programme allowed further easing of sanitary restrictions providing an impetus to economic activity. Favourable labour market developments in the last quarter of 2021 suggested beneficial income dynamics for households and businesses.

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Bank credit to private sector sustained

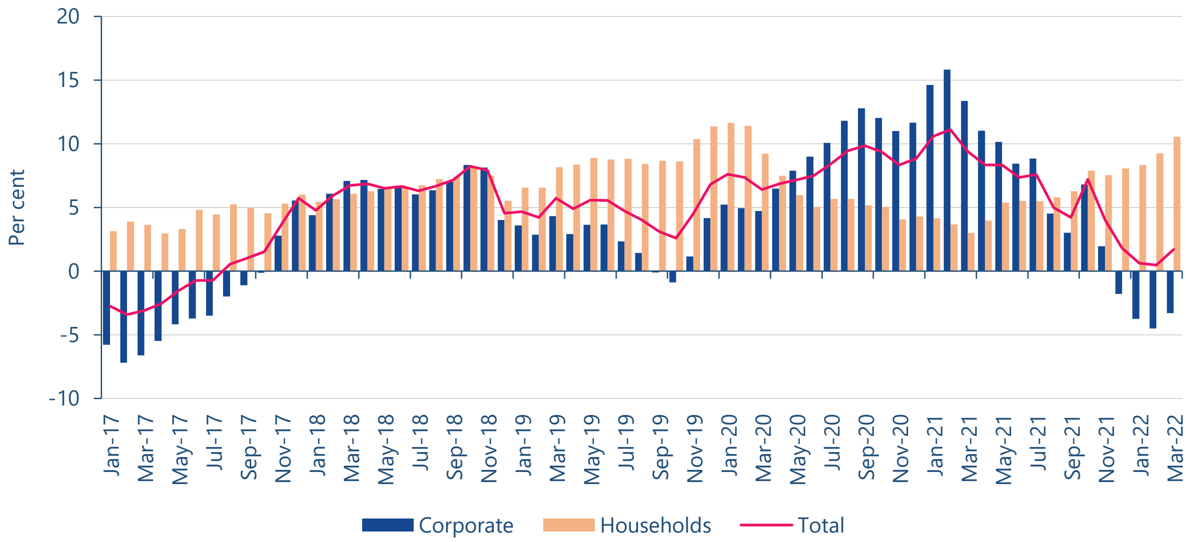
Private sector activities picked up, well supported by the flow of bank credit. The extension of the support measures by the Bank – such as the moratorium on repayment and restructuring of loans – supported corporates and households and helped them to recover faster from the economic downturn triggered by the pandemic. The quality of bank credit extended to businesses and households remained broadly sound.

The growth of bank credit to the private sector was in positive territory in the last quarter of 2021, though it was on a declining trend.[6] The annual growth of bank credit fell to 1.8 per cent as at end-December 2021, from 4.2 per cent as at end-September 2021 (Chart 2.1). The annual growth of household credit gained momentum in the last quarter of 2021, rising to 8.0 per cent in December 2021 from 6.2 per cent in September 2021. In contrast, credit to the corporate sector contracted at an annual rate of 1.8 per cent as at end-December 2021, which

[6] *Effective December 2021, the definition of credit to private sector has been aligned with the IMF FSI Compilation Guide (2019). Credit comprises loans and debt securities issued by private nonfinancial corporations and private sector encompasses private non-financial corporation, households and non-profit institutions serving households.*

dampened the overall credit growth. Nonfinancial sectors – notably, '*Agriculture, forestry and fishing*', '*Construction*', '*Wholesale and retail trade*', and '*Administrative and support service*' – had noticeably reduced their exposure to the banking sector.

Chart 2.1: Private sector bank credit growth



Source: Bank of Mauritius

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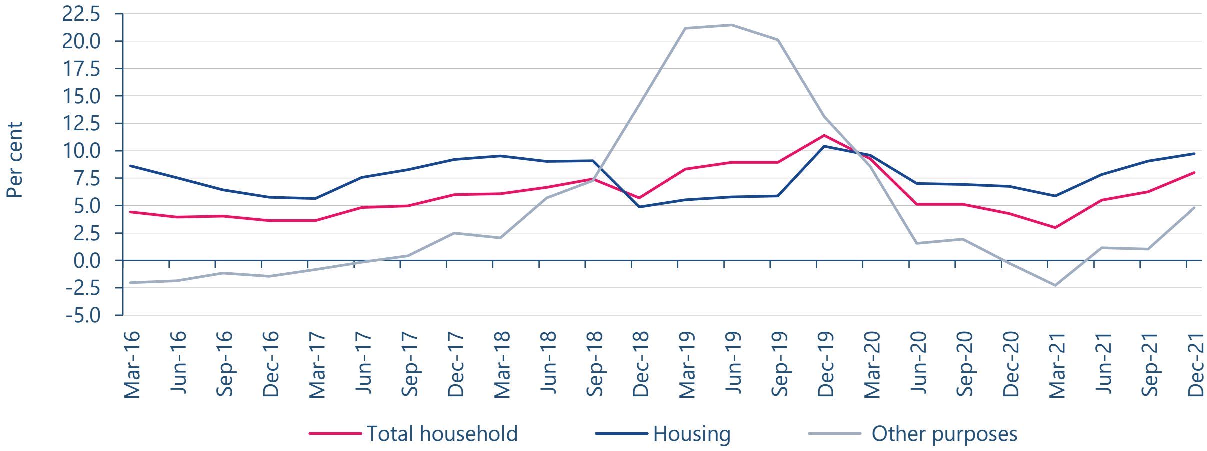
Household credit growth soared

Household credit expansion maintained a steady pace in the second half of 2021, with annual growth reaching 8.0 per cent as at end-December 2021, primarily driven by housing credit growth (Chart 2.2). Bank credit for housing purposes, accounting for around two-thirds of household credit, grew strongly in December 2021 relative to September 2021. The low interest rate environment and confidence in economic prospects were conducive to housing credit expansion.

Household credit directed to '*other purposes*', representing roughly the remaining one-third of total household credit, also grew at a strong pace of 4.8 per cent as at end-December 2021, compared to 1.0 per cent as at end-September 2021.[7] Higher consumption in the last quarter of 2021, partly caused by seasonal factors, contributed to the improved demand for household credit granted for other purposes (Chart 2.2).

[7] *Credit extended to households for 'other purposes' includes purchase of other consumer durable goods, purchase of land, purchase of motor vehicles, education purposes, medical purposes, investment purposes, and other unspecified purposes.*

Chart 2.2: Growth of credit to households



Source: Bank of Mauritius

Housing credit maintained its upward trajectory

The buoyancy in the housing credit market was reflected in the annual growth of housing loans, which rose to 9.7 per cent in December 2021, from 9.1 per cent in September 2021. As a result, the share of housing loans relative to total credit disbursed by the banking sector increased to 26.1 per cent as at end-December 2021, from 25.4 per cent as at end-September 2021 (Chart 2.3). In addition to the low interest rate environment, some key regulatory developments contributed to higher demand for housing credit, in particular the easing of the Debt-to-Income (DTI) and the Loan-to-Value (LTV) ratios in June 2021.[8] Furthermore, fiscal support measures announced in the Budget Speech 2021-2022 provided additional incentives to prospective borrowers. The resilience of the property market and sustained asset prices also upheld the risk appetite of banks.

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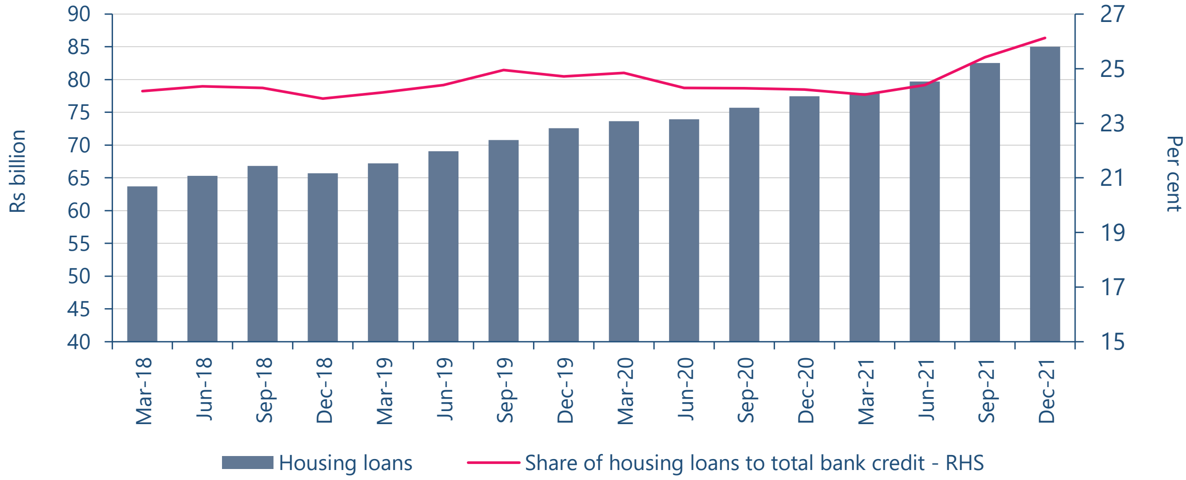
[8] In June 2021, the Bank reviewed the DTI ratio to 50 per cent of the borrower's monthly gross income. Previously, the limits were as follows: 40 per cent for borrower's with monthly gross income of less than Rs200,000 or 50 per cent where the borrower's monthly gross income is more than Rs200,000. In addition, the LTV ratio was re-introduced in June 2021 and was set at a maximum rate of 80 per cent for self-employed individuals and contractual employees, and at a maximum of 100 per cent for other individuals.

Chart 2.3: Share of housing loans to total bank credit



Source: Bank of Mauritius

The consistent rise in housing loans does not represent excessive leverage of the household sector and a source of systemic risk. The median annual growth of housing loans attained 7.3 per cent as at end-December 2021 (Chart 2.4). A median of 12 to 15 per cent growth for three consecutive years could be noted in countries prior to a banking crisis, according to the IMF Staff Guidance Note on Macroprudential Policy (2014).[9] The median for annual housing loan growth in Mauritius has not exceeded 10 per cent for the past three years.[10]

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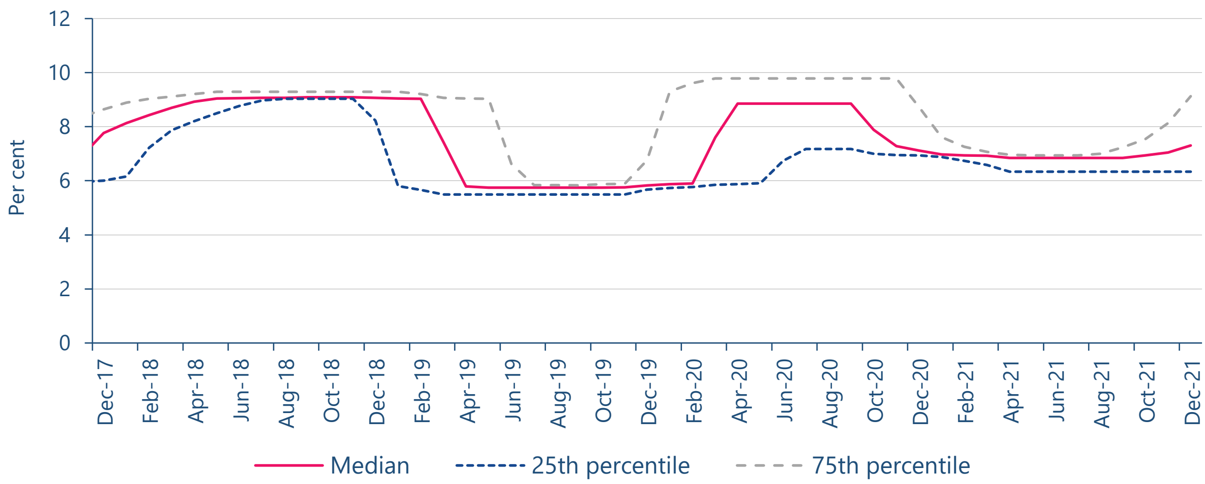
Chart 2.4: Housing loan growth



Source: Bank of Mauritius

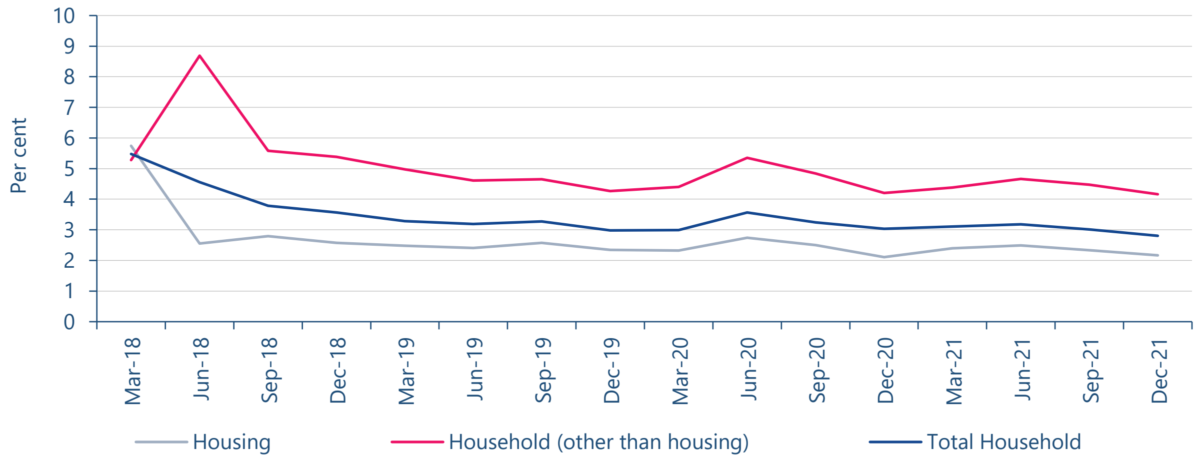
[9] *IMF Staff Guidance Note on Macroprudential Policy, 2014, pg 35.*

[10] *It is worth highlighting that the median mortgage loan growth was 12.8 per cent in December 2013, with growth ranging between 11.1 per cent and 17.8 per cent in 2013. As a result, the Bank introduced macroprudential policy measures to contain the build-up of systemic risk in the financial system.*

Quality of household bank credit improved

The quality of household credit remained broadly sound during the last quarter of 2021, primarily due to the pandemic-related support measures to assist households and buoyant economic activity that supported their debt servicing capacity. The non-performing loan (NPL) ratio for household credit improved to 2.8 per cent as at end-December 2021, from 3.0 per cent as at end-September 2021. For housing credit, the NPL ratio stood at 2.2 per cent as at end-December 2021, marginally down from 2.3 per cent as at end-September 2021. Concurrently, the NPL ratio for household credit granted for other purposes fell to 4.2 per cent as at end-December 2021, from 4.5 per cent as at end-September 2021 (Chart 2.5).

Chart 2.5: NPL ratio for households in Mauritius



Source: Bank of Mauritius

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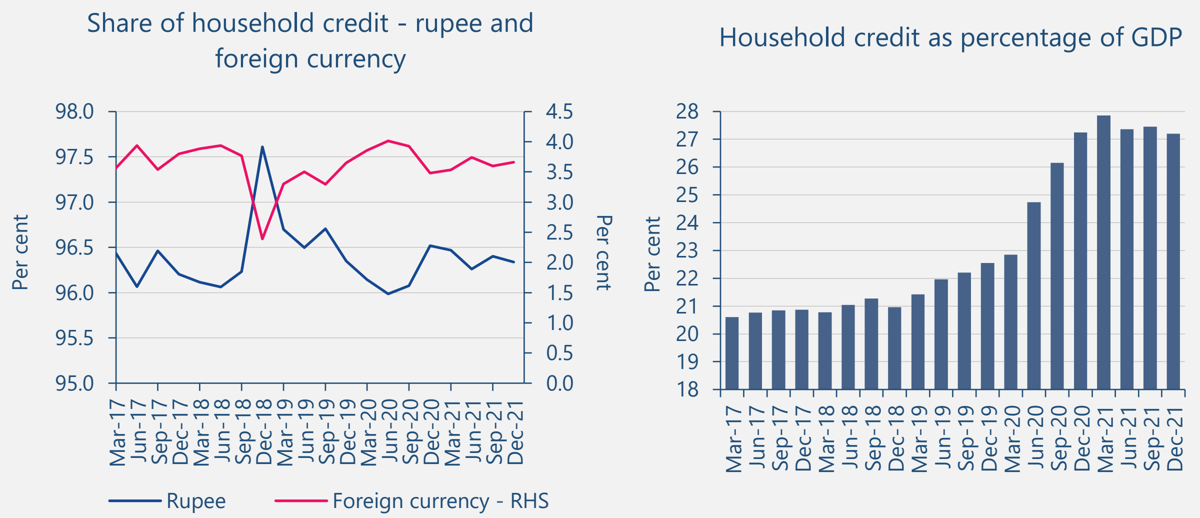
Household indebtedness declined

Household indebtedness as a proportion to GDP fell in the last quarter of 2021 (Chart 2.6). While indebtedness to banks was broadly unchanged at around 27 per cent as at end-December 2021, it improved when considering a broader measure that adds up household credit from banks, NBDTIs, insurance and leasing companies. The latter measure showed a decline from 40.4 per cent to 39.7 per cent of GDP between September 2021 and December 2021. The level of indebtedness of household to NBDTIs declined slightly to 10.5 per cent as at end-December 2021, relative to 10.8 per cent as at end-September 2021.

Chart 2.6: Indicators of household indebtedness



Source: Bank of Mauritius

Household credit-to-GDP gap narrowed

While household credit expanded strongly, the continued expansion of the economy in the last quarter of 2021 narrowed the household credit-to-GDP gap to 1.1 per cent as at end-December 2021, from 1.6 per cent as at end-September 2021. The narrowing of the gap lessened concerns about excessive leverage from the household sector (Chart 2.7).[11] Since output developments had a noticeable effect on the household credit-to-GDP gap following the GDP contraction in 2020, it is expected that the positive gap will decline further as output recovers.

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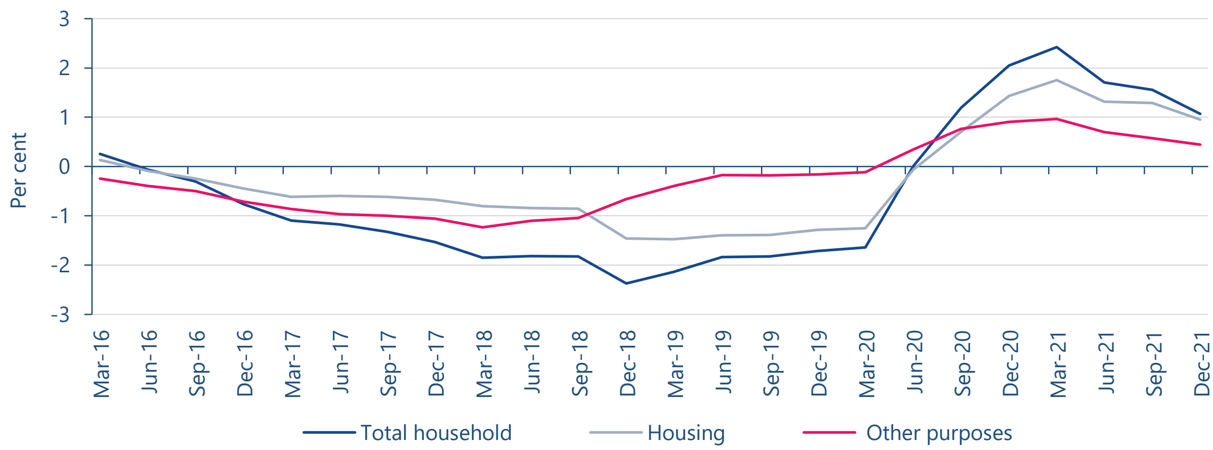
Chart 2.7: Household credit-to-GDP gap



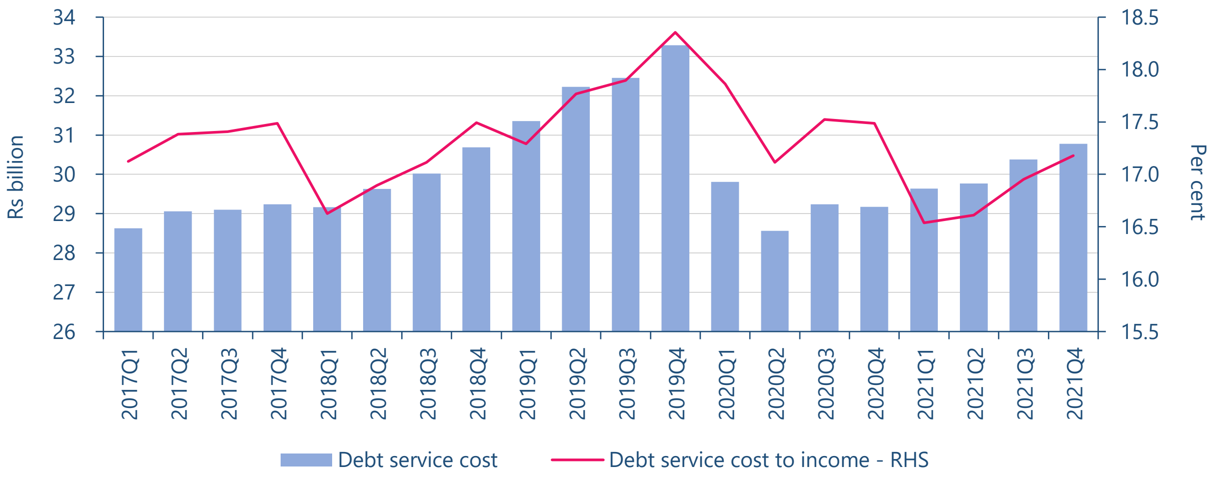
Source: Bank of Mauritius

[11] *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 Hodrick Prescott filter.*

Resilient household debt service capacity

The proportion of household debt service cost relative to income earned reached 17.2 per cent as at end-December 2021, a 0.2 percentage points increase from the previous quarter (Chart 2.8).[12] This has been mainly driven by an expansion in the value of household debt service cost during the last quarter of 2021. Compared to the pre-pandemic period, the ratio is marginally lower on average, suggesting suitable capacity of households to service their debt obligations. As the economy recovers, the income of households is expected to improve further and support their capacity to service their obligations.

Chart 2.8: Debt service cost to income



Source: Bank of Mauritius

The household debt service ratio indicator – computed as a ratio of household debt service cost to GDP – confirmed the resilience of households in servicing their aggregate debt level, as the ratio remained around 6.7 per cent in the last quarter of 2021 (Chart 2.9). The financial soundness metrics of households, therefore, eased possible concerns on the build-up of vulnerabilities in the household sector in the last quarter of 2021. The rise in income for public sector employees, following the award of the Pay Research Bureau in October 2021, is expected to improve the financial conditions of many households.

[12] *Income is proxied by 'Compensation of employees' compiled by Statistics Mauritius and published in the National Accounts estimates. The 'Compensation of employees' comprises mainly wages and salaries paid in cash and kind.*

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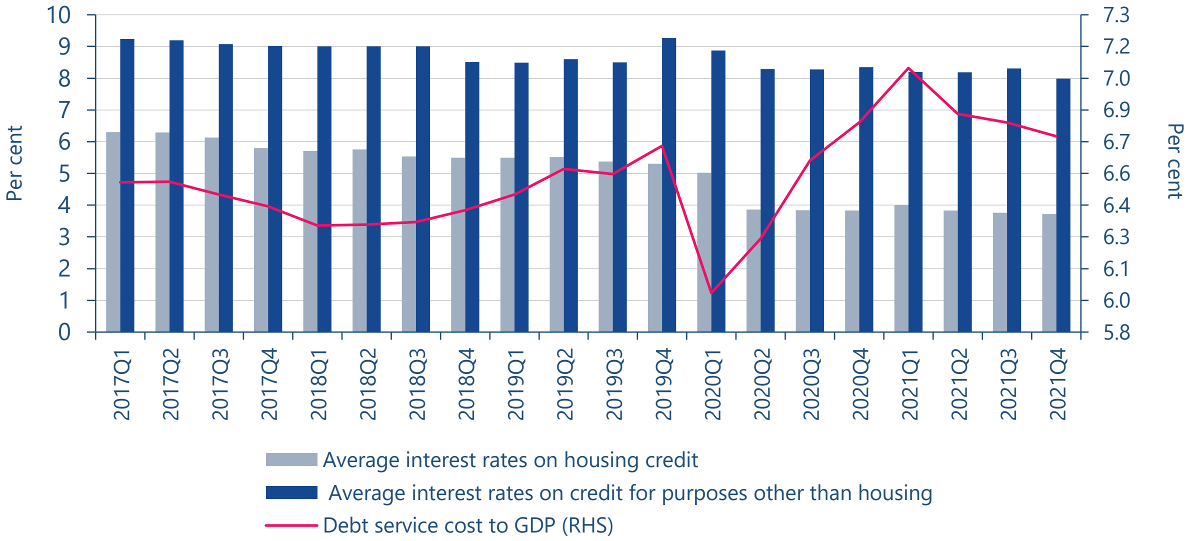
Chart 2.9: Household debt service cost and interest rates



Source: Bank of Mauritius

The financial conditions of households will, however, be tested as the Bank gradually normalises its monetary policy stance going forward, the pace and timing of which will depend on the economic and inflation outlook. Interest rate hikes, aiming to bring down inflation over the medium term by anchoring inflation expectations, are expected to increase the debt servicing burden of households, especially those who have borrowed at high DTI ratios. The debt servicing capacity of the household sector was not a major threat to financial stability in the last quarter of 2021. Going forward, however, those households that are more vulnerable financially may face strains with interest rate increases and high inflation that would adversely impact their cost of living.

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Potential risks to financial stability emerging in the household sector can be managed by the appropriate macroprudential tools, such as tightening the LTV and DTI ratios. These tools have been recalibrated periodically since their introduction in 2013 to reflect evolving systemic risks in the financial system. To provide a buffer against credit risk from the household sector, the Bank maintained the 0.5 per cent and 0.75 per cent additional macroprudential provisions for bank credit for housing purposes and for other purposes, respectively. The recalibration of the macroprudential policy tools will be considered in case any sign of vulnerabilities or macrofinancial risks emerge in the household sector.

Corporate credit contracted with deleveraging

The corporate sector maintained its recovery in the fourth quarter of 2021.[13] Strong positive performance was noted in several key sectors of the economy, namely '*Accommodation and food service activities*', '*Construction*', '*Real Estate*' and '*Wholesale and retail trade*'. The accommodative measures put in place by monetary authorities helped to ease balance sheet pressures and alleviated debt vulnerabilities in the corporate sector. The Russia-Ukraine war has partly undermined the outlook for the corporate sector with surging inflation, which could weaken demand for the sector's products and services to some extent.

The corporate sector has historically been the lead beneficiary of credit from the banking sector, with a share of 62.5 per cent of total banking sector credit. However, several economic sectors benefitted from financial assistance from the Mauritius Investment Corporation Limited (MIC), established inter alia to financially assist domestic systemic economic operators affected by the pandemic. These sectors reduced their exposures to the banking sector. Moreover, the stock of debt securities issued by the corporate sector and held by banks declined at an annual rate of 0.6 per cent in December 2021. As a result of these developments, corporate sector credit contracted at an annual rate of 1.8 per cent as at end-December 2021 (Chart 2.10). This trend was sustained in the first quarter of 2022 as well.

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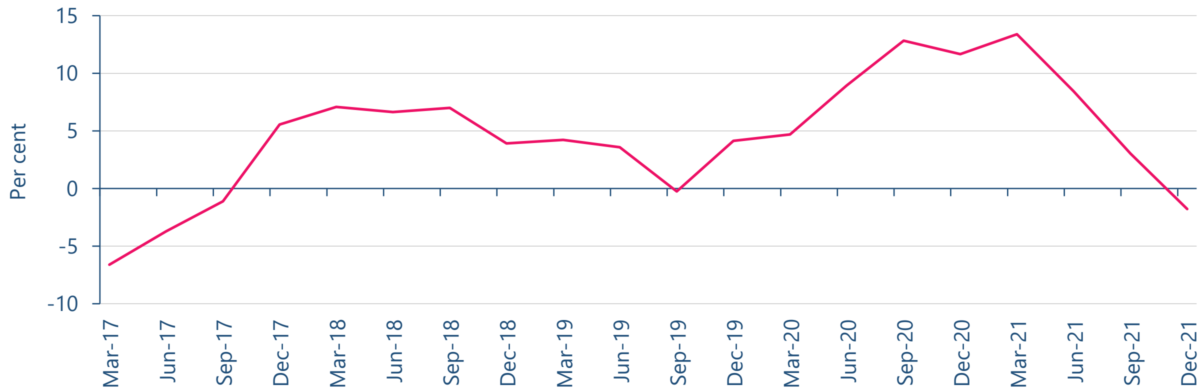
Chart 2.10: Growth of credit to the corporate sector



Source: Bank of Mauritius

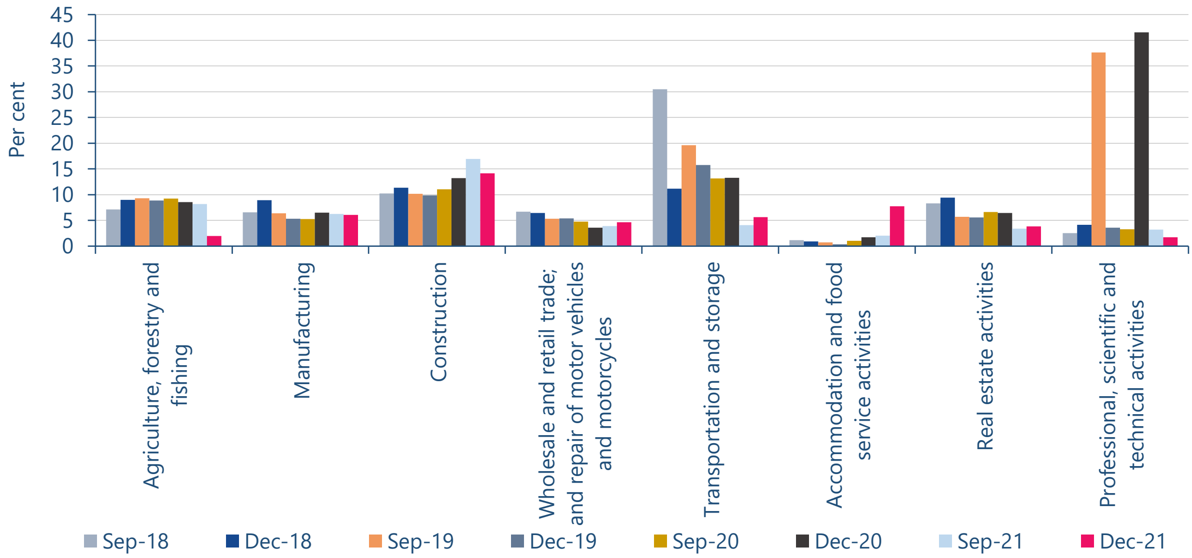
Corporate credit quality deteriorated due to specific sectors

Similar to households, the support measures provided a much-needed financial flexibility to the corporate sector. Bank loans allotted to the corporate sector were mostly performing though a deterioration was noted in the fourth quarter of 2021.

[13] Corporate sector, referred to in this chapter, comprise only Other Nonfinancial Corporations in Mauritius and, therefore, excludes GBCs.

The share of non-performing loans (NPLs) in credit to the corporate sector stood at 6.4 per cent as at end-December-2021, from 5.2 per cent as at end-September 2021. This deterioration in the corporate credit portfolio was due to defaults in the '*Accommodation and food service activities*' as well as in the '*Transportation and storage*' sectors. As economic recovery strengthens, the performance of the corporate sector is expected to improve in 2022. Further, the NPL ratio improved for many key sectors, notably the '*Manufacturing*', '*Agriculture and fishing*', *'Professional, scientific and technical activities' and 'Construction' sectors* between end-September to end-December 2021 (Chart 2.11).

Chart 2.11: Sector-wise NPL ratio for selected key sectors in Mauritius



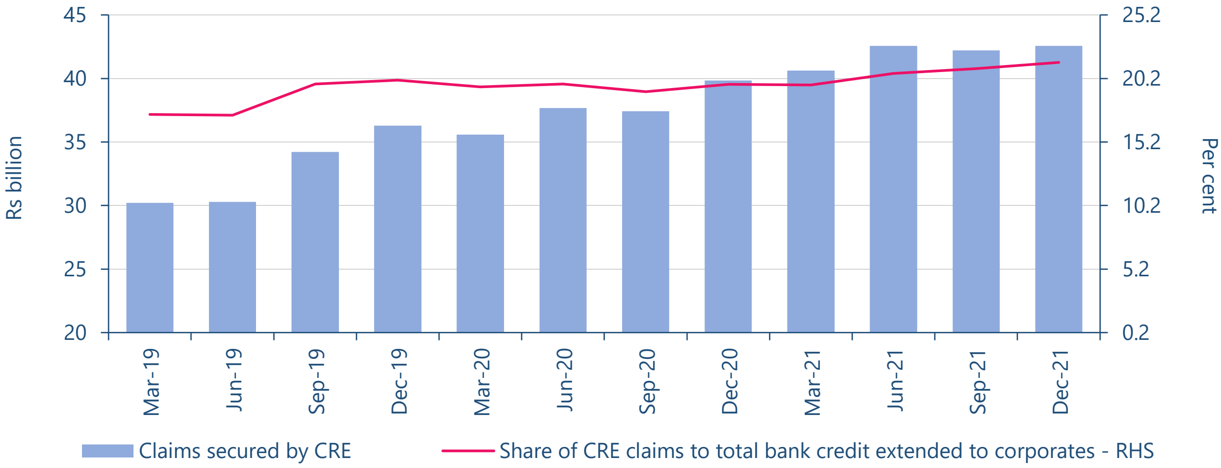
Source: Bank of Mauritius

Credit to the commercial real estate market was sustained

The share of loans secured by commercial real estate (CRE) relative to total banking sector credit to the corporate sector went up slightly to 21.4 per cent in December 2021, from 20.9 per cent in September 2021 (Chart 2.12). The ratio had not diverged significantly from the pre-pandemic level. The broad range of policy measures announced in the government`s budget 2021-2022 to support the real estate market provided some impetus to the CRE market, with loans secured by CRE rising at an annual rate of 6.8 per cent in December 2021.

The Bank had introduced macroprudential measures in 2013 to protect the banking sector against risks arising from the CRE sector. Specifically, banks have to apply a minimum of 100 per cent risk weight to loans secured by CRE, which can be higher depending on the size and quality of the credit facilities. The sector did not appear to be under strain and a source of systemic risk in the last quarter of 2021, and the current macroprudential policy measures are adequate.

Chart 2.12: Share of CRE loans to total bank credit to the corporate sector



Source: Bank of Mauritius

Corporate credit-to-GDP gap narrowed

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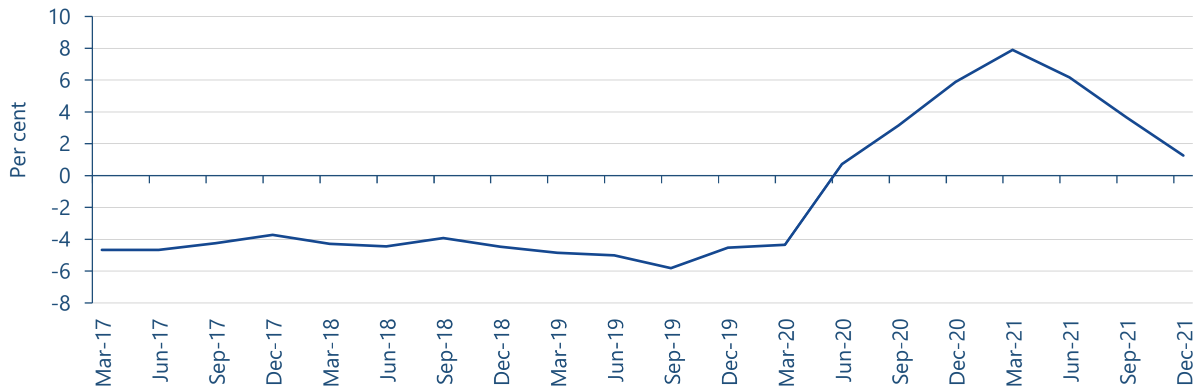
As the economy recovers, the risk to financial stability posed by tapering pandemic support measures to the corporate sector appeared to remain well contained. The contraction on corporate credit in the last quarter of 2021 resulted in a decline in the corporate credit-to-GDP ratio to 42 per cent as at end-December 2021, from 45 per cent as at end-September. Consequently, the corporate credit-to-GDP gap narrowed to 1.3 per cent from 3.7 per cent over the same period, also explained by a rebound in economic activity in the last quarter of 2021 (Chart 2.13).

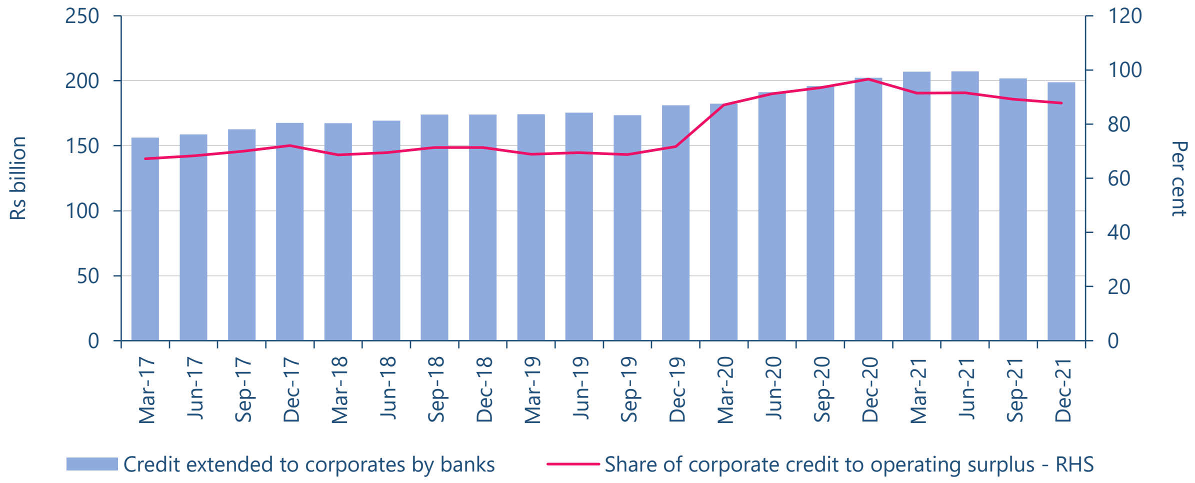
Chart 2.13: Corporate credit-to-GDP gap



Source: Bank of Mauritius

The capacity of the corporate sector to service their debt obligations improved, as denoted by the downward trend in the share of corporate credit to operating surplus since December 2020 to reach 87.8 per cent as at end-December 2021 (Chart 2.14). This declining trajectory is supported by the contraction in corporate credit towards the end of 2021 whilst corporate earnings remained stable. The continuous fiscal and monetary support extended by the fiscal and monetary authorities contributed to reducing balance sheet pressures and improved debt serviceability in the corporate sector.

Chart 2.14: Share of corporate credit to operating surplus



Source: Bank of Mauritius

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Box 1 – Update on COVID-19 support measures

Unwinding of support measures

The Bank is progressively unwinding the COVID-19 support measures, as economic recovery gathers momentum. The Bank continued to engage with the banking industry on the support measures, in particular through regular interactions at the level of the Task Force on Banking Sector Resilience. The unwinding process is well on track, with the Capital Conservation Buffer restored to 2.5 per cent with effect from 1 April 2022, from 1.875 per cent.

The amount of credit facilities under moratorium and restructuring continued to decline. For the moratorium on loans granted to economic operators, SMEs, households and individuals impacted by Covid-19, the banking sector has already embarked on a targeted approach in granting moratoria to borrowers, instead of blanket approach. The Bank closely monitors exposures on moratoria and other concessions granted in the context of the pandemic – including asset classification and provisioning level – and regularly conducts stress testing to ascertain the potential impact on the safety and soundness of financial institutions.

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Trends in loan moratoria and restructuring

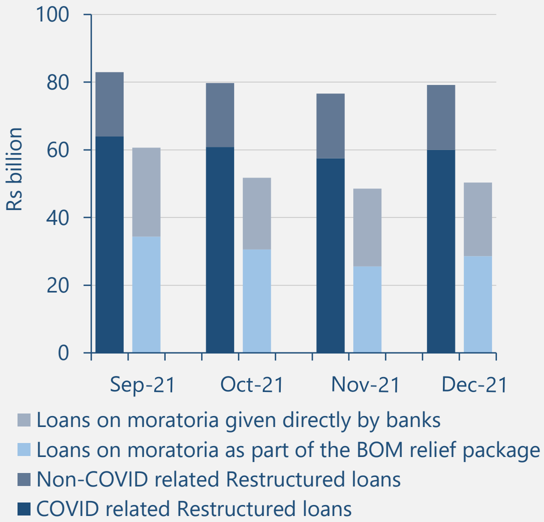
The moratoria on loans have significantly alleviated the financial burden of heavily-impacted borrowers by the pandemic, both the moratoria forming part of the Bank's support measures and those extended directly by banks. Total restructured loans shrunk by 4.5 per cent to Rs79 billion as at end-December 2021, from end-September 2021, of which 75.7 per cent was COVID-19 related. Loans on moratoria as part of the Bank's relief package stood at Rs29 billion as at end-December 2021, down from Rs34 billion in the previous quarter (Chart I). The decline in the outstanding value of moratoria is a positive indication that the economic recovery is well under way.

The highest proportion of restructured loans was allotted to the '*Accommodation and food services*' sector, accounting for around 45 per cent of total restructured loans. The aggregate amount of the moratoria was at Rs36 billion as at end-December 2021, compared to Rs37 billion as at end-September 2021. This is closely followed by the GB sector standing at Rs9 billion, representing around 11 per cent of total restructured loans. Restructured loans for the '*Construction*' and '*Manufacturing*' sectors maintained a declining trend (Chart II).

Box 1 – Update on COVID-19 support measures (*cont'd*)

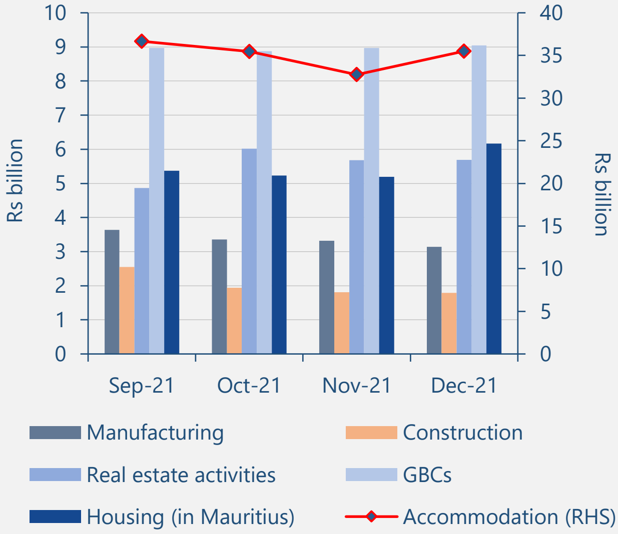
Moratoria to the '*Housing*' sector, accounting for 7.8 per cent of total restructured loans, increased to Rs6 billion as at end-December 2021, from Rs5 billion as at end-September 2021. This may be reflective of some strain in the household sector, probably those impacted by rising inflation and with DTI ratios close to the limit.

Chart I: Restructured loans and moratoria



Source: Bank of Mauritius

Chart II: Sector-wise restructured loans



Source: Bank of Mauritius

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Box 2 – The Mauritius Investment Corporation Ltd and financial stability

The unprecedented economic shock caused by the onset of the pandemic in early 2020 had warranted a prompt mix of conventional and unconventional measures. One of the major initiatives taken by the Bank – complementing its COVID-19 Support Measures – was the setting up of the fully-owned Mauritius Investment Corporation Ltd (MIC) in June 2020.

The establishment of the MIC is in line with the Bank's mandate to maintain the stability and soundness of the financial system as well as to promote the orderly and balanced economic development of Mauritius. It was instituted with a strong governance structure to ensure high degree of transparency in its activities. The MIC played an important role in sustaining key economic sectors directly impacted by the pandemic, including the tourism, tourism-related and agricultural sectors. As such, the MIC has greatly contributed to ensure financial stability and economic recovery.

The MIC has effectively prevented potential failures of systemically important domestic companies, which were negatively and significantly impacted by the COVID-19 pandemic. It invested in eligible companies through a number of investment tools, including both equity and quasi-equity instruments. This measure has successfully mitigated contagion risks from the real sector to the financial sector, that could have in turn jeopardised the stability of the banking sector given the large exposures of banks to many of these systemically important companies. The investments by the MIC in these companies have enabled them to remain afloat during the peak of the pandemic and recover fast from the headwinds of the COVID-19 and also helped the Bank to diversify its investment strategy. The intervention of the MIC has equally preserved jobs in these companies. Safeguarding employment contributed towards supporting the banking system by containing impairment of the household credit portfolio.

Overall, the MIC has been instrumental in preserving the resilience of the banking sector, in accelerating the recovery process and in generating returns for the Bank. It has disbursed an aggregate amount of Rs44,558 million to 37 entities as at end-March 2022, out of 161 applications received totalling Rs110,752 million. Of those applications made to the MIC, the majority were from the '*Accommodation and food services*' sector, followed by '*Agriculture, forestry and fishing*' sector, the '*Manufacturing*' sector and the '*Real Estate*' sector. Therefore, by upholding the soundness of the banking sector, the Bank's COVID-19 Support Measures and the MIC have contributed towards a rapid resumption of economic activities with minimal economic scarring.

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3. Financial soundness of deposit-taking institutions

Deposit-taking institutions showed commendable resilience, supported by adequate capital and liquidity buffers, and continued to sustain the flow of credit to the economy.[14] Banking sector assets expanded further, but some asset quality metrics deteriorated slightly. Indicators of profitability were broadly stable. As economic activity gathers momentum and the business environment improves further, profitability is expected to recover further and allow banks to strengthen their buffers. Cross-border banking activities continued to expand, with both funding and credit facilities going up. Thorough application of prudential standards by banks mitigate risks to financial stability arising from cross-border activities. Overall, the Banking Stability Indicator improved slightly. The NBDTIs sector contracted in the last quarter of 2021, with total assets falling by 0.4 per cent, but the sector's financial soundness metrics were resilient.

Structure of the deposit-taking financial sector remained unchanged

The banking system continued to hold the major share of the financial market. The composition of the banking industry was unchanged, with nineteen banks licensed to carry on banking business in Mauritius as at end-December 2021, of which six were domestic-owned, ten were foreign-owned and three were branches of foreign banks.

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Banking sector assets maintained an upward trend, rising to 435 per cent of GDP in December 2021 from 420 per cent in September 2021, as banks expanded their credit portfolios and deposit base. Concentration of the banking landscape persisted, with the two largest banks – which are domestic-owned – accounting for around 46 per cent of total deposits, 51 per cent of total advances, and 47 per cent of total assets as at end-December 2021.

The five D-SIBs were assessed to be sound, with adequate capital buffers inclusive of their D-SIB capital surcharges ranging from 1.0 to 2.5 per cent.[15] Indicators of asset quality suggested sound asset portfolios for the five D-SIBs. Their profitability was sustained and they remained sufficiently liquid – both in terms of Mauritian Rupees and the major foreign currencies – with comfortable liquidity buffers.

NBDTIs, constituting a smaller share of the financial ecosystem, held assets of around 14.5 per cent of GDP as at end-December 2021, barely unchanged from September 2021. There were six NBDTIs as at end-December 2021, comprising leasing and finance companies. They mobilise deposits from the public and grant leasing and loan facilities to individuals and corporates. NBDTIs have shown resilience and were profitable in the last quarter of 2021.

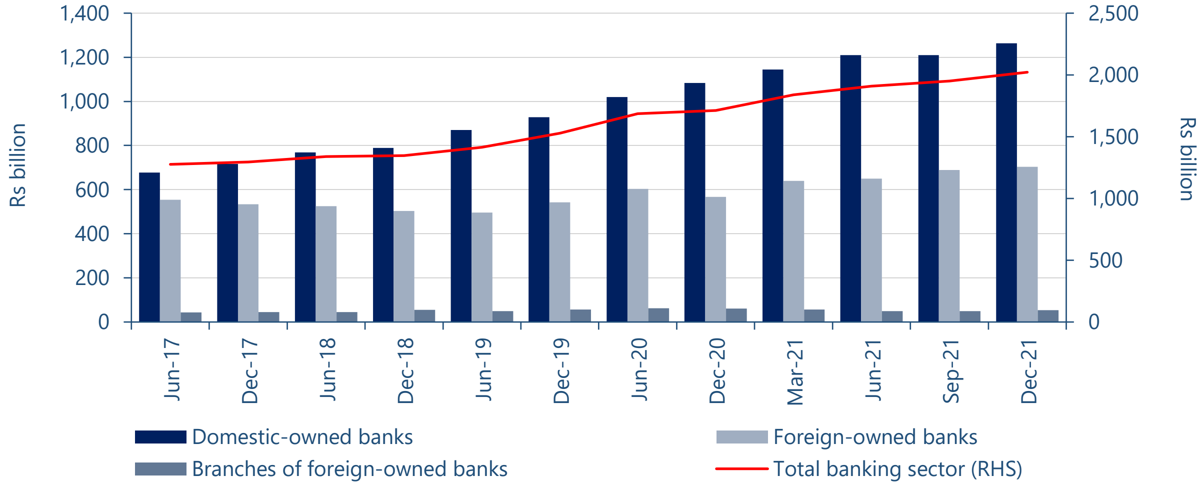
[14] *Deposit-taking institutions comprise banks and NBDTIs.*

[15] *The five D-SIBs are: The Mauritius Commercial Bank Limited; SBM Bank (Mauritius) Ltd; Absa Bank (Mauritius) Limited; The Hongkong and Shanghai Banking Corporation Limited; and AfrAsia Bank Limited.*

Banking sector assets continued to expand

Banking sector assets continued to expand, rising by an annual rate of 18 per cent to attain Rs2.0 trillion as at end-December 2021 (Chart 3.1). The successful exit of Mauritius from the FATF list of jurisdictions under increased monitoring and the withdrawal from the UK and EU List of High-Risk Third Countries, renewed trust of operators in the financial system and the Mauritius International Financial Centre (MIFC). Economic recovery, both at the global and domestic levels, supported the growth in banking sector assets.

Chart 3.1: Banking sector assets



Source: Bank of Mauritius

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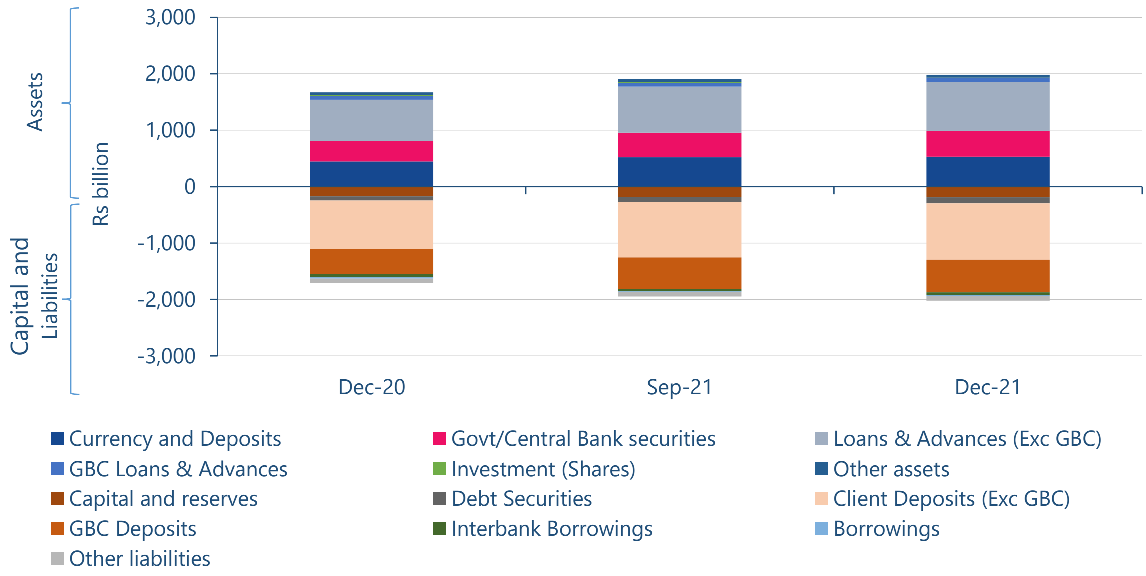
The growing credit portfolio (excluding GBCs) of banks contributed primarily to the expansion of banking assets, indicative of sustained confidence in the banking sector and in economic recovery prospects. Banks also balanced their risk-taking business through continuous investment in less risky assets, notably government and Bank of Mauritius securities. Investment in these securities registered a higher annual growth of 28.6 per cent as at end-December 2021, from 19.4 per cent as at end-September 2021. On the liabilities side, deposits (excluding GBCs) increased at an annual rate of 16.6 per cent to attain Rs1 trillion as at end-December 2021. The annual growth of GBC deposits was 30.4 per cent to reach Rs574 billion as at end-December 2021 (Chart 3.2).

Chart 3.2: Distribution of assets and liabilities



Source: Bank of Mauritius

Resilient capital buffers

Banks continued to hold strong capital buffers. The capital adequacy ratio (CAR) of the banking sector hovered at a comfortable level of 19.6 per cent as at end-December 2021. Regulatory capital of banks increased by 3.3 per cent, which was balanced by an equivalent increase in risk weighted assets (RWA) from end-September to end-December 2021. This rise in RWA signalled higher risk appetite amongst banks following an improvement in business environment and confidence.

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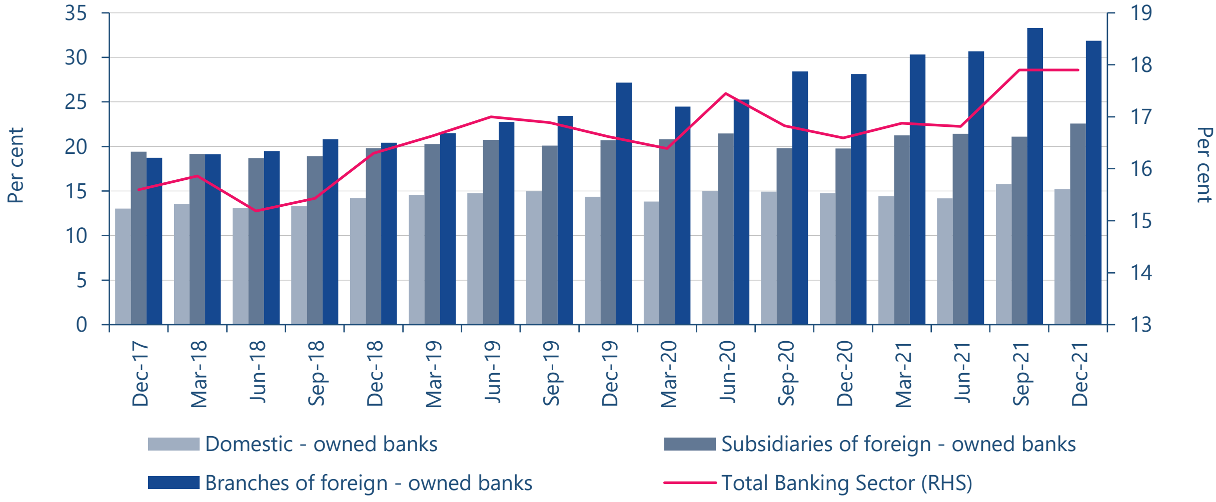
The Common Equity Tier 1 (CET1) ratio, representing 91 per cent of the banks' total regulatory capital, stood at 17.9 per cent as at end-December 2021, unchanged from previous quarter (Chart 3.3). Overall, the CAR of banks was above their respective regulatory minimum level, inclusive of the Capital Conservation Buffer and D-SIB charges where applicable.

The strong capital buffers supported the resilience of the banking sector to shocks and enabled the sector to sustain the flow of credit to the economy, despite the degree of uncertainty surrounding the economic outlook as downside risks emerged – such as the Russia-Ukraine war and high inflation in early 2022.

Chart 3.3: CET1 capital ratios



Source: Bank of Mauritius

Asset quality deteriorated slightly

After improving consistently in the first three quarters of 2021, banks' asset quality recorded a marginal deterioration in the last quarter of 2021 partly due to the unwinding of the Covid-19 support measures. The rise in NPLs was mostly in the domestic credit portfolio. The support measures provided flexibility and financial relief to banks as well as to their customers, alleviating the effects of the pandemic. It is inevitable that a marginal proportion of the loan portfolio may turn bad as these measures are withdrawn, but economic recovery and the decline in the unemployment rate are expected to limit any significant deterioration in asset quality.

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The NPL ratio went up to 4.9 per cent as at end-December 2021, from 4.5 per cent in September 2021, to reach close to Rs43 billion. NPLs were adequately provided for and, as a result, credit risk was at manageable level.

The NPL ratio for credit extended in Mauritius increased to 6.0 per cent as at end-December 2021, from 4.9 per cent as at end-September 2021. This rise in NPLs was mainly driven by the '*Accommodation and food services*' and '*Global Business*' sectors. On the other hand, the NPL ratio on credit facilities extended outside Mauritius improved to 3.8 per cent as at end-December 2021, from 4.1 per cent as at end-September 2021.

Against the rising NPLs, banks' had set aside adequate specific provisions reflecting the prudent credit risk management for anticipated future losses. Total specific provisions by banks stood at Rs26.9 billion as at end-December 2021, from Rs 24.4 billion as at end-September 2021. Nonetheless, the coverage ratio – the ratio of specific provisions to NPLs – fell to 63.1 per cent as at end-December 2021, from 65.7 per cent as at end-September 2021, given the proportion of default rates recorded in the domestic credit portfolio. It is worth highlighting that credit facilities granted by banks are generally well collateralised.

The level of stages 1 and 2 provisions – funds set aside by banks on new assets and on performing assets in a pre-emptive manner for anticipated future losses as per the IFRS 9 reporting standard – have declined slightly between September and December 2021. Further, there was a steady rise in stage 1 exposure particularly due to new loans, while stage 2 exposure recorded a decline as at end-December 2021.

Sustained profitability level

The profitability of the banking sector broadly stabilised over the period under review. Banks continued to register improving annualised net interest income as well as growing annualised net fees and commission income over the period ended December 2021. This improvement was supported by economic activity gathering momentum. On the expenses side, increases in annualised personnel costs and annualised net impairment loss charges offset the improvements noted in gross income. The pre-tax Return on Assets (ROA) remained at 1.2 per cent whilst the post-tax Return on Equity (ROE) dropped by 0.3 percentage point to 10.7 per cent in the last quarter of 2021 (Chart 3.4).

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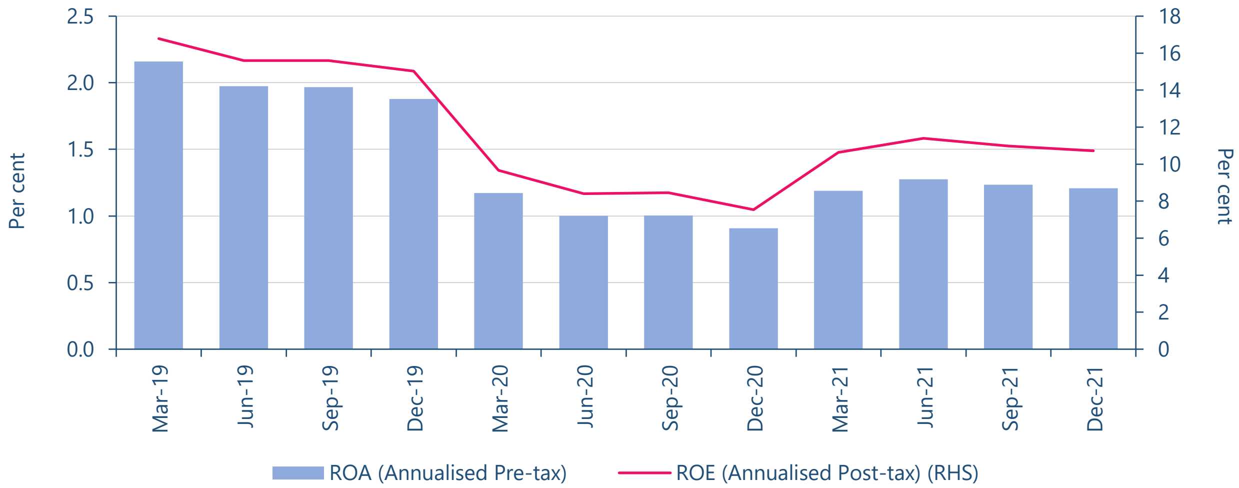
Chart 3.4: Profitability ratios



Source: Bank of Mauritius

The cost-to-income ratio in the banking sector worsened slightly on account of a larger increase in non-interest expenses relative to the growth in operating income. The ratio deteriorated to 45.1 per cent during the fourth quarter of 2021, from 44.6 per cent in the preceding quarter. Whilst it remains above pre-pandemic level, the ratio is expected to improve as economic recovery strengthens over 2022.

Ample liquidity buffers

Banks pursued prudent liquidity risk management by keeping strong liquidity buffers well above the regulatory standard, despite a drop in the Liquidity Coverage Ratio (LCR). The LCR for the banking sector declined to 237.2 per cent as at end-December 2021, from 258.9 per cent as at end-September 2021. The fall in the LCR was triggered by a surge of 22.3 per cent in banks' net cash outflows, which outweighed the rise of 12.1 per cent in their High-Quality Liquid Assets (HQLA) over the period under review. The consolidated LCR of banks, in both rupees and major international currencies, stayed well above the regulatory requirement of 100 per cent indicating the resilience of banks to short-term outflows of funds.

Credit concentration and FX exposures maintained within regulatory limits

Credit concentration risk of banks were contained within prescribed regulatory limits. Tier 1 capital of banks covered large credit exposures – denominated both in domestic and foreign currencies – at healthy levels. Similarly, foreign currencies exposures as a percentage of Tier 1 capital were maintained well below regulatory limits.

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Cross-border exposures expanded

As a leading financial hub in the region, the banking sector is a gateway for international financial activities channelled through the dynamic GB sector. One of the major attributes of the banking system has been the growing importance of cross-border exposures, as funds are channels through the financial system in the MIFC to other destinations. The high degree of cross-border exposures of the banks operating in Mauritius is a potential source of risk to the banking sector. Managing these risks with sound risk management practices is crucial to offset possible threats and reap benefits.

The current regulatory framework for cross-border exposures provides a robust mechanism to identify and manage risks. The prudential regime comprises the Guideline on Cross-Border Exposure, the Guideline on Country Risk Management, the Guideline on Credit Risk Management, and the Guideline on Credit Concentration Risk. In addition, banks have their own internal risk management systems to address possible threats and challenges from cross-border banking activities.

The banking sector's cross-border funding – which includes deposits and borrowings mainly – amounted to Rs465 billion as at end-December 2021, representing around 23 per cent of total funding. The cross-border funding of banks improved at an annual rate of 4.1 per cent as at end-December 2021, from Rs446 billion as at end-September 2021. The banking sector mobilised 20.7 per cent of its total deposits from non-residents. The share of deposits mobilised from the GB sector, considered as resident in the MIFC but with an outward-oriented business model, was 36.5 per cent as at end-December 2021.

The primary sources of funds for the banking system were South Africa and the UK as at end-December 2021. The banking sector remains prone to risks from cross-border exposure channels, as any adverse developments in both these and other source countries represent a risk for banks. As for the destinations of funds, the banking system is a net supplier of funds to countries such as the US, India, UK and Nigeria. While risks from these markets were not significant in the last quarter of 2021, any unfavourable developments in these countries could impact the quality of banks' assets (Chart 3.5). The application of the prudential standards by banks, closely overseen by the Bank, is expected to mitigate risks to financial stability arising from cross-border activities.

The credit portfolio exposure of the banking system to non-residents continued to grow. Credit facilities granted to non-residents accounted for 48.3 per cent of total loans and advances extended by the banking sector as at end-December 2021.

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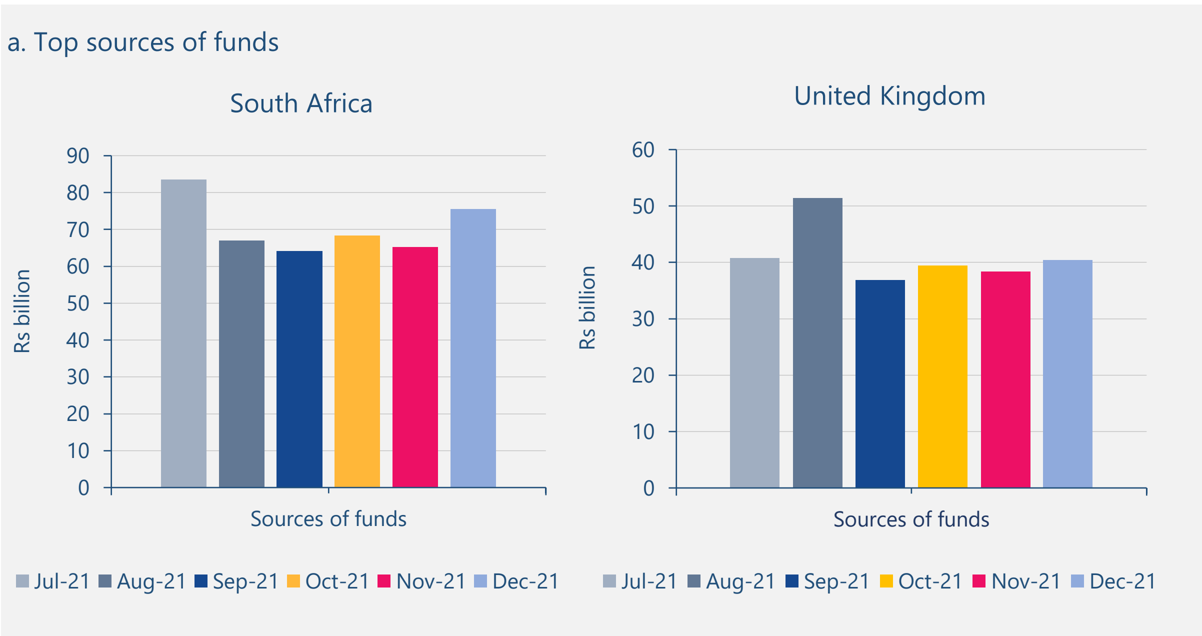
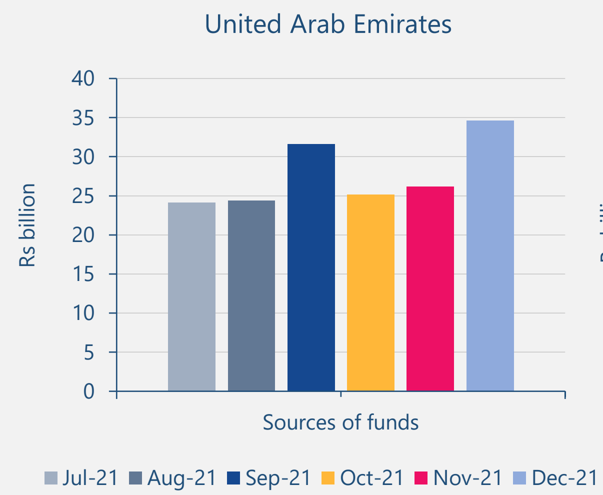
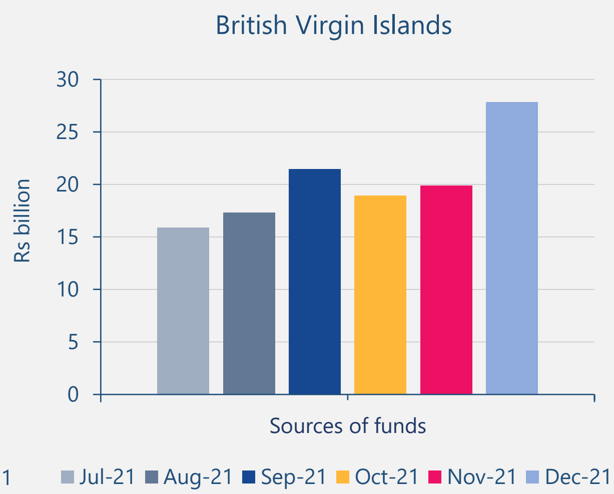
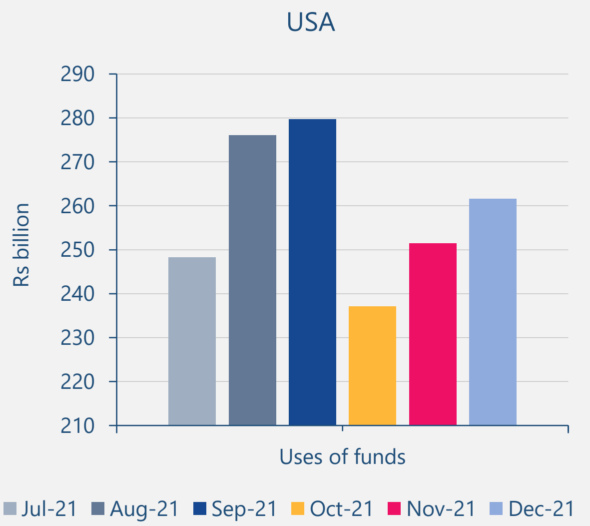
Chart 3.5: Evolution of cross-country exposure

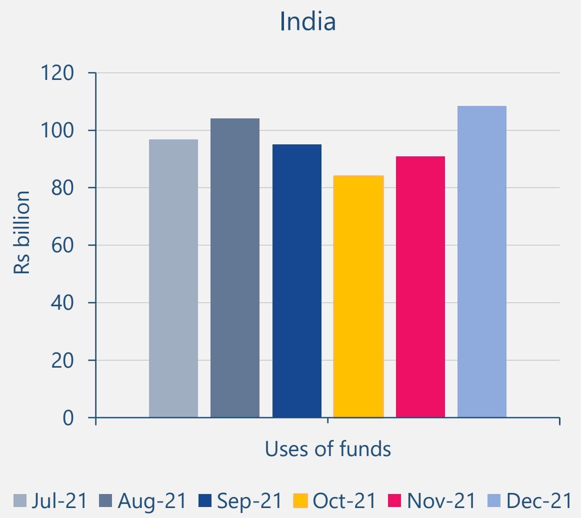


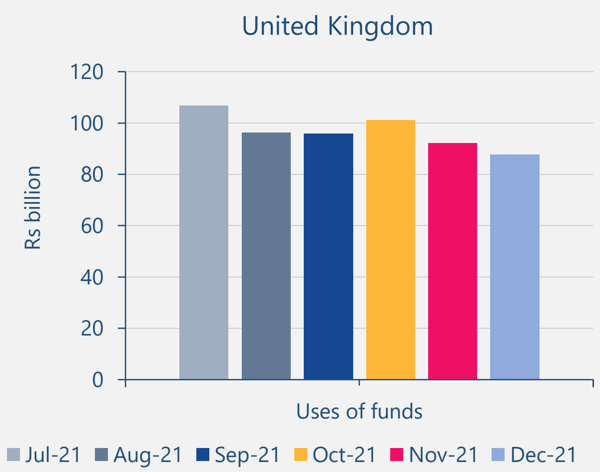


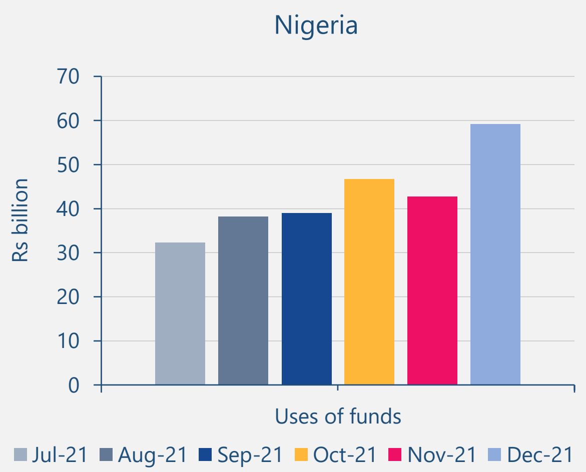


b. Top uses of funds









Source: Bank of Mauritius

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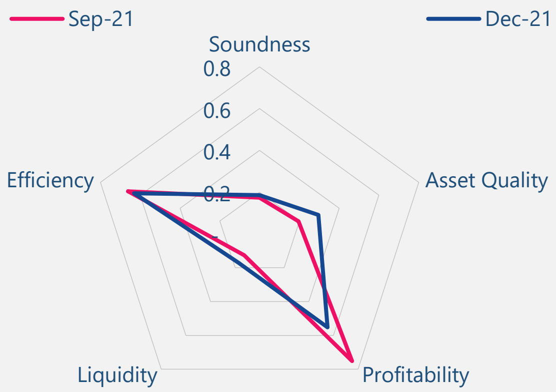
While the ongoing Russia-Ukraine war has impacted the global financial system to some degree, the direct consequences of the war on the Mauritius jurisdiction has so far been negligible given the insignificant exposure with these two countries. Nevertheless, financial sanctions imposed on Russia and the indirect effects – such as on economic prospects and the global financial system – have the potential to strain domestic financial conditions.

Banking Sector Stability indicator improved

The Banking Stability Indicator – a composite index of five indicators namely, soundness, asset quality, profitability, liquidity and efficiency – improved marginally over the quarter ended December 2021. The Banking Stability Indicator stood at 0.37 as at end-December 2021, progressing from 0.38 as at end-September 2021, well below the 'high risk' score of 1.[16] Sustained profitability, along with strong capital and liquidity buffers, promoted the positive development in the index. The marginal deterioration in asset quality partly offset these positive developments (Chart 3.6).

Chart 3.6: Banking stability indicator

a. Banking stability map



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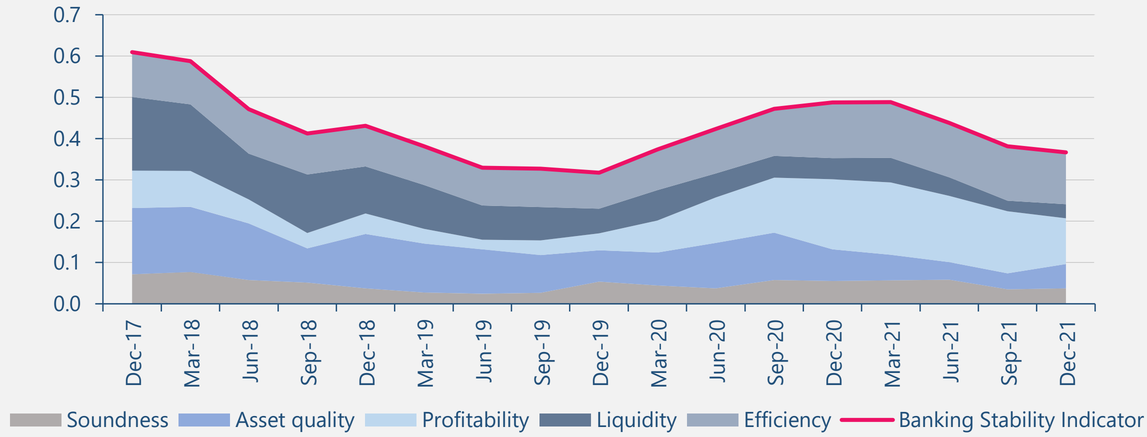
[16] *As the five risk indicators move further away from the centre (approach a score of 1), the composite measure of riskiness increases.*

b. Banking stability index



Source: Bank of Mauritius

Non-Bank Deposit-Taking sector contracted but was resilient

The NBDTIs maintained sound financial conditions in the last quarter of 2021, despite a marginal drop of 0.4 per cent in total assets to Rs67.1 billion relative to end-September 2021. Total deposits held at NBDTIs also contracted by 1.1 per cent, to stand at Rs42.1 billion as at end-December 2021 (Chart 3.7).

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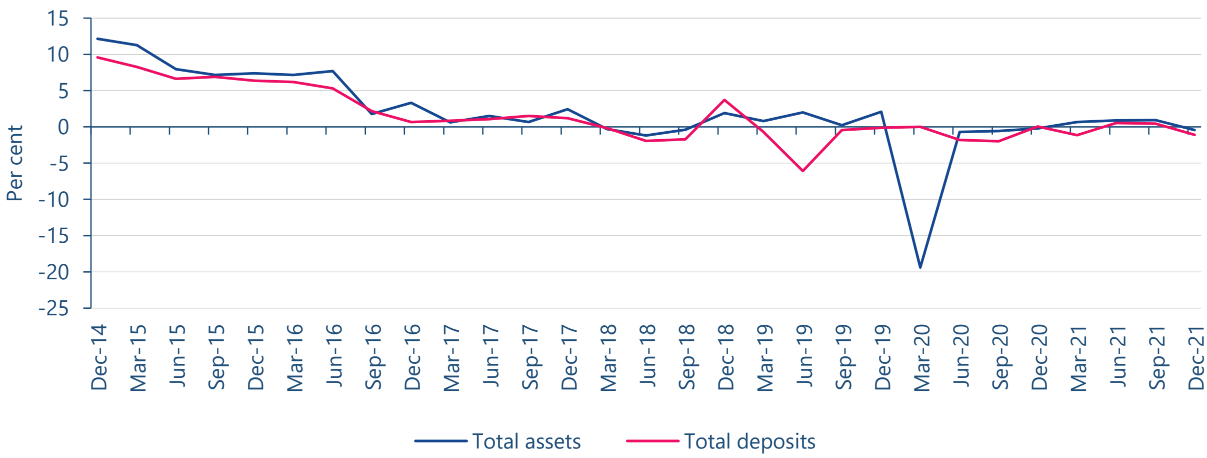
Chart 3.7: Growth of assets and deposits of NBDTIs



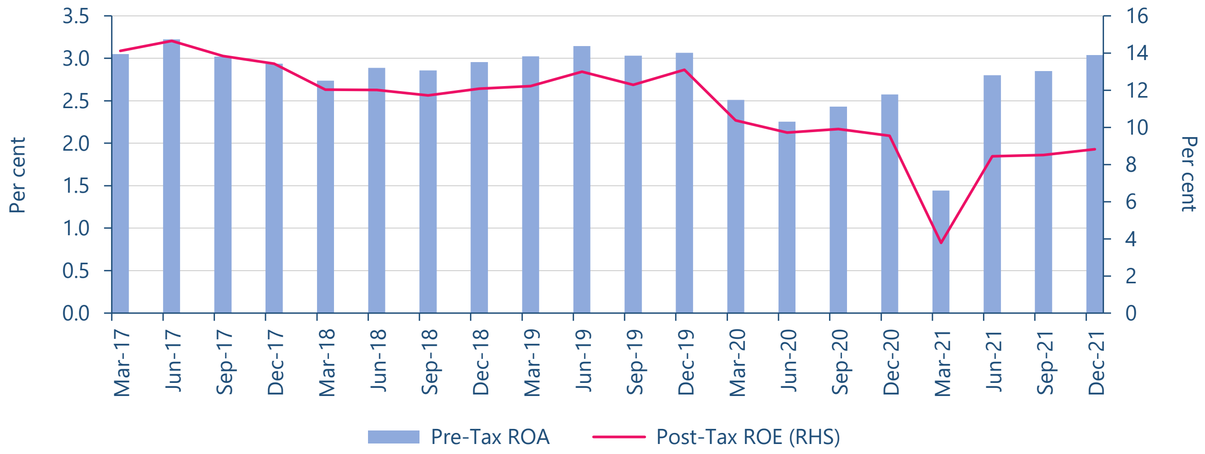
Source: Bank of Mauritius

The NBDTI sector was well capitalised. The CAR was at 49.5 per cent as at end-December 2021, an increase of 0.4 percentage point from the previous quarter. This increase was mainly due to a drop in RWA by 1.1 per cent, as NBDTIs invested in less risky assets such as in government and Bank of Mauritius securities, which increased by 7.6 per cent as at end-December 2021 relative to end-September 2021.

The asset quality of NBDTIs improved, as evidenced by the drop in the NPL ratio to 6.4 per cent as at end-December 2021, from 6.8 per cent as at end-September 2021. NBDTIs held ample liquidity buffers, well above regulatory minimum of 10 per cent during the period under review. The ratio of liquid assets to total deposits continued to hover around 22 per cent as at end-December 2021, although a slight decline in liquid assets was noted.

NBDTIs continued to remain profitable in the last quarter of 2021, despite dealing in a low interest rate environment. Profitability metrics was still below pre-pandemic levels. Aggregate annualised post-tax profit of NBDTIs hovered around Rs1.6 billion. Pre-tax ROA for NBDTIs was marginally higher at 3.0 per cent as at end-December 2021, compared to 2.9 per cent as at end-September 2021. Similarly, post-tax ROE rose to 8.8 per cent as at end-December, from 8.5 per cent in the previous quarter (Chart 3.8).

Chart 3.8: Profitability of NBDTIs



Source: Bank of Mauritius

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FSIs of deposit-taking institutions broadly sound

The Bank has adopted the new IMF Financial Soundness Indicators Compilation Guide (2019) and applied the new methodology to compute the Financial Soundness Indicators (FSIs) with effect from December 2021 (Chart 3.9). Some FSIs may, therefore, not be strictly comparable with those prior to December 2021. The upgraded set of FSIs incorporates new indicators and a few indicators have been discontinued. The definition of some existing indicators has concurrently been amended. Annex 1 provides more details.

Deposit-taking institutions continued to bolster their capital, resulting in aggregate CAR hovering around 20.7 per cent in the last two quarters of 2021.[17] Tier 1 capital strengthened by 2.8 per cent, to Rs187 billion, as at end-December 2021, while the RWA increased by 3.1 per cent to Rs970 billion over the same period. NPLs net of provision remained well supported by regulatory capital.

The asset quality of deposit-taking institutions remained broadly sound and was adequately provided for, though some ratios deteriorated. The quality of assets reflects the support measures put in place by the monetary and fiscal authorities to sustain the economy and the financial sector during the pandemic. The NPL ratio stood at 5.8 per cent as at end-December 2021, from 5.3 per cent as at end-September 2021, with coverage ratio (specific provisioning as a ratio of NPLs) at 61.3 per cent. The ratio of NPLs net of provision to regulatory capital worsened to 8.9 per cent as at end-December 2021, compared to 7.6 per cent as at end-September 2021, but is still comparatively well buffered.

Profitability metrics of deposit-taking institutions stabilised over the second semester of 2021 with annualised profit after tax amounting to Rs21 billion. The pre-tax ROA continued to hover around 1.3 per cent over the second semester of 2021. Post-tax ROE of DTIs stood at 10.5 per cent in December 2021.

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The liquidity ratios of deposit-taking institutions remained at healthy levels as at end-December 2021, providing comfortable buffers against liquidity risk among deposit-taking institutions. Liquid assets, consisting of currency and deposits and government and Bank of Mauritius securities, stood at Rs1 trillion as at end-December 2021. Liquid assets represented 48.6 per cent and 54.3 per cent of deposit-taking institutions' total assets and short-term liabilities, respectively, as at end-December 2021.

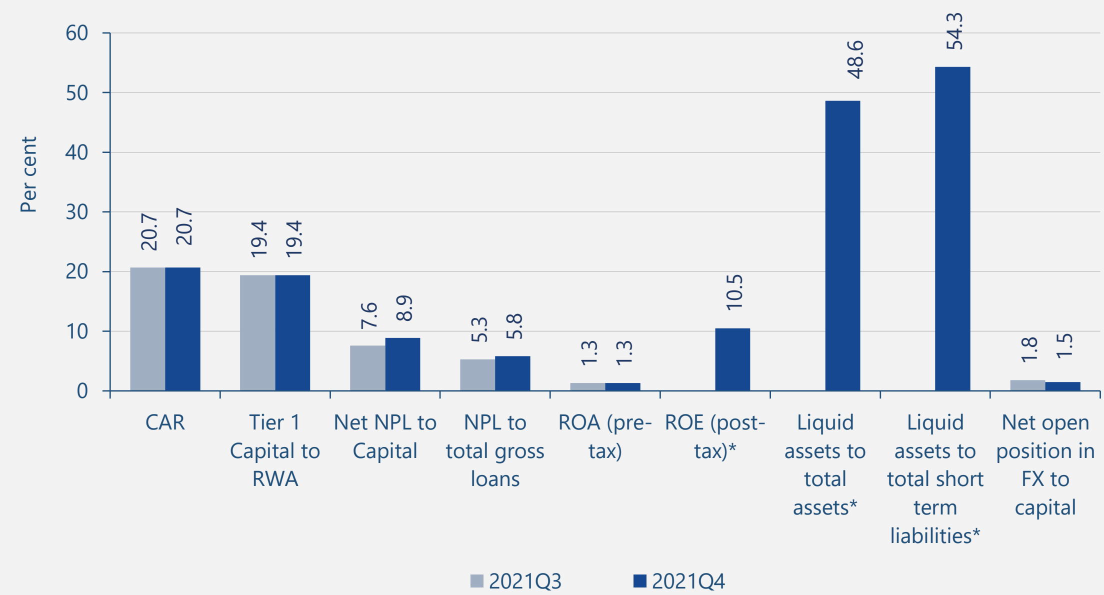
The '*Accommodation and food service activities,*' '*Real estate activities,*' and '*Wholesale and retail trade*' sectors held the top three positions in terms of deposit-taking institutions' credit exposures to nonfinancial sectors as at end-December 2021. These sectors represented 49.6 per cent of deposit-taking institutions' gross loans to nonfinancial corporations.

Cross-border geographical distribution of credit facilities converged mainly towards Sub-Saharan Africa and emerging markets and developing Asia. They represented 17.1 per cent and 14.9 per cent, respectively, of deposit-taking institutions' total loans as at end-2021.

[17] *Deposit-taking institutions include the nineteen banks and the six NBDTIs.*

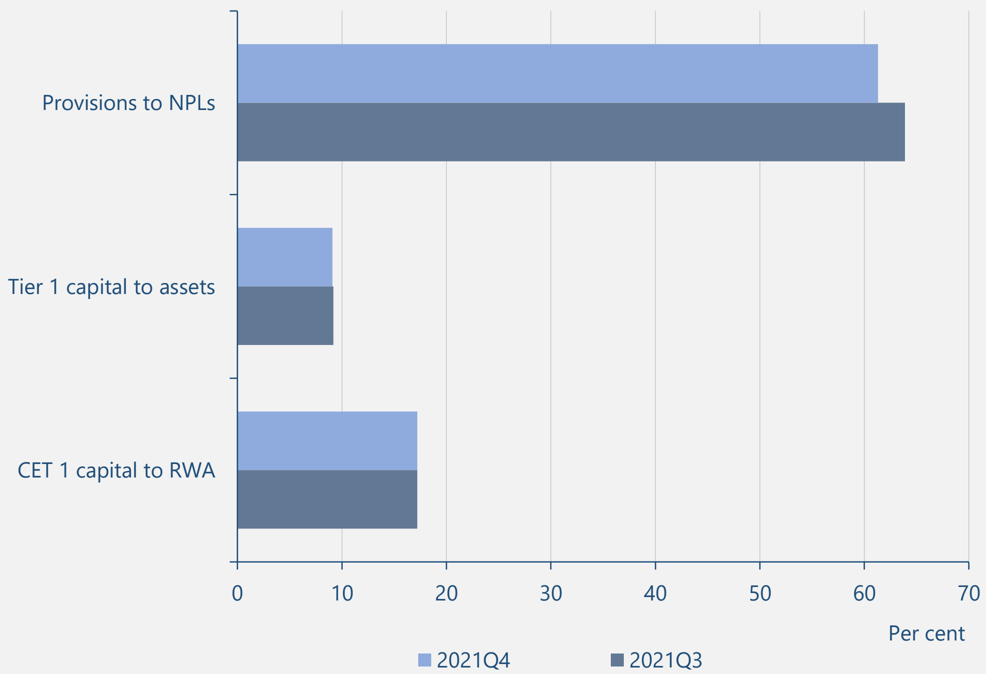
Chart 3.9: Financial soundness indicators

a. Core FSIs



Note: Ratios marked with an asterix (*) have been amended in the line with definitions in the IMF FSI Compilation Guide (2019).

b. New FSIs



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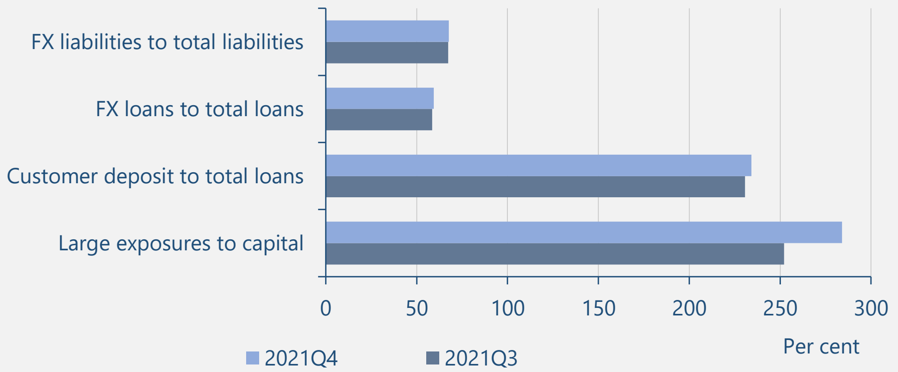
c. Encouraged profitability FSIs

d. Selected encouraged FSIs



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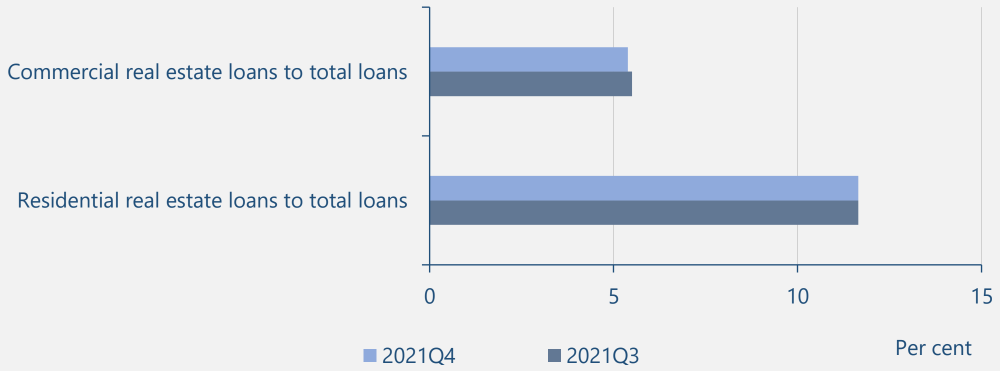
e. Real estate markets



Source: Bank of Mauritius

Climate change regulatory response

The Climate Change Centre, launched by the Bank in October 2021, is pursuing its efforts to respond to climate-related risks. On 1 April 2022, the Bank published its Guideline on Climate-related and Environmental Financial Risk Management (Guideline). The Guideline defines the physical and transition risks arising from climate-related and environmental financial risks and set outs expectations in terms of governance and risk management framework.

A transitional period ending 31 December 2023 has been granted to banks and NBDTIs for the full implementation of the Guideline. These institutions still have to submit their internal roadmaps for the development of their internal framework by 30 September 2022 and progress reports on same on a half-yearly basis.

The Bank is currently working on data gaps. It is engaging with the Ministry of Environment, Solid Waste and Climate Change and with other international regulatory bodies and standard setters for collaboration and sharing of information.

Continuous upgrading of the regulatory framework

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On 6 December 2021, the Bank issued a revamped Guideline on Private Banking and a new Guideline for Digital Banks, which set out the relevant enabling regulatory and supervisory frameworks for private banking and digital banks, respectively. The aim is to provide a conducive environment for private banking and digital banks to thrive in Mauritius.

On 1 April 2022, the Bank issued a revised Guideline on Standardised Approach to Credit Risk and a revision of the Additional Macroprudential Measures for the Banking Sector.

Box 3 – Digitalisation and cybersecurity

Digital technology is revolutionising the way businesses operate and the way people socialize. This ongoing revolution unveils a future filled with opportunities. The prospects that digital technologies can unleash not only support but has potential to guide to socio-economic progress: for instance, unrestrained access to information can create unique opportunities in all areas of our lives, including the way people work, play, socialize and transact and others yet to unfold.

Mauritius has been keeping pace with international developments, as evolving technologies shape the planet with the web of Things, blockchain, cloud computing, data analytics and computer science. The pandemic has accelerated the move to digital services and remote working arrangements in Mauritius. Banks are also increasingly adopting cloud-based services. These initiatives are increasing the cyber threat landscape. Accordingly, the Bank has initiated several projects with a view to enhancing its regulatory and supervisory framework to keep pace with current innovations.

The consultation process with banks on the Guideline on the Use of Cloud Services has been completed and the guideline will be issued shortly. A draft Guideline on Cyber and Technology Risk Management has also recently been issued for consultation with a view to assisting banks to develop a sound and robust cyber and technology risk management framework and enhance their resilience against such risks. The regulatory framework will, *inter alia*, aim at setting out the minimum requirements which banks will be expected to implement.

The Bank is also developing a risk-based supervision module on Operational Risk, with the assistance of the World Bank, which includes IT risks and is enhancing its framework for IT-related on-site examinations with the assistance of the IMF Afritac South.

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Box 3 – Digitalisation and cybersecurity *(cont'd)*

Payment landscape

The Bank has been upgrading the payment infrastructure to support digitization of payments. The landmark developments were the implementations of:

a) The Mauritius Automated Clearing and Settlement System (MACSS), a real time gross settlement system, in 2000, which was replaced by a modern multi-currency system in 2008;
b) A bulk clearing system which has the capability to clear cheques electronically based on images, clear retail low value credit transfers in batch mode and enable payments by direct debit;
c) The Mauritius Central Automated Switch (MauCAS) which has two components, namely:
    - The Card Payment System (CPS) which processes domestic payments effected with locally issued cards;
    - The Instant Payment System (IPS) which a platform enabling retail payments on a 27x7 basis through electronic channels such as mobile phones and internet banking.

The IPS has been a game changer in the Mauritian payment landscape. The platform has enabled the inter-operability of mobile payment initiatives, which were being operated in silo, and democratized electronic payments. The Bank has leveraged on the IPS to introduce a national QR Code in September 2021 to further support digitalization of payments. The QR Code, being asset light, is affordable to a larger spectrum of merchants.

The IPS has also provided a level playing field for new types of operators to enter the payment arena by lowering entry barriers and introduced the open banking concept. Open banking allows fintech companies or other third-party services to access the financial information of the customer and provide financial services on behalf of the customer via application programming interface (API). Open banking offers lots of opportunities to non-bank operators and promotes competition in the market to the benefit of customers who will now have a larger spectrum of service providers at lower cost. However, open banking may potentially pose significant risks and concerns around, *inter alia*, cybersecurity.

Open banking architectures, based on the enhanced sharing of data, increase the surface area for cyber frauds. As the API provides access to customer banking data such as transactions and balance stored within the infrastructure, it may also pose a severe cybersecurity risk. Institutions may also face cyber security issues related to the use of APIs, including data breaches, misuse, falsification, and denial of service attacks.

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Box 3 – Digitalisation and cybersecurity *(cont'd)*

The conducive payment infrastructure and pandemic have accelerated the transition away from cash to digital payments perceived as safer during the pandemic. While the digital payment penetration is gaining traction, the financial sector is being increasingly exposed to cyber risk as it becomes more information technology-intensive and highly interconnected through payment systems. It is, therefore, important for financial institutions to strengthen their cyber resilience, defined by the Financial Stability Board (FSB) as "*the ability of an organisation to continue to carry out its mission by anticipating and adapting to cyber threats and other relevant changes in the environment and by withstanding, containing and rapidly recovering from cyber incidents*."

The Bank recognises that cyber incidents can have serious impact on the stability of the financial sector. It is fully committed to address this risk with necessary upgrades in its prudential regulatory framework. Among the actions undertaken, the Bank is finalising guidelines on cyber and technology risk management, and the use of cloud-based services to ensure that financial institutions have in place a sound and robust cyber and technology risk management framework to mitigate against cyber and other technology risk incidents. Additionally, as a member of CERT-mu, the Bank also provides its licensees access to latest cyber security bulletins and advice on critical security patches.

The Bank's systems and infrastructures are at the centre of the country's payment ecosystem and are at risk to cyber threats. IT risk management and cybersecurity are key concerns for the Bank due to the risks of financial stability and their potential impact on firms and/or customers. To strengthen its resilience in terms of procedures and good practices, the Bank has adopted the COBIT 5 framework for IT governance. Moreover, significant investment has been made to ensure that all critical infrastructures are replicated near real time to disaster recovery sites with a drill taking place twice yearly.

The Bank has also opted to use the SWIFT network for domestic transaction and fully complies with SWIFT's customer security programme (CSP) which aims at preventing and detecting fraudulent activity through a set of mandatory security controls, community-wide information sharing initiatives and enhanced security features. Commercial banks using this closed user group have to also adhere to those principles fully.

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Box 3 – Digitalisation and cybersecurity *(cont'd)*

The types of cyber threats are evolving and becoming more sophisticated. Regulators must therefore brace themselves for cyber security management as new technologies become an integral part of the financial landscape as well. The Bank is ensuring that it has specialized and trained resources to help it in digitalization and better understand innovative and disruptive technologies and associated risks.

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4. Non-bank financial services sector

The non-bank financial services sector was resilient, despite lingering effects of the pandemic. The long-term insurance industry registered relatively healthy solvency margins in terms of gross premiums. Since the onset of the pandemic, life insurers have demonstrated resilience by re-allocating their investment mix, primarily by shifting to safer assets at the peak of the economic downturn in 2020 and gradually to riskier assets as the economy recovers. Similarly, the general insurance sector was assessed to be resilient as the solvency margin was above requirement and gross premiums grew strongly.

The non-bank financial services sector – comprising life insurances, general insurances and pension funds – continued to remain relatively resilient to the prolonged impact of the pandemic on the economy. In the wake of recent market volatility, the FSC has been closely monitoring the solvency of financial institutions operating in the long-term insurance industry for better risk management. The pension scheme business was assessed to be strong with healthy asset growth and risks largely well managed.

Life insurance industry exhibited resilience

The long-term insurance industry exhibited resilience to weather the effects of new COVID-19 variants towards the end of 2021. The assets of the industry, comprising 7 life insurers operating under the domestic regime, increased by 4.0 per cent to reach Rs107.4 billion as at end-December 2021, compared to the previous quarter (Chart 4.1).

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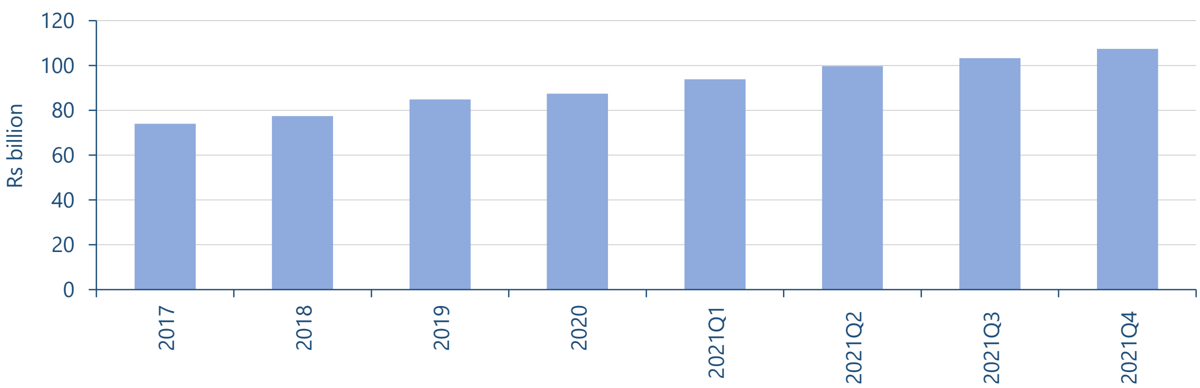
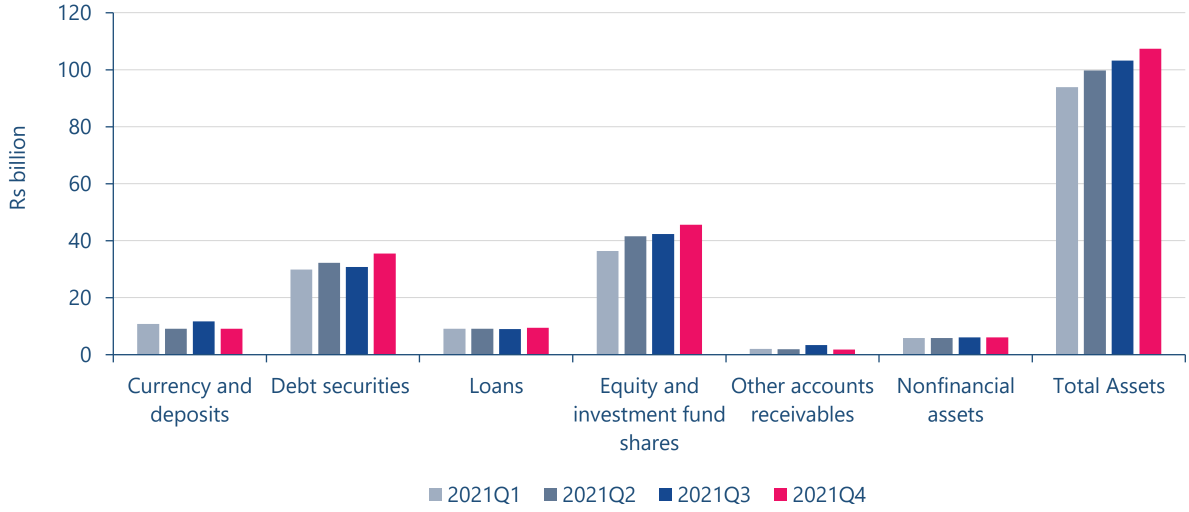
Chart 4.1: Long-term insurance assets value



Source: Financial Services Commission

The rise in long term insurers' assets is attributed to the good performance in debt securities and equity investment that surged by 15 per cent and 7 per cent, respectively, as at end-December 2021 as compared to end-September 2021 (Chart 4.2). Since the onset of the pandemic, life insurers have demonstrated resilience by re-allocating their investment mix, notably shifting to safer assets at the peak of the economic downturn in 2020 and gradually to riskier assets during the recovery phase.

Chart 4.2: Distribution of assets by class



Source: Financial Services Commission

Gross premiums sustained

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On the income side, short-term fluctuations were noted in the evolution of total gross premium for the quarter ended December 2021, though disruptions triggered by the pandemic have subsided throughout 2021. Gross premiums contracted by 4 per cent, relative to end-September 2021 (Chart 4.3).

Chart 4.3: Total gross premium

Source: Financial Services Commission

All life insurers, which reported their Actuarial Valuation Report (AVR) for 2021, were solvent.[18] According to the Insurance (Long-Term Insurance Business Solvency) Rules 2007, life insurers are required to maintain a solvency margin of at least equal to their minimum capital requirement. The long-term insurance industry was resilient to volatility caused by the unprecedented crisis, with large insurance companies – as measured by gross premiums – maintaining larger solvency margins.

Table 4.1: Solvency position of life insurers

	Capital available as a % of Minimum Capital required falling between		
Solvency Position of Life Insurers[18]	Less than 150%	150% - 250%	Above 250%
Large Companies (Gross Premium > Rs1 billion)	0	1	3
Medium Companies (Gross Premium > Rs100 million; < Rs1 billion)	0	1	0
Small Companies (Gross Premium < Rs100 million)	0	1	0

Source: Financial Services Commission

General Insurance industry grew strongly

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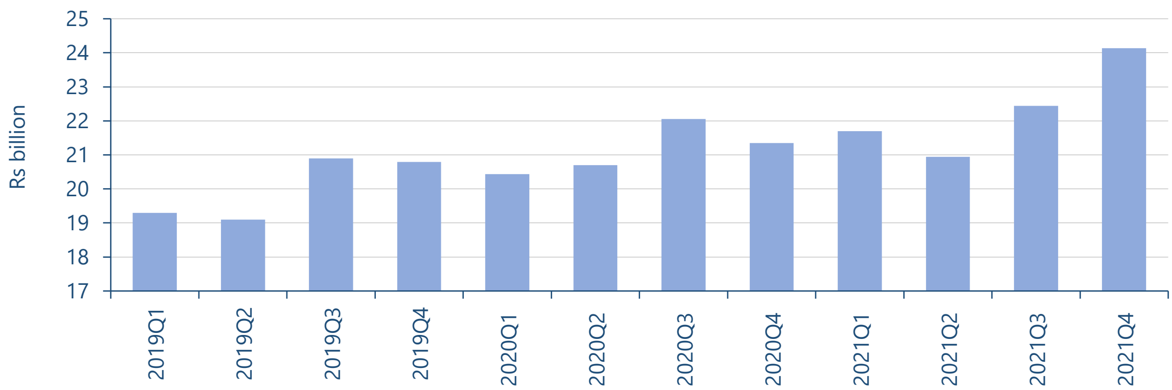
The overall performance of the general insurance business, consisting of 15 insurers at the end of 2021, was strong in the last quarter of 2021 and reflected the resilience of the sector (Chart 4.4). The value of assets of general insurers trended upwards, even attaining a level well above that prevailing during the pre-pandemic period.

Chart 4.4: General insurance asset's value

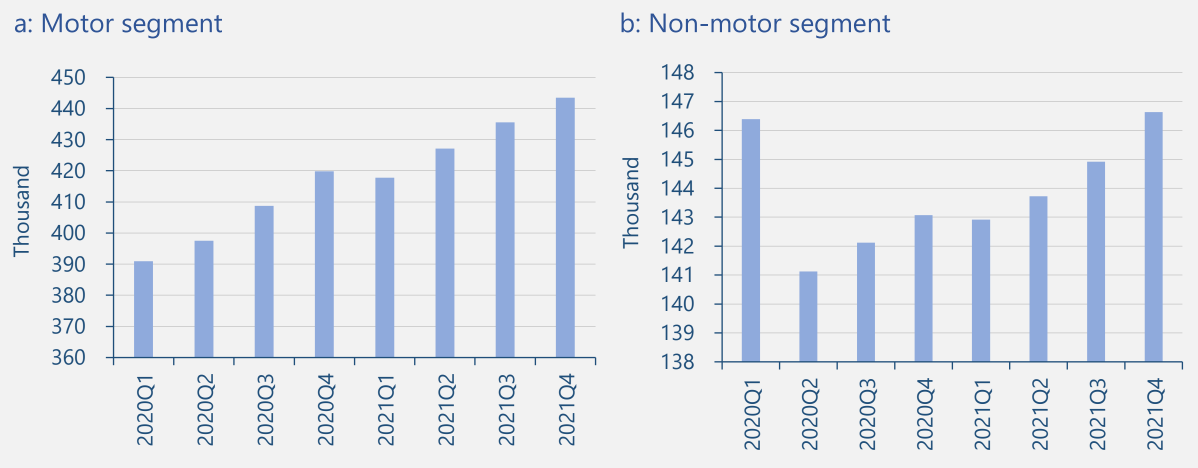


Source: Financial Services Commission

[18] *One life insurer has requested an extension for submission of its AVR.*

The number of policies in force in the motor and non-motor segments of the general insurance industry maintained an upward trajectory in the last quarter of 2021 (Chart 4.5).

Chart 4.5: General insurance – number of policies in force



Source: Financial Services Commission

Peaks were observed in total gross premiums due to seasonal factors during the third quarters of each year (Chart 4.6). Gross premiums grew by 7 per cent to reach Rs12,153 million in 2021, from Rs11,397 million in 2020.

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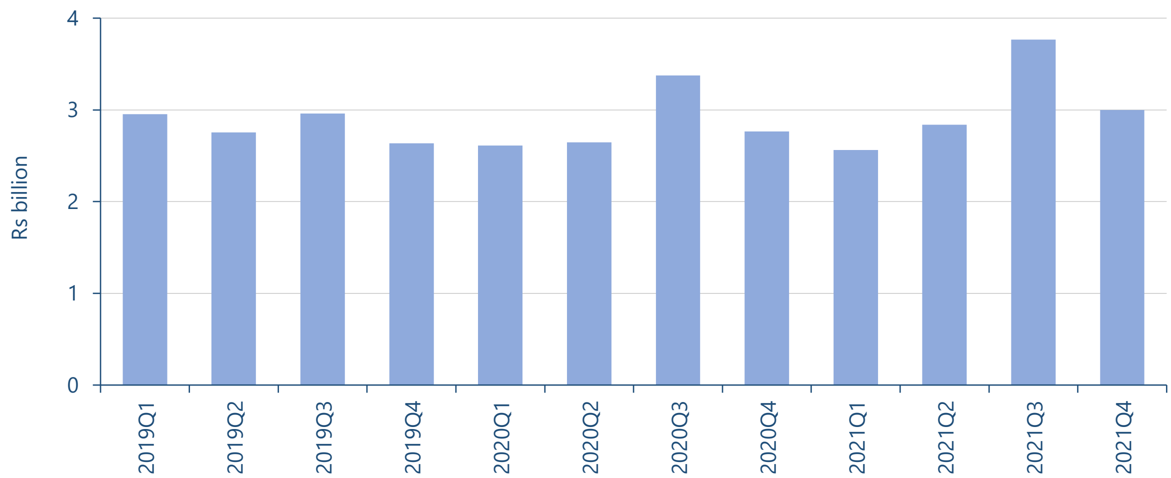
Chart 4.6: General insurance – total gross premium



Source: Financial Services Commission

The FSC closely monitored the solvency status of general insurance companies given its important role in the financial sector and the economy at large. The solvency margins of general insurers were well above the minimum requirement 150 per cent as at 31 December 2021 (Table 4.2).

Table 4.2: Solvency position of general insurers

Solvency Position of General Insurers	Less than 150%	150% - 250%	Above 250%
Large General Insurers (Gross Premium>Rs1 billion)	0	3	0
Medium General Insurers (Gross Premium>Rs100 million<Rs1 billion)	0	5	3
Small General Insurers (Gross Premium<Rs100 million)	0	0	2

Note: Actuarial Valuation Reports of 2 general insurers are not yet available

Source: Financial Services Commission

Pension scheme industry performed favourably

The value of assets in the pension scheme industry maintained a general upward trend as the economy recovered, supported by the performance of financial markets despite some volatility. Assets in the pension scheme industry were invested mostly in equity. As opposed to the exposure of the life insurance industry with the various segments of the economy, the pension scheme sector was mostly geared towards investment with higher yielding assets which explained its assets growth.

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Overall, prospects for the pension scheme business appeared optimistic. While the pandemic still presented challenges and uncertainties, asset growth was strong and risks have been largely managed.

Box 4 – Insurance sector development

The pandemic slowed down the world economy in 2020 which started recovering in 2021. In addition, longer term challenges such as geopolitical disputes, protectionism and the tightening of monetary policy have changed the landscape of the insurance sector. Accordingly, the FSC brought forward several amendments to the legislation for the insurance sector as outlined below:

Amendments	Description
Guidelines on Stress Test Requirement for Long Term Insurers	On 15 January 2021, the FSC issued amendments to the Guidelines on Stress Test Requirement for Long Term Insurers. The Guidelines were amended to reflect market conditions in view of the worldwide decline in interest rate during that period. With this amendment, the "worse investment return" scenario assumes that future investment returns would be 0.80 (instead of 0.85) of the valuation assumption subject to minimum of 1% (instead of 2%) per annum, lower than assumed in valuation.
Insurance Act 2005	The Insurance Act 2005 was amended on 5 August 2021 with respect to: **1. Insurance agents** a) insurers are required to ensure that their insurance agents are at all times in good standing in terms of their fees and reporting obligations (section 71(1A)), and b) small private companies and natural persons licensed as insurance agents are allowed to submit financial summaries instead of audited financial statements (section 72(3A)). **2. National Insurance Claims Database** The Budget Speech 2021-2022 announced the implementation of a digital centralised database to facilitate motor insurance claim recoveries. The objective of this policy is to collate data on insurers, policyholders, beneficiaries or third-party claimants which may assist in maintaining fair, safe, stable and efficient insurance markets for the benefit and protection of the public. Thus, Section 6 of the Insurance Act 2005 was amended to include the requirement for a National Insurance Claims Database.

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Box 4 – Insurance sector development *(Cont'd)*

	3. Third Party Administrators Section 78(A) of the Insurance Act 2005 was amended to include the licensing of other insurance professionals. In line with the Budget Speech 2021-2022, the FSC is currently working on a regulatory framework that would cater for the licensing and regulatory requirements applicable to Third-Party Administrators ('TPAs'). The purpose is to provide a structured environment for TPAs to operate in the best interest of policyholders.
Draft Insurance Structured Investment-Linked Insurance Business (SILIB) Rules	The Budget Speech 2020-2021 announced the introduction of a Structured Investment-Linked Insurance Business (SILIB), in line with the recommendations of the 10-year blueprint. The introduction of SILIB is aligned with the vision of the FSC "to be an internationally recognised financial supervisor committed to the sustained development of Mauritius as a sound and competitive financial services centre". SILIB will be introduced within the Insurance Act as a fifth class of long-term insurance business. The FSC is confident that the introduction of SILIB will contribute to further consolidate wealth management – one of the pillars mentioned in the report entitled "Innovation and transforming the Mauritius International Financial Centre of 2030". The FSC issued a draft Insurance (Structured Investment-Linked Insurance Business) Rules for consultation on 2 March 2022. Comments and feedback have been received from interested parties and have been assessed by the FSC.

Source: Financial Services Commission

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5. Global business sector

The performance of the GB sector improved in 2021, after it faced major challenges in 2020. The exit of Mauritius from the FATF list of jurisdictions under increased monitoring and the UK list of High-Risk Third Countries in the last quarter of 2021 improved the outlook for the sector. Further, the European Commission (EC) announced in February 2022 the withdrawal of Mauritius from the EU List of High-Risk Third Countries. Complementing the exit of the aforementioned lists, the surge in investor sentiment in 2021 propelled both FDI and FPI flows through the MIFC, which remained India-focused. The exposures of the banking sector to the GB sector, both in terms of deposits and credit facilities, were prudently managed. GBC deposits continued their growth trajectory during the last quarter of 2021. Overall, risks to financial stability from developments in the GB sector were well controlled by prudent risk management in the banking sector.

The performance of the GB sector improved in 2021, following a contraction of 10.3 per cent in its contribution to the Gross Value Added at basic prices in 2020. The contribution of the GB sector to the country`s GDP increased to 6.5 per cent in 2021, from 6.0 per cent in 2020. This contribution stems principally from employment generated through GB activities in the MIFC, regulatory costs paid by GBCs and tax revenue collected from GBCs.

The aggregate assets of the GB sector continued to expand strongly, growing by 5.4 per cent between end-September to end-December 2021 to reach US$682 billion. The majority of the assets are held in the form of investments in non-resident enterprises. Likewise, on the financing side, GBCs are predominantly held by non-residents. These characteristics are typical of the Special Purpose Entities (SPEs) model, whereby non-resident investors set-up a GBC in Mauritius for investment outside the jurisdiction.

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The consequences on the GB sector of heightened geo-political uncertainty, caused by the Russia-Ukraine war, have remained very limited so far. As extensively covered in the April 2022 edition of the IMF Global Financial Stability Report, the war in Russia-Ukraine is likely to increase downside risks for portfolio flows. As a result, the volume of both FDI and FPI flows through the MIFC could be impacted, but these adverse effects have not yet been observed.

Global Business sector activities expanded

Following the exit of Mauritius from the FATF list of jurisdictions under increased monitoring in October 2021 and UK List of High-Risk Third Countries in November 2021, the EC announced in February 2022 that Mauritius has been withdrawn from the EU List of High-Risk Third Countries. The exit of the Mauritian jurisdiction from the aforementioned lists reinforces the position of the MIFC as a robust platform for cross-border investments and transactions.

These de-listings, achieved by the Mauritian authorities well ahead of the agreed deadline with the FATF, are expected to improve prospects for the GB sector and noticeably reduce risks to financial stability originating either directly or indirectly from this sector. It also demonstrates the strength and commitment of the Mauritian authorities to enhance the AML/CFT framework in line with international standards. Further, exiting the different lists sends a strong signal about the willingness of the institutions to combat money laundering and terrorist financing and uphold the international repute of the MIFC.

The inclusion of the Cayman Islands on the EU List of High-Risk Third Countries in March 2022 may pose some risk to GB flows through Mauritius. Flows from Cayman Islands, the second largest source of direct inward investment for the MIFC, would be subject to enhanced due diligence measures from financial institutions in the EU. This additional regulatory burden on transactions could impact flows from the Cayman Islands to Mauritius.

Furthermore, the uncertainties prompted by the Russia-Ukraine war could affect global financial flows going forward. While the direct flows going through Mauritius from and to these countries are insignificant, the indirect effects through flows from other regions could impact the GB sector. In addition, the sanctions imposed by several countries – particularly by the EU and the US on Russia and its trading partners – are expected to cause disruptions in several areas. Soaring food prices are, and will continue, dampening real income thereby reducing global consumption and trade. As a result, the short-term outlook for global investment is on the downside.

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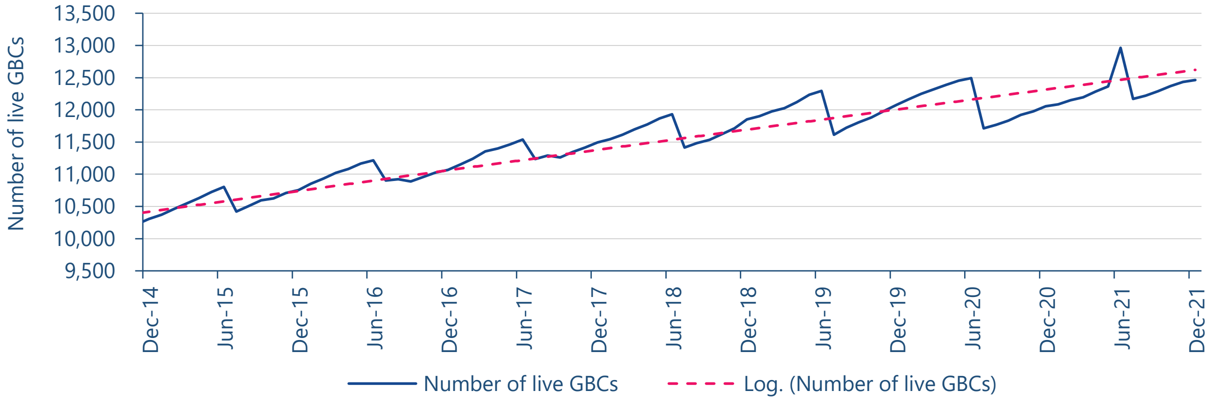
In spite of the above-mentioned risks, preliminary assessment suggests that the impact of these risks to the stability of the financial system in Mauritius may not be significant, even on the activities in the GB sector. As evidence, GBC deposits continued to expand in the first quarter of 2022, registering a 6.3 per cent growth from end-January 2022 to end-March 2022. The exposure of the banking sector to Russian and Ukrainian counterparts represented less than 1 per cent of total banking sector assets as at end-December 2021. The Bank and the FSC will continue to closely monitor international developments and their implications on the GB sector.

Sustained increase in live GBCs

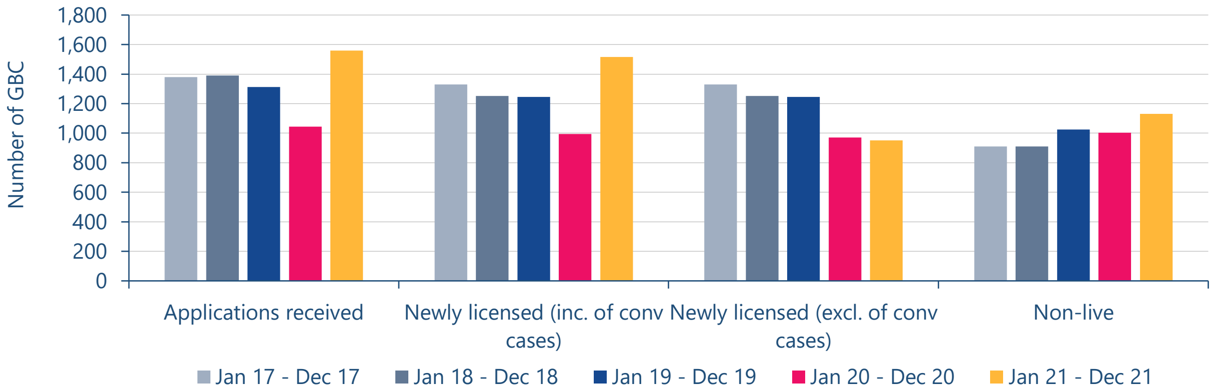
The GB sector counted 12,461 live GBCs as at end-December 2021, representing a rise of 3.4 per cent compared to end-December 2020 (Chart 5.1). Likewise, the number of newly-licensed GBCs surged by nearly 53 per cent to attain 1,516 as at end-December 2021. Of these, 564 were conversion cases from the GBC2 regime. Exclusive of these cases, the number of newly licensed GBCs stood at 952, reflecting a slight drop as compared to a year earlier. The number of non-live GBCs increased by nearly 13 per cent in the year to end-December 2021 (Chart 5.2).

Chart 5.1: Evolution of live GBCs



Source: Financial Services Commission

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



Source: Financial Services Commission

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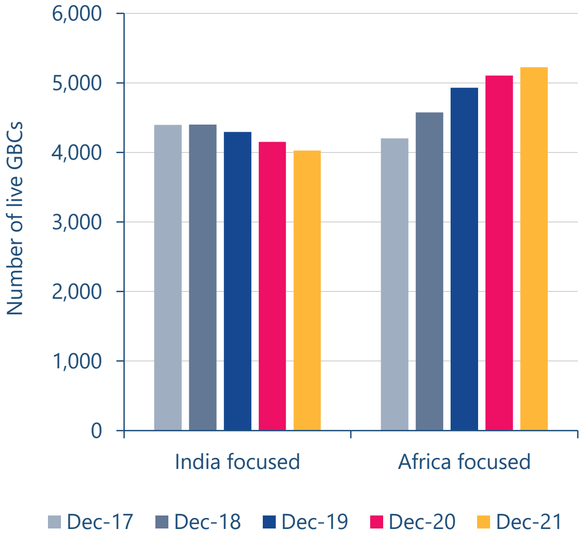
In terms of the primary target investment region, Africa has gained momentum since 2019, with an annual growth of approximately 2.3 per cent in December 2021 (Chart 5.3). However, the Fund segment of the GB sector still predominantly targeted India and represented almost 78 per cent of the total schemes, while Africa-focused GB Funds accounted for the rest (Chart 5.4).

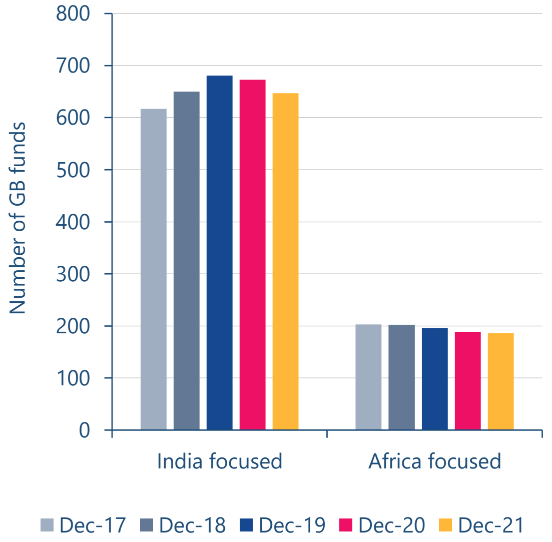
The GB funds originated primarily from portfolio investors investing in listed instruments on stock markets. The relatively low number of advanced and liquid exchange markets in Africa may explain the small percentage of GB funds targeting this region. Investment in African countries through Mauritius was 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

Chart 5.4: GB funds targeting India vs Africa



Source: Financial Services Commission

Gross direct investment flows to India remained buoyant

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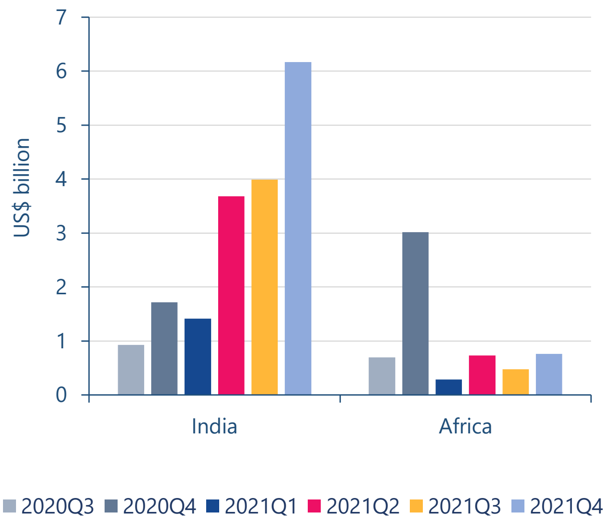
Investment flows channelled by India-focused GBCs were significantly higher than Africa-focused GBCs, though there were more live GBCs targeting Africa than India. Improved economic outlook and a surge in investor sentiment throughout 2021 supported both FDI and FPI flows towards India.

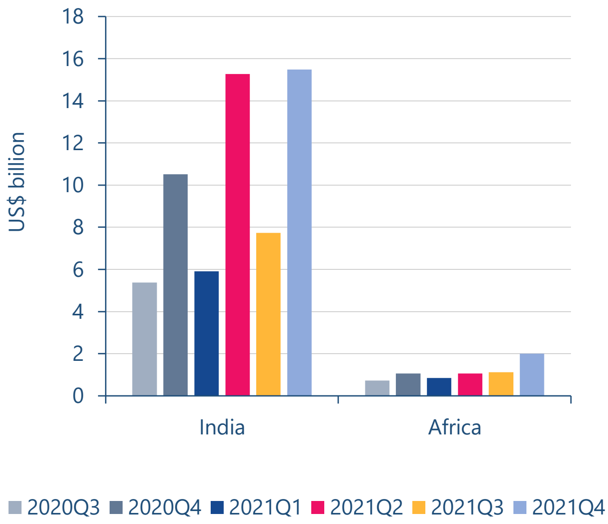
Gross investment flows went up in the third quarter of 2021, but major fluctuations were noted across regions, notably in EMDEs. Total FDI into India recorded a 54.6 per cent increase during the last quarter of 2021 relative to the preceding quarter. Similarly, total FPI towards the Indian market doubled over the same period. Likewise, an increase of nearly 60 per cent was noted for FDI flows into Africa from Mauritius during the last quarter of 2021 relative to the third quarter of 2021 (Charts 5.5 and 5.6).

Chart 5.5: Gross flows of foreign direct investment



Source: Financial Services Commission

Chart 5.6: Gross flows of portfolio investment



Source: Financial Services Commission

The spike in both gross portfolio and direct investment flows from Mauritius to India was supported by multi-year low interest rates, strong vaccination campaign and a wave of optimism which led to the sharp pick up of the Indian economy. On the other hand, investment flows to Africa faced weaker recovery. The driving factors ranged from slow vaccine roll-out programme, high inflation and emergence of new variants of COVID-19 that dampened prospects of rapid economic recovery.

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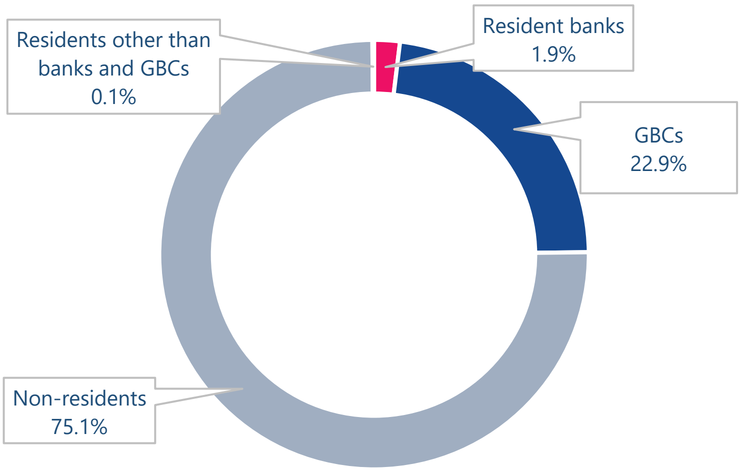
Linkages between the global business and banking sectors

The mainstream business model of GBCs is typically the SPE model, whereby funds from non-residents are channelled through the MIFC for investment towards the Asian and African regions. This is reflected in the breakdown of the monetary and financial assets of GBCs by institutional sectors (Chart 5.7). The largest asset exposures of GBCs were to non-residents, representing 75.1 per cent, followed by cross shareholding between GBCs, at 22.9 per cent, indicating the presence of GBC group structures operating in the sector. The exposures of GBCs to domestic institutional sectors were essentially in the form of deposits with banks.

Chart 5.7: Exposure of GBCs by institutional sectors as at end-December 2021



Source: Financial Services Commission

The GB sector is highly exposed to externalities – such as global economic prospects impacting financial flows – that can have direct implications on the volume of GBC deposits held with the banking system. As a major contributor of funds, any sudden large-scale withdrawal of deposits could exert substantial pressure on the FX liquidity position of the banking system. To measure the resilience of the banking system to such shocks, the Bank conducts regular stress tests based on various plausible scenarios. The LCR, requiring banks to hold HQLAs, provides a strong cushion against the risk of large outflows of GBC deposits.

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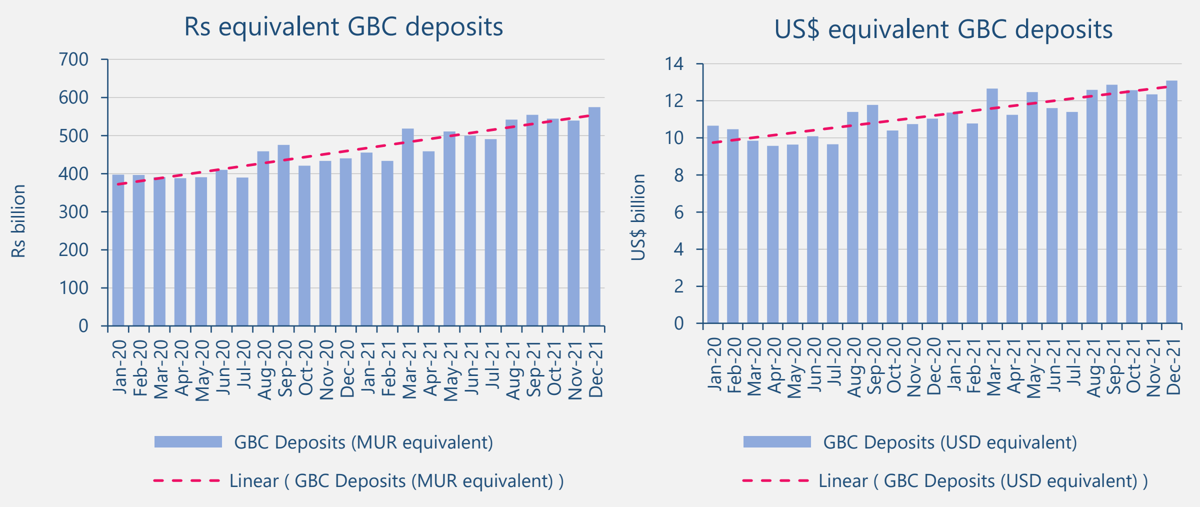
The share of GBC deposits to total banking sector deposits stood at 36.5 per cent as at end-December 2021 – roughly around the level prior to the pandemic despite the volatile nature of GBC deposits. The proportion of GBC deposits to total FX deposits in the banking system hovered around 55 per cent. This demonstrates the trust and confidence of GB operators in the MIFC, despite the challenges faced by the GB sector over the past two years. GB deposits rose to US$13.1 billion as at end-December 2021, compared to US$12.9 billion as at end-September 2021 (Chart 5.8).

Chart 5.8: Evolution of GBC deposits



Source: Bank of Mauritius

The volatile nature of GBC deposits limits banks' ability to lock such funds in long-term or illiquid assets. The GBC deposits are, therefore, mostly deployed in liquid assets – such as in the form of deposits or balances with banks and in liquid sovereign FX securities – to cushion against the risk of sudden withdrawal of funds that could undermine the liquidity position of a bank (Chart 5.9).[19] The average share of FX balances held with banks to GBC deposits for the four-year period to end-December 2021 stood at 70.7 per cent. The FX balances with banks dropped towards the end of 2021 but recovered during the first quarter of 2022, whilst a sustained increase could be noted in liquid sovereign FX securities held by banks. Furthermore, an analysis of the stickiness of GBC deposits, using data for recent years, revealed that around 80 per cent of the total GBC deposits tend to be stable. Overall, banks maintained strong liquidity buffers to respond to any large withdrawals of GBC deposits.

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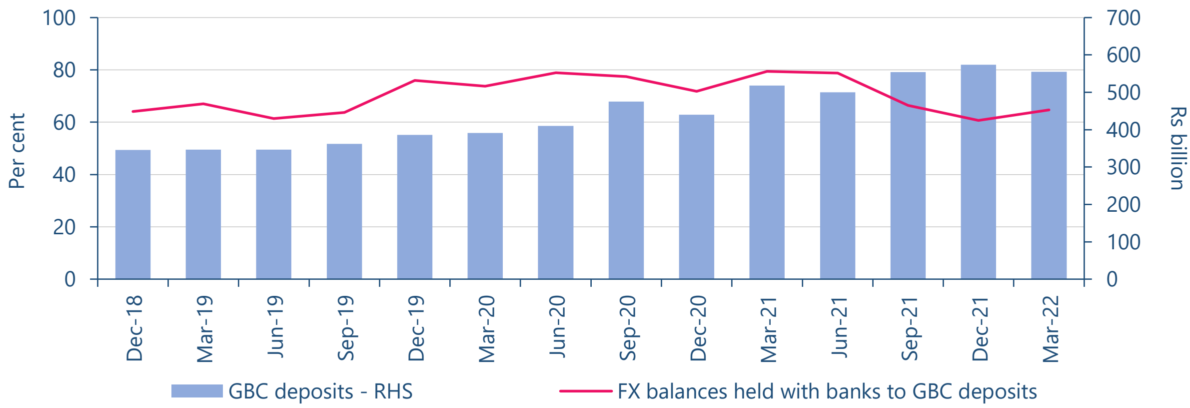
Chart 5.9: Deployment of GBC deposits



Source: Bank of Mauritius

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[19] *Balances with banks include balances held by banks with their respective correspondent banks.*

To have a better assessment of the likelihood of a significant outflow of GBCs from the Mauritian jurisdiction and its potential impact on the banking sector, a risk map was developed by the FSC. The risk map measures the exposure of each bank to a sudden withdrawal of GBC deposits. Based on data as at 31 December 2021, between 2 per cent and 15 per cent of the GBC deposits were classified under the high risk and high impact categories (Table 5.1). This finding is broadly aligned with estimates of short-term core deposits of the GB sector with the banking sector.

The risk map indicated that 10.8 per cent of GBCs are viewed to be at high risk of leaving the jurisdiction while 26.9 per cent of GBC deposits would have a high impact, in the event of an outflow from the jurisdiction. Overall, it is estimated that 2.7 per cent of total GBC deposits were both at high risk of leaving the jurisdiction and having a high impact.

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

Risk Score – GBCs leaving the Mauritian jurisdiction	Sub-Total Risk scores					
High Risk	10.8	0.0	2.7	2.9	2.5	2.7
Medium-High Risk	16.1	0.0	4.8	5.4	2.0	3.9
Medium-Low Risk	12.3	0.0	3.9	3.1	1.5	3.8
Low Risk	60.6	0.1	21.5	18.6	3.9	16.5
	Sub-Total Impact Score	0.1	32.9	30.0	9.9	26.9
		Low Impact	Medium-Low Impact	Medium Impact	Medium-High Impact	High Impact
		Impact Score – Deposit withdrawals				

Source: Financial Services Commission

The exposure of the banking sector to the high-risk components of the GB sector remained low and, therefore, underscored the limited credit and market risks to the GB sector (Chart 5.10). The share of loans extended to the GB sector relative to total loans extended by the banking sector remained low at 7.1 per cent as at end-December 2021. Bank loans granted to the GB sector declined to US$1.5 billion as at end-December 2021, from US$1.6 billion as at end-September 2021.

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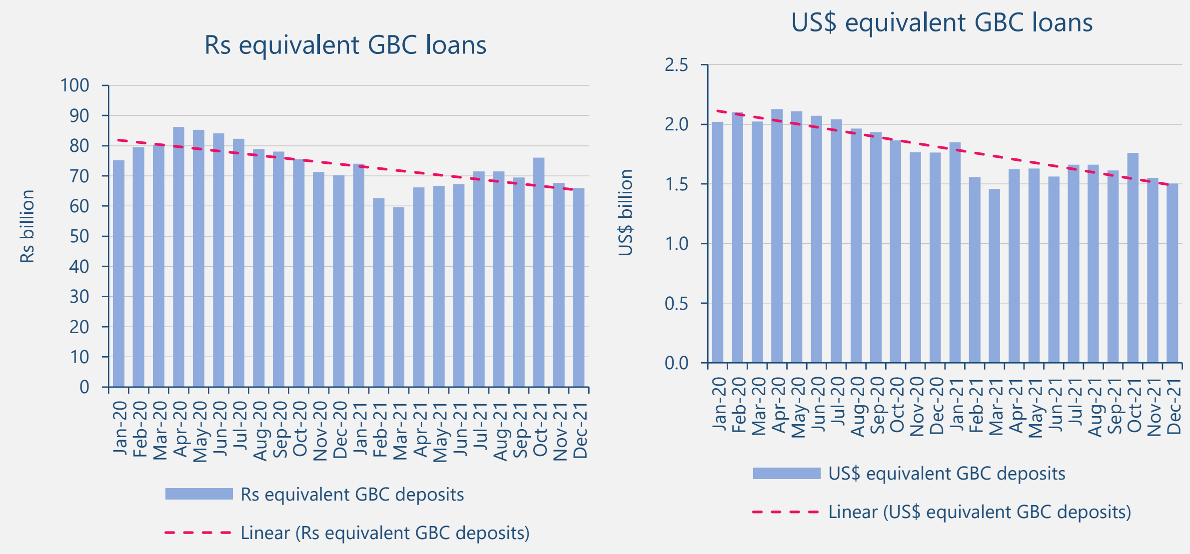
Chart 5.10: Evolution of GBC loans



Source: Bank of Mauritius

Despite limited bank credit exposure, the asset quality of the GB sector has weakened, partly on account of the impact of the pandemic. The NPL ratio of the sector rose to 15.9 per cent as at end-December 2021, from 9.5 per cent as at end-September 2021 (Chart 5.11). However, this increase was primarily driven by one bank which classified two credit facilities as NPLs. The rise in the NPL ratio is, therefore, not representative of a broader deterioration in asset quality of the GB sector. Adjusting for these specific impaired assets, the NPL ratio would stand at 8.3 per cent. Specific provisions to NPLs stood at 57.1 per cent as at end-December 2021. The NPLs for the GBC sector represented around 24 per cent of the total banking sector's impaired credit (Chart 5.11).

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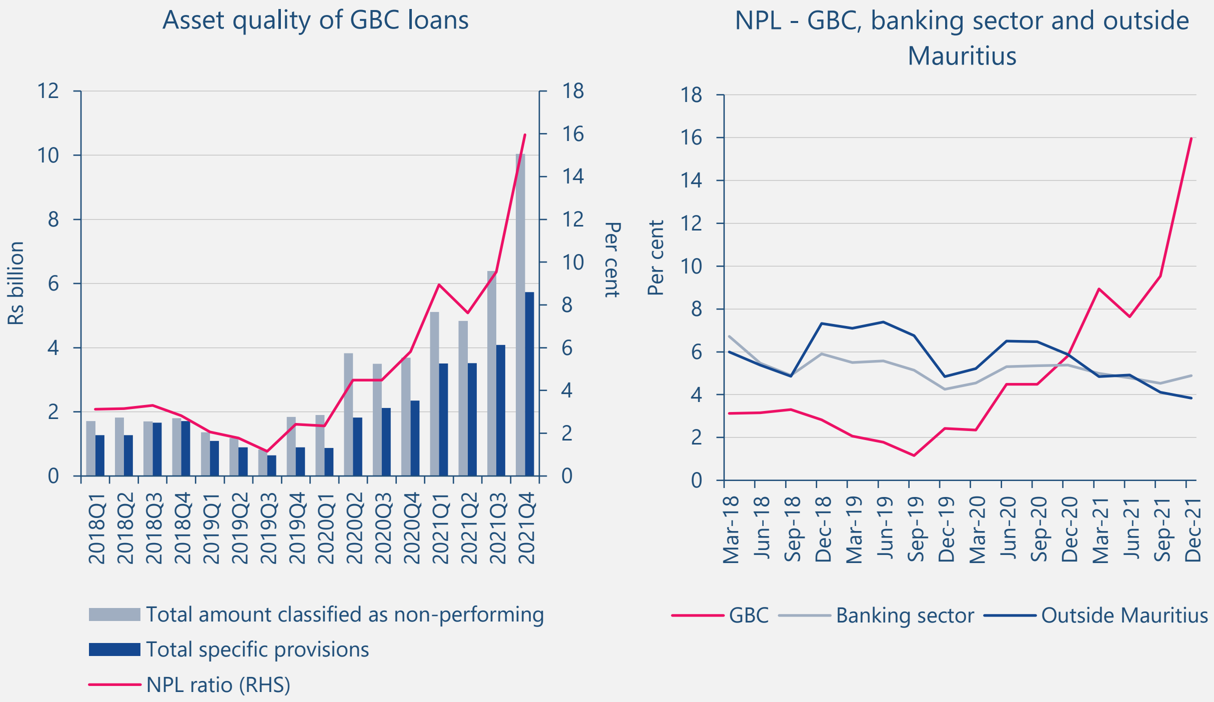
Chart 5.11: Evolution of GBC NPLs



Source: Bank of Mauritius

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6. Stress testing the Mauritian banking sector

The resilience of the banking sector to macroeconomic and other idiosyncratic shocks, evaluated through a range of plausible scenarios, was sustained mainly due to strong capital and liquidity buffers. The stressed scenarios – comprising mainly shocks to the credit portfolios, interest rate, exchange rate and liquidity – were calibrated to reflect the conceivable developments due to the pandemic as well as the Russia-Ukraine war. A few banks showed signs of vulnerabilities in specific areas. The Bank is addressing these weaknesses, as appropriate. Two banks, for instance, planned to increase their capital during 2022 to suit their risk appetite and enhance their resilience to shocks. More broadly, as economic recovery gathers momentum, the banking sector continues to consolidate its financial buffers and, consequently, risks to financial stability are well cushioned. With the frequency and severity of shocks in recent years, the Bank maintains its prudent approach by closely monitoring and assessing risks to financial stability.

The banking sector in Mauritius maintained strong capital and liquidity buffers in the last quarter of 2021, well above regulatory limits. Most banks displayed comfortable positions in terms of solvency and liquidity as a cushion against shocks. A few banks presented signs of vulnerabilities in some areas. Appropriate measures have been initiated to improve the resilience of these banks. In spite of the emergence of the Omicron variant in November 2021 that delayed the economic recovery to some extent, risks to financial stability were still contained.

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However, with the lingering pandemic and the outbreak of the Russia-Ukraine war in February 2022 posing a threat to global economic prospects, the risks to financial stability have heightened in early 2022. In addition, high inflation and monetary policy tightening have the potential to exert strains on the stability of the financial system.

Stress test evaluates the capacity of the banking sector and individual banks to continue operating during periods of strain. The stress test exercise investigated the risks to the normal operation of the banking sector from macroeconomic shocks as well as shocks to the credit portfolios, interest rate, exchange rate and liquidity. The findings of the exercise are discussed in the following sections.

Macroeconomic scenario analysis

Three hypothetical scenarios with increasing degree of severity — namely, baseline, moderate, and severe scenarios — were applied to test the adequacy of the capital buffers of banks. The scenarios were based on different sets of assumptions of macroeconomic shocks.

The “baseline” scenario assumes that the economy will grow by 7.5 per cent in 2022. The revival of the tourism industry is assumed to be strong, well supported by the series of measures initiated by the authorities to achieve the set target of 1 million tourists in 2022. In addition, the other major sectors of the economy are expected to perform well, partly supported by spill-overs from the tourism sector. The ‘*Manufacturing*’ sector is expected to expand further in 2022. Expected interest rate hikes in 2022 are not anticipated to significantly impact growth as monetary policy may still be broadly supportive of economic recovery. It is assumed that the Russia-Ukraine war does not trigger protracted effects on global economic recovery and its impact on international travel and demand from our main markets is limited.

For the “moderate” scenario, it is assumed that the domestic economy stagnates in 2022, with zero growth, but resumes with positive growth as from early 2023. The rebound of the ‘*Manufacturing*’ sector is stalled due to a protracted Russia-Ukraine war and the persistence of the pandemic causing significant disruptions to demand from Mauritius’ main markets and to global supply chains. The war also adversely impacts international travel and hinders the recovery in the tourism sector. The pandemic intensifies as booster vaccination campaigns are much slower. The Russia-Ukraine conflict escalates and is resolved towards the end of 2022. Higher global inflation than initially anticipated significantly inhibits global and domestic economic recovery, as central banks continue to tighten monetary policy.

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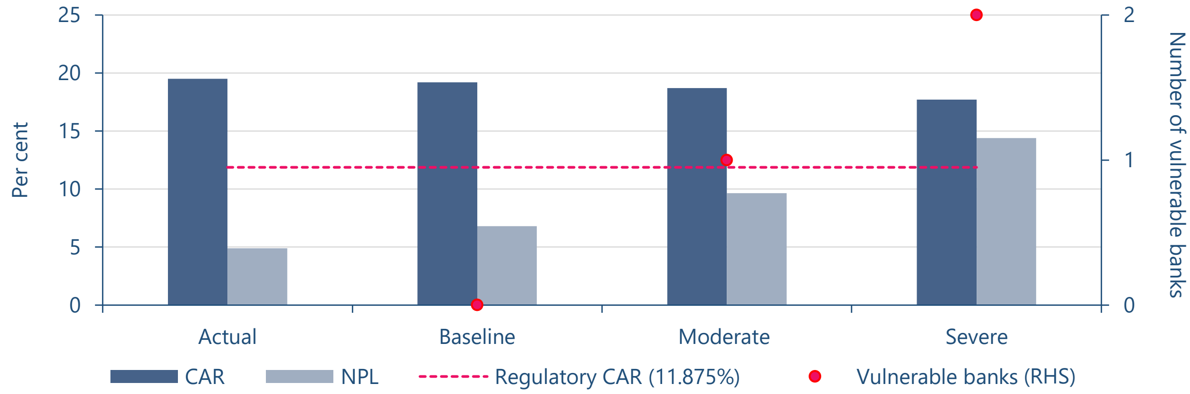
The “severe” scenario assumes the domestic economy registers a contraction of 5 per cent in 2022, with growth occuring in the second half of 2023. The pandemic intensifies and significantly disrupts supply chains. Rising inflation leads to overtightening of monetary policy resulting in growth stalling in key exports markets. In addition, the Russia-Ukraine conflict intensifies in 2022 and is resolved after lengthy negotiations in 2023. These factors are assumed to drive the global economy to the brink of recession in 2022 and stall recovery in the domestic tourism sector, leading to a contraction in output in the ‘*Manufacturing*’ sector.

The above macroeconomic shocks are transmitted to the banking sector via the impact on credit portfolios primarily. The sensitivity of the credit portfolios to economic growth dynamics is estimated using satellite models. The NPL ratios are forecast for the three scenarios based on the effect of the GDP shock parameter on the credit portfolio and consequently on NPLs. The subsequent impact on capital is projected using assumptions on the provision that has to be set aside for the additional NPL. Any change in provisioning requirements, therefore, affects the value of capital and ultimately the resilience of the banking sector to macrofinancial risks.

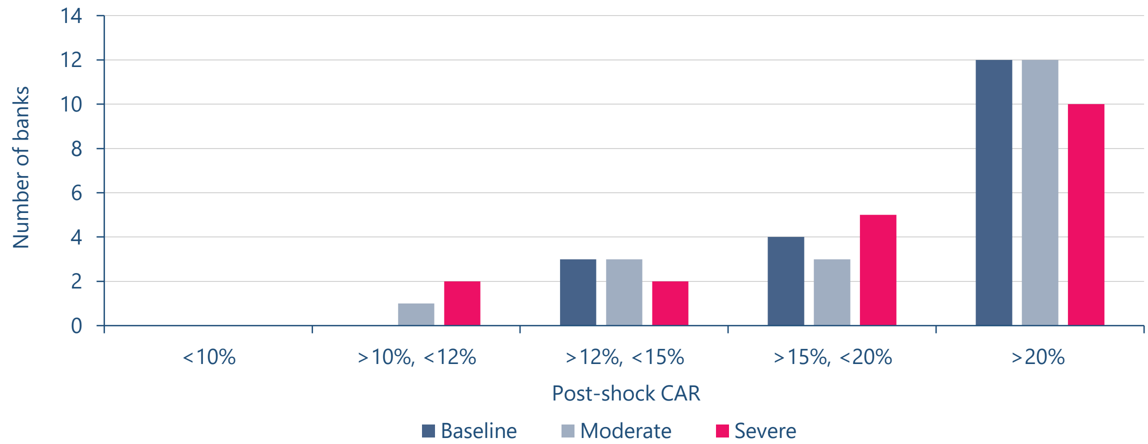
The stress test results, using December 2021 data, demonstrated that the banking sector as a whole can withstand the strains exerted by the three macroeconomic scenarios. Almost all banks showed commendable resilience, with the exception of one bank in the moderate scenario and two banks in the severe scenario, with one of these two banks breaching the regulatory limit very marginally. These banks recorded post-shock CAR below regulatory limit of 11.875 per cent (Chart 6.1.a), which includes the Capital Conservation Buffer of 1.875 per cent as at end-December 2021. Nontheless, all banks were able to meet the minimum CAR of 10 per cent and most banks were in the post-shock CAR bucket of '>20%' (Chart 6.1.b).[20]

Chart 6.1.a: Macroeconomic scenario results



Source: Bank of Mauritius

Chart 6.1.b: Bank-wise distribution of CAR



Source: Bank of Mauritius

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Interest rate and exchange rate

Interest rate and exchange rate scenarios were subsequently built into the baseline and moderate macroeconomic scenarios to assess the resilience of the banking sector to changes

[20] Under Basel III, the minimum capital adequacy ratio that banks must maintain is 8 per cent. According to the Bank's guideline, banks in Mauritius have to maintain a 10 per cent minimum capital adequacy ratio, thus providing higher insurance against risks.

in the policy interest rate and the exchange rate. Two plausible scenarios were considered to test the implications of an increase in interest rate and a depreciation of the exchange rate (Table 6.1). The severe scenario was not simulated as the policy rate would likely not be raised when aggregate output contracts.

It must be highlighted that the MPC takes its decision independently and, therefore, the stress test scenarios should not be considered as forecast for upcoming MPC decisions. Similarly, the exchange rate responds primarily to domestic market conditions and international currency movements. As such, the assumptions on exchange rate depreciation should not be construed as forecast or expected exchange rate movements.

Table 6.1: Interest rate and exchange rate scenarios

	Baseline Scenario	**Moderate Scenario**
GDP growth	7.5 per cent	Zero growth
Interest rate hike	50 basis points	50 basis points
Exchange rate depreciation	2 per cent	5 per cent

Source: Bank of Mauritius

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The banking sector remained broadly resilient under the adjusted macroeconomic scenarios. The results showed that the CARs of most banks remained above the regulatory limit of 11.875 per cent under the two macroeconomic scenarios adjusted for interest rate and exchange rate movements. The CAR of one bank dropped below 11.875 per cent under the moderate scenario, but still remained above 10 per cent.

Sensitivity analysis

Numerous single-factor sensitivity analysis using December 2021 data were carried out on the banking sector to evaluate its vulnerabilities and resilience. A top-down approach using micro models for the sensitivity analysis was applied to evaluate the resilience of banks with respect to: (i) sectoral credit risk, (ii) credit concentration risk, (iii) liquidity risk, and (iv) reverse stress test.

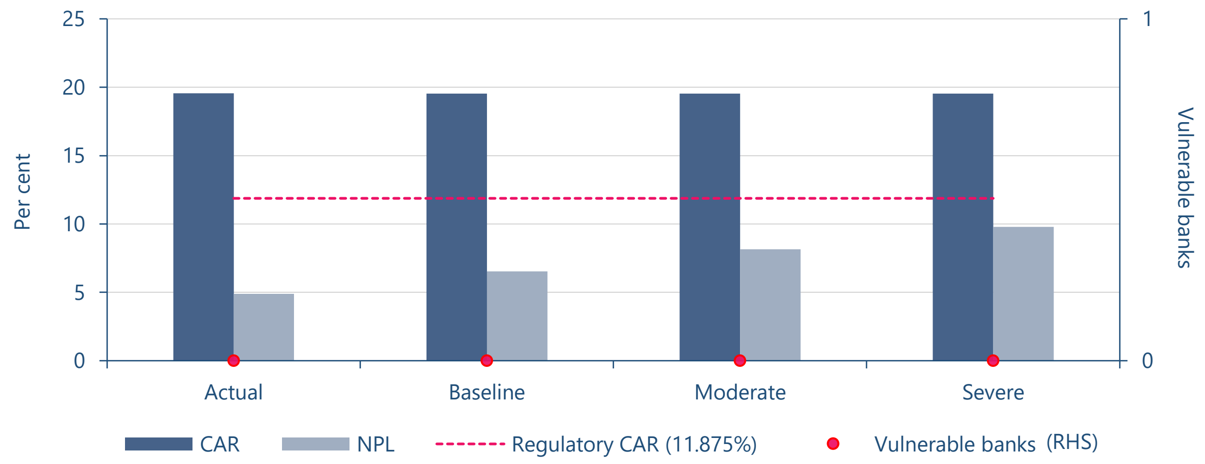
Sectoral credit risk

A sensitivity analysis was performed on the system-wide sectoral gross NPLs as at end-December 2021 to assess the resilience of the banking sector to credit risk. For this exercise, shocks were administered to *'Agriculture'*, *'Manufacturing'*, *'Construction'*, *'Trade'*, '*Accommodation and food services*', and '*Housing*' sectors. These domestic sectors represent the largest credit portfolios of banks, aggregating around 64 per cent of private sector credit.

The sensitivity analysis postulates that a proportion of the performing credit portfolio for each sector is impaired, with this proportion rising as the scenarios become harsher. For the baseline scenario, it is assumed that 4 per cent of the performing portfolio is impaired. This share rises to 8 per cent under the moderate scenario and to 12 per cent under the severe scenario.

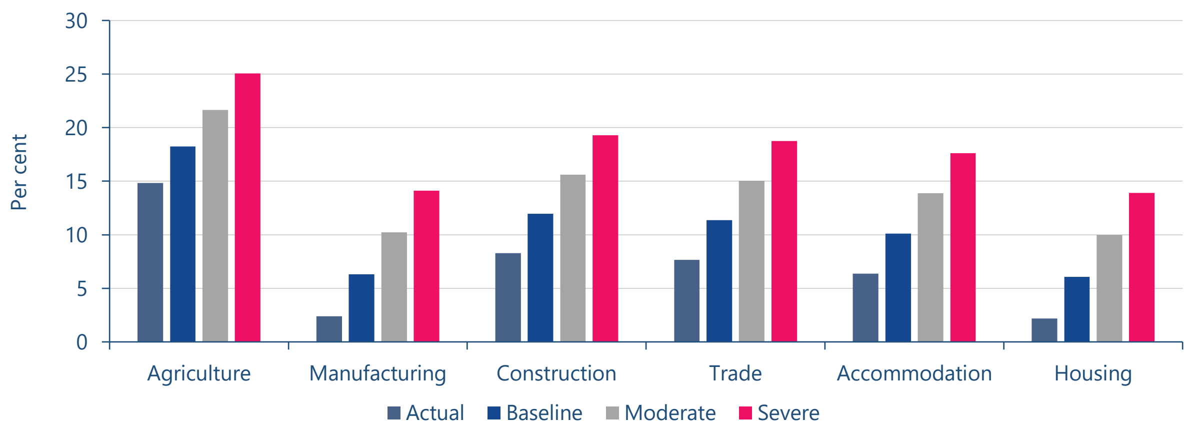
The results suggested that all banks would be able to absorb the shocks under the three scenarios (Chart 6.2.a). The '*Agriculture*' sector would have the highest post-shock NPL ratio, as its actual ratio is already high. The '*Accommodation and food services*' sector recorded the highest increase in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

Chart 6.2.a: Sensitivity results



Source: Bank of Mauritius

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



Source: Bank of Mauritius

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Credit concentration risk

Three scenarios have been used to assess sensitivity to credit concentration risk. It is assumed that the performing credit of the top individual borrowers, comprising both domestic and cross-border clients, becomes impaired for the respective 19 banks in the system. These borrowers are unlisted on the stock exchange and are non-governmental entities. They operate mainly in the *'Agriculture', 'Manufacturing', 'Construction', 'Trade, Transportation and storage'*, and *'Accommodation and food services'* sectors.

Specifically, the "baseline" scenario assumes the top single borrower of each bank defaults. The two other scenarios, "moderate" and "severe", assume that the top five and the top ten borrowers of each bank default, respectively.

The results showed that most banks were able to sustain the credit concentration shock, with the exception of three banks. Specifically, banks' aggregate post-shock CAR would drop from actual rate of 19.6 per cent to: (a) 19.1 per cent in the baseline scenario; (b) 18.0 per cent in the moderate scenario; and, (c) 17.2 per cent in the severe scenario (Chart 6.3.a). One bank fell marginally below 11.875 per cent in the baseline scenario. Under the moderate scenario, two banks breached the regulatory threshold while under the severe scenario, three banks demonstrated vulnerabilities. Most banks were able to hold CAR in the '>20%' bucket for all three scenarios. However, one non-D-SIB was unable to meet the minimum CAR of 10 per cent in both the moderate and severe scenario (Chart 6.3.b).

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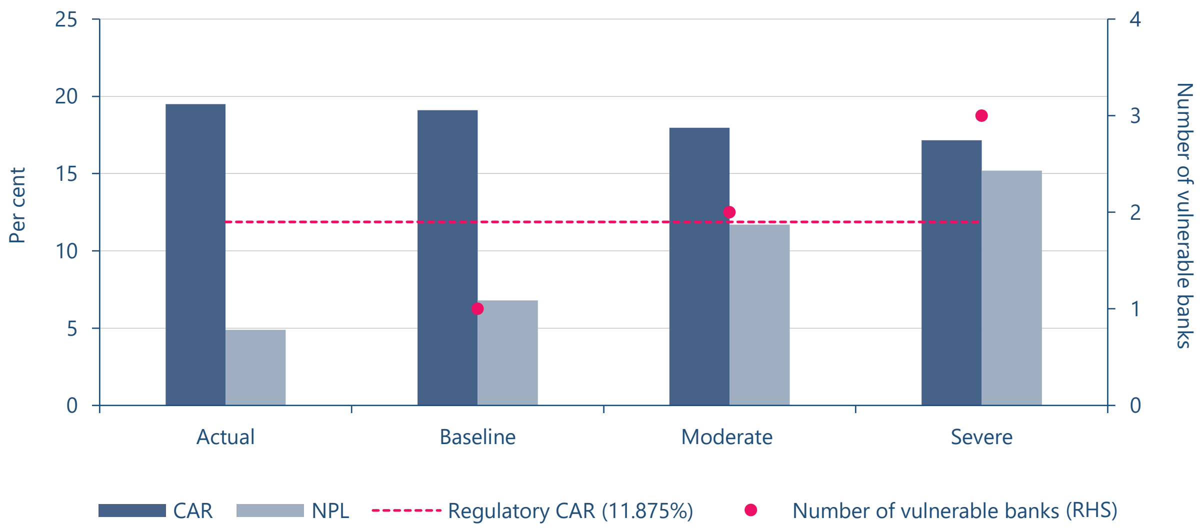
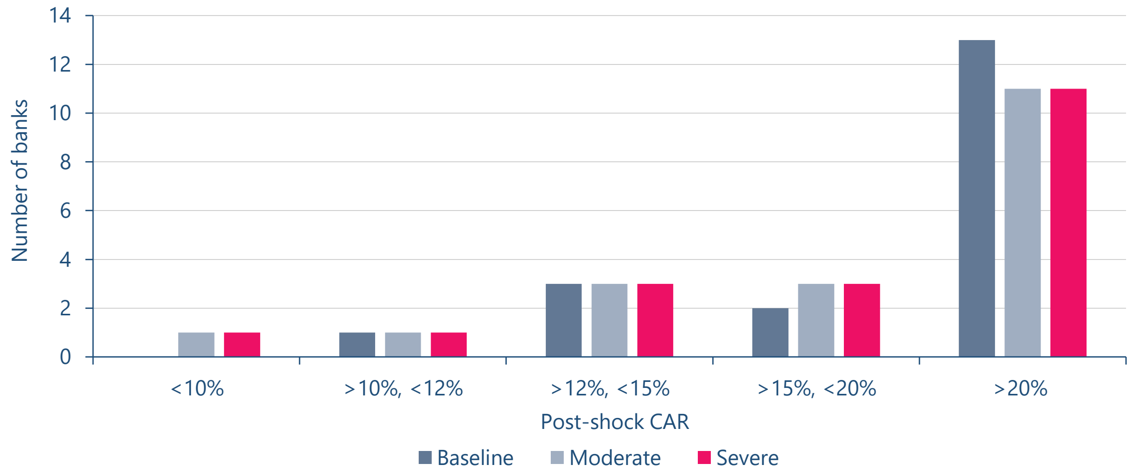
Chart 6.3.a: Credit concentration risk



Source: Bank of Mauritius

Chart 6.3.b: Bank-wise distribution of CAR



Source: Bank of Mauritius

Liquidity risk

Liquidity stress tests have been conducted to evaluate the extent to which banks can sustain liquidity outflows, based on five shock scenarios specifically relating to the GB sector deposits (Table 6.2). Many banks hold a high proportion of GBC deposits on their balance sheet, especially foreign banks, that exhibit some degree of volatility. Stress testing these deposits assesses the resilience of banks against potential outflows of GB deposits.

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These five scenarios are designed to examine the capacity of banks in Mauritius to sustain rising withdrawals of FCY deposit against their Adjusted FCY HQLA (Adjusted HQLA). The Adjusted HQLA is determined by combining: (1) the FCY HQLA (as per LCR definition) and (2) FCY interbank placements held. A bank is considered 'vulnerable' if its Adjusted HQLA becomes negative under stressed conditions.

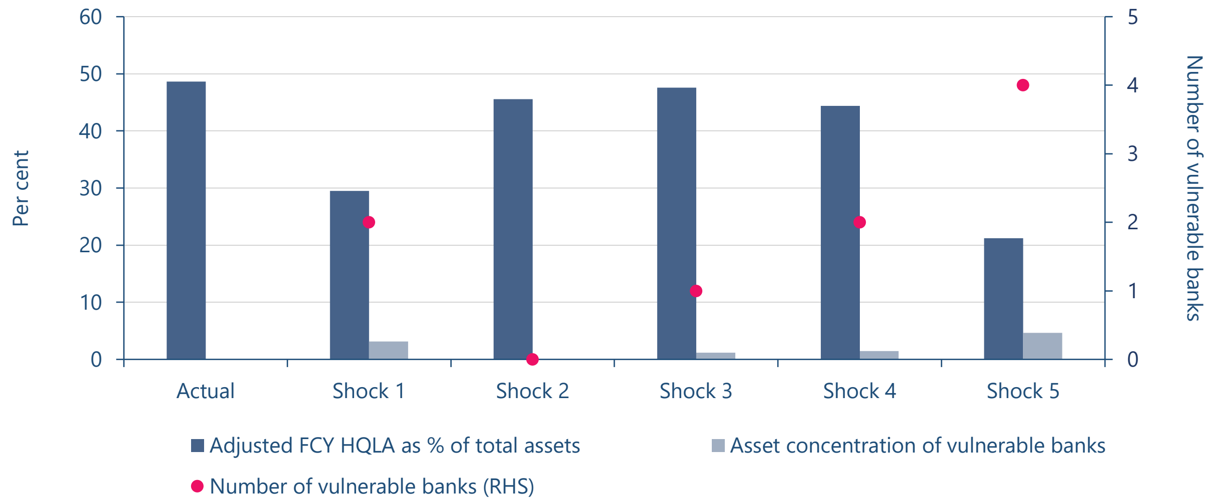
Table 6.2: Liquidity risk – FCY deposit withdrawals by GBCs

Shocks	Description
1	Assume 35 per cent one-off FCY 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

The results revealed that two banks would show signs of vulnerability when Shock 1 is applied. As for Shock 2 the Adjusted HQLA of all banks would remain resilient. Under Shock 3, one bank would have its Adjusted HQLA turned negative. Two and four banks would show signs of vulnerability under Shock 4 and Shock 5, respectively (Chart 6.4).

Chart 6.4: Liquidity risk – adjusted FCY HQLA



Source: Bank of Mauritius

Reverse stress test

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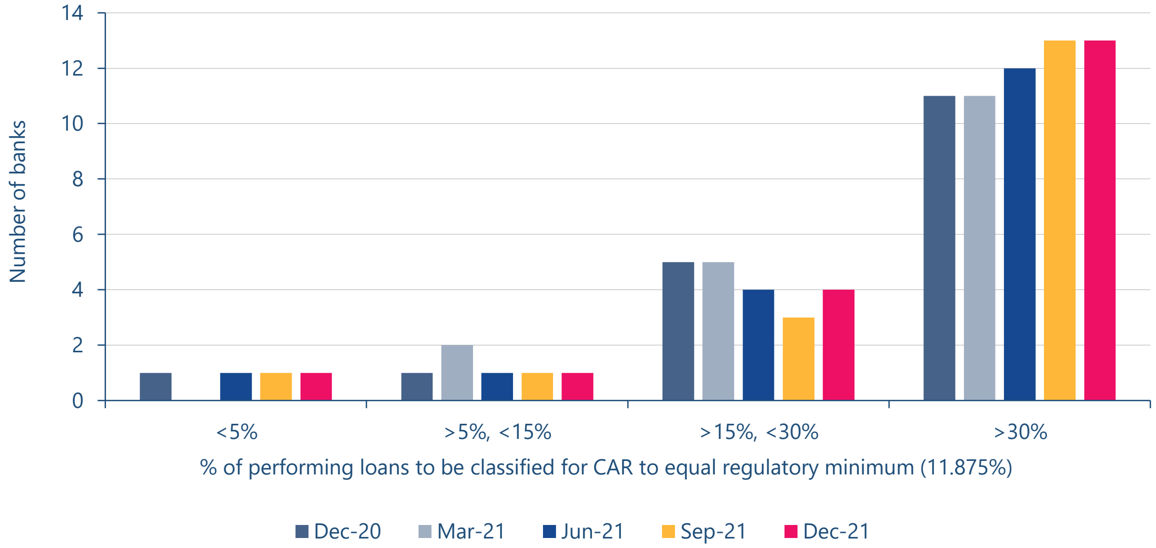
The reverse stress test examines the maximum percentage increase in NPL that each bank would be able to absorb for its CAR to fall to the regulatory minimum. The increase in NPL was based on each bank's performing credit portfolio.

Banks' capital buffers would be able to absorb shocks to their performing loans portfolio ranging from 2.6 per cent (1.0 per cent as at end-September 2021) to 176.4 per cent (398.5 per cent as at end-September 2021). It should also be noted that 17 out of the 19 banks would have to experience more than 15 per cent increase in their NPL for their CAR to drop to the regulatory minimum (Chart 6.5). One bank which was in the '>5%, <15%' bucket accounted for less than 5 per cent of market share while another bank falling into the '<5%' accounted for less than 5 per cent of the market share.

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

FSIs of other depository corporations [a, b, c]

Per cent

Core set of FSI	Sep-20	Dec-20	Sep-21	Dec-21[c]
Capital-based				
Regulatory capital to risk-weighted assets	19.9	19.7	20.7	20.7
Regulatory Tier 1 capital to risk-weighted assets	18.5	18.3	19.4	19.4
Non-performing loans net of provisions to capital	11.1	10.2	7.6	8.9
Common Equity Tier 1 capital to risk-weighted assets[1]	…	…	…	19.0
Tier 1 capital to assets[1]	…	…	…	9.1
Asset quality				
Non-performing loans to total loans[2]	6.1	6.2	5.3	5.8
Loan concentration by economic activity[1]	…	…	…	49.6
Provisions to nonperforming loans[1]	…	…	…	61.3
Sectoral distribution of loans to total loans[3]				
Interbank loans	2.8	4.3	4.9	…
Other financial corporations	9.8	9.6	9.1	…
Non-financial corporations	28.3	27.8	26.6	…
Other domestic sectors	22.0	22.0	22.3	…
Non-residents	37.1	36.3	37.0	…
Earnings and profitability				
Return on assets	1.1	1.0	1.3	1.3
Return on equity[4]	9.7	8.9	12.4	10.5
Interest margin to gross income[4]	68.2	69.0	66.6	65.9
Non-interest expenses to gross income[4]	43.3	44.1	45.9	44.6
Liquidity				
Liquid assets to total assets[4]	27.7	26.0	26.5	48.6
Liquid assets to short-term liabilities[4]	31.1	29.3	29.6	54.3
Liquidity Coverage Ratio[1]	…	…	…	236.3
Sensitivity to market risk				
Net open position in foreign exchange to capital	1.6	1.6	1.8	1.5

Per cent

Encouraged set of FSI	Sep-20	Dec-20	Sep-21	Dec-21[1]
Capital to assets[3]	10.6	10.8	10.3	…
Credit growth to private sector[1]	…	…	…	2.2
Value of large exposures[5] to capital	257.7	242.3	236.5	284.0
Customer deposits to total (non-interbank) loans	194.8	197.4	230.8	234.3
Residential real estate loans to total loans[2]	11.3	11.5	11.7	11.6
Commercial real estate loans to total loans[2]	5.1	5.4	5.5	5.4
Trading income to total income[4]	13.3	11.0	12.8	12.4
Personnel expenses to non-interest expenses[4]	45.6	51.1	45.3	47.6

[a] *FSIs prior to December 2021 were calculated on a domestic consolidation basis using the Financial Soundness Indicators Compilation Guide (2006) of the IMF.*

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

[c] *Effective December 2021, FSIs are computed based on the Financial Soundness Indicators Compilation Guide (2019) of the IMF. Some FSIs may, therefore, not be strictly comparable with those prior to December 2021*

[1]*New indicators introduced following the adoption of the Financial Soundness Indicators Compilation Guide (2019) of the IMF as from December 2021.*

[2]*Total loans include commercial loans, installment loans, hire-purchase credit, loans to finance trade credit and advances, finance leases, repurchase agreements not classified as a deposit, and overdrafts.*

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[3]*Indicators discontinued following adoption of the new Financial Soundness Indicators Compilation Guide (2019) of the IMF as from December 2021.*

[4]*Indicators amended following adoption of the new Financial Soundness Indicators Compilation Guide (2019) of the IMF as from December 2021. Hence, data may not be strictly comparable to quarters prior to December 2021.*

[5]*As from December 2017, the measurement of credit concentration ratio has been revised to aggregate large credit exposure (above 10 per cent of Tier 1 capital) as a percentage of aggregate Tier 1 capital. Hence, data are not strictly comparable with those prior to December 2017.*

… not available. Also, refer to footnote 5.

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Glossary

Annual change or growth *compares the value of a variable at one period in time with the same period of the previous year.*

Credit to private sector *has been aligned with the IMF FSI Compilation Guide (2019). Credit comprises loans and debt securities issued by private nonfinancial corporations and private sector encompasses private non-financial corporation, households and non-profit institutions serving households.*

Credit extended to households for other purposes *include purchase of other consumer durable goods, purchase of land, purchase of motor vehicles, education purposes, medical purposes, investment purposes, and other unspecified purposes.*

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.*

Corporate sector *comprises only Other Nonfinancial Corporations in Mauritius.*

Household indebtedness *considers a broader measure that adds up household credit from banks, NBDTIs, insurance and leasing companies.*

Non-performing loans ratio *is measured by the share of non-performing loans to gross loans.*

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Percentage point *is the arithmetic difference of two percentages.*

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

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

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.*

List of acronyms

ARA	Assessing Reserve Adequacy
AVR	Actuarial Valuation Report
Bank	Bank of Mauritius
CAR	Capital Adequacy Ratio
CET1	Common Equity Tier 1
D-SIBs	Domestic Systemically Important Banks
DTI	Debt-to-Income
EC	European Commission
EMDEs	Emerging Market and Developing Economies
EU	European Union
FATF	Financial Action Task Force
FCY	Foreign Currency
FDI	Foreign Direct Investment
FPI	Foreign Portfolio Investment
FSC	Financial Services Commission
FSIs	Financial Soundness Indicators
FSR	Financial Stability Report
FX	Foreign Exchange
GB	Global Business
GBCs	Global business corporations
GDP	Gross Domestic Product
GOIR	Gross Official International Reserves
HQLA	High-Quality Liquid Assets
IMF	International Monetary Fund
LCR	Liquidity Coverage Ratio
LTV	Loan-to-Value
MIFC	Mauritius International Financial Centre
MPC	Monetary Policy Committee
MSCI	Morgan Stanley Capital International
NBDTIs	Non-Bank Deposit-Taking institutions
NPL ratio	Non-Performing Loan ratio
NPLs	Non-performing Loans
ROA	Return on Assets
ROE	Return on Equity
Rs	Mauritian Rupee
RWA	Risk Weighted Assets
SMEs	Small and Medium Enterprises
SPEs	Special Purpose Entities
SRI	Systemic Risk Indicator
UK	United Kingdom
US	United States
US$	US dollar
WEO	World Economic Outlook

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