

1. Executive Summary

Global economic activity remained subdued and fragile. The International Monetary Fund (IMF) revised downward its estimates of world economic growth for 2013 and 2014 by 0.2 percentage point each to 3.1 per cent and 3.8 per cent, respectively. The downward revisions were more pronounced for major emerging economies, where growth slowed on the back of domestic capacity constraints, decelerating credit growth, and weak external conditions. The downside risks to the global growth outlook stem mainly from prolonged economic weakness in the euro area, excessive fiscal consolidation in the US as well as an extended slowdown in economic activity of emerging market economies.

The global financial environment has generally improved for most of the period since the February 2013 Financial Stability Report (FSR) on the back of strong commitment by authorities to support orderly market conditions. However, market volatility increased in June 2013, reflecting uncertainty about the eventual exit from monetary stimulus in the US. The impact of this announcement was mostly felt in emerging market economies, which experienced capital outflows, equity price declines, rising local yields and currency depreciation.

Although its main trading-partner countries registered weak economic growth, the domestic economy recorded a y-o-y growth rate of 3.7 per cent in 2013Q1 and is projected by Statistics Mauritius to grow by 3.3 per cent in 2013. From a short- to medium-term perspective, macroeconomic risks stem principally from a prolonged downturn in the euro area.

The current account deficit as a percentage of GDP at market prices, inclusive of cross-border transactions of global business companies (GBC1s), worsened from 5.3 per cent a year earlier to 8.2 per cent in 2013Q1. The persistently high current account deficit, funded principally through foreign capital flows, constitutes a key source of external vulnerability for the economy. Gross official international reserves increased by 21.2 per cent y-o-y to Rs105.0 billion as at end-June 2013, representing 5.6 months of imports. As a percentage of GDP, the country's gross external debt increased to 14.5 per cent as at end-March 2013 from 13.8 per cent as at end-March 2012. The Government has pursued its efforts towards fiscal consolidation in order to improve debt sustainability.

Though banks in Mauritius faced a difficult economic environment, they remained sound, generally profitable and well-capitalised. Private sector credit growth has increased and overall asset quality is relatively good. 'Construction' remains a vulnerable sector where the level of non-performing loans (NPL) requires close monitoring as the credit off-take, amid lacklustre construction activity, may pose financial stability concerns. Stress tests carried out by the Bank and the IMF indicated that the Mauritian banking system is well-capitalised and resilient against a range of shocks to its credit portfolios. Work towards the implementation of Basel III has progressed since the last FSR to further strengthen the banking sector.

Non-bank deposit-taking institutions (NBDTIs) proved to be resilient in 2012. According to the Financial Services Commission (FSC), the insurance sector performed relatively well in 2012 and maintained adequate buffer to withstand shocks that might affect its soundness. During 2013H1, the payment systems operated efficiently and transactions were generally settled on the system without delay and loss.

In the medium term, risks to financial stability in Mauritius continue to emanate from global economic and financial developments. The Bank continues to watch trends in private sector debt in Mauritius and the risks they may present to overall financial stability. The banking sector remains resilient and profitable, with adequate capital to withstand a range of shocks.