Financial Stability Report

June 2020

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FOREWORD

The Bank of Mauritius is issuing its first edition of the Financial Stability Report of 2020, which covers developments taking place in the first quarter of 2020, as well as updates related to the COVID-19 pandemic.

In line with its mandate*, the Bank of Mauritius' assessment of risks to financial stability with a view to identifying and mitigating vulnerabilities in the domestic financial system are underlined in this Report. The analysis provides insights into the resilience of the domestic financial system.

This Report is available on the Bank of Mauritius' website at: https://www.bom.mu.

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**As prescribed under Section 4(2)(b) of the Bank of Mauritius Act 2004, one of the other objects of the Bank of Mauritius is to ensure the stability and soundness of the financial system of Mauritius. A stable and sound financial system is a prerequisite for proper intermediation and allocation of funds in the economy, thereby being conducive to economic and financial development.*

1. Executive Summary

Global economic and financial conditions have deteriorated with the onset of the Covid-19 in early 2020. Globally, growth estimates have been revised downwards to negative levels and there are fears that the global economic contraction could mirror the one seen during the Great Depression of the 1930s. Cyclical sectors such as aviation, tourism, manufacturing and trade have been hard hit and the unprecedented scale of the global contraction has triggered fears of massive job losses worldwide. The subsequent lockdowns initiated in several countries on health and safety grounds to curtail the transmission of the disease have only accentuated the global economic meltdown. In its latest edition of the World Economic Outlook (WEO) of June 2020, the International Monetary Fund (IMF) projects global growth rate figures for 2020 to contract sharply by -4.9 per cent, 1.9 percentage points below its April 2020 projection, and worse than during the 2008–09 financial crisis.

Global financial market conditions tightened at the onset of the pandemic and exposed underlying vulnerabilities in the financial systems of some of the world's largest economies. Asset and commodity prices declined globally as investors exhibited greater risk aversion and headed for safer assets. These adverse financial market developments and a resulting spike in asset price volatility to levels seen during the 2008 Global Financial Crisis (GFC) negatively affected liquidity, which dried up in many money and foreign exchange markets. This had also threatened to impede effective credit allocation by banks as credit conditions became tighter. However, investor risk aversion somehow pacified in late March-early April 2020 as policy measures were being enacted globally to contain the fallout of the pandemic, with financial markets partially recovering.

Policy responses proposed by authorities worldwide have been swift, timely and targeted. One of the main worries of decision-makers worldwide was that massive disruptions to the real sector could uncover underlying weaknesses in the financial system and trigger financial distress with potential feedback effects on the real sector. Thus, policy measures were essentially aimed at curtailing this feedback loop between the real and financial sectors, while keeping macro-fiscal risks at bay. Many countries have lowered their policy rates and implemented large-scale market stabilization programs, which consisted of massive liquidity injections to support their money-markets as well as banks. In many instances, given the low interest rate environment, countries have had recourse to unconventional monetary policy through the lens of quantitative easing programs, helicopter money drops, forward guidance, negative interest rates and yield curve control, to name a few. In other instances, support was geared at sustaining the flow of credit, as well as in alleviating the burdens of existing borrowers through moratoriums and various loan-restructuring packages.

International organizations such as the IMF have recommended countries to draw from their existing capital and liquidity buffers to weather the storm and contain the disruptive effects on the financial health of their banks. The Bank of International Settlement has advocated more flexibility in the application of regulatory and accounting guidelines with regards to loan impairment. Governments have also been steadfast with initiating fiscal support in the form of tax relief measures, as well as wage assistance programs for those who were furloughed or made redundant.

The openness of the Mauritian economy and its relatively high dependence on tourism, manufacturing, and trade make it vulnerable to the pandemic. Both demand-side and supply-side indicators are pointing towards contraction of economic activities more generally, with possible disruptions on the labour market. On the supply-side, the decision to instigate a lockdown period of nearly ten weeks had had its toll on businesses involved in the above sectors, as well as small enterprises which suffered direct revenue shortfalls. The demand side indicators are likely to suffer major setbacks as well: consumption has been constrained during the lockdown, private investment is likely to suffer as businesses have lower profits to plough back into investment projects and exports have taken a hit with closure of borders. With lower personal disposable income and revenue, private borrowers are likely to face mounting debt-servicing constraints without some form of assistance from the authorities.

Similar to developments taking place elsewhere, the domestic stock market felt the full force of the COVID-19 pandemic, with the SEMDEX falling substantially prior to the lockdown and recovering to some extent after re-opening. The rupee depreciated, in line with international currency movements and a fall in domestic market turnover. Rupee liquidity was allowed to build up in the banking system to support the flow of credit.

So far, the financial system in Mauritius appears to be resilient to the pandemic. Banks in Mauritius enjoyed relatively high capital and liquidity buffers prior to the COVID-19 pandemic. The loan portfolio of banks was relatively more skewed towards financial services prior to the pandemic and Non-Performing Loans (NPLs) in affected sectors such as tourism were low and well covered. Furthermore, banks were primarily funded through deposits and enjoyed relatively high Liquidity Coverage Ratios. The Bank of Mauritius (Bank) conducted a survey on risks facing banks during the lockdown in early April 2020. So far, it can be concluded that resilience of the banking system can be supported by three main mechanisms: (a) bold measures that were, both, targeted and timely taken by the authorities; (b) adequate capital and liquidity buffers in the banking system; and (c) prudential measures already followed by banks to deal with 'black swan' contingencies, e.g., liquidity and capital restoration plans. Banks did not witness any major changes to their funding structure or to their liquidity situation during the lockdown.

While risks to banks have increased in the wake of the pandemic, stress tests results show that, so far, (a) banks appear to have adequate liquidity coverage as depicted by the Liquidity Coverage Ratio (LCR) and there seems to be no disruptions to funding. In fact, funding in the form of deposits rose during the lockdown. And, (b) although solvency may take a hit with the crisis, banks appear to have adequate buffers to weather the storm. However, if the ripple effects of the crisis remain sustained for a long period of time, some banks appear to be more vulnerable than others.

On the non-bank financial sector front, the Financial Services Commission (FSC) is closely monitoring risks and potential build-up of vulnerabilities. The largest Life Insurance Companies may potentially suffer a deterioration in their solvency margin situation due to their exposure to equity investments in companies operating in industries affected by the pandemic. However, stress test results show that they are broadly able to absorb a foreseeable increase in default interest payments caused by the COVID-19 situation. The situation regarding the Global Business (GB) sector is equally being monitored, given its importance in funding the banking system and the Balance of Payments. The impact of the COVID-19 crisis on the GB sector is largely contingent on the speed and success of recovery efforts in key partner countries, both, those of origin and those to whom the Global Business Corporations (GBCs) flows are channelled. The categorization of Mauritius in the list of 'jurisdictions under increased monitoring' by the Financial Action Task Force (FATF) and the country's black listing by the European Union (EU) may also entail risks to the sector in the absence of remedial measures. However, the Mauritian authorities remain determined to address any deficiencies that remain so as to improve the rating category of the country and salvage the reputation and integrity of the jurisdiction.

The Mauritian authorities have been steadfast in proposing bold, timely and targeted measures to contain the impact of the pandemic and of the lockdown. The Bank has implemented a number of financing options, and has reviewed its regulatory and supervisory measures through schemes designed to financially assist borrowers who are most likely to be affected by the crisis. On the financing front, the Bank lowered its Key Repo Rate (KRR) on two occasions from 3.35 to 2.85 per cent in March 2020 and from 2.85 to 1.85 per cent in April 2020, and came up with a Special Relief Fund of Mauritian Rupee (MUR) 5 billion to assist the most affected sectors. The Cash Reserve Ratio has been reduced from 9 per cent to 8 per cent so as to increase the supply of loanable funds of banks. Foreign currency funding facilities have been made available through banks to exporters and importers. On the regulatory and supervisory fronts, the Bank has reviewed its risk weight for certain categories of exposures and has temporarily put on hold its guideline on income recognition and loan impairment as well as its debt-to-income ratio requirement. Furthermore, banks have been encouraged to be flexible with respect to the application of IFRS9. Banks have also been encouraged to provide moratoriums to existing borrowers to help them contain the effects of the shock on their indebtedness level, with the proviso that these moratoriums would not entail penalties in the Mauritius Credit Information Bureau.

Likewise, the Government of Mauritius has introduced fiscal support measures such as wage assistance schemes for those made redundant or furloughed. In addition, various financing schemes have been proposed through the nexus of state-owned financing enterprises to assist businesses most affected by the pandemic.

The COVID-19 (Miscellaneous Provisions) Bill amended the Bank of Mauritius Act so that the Government of Mauritius may be granted amounts required to assist in its fiscal measures to stabilize the economy. The Bill also made provision for necessary amounts of the official foreign reserves to be used in a newly-created company, the Mauritius Investment Company, which would be set up to provide equity and quasi-equity funding to the affected sectors and to facilitate economic development.

The Bank is monitoring the evolution of the major risk indicators for the banking and non-bank deposit-taking sector. It stands ready to take any additional measures it deems appropriate to maintain the stability of the financial system and to mitigate any adverse impact on the economy.

2. Global and Domestic Macro-Financial Linkages

2.1 The Global Economy

The COVID-19 pandemic has triggered global challenges on the health, economic and financial stability fronts. As the pandemic began to work its way contagiously across borders claiming a huge toll of lives, public health and safety became a priority and countries proceeded with large-scale lockdowns / confinement periods. While checking the spread of the pandemic was salutary, the economic costs blew out of proportion and represented a major challenge for policymakers worldwide. While the pre-COVID-19 period saw global growth averaging 3 per cent, the outlook for 2020 has swung to negative territory, with estimates of economic contraction ranging anywhere from negative 3 to 5 per cent – worse than that witnessed during the 2008 GFC and close to those of the Great Depression of 1930s. At the onset of the pandemic, it was feared that economies with weaker healthcare systems, relatively older population, limited fiscal space, and with highly open cyclical sectors such as trade and travel would be affected and face relatively slower recovery prospects. As the crisis unfolded, it became conspicuous that the duration of the crisis and the timing of a recovery to pre-COVID-19 levels were highly uncertain, in view of the staggered and unsynchronized phases of the pandemic across different countries.

While the crisis was unfolding and the decision to instigate a lockdown period was being imposed in several parts of the globe, financial markets experienced heightened vulnerability amidst significant investor risk aversion. The USD funding market in several jurisdictions showed signs of strain, with liquidity drying up and yield spreads spiking to around the highest levels seen since the GFC. The corporate bond markets sold off as investors searched for liquidity. After broad-based expansion recorded in the previous years, global equities suffered steep declines in March 2020, while government bond yields fell as investors favoured safer assets and central banks pursued more accommodative monetary policies. Prompt actions by the Federal Reserve to increase dollar funding and shore up the US corporate bonds market, as well as the operations undertaken by other major central banks to support their domestic markets ultimately calmed investor fears, leading to partial recoveries in most asset markets.

Oil prices, which initially plunged as the spread of coronavirus across border weakened the outlook for global demand and the agreement among the major oil producers to constrain supply broke down, have recovered somewhat. Gold prices, on the other hand, shot up to historical highs as market volatility triggered flows into the safer havens. They continue to benefit from the volatile and uncertain financial environment.

The decisions to impose a lockdown period had its toll on household and business sectors globally. In many parts of the world, the prospects of escalating unemployment as businesses suffered from severe turnover shortfalls in the face of fixed financial contractual commitments raised the risk of growing inability of borrowers to service, roll-over and repay their debt – thus, raising the prospect of widespread default. Businesses were badly impacted by tightening financial market conditions, which accentuated the risk of a more pronounced negative feedback loop between real sector developments and financial stability considerations. In turn, deteriorating household and corporate fundamentals coalesced to tighten credit market conditions and to put growing pressures on banks, which subsequently become exposed to deteriorating loan portfolios.

European economies - the main trading partners of Mauritius - have suffered from important economic setbacks as a result of the pandemic and of the subsequent lockdown instigated in Europe. Although economic activity in the Eurozone seems to have begun to recover in June 2020, as confirmed by improvements in high frequency data and business surveys conducted in May 2020, growth figures have been revised downwards and are now hovering in negative territory in countries such as France, Germany and the United Kingdom (UK). Increased financial vulnerabilities may undermine the European financial system, which was already fragile before the crisis. Embedded macro-fiscal risks could easily morph into macro-financial vulnerabilities. Indeed, government debt exceeded 90 per cent of Gross Domestic Product (GDP) in several Euro area countries in 2019, and is likely to increase as many countries have engaged in massive unconventional monetary accommodation and generous fiscal support programs.

China, another important trading partner of Mauritius, is gradually recovering after having experienced sharp contractions in January and February 2020 due to lockdown. So far, Chinese banks appear to be able to weather the storm due, in part, to the success of policy measures. The non-bank financial sector appears vulnerable to materialization of credit and liquidity risks as these could percolate through the complex networks of interconnectedness tying banks and non-bank financial sector to conglomerates. The latest survey data in China suggests that economic growth accelerated in June 2020 thanks to a faster recovery in manufacturing and services, alongside continued strength in construction activity.

Emerging Market Economies (EMEs) were not spared from the ripple effects of this global meltdown. EMEs with relatively high amounts of external funding in the form of foreign currency portfolio investments or foreign currency debt topped the list of fragilised economies, given their relatively high propensity to be affected by tight global financial conditions. To illustrate, over 90 countries have requested for emergency financial assistance from the IMF in April 2020.

Globally, the reaction of Central Banks has been swift to prevent real shocks from undermining any existing underlying fragilities and/or from triggering financial vulnerabilities. Containing the feedback loop between the real, fiscal and financial segments of the crisis chain formed the core element of any Central Bank stimulus package program. Indeed, Central Banks have come up with bold measures aimed at repairing distorted money and credit markets, and at restoring the flow of credit in the economy. In many cases, the low interest rate environment has proved to be challenging and prospects to steer the economy through the traditional conduits of the transmission mechanism have proved to be futile. In some instances, Central Banks have resorted to foreign-currency swap lines to provide dollar funding in domestic markets as dollars became scarce. This topped up unconventional monetary stimulus packages such as quantitative easing, helicopter drops of money, forward guidance, negative interest rates and yield curve control strategies that many Central Banks have instigated to inject liquidity in the banking system and manage expectations of financial market participants. These efforts were also complemented by bold measures to help businesses and households weather the storm through temporary freezes or moratoriums on loan repayments, as well as appropriate loan restructuring through refinancing and foreclosure.

Bank supervisors have also encouraged banks to use their existing capital and liquidity buffers as first line of defence to check the transmission of real shocks to banks' balance sheets. In some cases, regulatory bodies have showcased more flexibility in the application of their guidelines / rules on loan impairment so as to offer banks greater breather in managing the large scale of restructured loans. Government authorities have also extended sizeable, timely and targeted financial assistance to households and businesses that are most likely to be affected by the pandemic so as to limit the risk of potential defaults from contaminating the financial system. In many countries, relief in the form of temporary tax holidays, grants and guarantees on loans have been offered.

As a response to the pandemic and to subsequent lockdown measures, financial institutions worldwide have also shored up their business continuity contingency plans by making provisions in their operational framework for their staff to work remotely. While operational capacity has fallen in many countries as it became more difficult to on-board new clients during the lockdown and undertake due diligence, countries and financial systems, at large, became more vulnerable to the risk of cyber-attacks.

The second quarter of 2020 is gradually seeing an improvement in sentiment, as the size and speed of the global policy response to the economic fallout of the pandemic gave investors confidence to move out to riskier assets. The United States (US) Federal Reserve Board, for example, has added USD3 trillion to its balance sheet—more than the UK's entire 2019 GDP—in just three months. The European Central Board, already dovish pre-crisis, turned even more accommodative as it launched a Euro750 billion Pandemic Emergency Purchase Program, expected to last until the coronavirus crisis period is over.

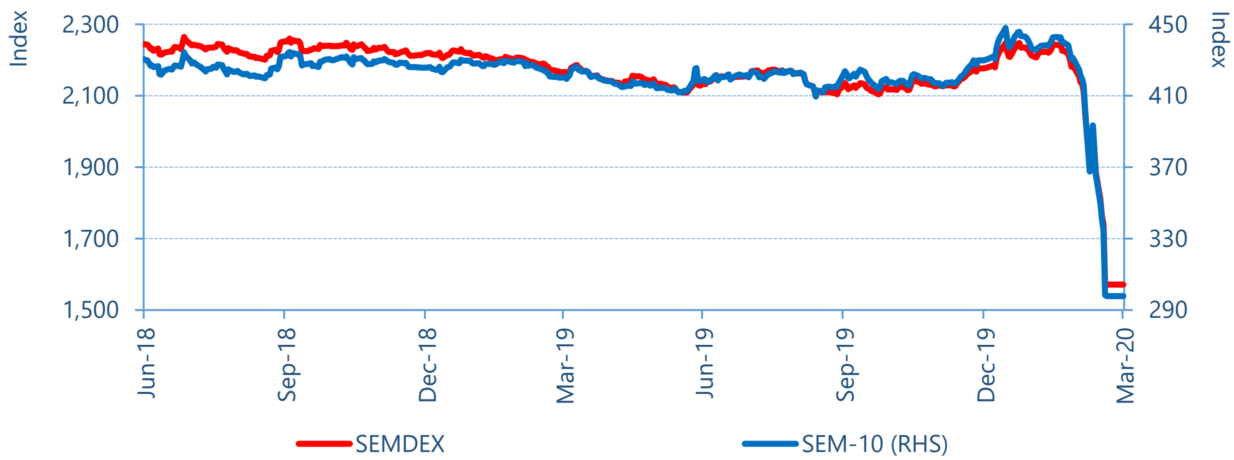
Entering in the second half of 2020, uncertainty abounds with both upside and downside risks to economic outlook. On the upside, better news on vaccines and treatments, and additional policy support can lead to a quicker resumption of economic activity. On the downside, further waves of infections can reverse increased mobility and spending, and can rapidly tighten financial conditions, triggering debt distress. Geopolitical and trade tensions could damage fragile global relationships at a time when trade and growth is projected to collapse.

2.2 The Domestic Economy

The relatively high degree of openness of the Mauritian economy and the high degree of *'euro centrism'* make the economy vulnerable to adverse developments taking place abroad and to lockdowns in main trading partner countries. As the national lockdown started in March 2020, several sectors of the economy (mostly the cyclical and open-oriented ones such as tourism, manufacturing and trade) were deemed to take a hit. This was also applicable to the value-chains that depend on these sectors (for instance, the national airline, Air Mauritius, which provides over 50 per cent of tourists to hotels in Mauritius, as well as travel agents, restaurants, tour operators, amongst others). The lockdown also took its toll on the activities of Small-and-Medium Enterprises (SMEs) whose turnovers suffered from serious shortfalls.

The domestic stock market was significantly affected by the onset of Covid-19, as illustrated in Chart 2.1. Whilst both the SEMDEX and the SEM-10 were on a rising trend at the start of the year, the spread of the pandemic contributed to panic reactions from stockholders and resulted in massive selling at depressed prices. The hospitality industry as well as banks were among those sectors that suffered the most. The domestic stock market suspended operations on 20 March 2020, in line with the nation-wide imposed lockdown, and resumed trading on 6 April 2020. The SEMDEX reached a low of 1,571 in March 2020 before partly recovering upon resuming its activities. The SEM-10, comprising the 10 most capitalized stocks on the Official Market, closely tracked the movements of the SEMDEX.

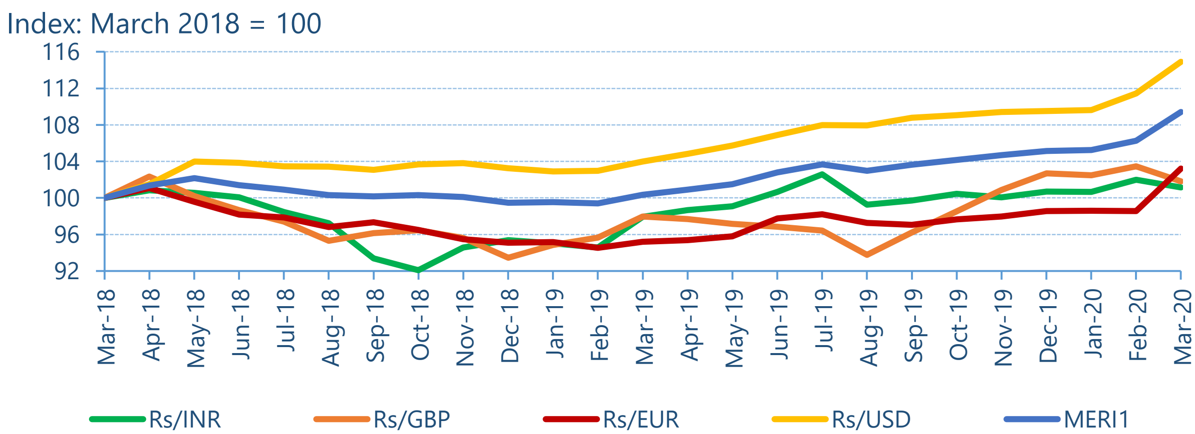
Chart 2.1: Evolution of SEMDEX and SEM-10



Source: Bank of Mauritius

With the country entering into national confinement as from 20 March 2020, daily foreign exchange turnover decreased markedly, particularly in the manufacturing and accommodation sectors. Coupled with an appreciation of the USD against the Euro and other major currencies on international markets throughout most of March and April 2020, this led to a depreciation of the rupee, as illustrated in Chart 2.2. Compared to the end of December 2019, the MUR lost 4.7 per cent, 4.5 per cent and 0.9 per cent, respectively, against the USD, Euro and Pound sterling at the end of March 2020. The currency-weighted nominal exchange rate (MERI1) also depreciated in the first quarter of 2020.

Chart 2.2: Evolution of the Rupee and MERI1

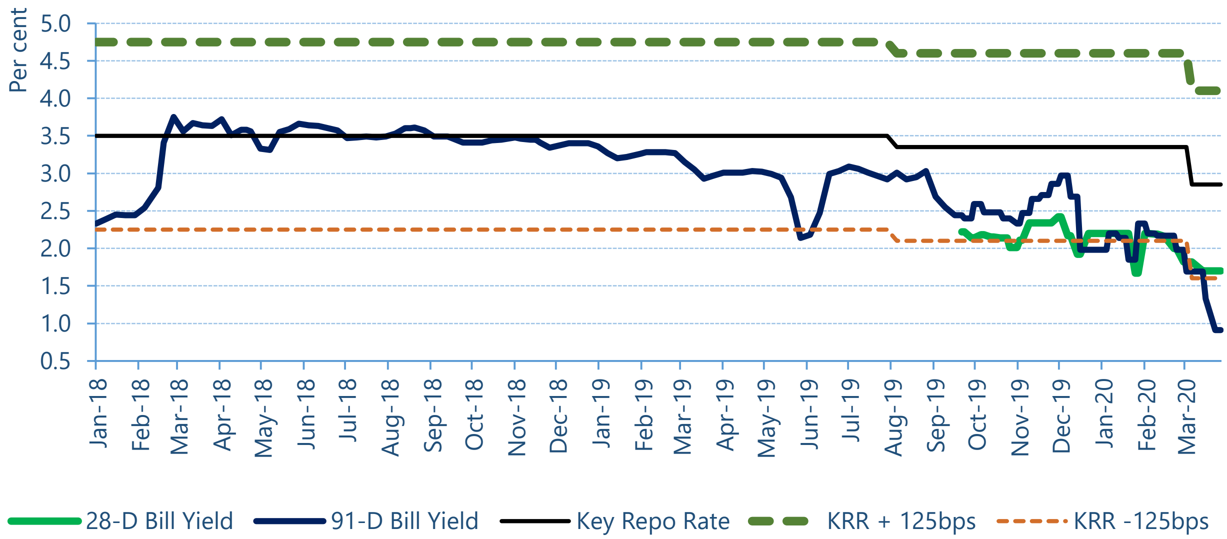


Source: Bank of Mauritius

With the objective of preventing real sector shocks from propagating to the financial sector in an environment characterized by relatively limited fiscal space, the authorities in Mauritius were steadfast in enacting bold measures that were, both, targeted and timely. The Bank reduced the KRR by 50 and 100 basis points in March and April 2020, respectively, and generally allowed MUR liquidity to build up into the banking system to help maintain the flow of credit in the domestic economy. MUR excess liquidity hovered on average at around MUR16.3 billion during the first quarter of 2020, compared to MUR11.3 billion in the last quarter of 2019. Effective 13 March 2020, the Bank reduced the Cash Reserve Ratio applicable on rupee deposits from 9 per cent to 8 per cent, thus releasing approximately MUR4.3 billion which was credited to a Special Account at the Bank. Banks can use these particular balances for any facility to be granted to any impacted economic operator.

Short-term yields moved down, reflecting both the cumulative decrease of 150 basis points in the KRR and the substantial amount of liquidity available on the domestic money market. The 91-Day yield reached a low of 0.91 per cent in the first quarter of 2020. (Chart 2.3)

Chart 2.3: Monetary Policy Framework



Source: Bank of Mauritius

The Bank additionally proposed a swathe of measures designed to assist banks financially and to provide a breather in the form of moratoriums to existing borrowers, some of whom would otherwise financially struggle given their revenue shortfall, or having been furloughed or made temporarily redundant. Other measures proposed by the Bank included provision of foreign currency facilities to exporters and importers through banks, temporary suspension of the guideline dealing with income recognition and loan impairment, as well as amendments to other guidelines dealing with requirements with regard to debt servicing.

The Mauritian government has shown its determination to weather the storm by coming up with a range of fiscal support measures[1] such as wage assistance schemes for the unemployed, as well as financial support by other non-bank state-owned developmental or investment institutions, such as the Development Bank of Mauritius (DBM) and the State Investment Company (SIC). The 2020-2021

[1] Please refer to Box 1 for a summary of measures taken by the authorities to mitigate the adverse consequences of the crisis.

Budget contained additional measures designed to facilitate provision of funding to affected companies. The new company set up by the Bank as a Special Purpose Vehicle, the Mauritius Investment Company (MIC), which will furnish equity or quasi-equity type of financing to affected companies, is expected to play a major role in sustaining the large affected companies going forward.

Whether these measures will suffice going forward, will ultimately depend upon the magnitude, duration and intensity of the pandemic, as well as on the speed and shape of economic recovery prospects worldwide. The authorities have expressed their commitment to undertake whatever is required to address economy-wide restructuring and support the recovery prospects.

The GBC Sector, an important source of funding for banks in Mauritius, has been subject to a shockwave in the first quarter of 2020 through the country's classification in the list of "Jurisdictions under Increased Monitoring" by the FATF and through the black-listing by the EU. As a result, Mauritius has promptly formulated and agreed upon a detailed action plan with the FATF, with specific deadlines to remedy the identified shortcomings. Noteworthy of being mentioned is that, out of a total of fifty-eight recommended actions, Mauritius has only five remaining actions to implement by September 2021.

Mauritius is currently implementing its action plan which aims to address the strategic deficiencies that have been identified, namely by:

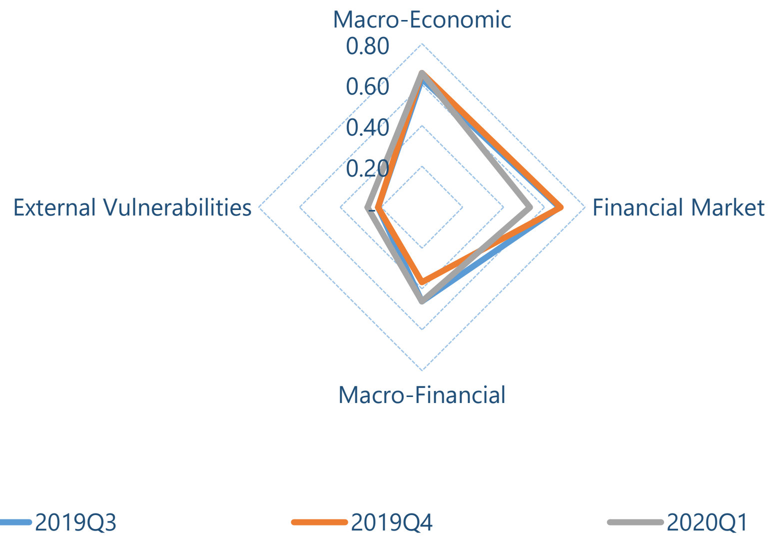
- demonstrating that the supervisors of its GBC sector and of the Designated Non-Financial Business and Professions sector implement risk-based supervision;
- ensuring access to accurate basic and beneficial ownership information by competent authorities in a timely manner;
- demonstrating that Law Enforcement Agencies have capacity to conduct money laundering investigations, including parallel financial investigations and complex cases;
- implementing a risk based approach for the supervision of Non-Profit Organization sector to prevent abuse for Terrorist Financing purposes, and
- demonstrating the adequate implementation of targeted financial sanctions through outreach and supervision.

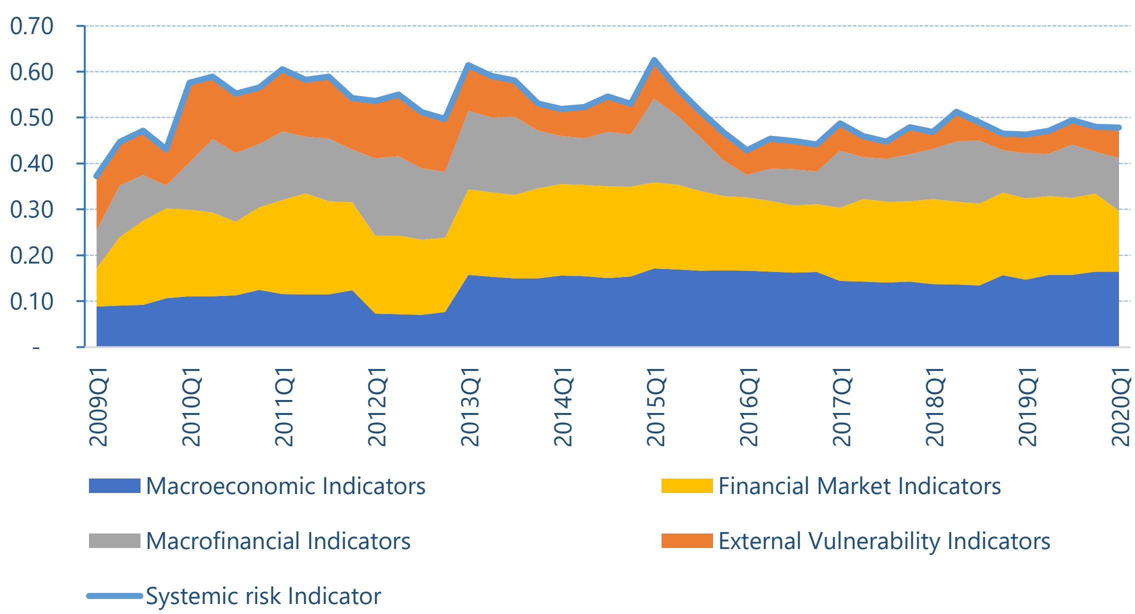
Mauritius remains wholly committed to uphold the integrity of the domestic financial system. In this regard, the FSC is prioritizing its work in order to address all of the action points recommended for the GBC sector ahead of the set timeline. This work is focused on demonstrating the implementation of risk-based supervision of the GBC sector by way of a comprehensive onsite inspection schedule and taking enforcement action against non-compliance. The FSC is engaged in revising its staffing targets in response to the revised on-sites targets and is providing ongoing training on Anti-Money Laundering and Terrorist Financing (AML/CFT) risk based supervision to existing and new staff. The FSC is also collaborating with the industry to promote the understanding of AML/CFT risks and obligations through proper outreach and guidance to its licensees.

2.2.1 *Systemic Risk Indicator*

The Systemic Risk Indicator (Chart 2.4) shows that, just before the country instigated the lockdown, main sources of vulnerabilities to the financial system were essentially stemming from the financial markets, because of adverse global financial market developments in February-March 2020, which saw global investors rally for safer assets in a quest to re-allocate their portfolios.

Chart 2.4: Systemic Risk Indicator[2]





Source: Bank of Mauritius

[2] The systemic risk indicator covers the first quarter of 2020. It does not cover subsequent months due to lack of data at the time of writing.

Box 1: Measures taken by Government and Bank of Mauritius following the outbreak of the COVID-19 Pandemic

The World Health Organization declared the new coronavirus 2019 (COVID-19) as a pandemic on 11 March 2020. In view of the threat posed by the spread of the virus to all economic sectors, the Government of Mauritius and the Bank promptly implemented various fiscal and monetary measures to support households and businesses.

Measures taken by the Government:

1. The Government Wage Assistance Scheme (GWAS) and the Self-Employed Assistance Scheme (SEAS) were introduced during confinement. Under the GWAS, eligible employers benefited from financial support for salaries of employees drawing a monthly basic wage of up to MUR50,000, covering the months of April and May 2020. Under the SEAS, self-employed individuals were entitled to receive an amount of MUR5,100 per month for the period from 16 March 2020 to 30 April 2020. These schemes continue in various forms today.

2. Government introduced a host of financial measures to support businesses. The Investment Support Programme Ltd (ISP), a body set up under the aegis of the Ministry of Finance, Economic Planning and Development, supports businesses through financial, leasing and factoring schemes. Additional support in the form of reduced interest rates is provided through the SME Factoring Scheme and the Leasing Equipment Modernisation Scheme. The ISP also issued corporate guarantee to banks to enable them grant loans to companies affected by COVID-19. Under the SIC Equity Participation Scheme, businesses were given the possibility of obtaining additional funding in the form of additional equity by issuing preference shares to SIC. The SIC also provides up to 50 per cent guarantee to existing loans of SMEs. The SME Equity Fund Ltd reduced its minimum return dividend rate requirement on equity/quasi-equity financing from 6 per cent to 3 per cent up to 31 December 2020.

3. The DBM introduced certain measures for enterprises having an annual turnover of up to MUR10 million, to assist them in reducing liquidity and cash flow pressures.

4. The Mauritius Revenue Authority removed penalties or interest for late submission of return/statements due to the lockdown. Companies affected by COVID-19 were entitled to double tax deduction for their investment made in plant and machinery for the period March to June 2020. Individuals and companies, which donated to the COVID-19 Solidarity Fund, were declared eligible to claim deduction for the amount contributed.

Box 1: Measures taken by Government and Bank of Mauritius following the outbreak of the COVID-19 Pandemic (continued)

Measures taken by The Bank of Mauritius:

1. To support economic operators, the Bank reduced the KRR by 50 basis points from 3.35 per cent to 2.85 per cent in March 2020, and by 100 basis points, from 2.85 per cent to 1.85 per cent per annum in April 2020. The Cash Reserve Ratio was also reduced from 9 to 8 per cent to allow banks to further assist businesses directly impacted by COVID-19.

2. A special relief amount of MUR5 billion was provided to economic operators, including SMEs in all sectors of activities, to meet cash flow and working capital requirements. Interest, initially fixed at 2.5 per cent per annum, was later reduced to 1.5 per cent per annum; a two-year repayment period was given with a moratorium of 6 months on capital and interest repayments.

3. The Bank allowed households a moratorium of six months on capital repayments on their existing household loans as from 1 April 2020. For low-income groups, the Bank offered to bear the interest payable on outstanding loans for the period 1 April to 30 June 2020.

4. The Bank provided a USD/MUR swap arrangement with commercial banks for an initial amount of USD100 million to enable commercial banks to support import-oriented businesses, except for the State Trading Corporation (STC), which would deal directly with the Bank for its foreign currency requirement.

5. A Special Foreign Currency Line of Credit of USD300 million was provided to operators, including SMEs, having foreign currency earnings.

6. The Bank introduced a 2.5 per cent Two-Year Bank of Mauritius 2020 Savings Bond for an amount of MUR5 billion, with the aim of further assisting depositors to diversify their savings portfolio.

7. Regulatory measures taken by the Bank included putting on hold of the Guideline on Credit Impairment Measurement and Income Recognition, which was introduced in January 2020. The objective was to allow commercial banks to support enterprises facing cash flow and working capital difficulties. The Bank has also reviewed two other of its guidelines, namely the Guideline on Standardised Approach to Credit Risk and the Guideline on the Computation of Debt-to-Income Ratio for Residential Property Loans. With relation to its Guideline on Scope of Application of Basel III and Eligible Capital, the Bank has deferred the implementation of the last tranche of the Capital Conservation Buffer (CCB) amounting to 0.625 per cent to 1 January 2021. These measures are aimed at releasing more capital to banks whilst also giving them more flexibility in terms of funding capacity and support they can provide to customers.

Box 1: Measures taken by Government and Bank of Mauritius following the outbreak of the COVID-19 Pandemic (continued)

COVID-19 (Miscellaneous Provisions) Bill:

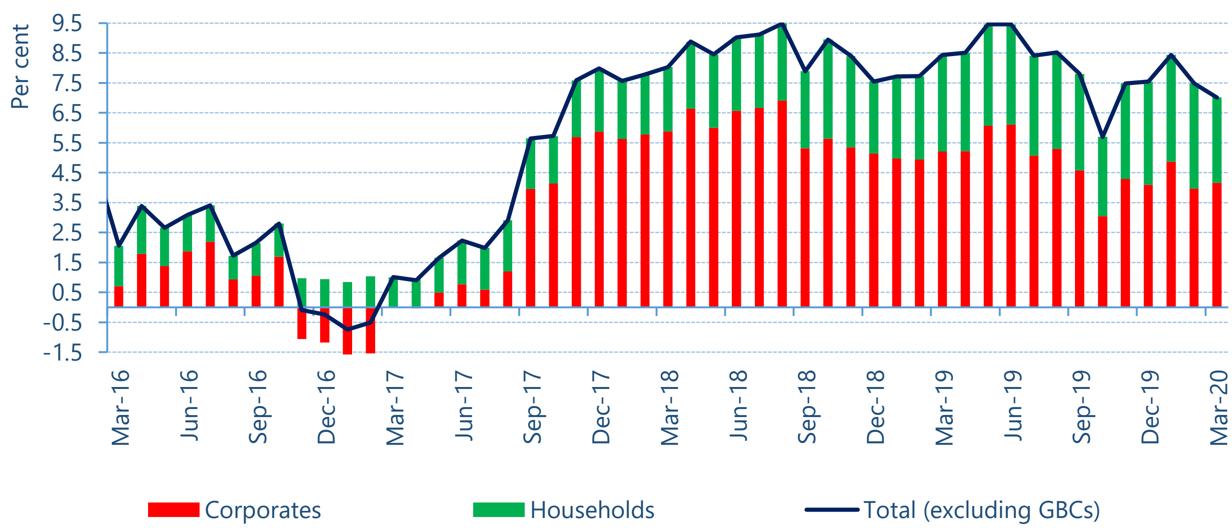
1. The COVID-19 (Miscellaneous Provisions) Bill amended the Bank of Mauritius Act so that the Government may be granted amounts required to support its fiscal measures to stabilize the economy. The Bill also made provision for necessary amounts of the official foreign reserves to be channelled through a newly created company, the MIC. The MIC will provide support to affected domestic systemic economic operators through a range of equity/quasi-equity instruments in view of ensuring that they are kept afloat during these challenging times and that jobs are preserved.

3. Financial Soundness of Households and Corporates – Debt Indicators[3]

The slowdown in economic activity arising from the Covid-19 pandemic pose substantial challenges to credit growth and credit quality, which the Bank is trying to mitigate through the specific measures taken to support the flow of credit in the economy. Potential vulnerabilities in lending activities have increased from both the demand and supply sides perspectives. The demand for credit is likely affected by revenue and income shortfalls, while banks are prone to exercise greater caution in the supply of credit.

Bank credit to the private sector has continued to expand, but the pace of acceleration has slowed in 2020Q1. Annual growth in bank credit (excluding GBCs) moderated from 9.5 per cent in June 2019 to 5.5 per cent in October 2019, before picking up to 8.5 per cent in February 2019 and slowing down to 7.0 per cent in March 2020. Corporates have historically accounted for the brunt of year-on-year (y-o-y) changes in credit to the private sector (Chart 3.1).

Chart 3.1: Contribution to y-o-y Growth of Credit to the Private Sector



Note: Credit extended to corporates include Public Corporations.
Source: Bank of Mauritius

Private sector credit to GDP ratio stood at 71.6 per cent in March 2020, of which 22.6 per cent was attributable to household credit (representing 31.6 per cent of total private sector credit) and 48.9 per cent was attributable to corporate credit (representing 68.4 per cent of total private sector credit).

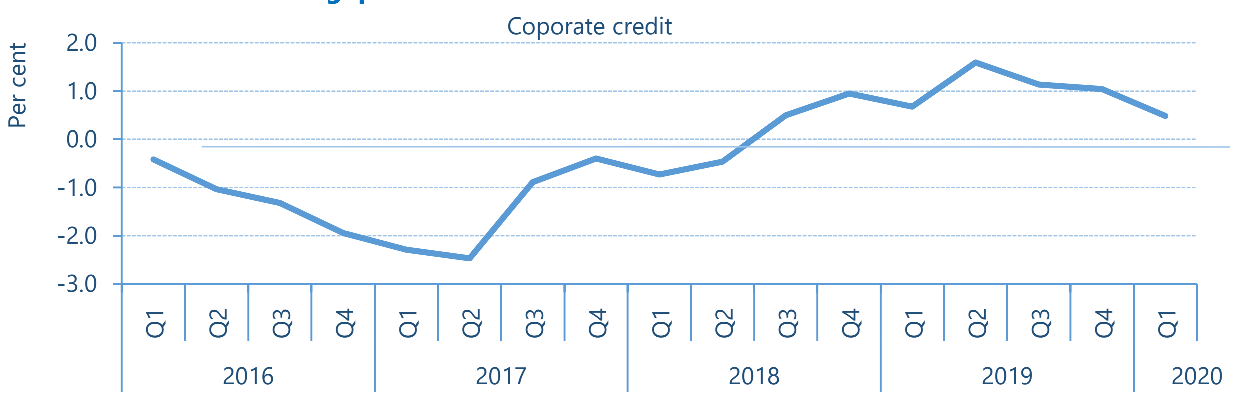
Total corporate debt grew by around 4.9 per cent as at end-March 2020 compared to a growth of 9.7 per cent as at end-June 2019. Corporates continue to have a preference for domestic financing, with the ratio of domestic corporate debt to total corporate debt slightly up from 91.3 per cent as at

[3] Analysis in this chapter is based on data as reported by banks, unless stated otherwise.

end-June 2019 to 91.5 per cent in as at end-March 2020. External debt of corporates, which accounts for around 8.5 per cent of total corporate debt, contracted by 0.6 per cent as at end-March 2020 (Table 3.1). The decline in the external debt stock contributed to the improvement of external debt matrices such as external corporate debt-to-GDP ratio and external debt to Gross Official International Reserves ratio.

The Credit-to-GDP gap – a leading indicator of vulnerability – has eased, reflecting the deceleration of growth of credit extended to the private sector, and to the corporate sector in particular. The continuous drop in the Credit-to-GDP gap point to deleveraging by corporates in some sectors such as 'Agriculture', 'Construction', 'Manufacturing' and 'Professional, scientific and technical activities'. (Chart 3.2)

Chart 3.2: Credit-to-GDP gap

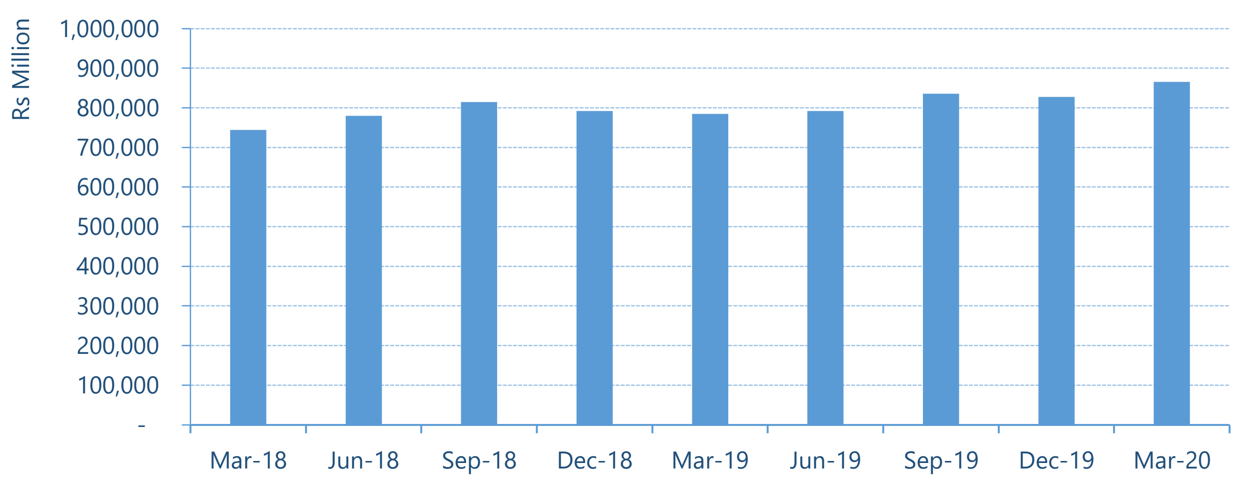


Source: Bank of Mauritius

3.1 Overall Credit and Sectoral Impairment situation

Total Private Sector Credit has improved over the last two quarters to stand at approximately MUR865,871 million as at end-March 2020. (Chart 3.3)

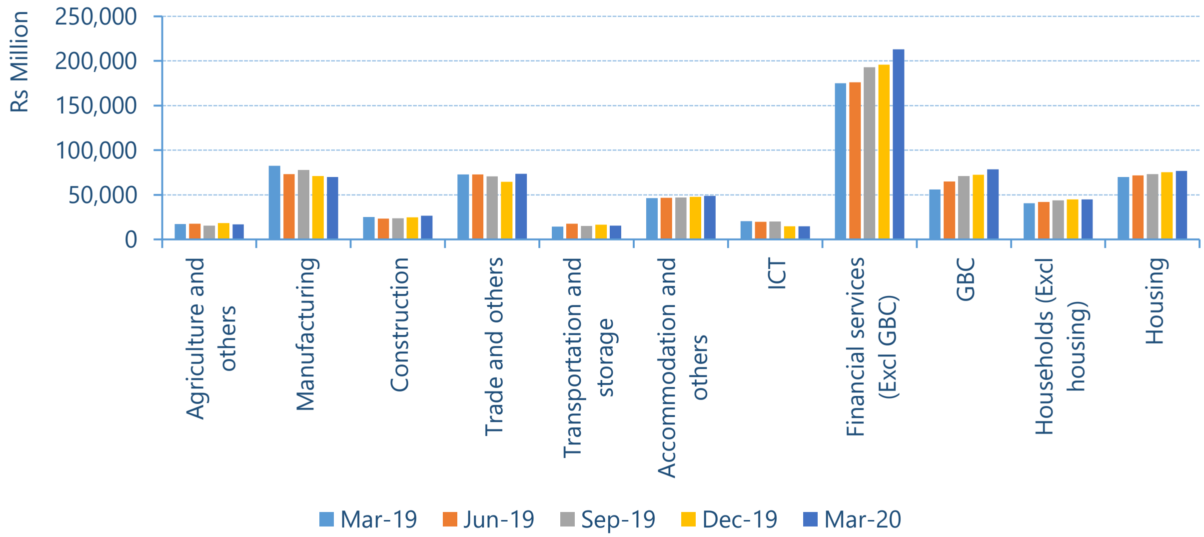
Chart 3.3: Total Private Sector Credit



Source: Bank of Mauritius

Total Credit distribution shows that the 'Financial Services', 'GBC', 'Housing', 'Accommodation', 'Manufacturing' and 'Trade' Sectors generally accounted for the largest share of bank loan portfolio. (Chart 3.4). Growth in Total Credit has been driven by the expansion of credit to key sectors such as 'Financial services (Excluding GBC)', 'GBC', 'Households (Excluding housing)' as well as 'Housing' whilst credit to other key sectors of the economy, such as 'ICT', 'Manufacturing', and 'Agriculture and others' declined.

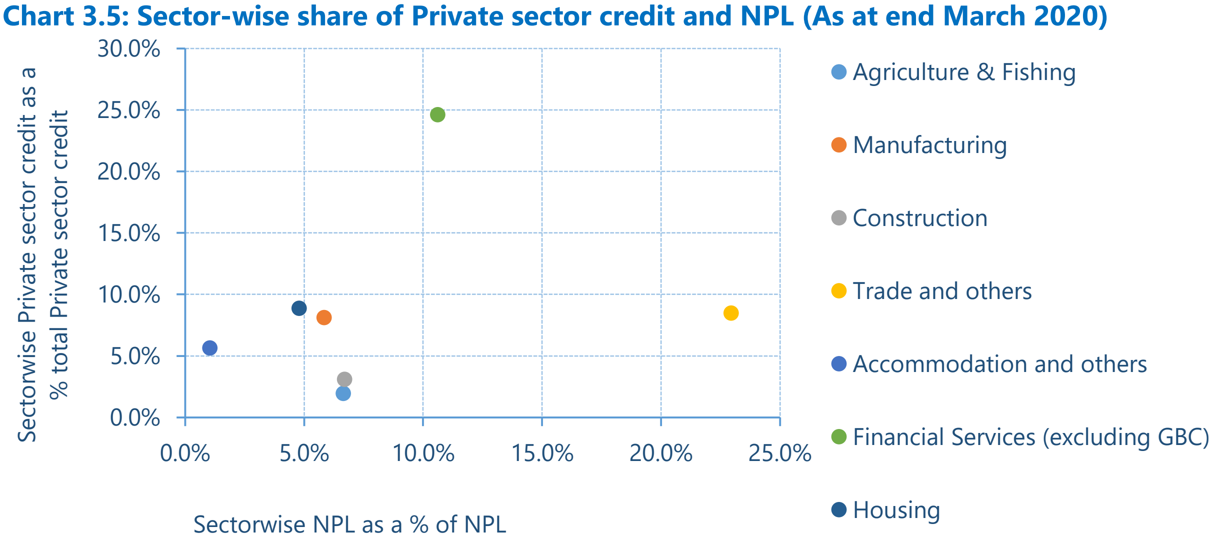
Chart 3.4: Sector-wise Credit distribution evolution



Source: Bank of Mauritius

Taken together against NPL, as at end-March 2020, Chart 3.5 shows that whilst 'Financial services' sector accounted for the largest market share of Total credit, both in and out of Mauritius, at 24.6 per cent; it also held the second highest market share of impaired credit. Indeed, the largest market share of NPL was in the 'Trade' sector at 22.9 per cent.

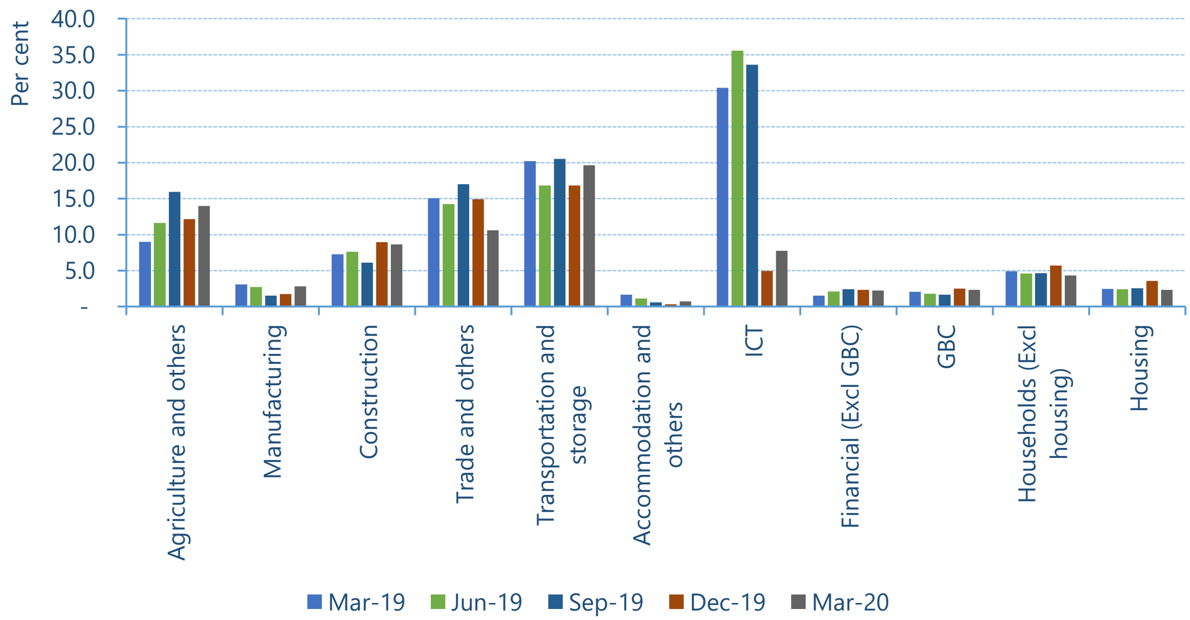
Chart 3.5: Sector-wise share of Private sector credit and NPL (As at end March 2020)



Source: Bank of Mauritius

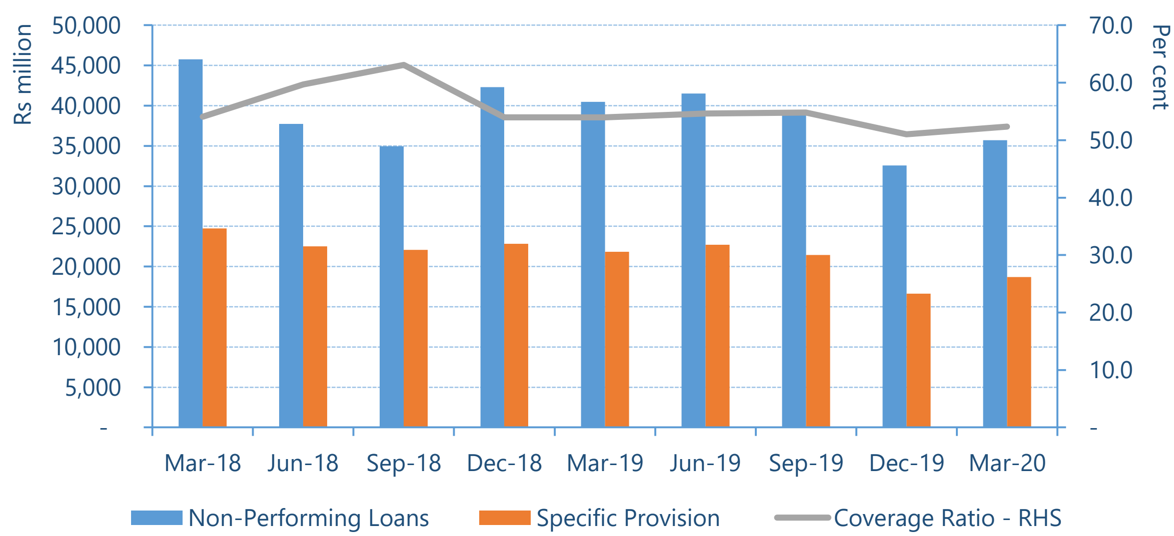
Considering the moratoriums on loan repayments currently being extended to households and corporates, NPL ratio distribution over the various sectors have not changed much over the last two quarters (Chart 3.6). On the other hand, the Coverage ratio (Chart 3.7) has improved slightly by 1.3 percentage points to reach approximately 52.4 per cent as at end-March 2020, mainly on grounds of improved provisioning by 12.4 per cent. Thus, banks seemed well shielded from potential deteriorations in credit quality in the pre-COVID-19 period. Going forward, the risks that this might change should be partly offset by the continuous loan restructurings being effected by banks and by the operations of the MIC.

Chart 3.6: Sector-wise Non-Performing Loans ratios



Source: Bank of Mauritius

Chart 3.7: Coverage ratio



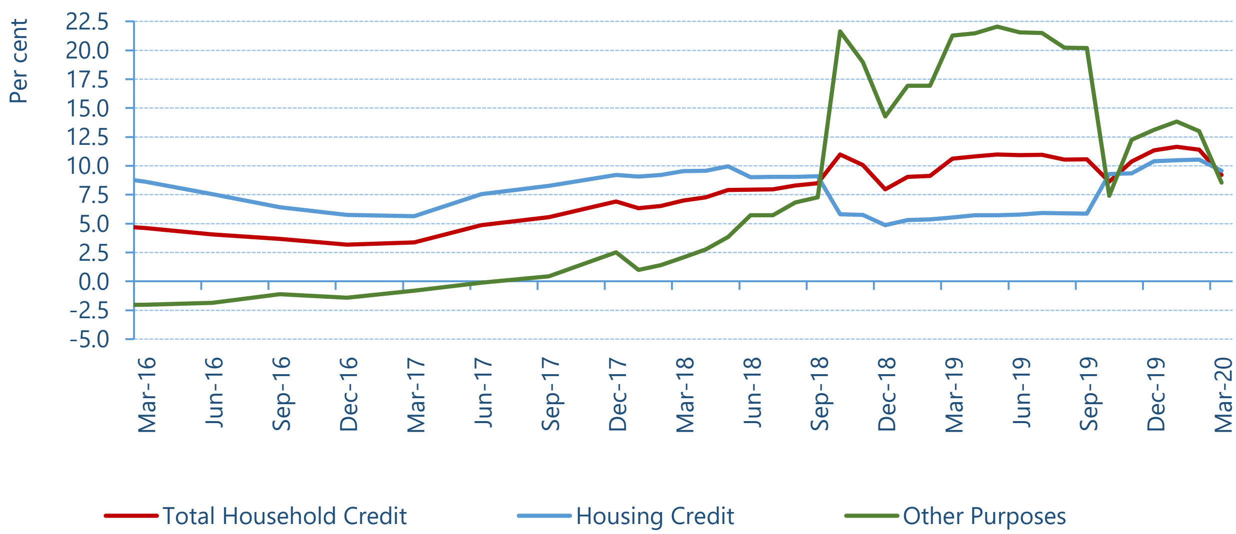
Source: Bank of Mauritius

3.2 Households Credit and Indebtedness

The pre-COVID-19 accumulation of debt by households was tributary to the prevailing low interest rate environment and rather benign economic conditions. The share of housing credit in total household credit rose stood at 64.8 per cent in March 2020, with the rest – 35.2 per cent - being attributable to credit allocated for purposes other than housing. Household credit denominated in domestic currency continues to account for a dominant share of the total (at over 95 per cent in March 2020), with the remaining proportion being denominated in foreign currency.

While the y-o-y growth in total household credit in each successive quarter has historically been steady, the underlying components have exhibited significant fluctuations in recent years. For instance, credit facilities availed by households for housing purposes grew by 9.6 per cent y-o-y as at end-March 2020, up from 5.8 per cent as at end-June 2019 while y-o-y growth in credit to households for purposes other than housing, fell from 21.5 per cent as at end-June 2019 to 8.6 per cent as at end-March 2020 (Chart 3.8).

Chart 3.8: Y-o-y Growth of Credit to Households

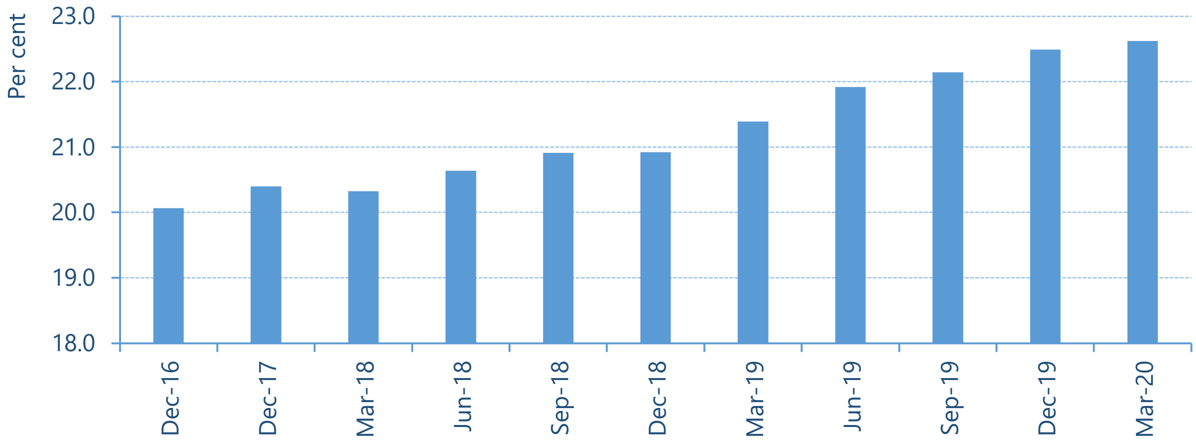


Note: Data on the sector-wise distribution of credit as from October 2018 is based on a new reporting template as per the United Nations International Standard Industrial Classification (ISIC) of all economic activities and thus may not be strictly comparable.
Source: Bank of Mauritius

3.2.1 Indebtedness

Indebtedness of households - measured by the ratio of bank credit to households to GDP - edged up from 21.9 per cent as at end-June 2019 to 22.6 per cent as at end-March 2020 (Chart 3.9). Broadening the definition of households' debt to include borrowings from banks, Non-Bank Deposit-Taking institutions (NBDTIs), insurance companies and leasing companies, it is estimated that the ratio of household indebtedness stood at 33.5 per cent as at end-March 2020, lower compared to 33.7 per cent as at end-June 2019.

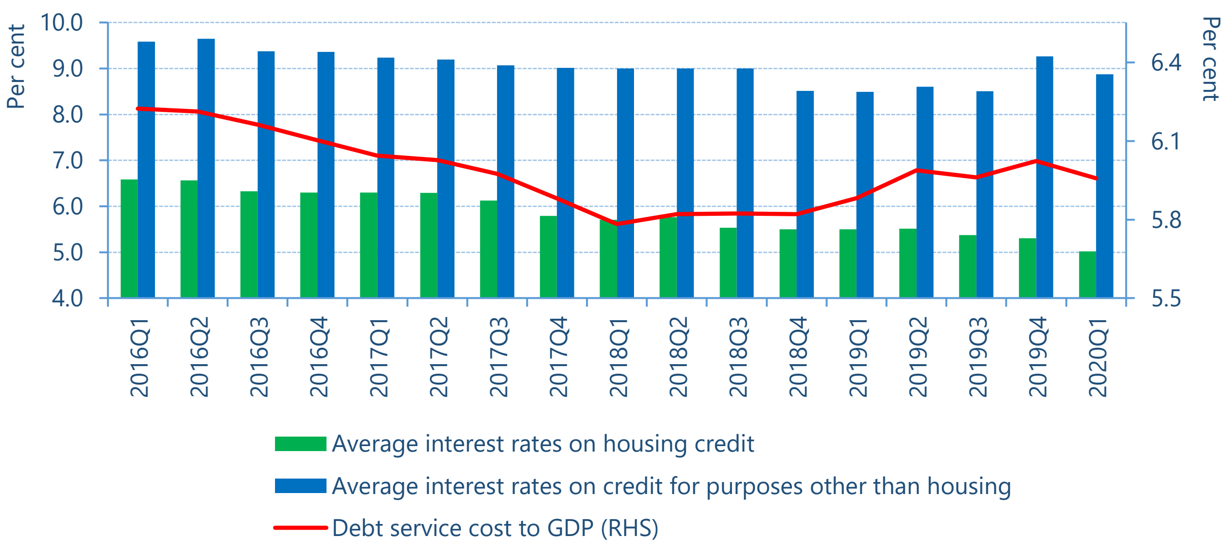
Chart 3.9: Household Debt-to-GDP Ratio



Source: Bank of Mauritius

Household debt service ratio - measured as the ratio of household debt service cost to GDP – fell during the first quarter of 2020 and stood at 5.9 per cent as at end-March 2020 (Chart 3.10). This decline largely reflects lower average interest rates on housing credit – which accounts for a relatively important share of household credit.

Chart 3.10: Household Debt Service Cost and Interest Rates



Note: The debt-service-cost to GDP ratio prior to September 2019 has been adjusted to cater for the surrender of Non-Bank Deposit- Taking licences by two entities in September 2019 and February 2020.
Source: Bank of Mauritius

The last two successive reductions in the KRR are likely to provide a respite to borrowers, in addition to the moratoriums on debt repayments. The measures regarding relaxation of risk weights, together with temporary suspension of the Guideline on Loan Impairment and Income Recognition, as well as of that on the Debt-to-Income requirement, are also likely to encourage banks to maintain credit supply to households.

Table 3.1: Domestic and External Corporate Debt

	2016	2017	2018	2019				2020
			Q4	Q1	Q2	Q3	Q4	Q1
								MUR Million
Total Corporate Debt	**222,935**	**236,896**	**257,108**	**258,765**	**265,767**	**268,545**	**273,087**	**271,452**
Corporate External Debt	20,047	22,315	22,824	23,157	23,038	23,291	23,019	23,011
Short Term[1]	5,727	5,008	5,123	5,197	5,296	5,520	5,554	7,012
Long Term[2]	14,320	17,306	17,702	17,959	17,743	17,771	17,465	15,999
Corporate Domestic Debt[ǂ]	202,888	214,582	234,284	235,608	242,729	245,254	250,067	248,441
								Per cent of total corporate debt
Total Corporate Debt	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**
Corporate External Debt	9.0	9.4	8.9	8.9	8.7	8.7	8.4	8.5
Short Term[1]	2.6	2.1	2.0	2.0	2.0	2.1	2.0	2.6
Long Term[2]	6.4	7.3	6.9	6.9	6.7	6.6	6.4	5.9
Corporate Domestic Debt[ǂ]	91.0	90.6	91.1	91.1	91.3	91.3	91.6	91.5
								Per cent of GDP
Total Corporate Debt	**51.3**	**51.8**	**53.4**	**53.2**	**54.2**	**54.2**	**54.8**	**54.1**
Corporate External Debt	4.6	4.9	4.7	4.8	4.7	4.7	4.6	4.6
Short Term[1]	1.3	1.1	1.1	1.1	1.1	1.1	1.1	1.4
Long Term[2]	3.3	3.8	3.7	3.7	3.6	3.6	3.5	3.2
Corporate Domestic Debt[ǂ]	46.7	46.9	48.7	48.4	49.5	49.5	50.2	49.5

** First Estimate*

ǂ Culled from banks' sector-wise distribution of credit

1. Refers mainly to trade credit as recorded in balance of payments statistics

2. Excluding loans of Global Business Companies

Sources: Mauritius SDDS country page and Bank of Mauritius.

4. Financial Soundness of Deposit-Taking Institutions

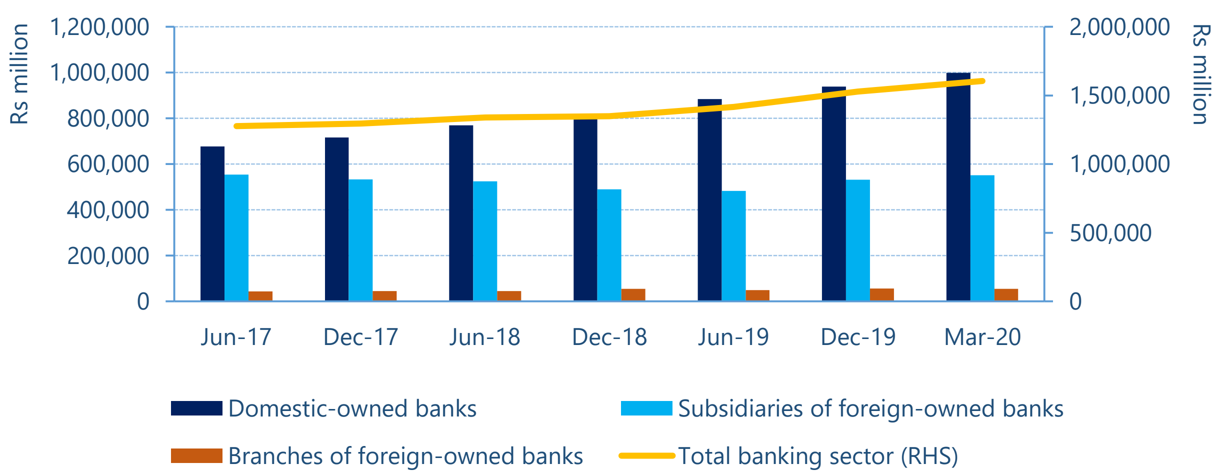
As at end-March 2020, twenty banks were licensed to carry out banking business in Mauritius, of which nine were domestic-owned, eight were foreign-owned subsidiaries and three were branches of foreign banks. One bank is currently under conservatorship.

The Total Assets of the sector represented around 319.3 per cent of GDP as at the end of March 2020 compared to 303.6 per cent as at end-December 2019. The banking landscape remains relatively concentrated, with the two largest banks accounting for over 40 per cent of market shares for total deposits, advances and assets. Following the surrender of licenses of two NDBTIs during the quarter under review, NBDTIs, comprising leasing companies and finance companies, held assets equivalent to 13.3 per cent of GDP, down from a ratio of 16.4 per cent as at end-December 2019.

4.1. Banking Sector Overview

Banks in Mauritius entered the COVID-19 period (and the lockdown which was imposed in Mauritius) with relatively strong solvency and liquidity positions. Banks were relatively well-funded with rather stable deposits namely retail deposits which accounted for about30 per cent of liabilities. GBC deposits – which are, by nature, somewhat more volatile - accounted for nearly 33 per cent of total liabilities. Banks channel their funds into loans, followed by placements abroad and by investments in domestic and foreign assets. The asset size of the banking system – mostly reflecting growth in domestic-owned banks - had been expanding prior to the lockdown (Chart 4.1).

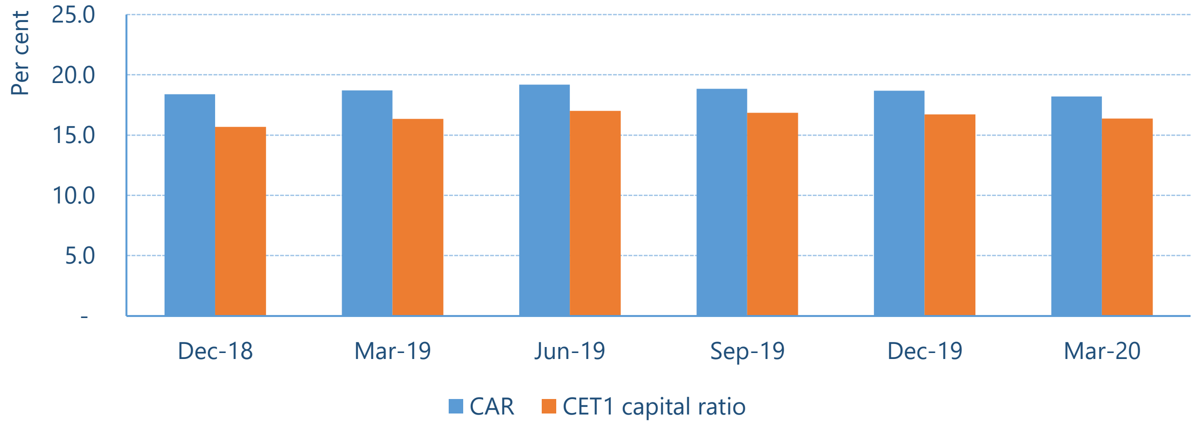
Chart 4.1: Banking Sector Assets



Source: Bank of Mauritius

Performance-wise, indicators were good. The Capital Adequacy Ratio (CAR) of banks stood at 18.2 per cent as at end-March 2020. Common Equity Tier 1 (CET1) Ratio, which is indicative of the strength of banks' core capital structure, stood at 16.4 per cent as end-March 2020, just before the lockdown. (Chart 4.2)

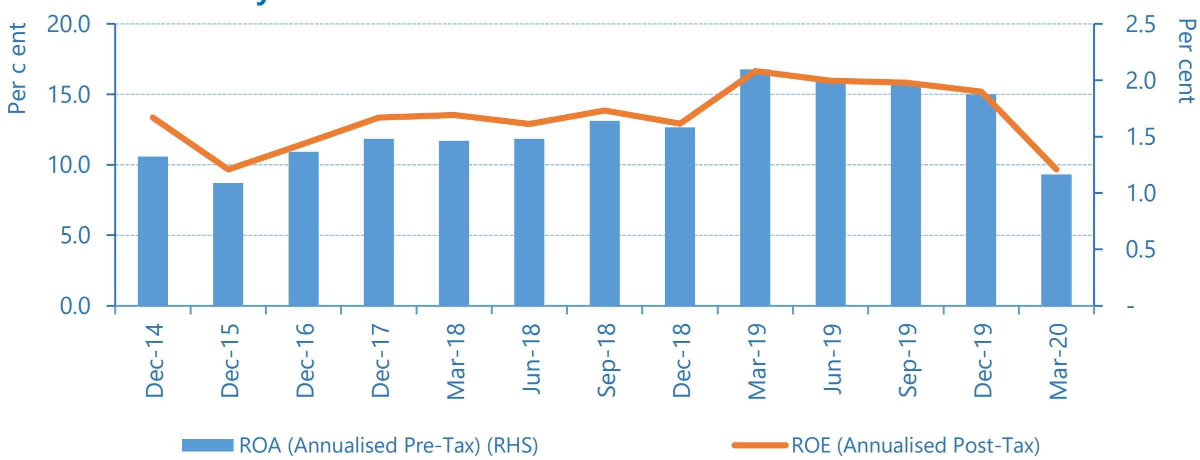
Chart 4.2: Capital Ratios



Source: Bank of Mauritius

NPL ratio stood at 4.5 per cent and was relatively well covered, as at end-March 2020. Profitability, as measured by post-tax return on equity and pre-tax return on assets stood at 9.8 per cent and 1.2 per cent, respectively as at end-March 2020 (Chart 4.3).

Chart 4.3: Profitability Ratios



Note: The Profitability ratios have been based on the Financial Soundness Indicators Compilation Guide (2006) of the International Monetary Fund and may defer from prior figures.
Source: Bank of Mauritius

The banking sector remained liquid as at end-March 2020, with liquidity indicators, namely liquid assets to total assets and liquid assets to short-term liabilities standing at 25.1 per cent and 28.2 per cent, respectively. The Liquidity Coverage Ratio (LCR) for the banking sector stood at 237.4 per cent as at end-March 2020, compared to 246.0 per cent as at end-December 2019. Taken together, the LCR of banks in, both, MUR and other major currencies, stayed above the regulatory requirements. Other prudential ratios, such as the Foreign Exposure Limit as a percentage of Tier 1 Capital and Credit Concentration Limits, were satisfactorily met.

During the lockdown period, the Bank and the Government of Mauritius took a wide range of measures to prevent the real sector shocks from propagating to the financial sector and to prevent the collapse of the credit market. These were highlighted in Box 1 of this report. The measures appear to be successful in preventing major disruptions in the balance sheet of the banking system.

The Bank conducted a survey on the impact of the COVID-19 on banks. The survey comprised, both, qualitative and quantitative questions on how the COVID-19 and the subsequent lockdown affected banks' activities and operations. Risk areas that were covered by the survey included credit quality, profitability, liquidity, capital adequacy, as well as AML/ CFT and other operational risks. Most banks have reported that the pandemic and the subsequent lockdown have curtailed their operations, and that their major revenue clusters have taken a hit. Key affected areas include net interest income (due to opportunity loss of impaired credit and moratoriums and declining dollar yields), trade finance income, and commissions and fees. Some banks anticipate the volume of their impaired credit to rise, given their exposure to the affected sectors.

Most banks reported a sound liquidity situation. Most banks have in general indicated that they currently have sufficient High Quality Liquid Assets (HQLA) holding to withstand a potential 30-day liquidity stress. In fact, a look at the funding side of banks shows that deposits have not taken a major hit. So far, risks seem to materialize mostly on the asset side of their balance sheets. A synopsis of the main findings of the survey is available in Box 2.

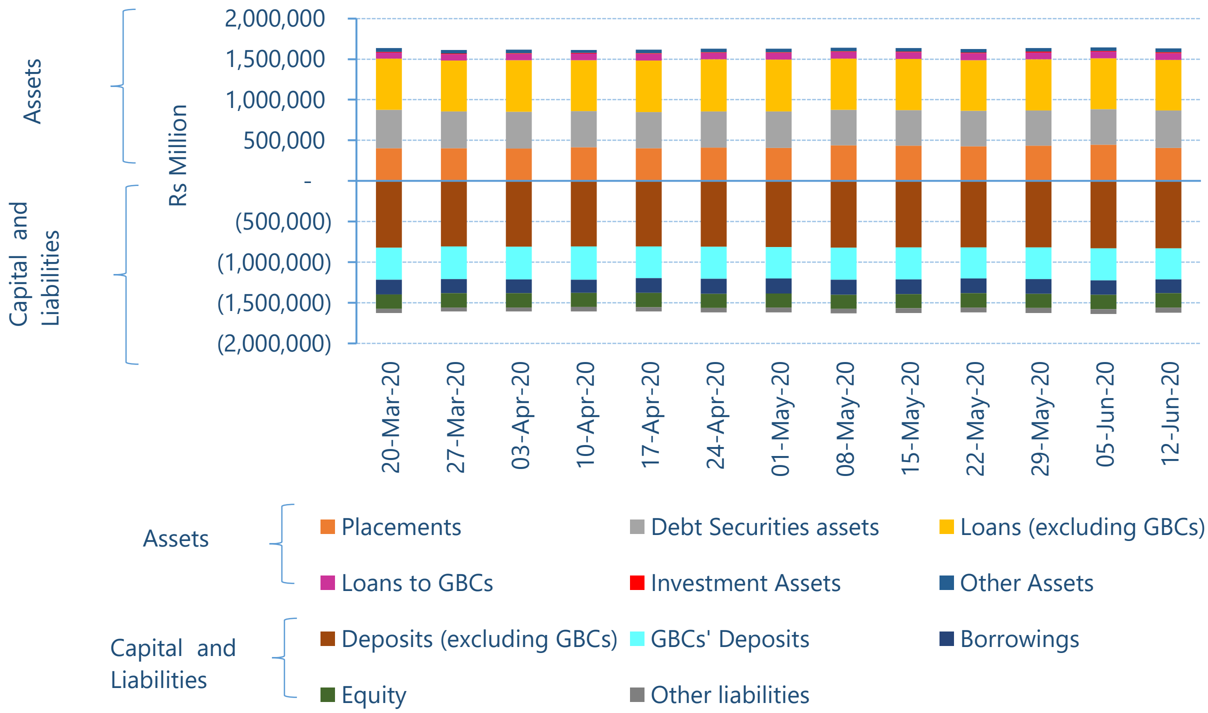
The potential impact of the pandemic can somewhat be contained in several ways:

- First, the capital and liquidity buffers of the banking system appear sound and strong;
- Second, beyond the measures already implemented, the Mauritian authorities have announced their determination to contain the economic impact of the pandemic and to preserve financial stability by coming up with additional measures, if need be;
- Third, systemically important banks in Mauritius have relatively diversified portfolios, which should also act as a buffer against impaired credit rising in the key affected sectors; and
- Fourth, NPLS of banks are relatively more concentrated in the non-tradable sector (for example, professional, ICT, transport, and construction).

The pattern of assets and of liabilities seem to have remained relatively unchanged during the lockdown (Chart 4.4). Weekly analysis of assets and liabilities during the lockdown had shown that the banking system as a whole did not suffer any funding changes, although the situation varied from bank to bank.

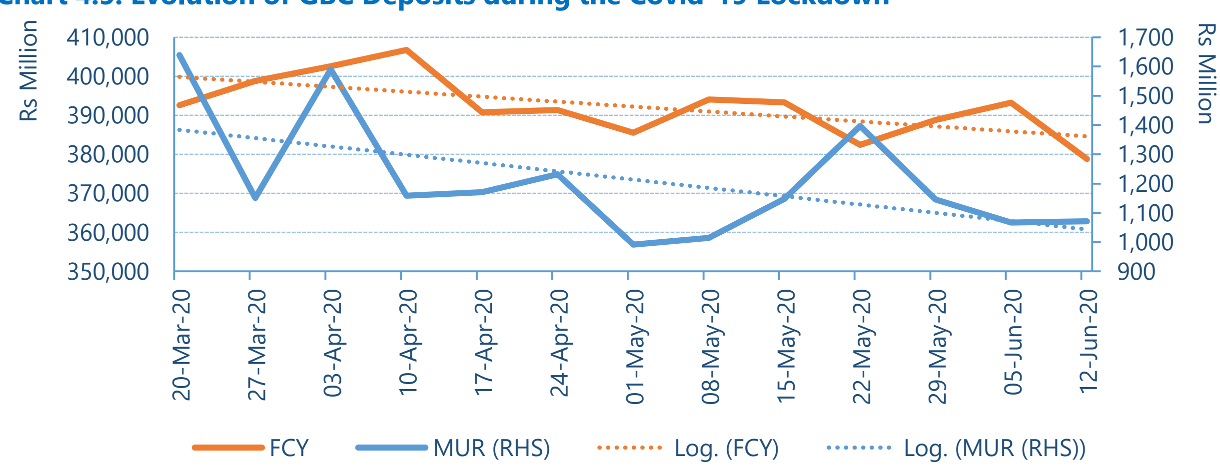
GBC deposits fluctuated during the lockdown on a slightly downward trend, but not necessarily tied to the COVID-19 (Chart 4.5). Banks exhibited some risk aversion in granting new loans during the lockdown and preferred a *'wait and see'* attitude until any uncertainties are dispelled, before they engage in new lending activities.

Chart 4.4: Assets and Liabilities allocation of banks – Evolution during the Covid-19 Lockdown



Note: "Asset" and "Capital and Liabilities" are shown in the positive territory and negative territory, respectively, for illustrative purposes only.
Source: Bank of Mauritius

Chart 4.5: Evolution of GBC Deposits during the Covid-19 Lockdown



Source: Bank of Mauritius

Banks in Mauritius have relatively heavy exposure to foreign countries as funds are routed through the system from abroad to find their way to other destinations. The banking system is a net recipient of funds from China and is thus vulnerable on the funding side to adverse developments taking place in China. On the other hand, the banking sector is a net provider of funds to countries such as the USA, UK, South Africa and India (Chart 4.6). Adverse developments in these countries could affect the quality of assets exposure.

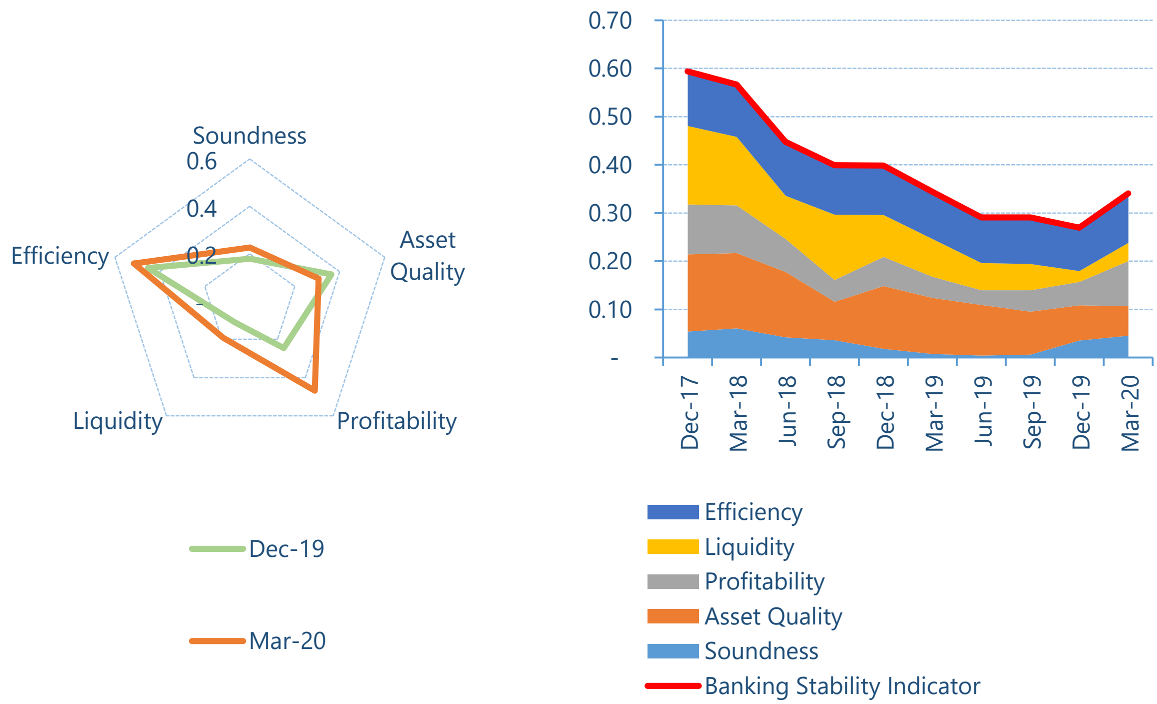
Chart 4.6: Evolution of Cross-country exposure (February-April 2020)

Source: Bank of Mauritius

4.2 Banking Sector Stability Indicator

The banking stability indicator is a composite index of five indicators: soundness, asset quality, profitability, liquidity and efficiency. As the five risk indicators move farther away from the center (approach a score of 1), the composite measure of riskiness increases (Chart 4.7). The banking stability index pointed to higher riskiness over the first quarter of 2020, compared to last quarter of 2019, and was brought through the soundness, profitability, efficiency and liquidity indices[4].

Chart 4.7: Banking Stability Indicator



Source: Bank of Mauritius

4.3 Z-score

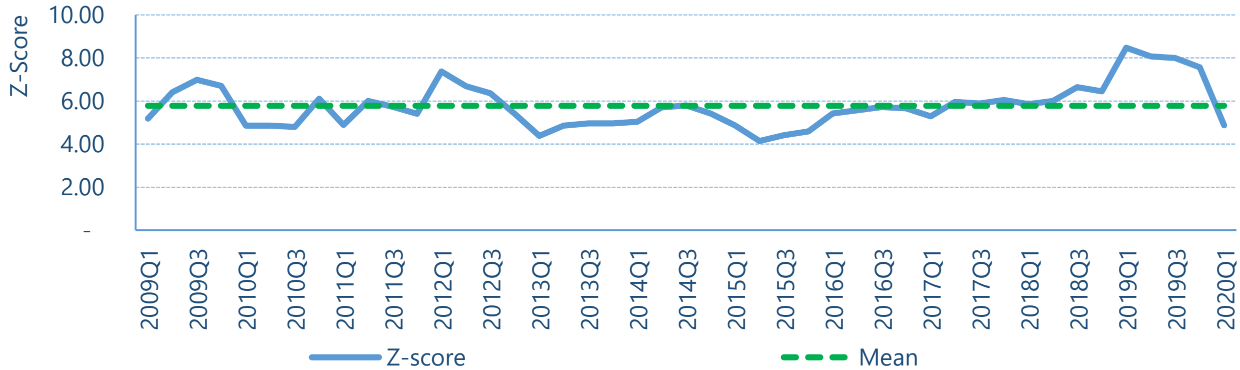
A Z-score approach has been devised for the further monitoring of banks. The basic principle of the Z-score measure is to relate a bank's capital level to the variability in its returns. The Z-score has been derived through the following formula:

$$Z - score = \frac{(\frac{Capital}{Asset} + ROA)}{Std\ Dev\ (ROA)}$$

The Z-score of the banking sector contracted from 7.57 as at end-December 2019 to 4.87 as at end-March 2020, and stood below its mean of 5.8. This fall is partly explained by a decrease in the Profitability levels compared to a more than proportional increase in Total Assets of banks during the first quarter of 2020, compared to the last quarter 2019. (Chart 4.8)

[4] Liquidity index is the weighted average of LCR, Liquidity ratio and Customer Deposit to Total Assets, which may not match to other sections in the report.

Chart 4.8: Z-Score for banks

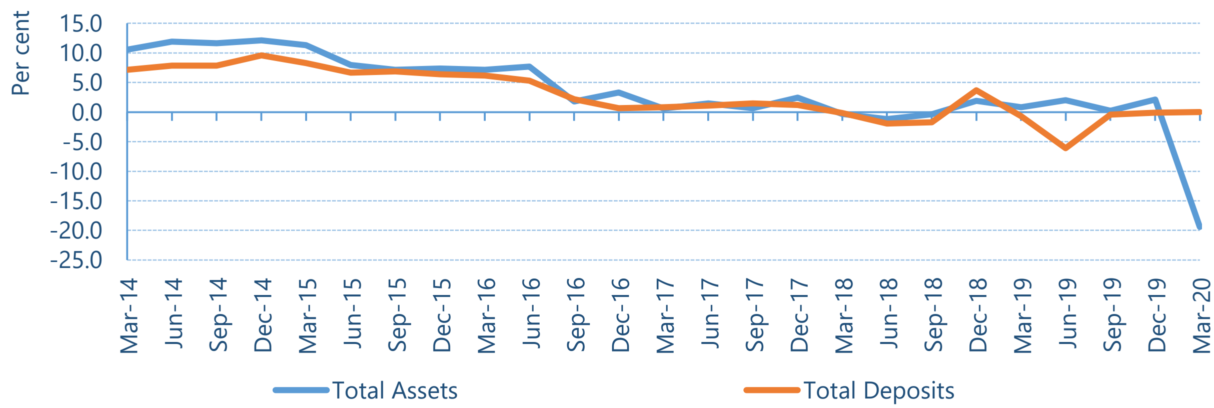


Source: Bank of Mauritius

4.4. Non-Bank Deposit Taking Sector

NBDTIs mobilise deposits from the public, and grant leasing and loan facilities to individuals and corporates. There were six NBDTIs licensed as at the end-March 2020, compared to eight NBDTIs as at the end-December 2019 since Mauritian Eagle Leasing Company Limited and CIM Finance Ltd surrendered their licenses with effect from 17 January 2020 and 10 February 2020, respectively

Chart 4.9: Assets and deposits growth of NBDTIs



Source: Bank of Mauritius

NBDTIs were found to be sound and adequately capitalized during the first quarter of 2020. Their aggregate CAR increased to 45.7 per cent as at end-March 2020, from 36.0 per cent as at end-December 2019. With the current level of capitalization, NBDTIs continue to have robust capital adequacy position. During the first quarter of 2020, NBDTIs experienced a drop in liquid assets and total assets. Nevertheless, all NBDTIs maintained liquidity ratios above the statutory minimum of 10 per cent. The ratio of Liquid Assets to Total Deposits, which stood at 27.8 per cent as at end-December 2019, decreased to 26.6 per cent as at end-March 2020.

4.5 Financial Soundness Indicator[5]

Financial Soundness Indicators (FSIs) have been assessed for deposit-taking institutions[6] (banks and NBDTIs) over the last two quarters, as illustrated in Chart 4.10. These indicators have been grouped in five distinct categories and each color-coded line indicates the position of these indicators over the quarters under review. The principle of the chart is that, the farther away the indicators are from the center, the better positioned are the depository corporations; except for those indicators, marked with *, which flow in the opposite direction.

Deposit-taking institutions experienced a slight drop in their capital positions, with their CAR coming down from 19.6 per cent as at end-December 2019 to 19.2 per cent as at end-March 2020. Total Regulatory Capital of deposit-taking institutions grew by 1 per cent over the period under review to MUR175,942 million, as a result of an increase in Tier 1 Capital whilst Risk-Weighted Assets (RWAs) grew by 3 per cent to MUR917,636 million as at end-March 2020. Credit growth of deposit-taking institutions was accompanied with an increase in impaired credit, resulting in a slight worsening of the NPL ratio to 5.3 per cent. Adjusted for specific provisioning, the Net NPL ratio also worsened somewhat by 1.1 percentage point to 11.5 per cent as at end-March 2020.

Deposit-taking institutions also experienced a 29.2 per cent fall in their Annualized Average Net Income (before tax) to MUR20,141 million as at end-March 2020 The pre-tax Return on Assets and pre-tax Return on Equity contracted to 1.2 per cent and 11.0 per cent, respectively, as at end-March 2020 compared to 1.9 per cent and 16.4 per cent, respectively, as at end-December 2019.

With regard to liquidity indicators, both measures, i.e. liquid asset as a ratio of total assets and liquid asset as a ratio of short-term liabilities, remained quasi unchanged. Liquid assets as a ratio of total assets continued to hover at around 24.6 per cent while liquid assets as a ratio of short-term liabilities stood at 27.8 per cent as at end-March 2020.

Sectoral loan distribution indicated a mild shift from "Other domestic sectors" towards the "Deposit-taking" sector, with the largest share of loans still attributed to Non-Financial Corporations. Asia and Africa remained the main cross border destinations for credit facilities originating from banks in Mauritius.

A detailed tabled trend of the Core and selected Encouraged Set of Financial Soundness Indicators can be found in Annex A.

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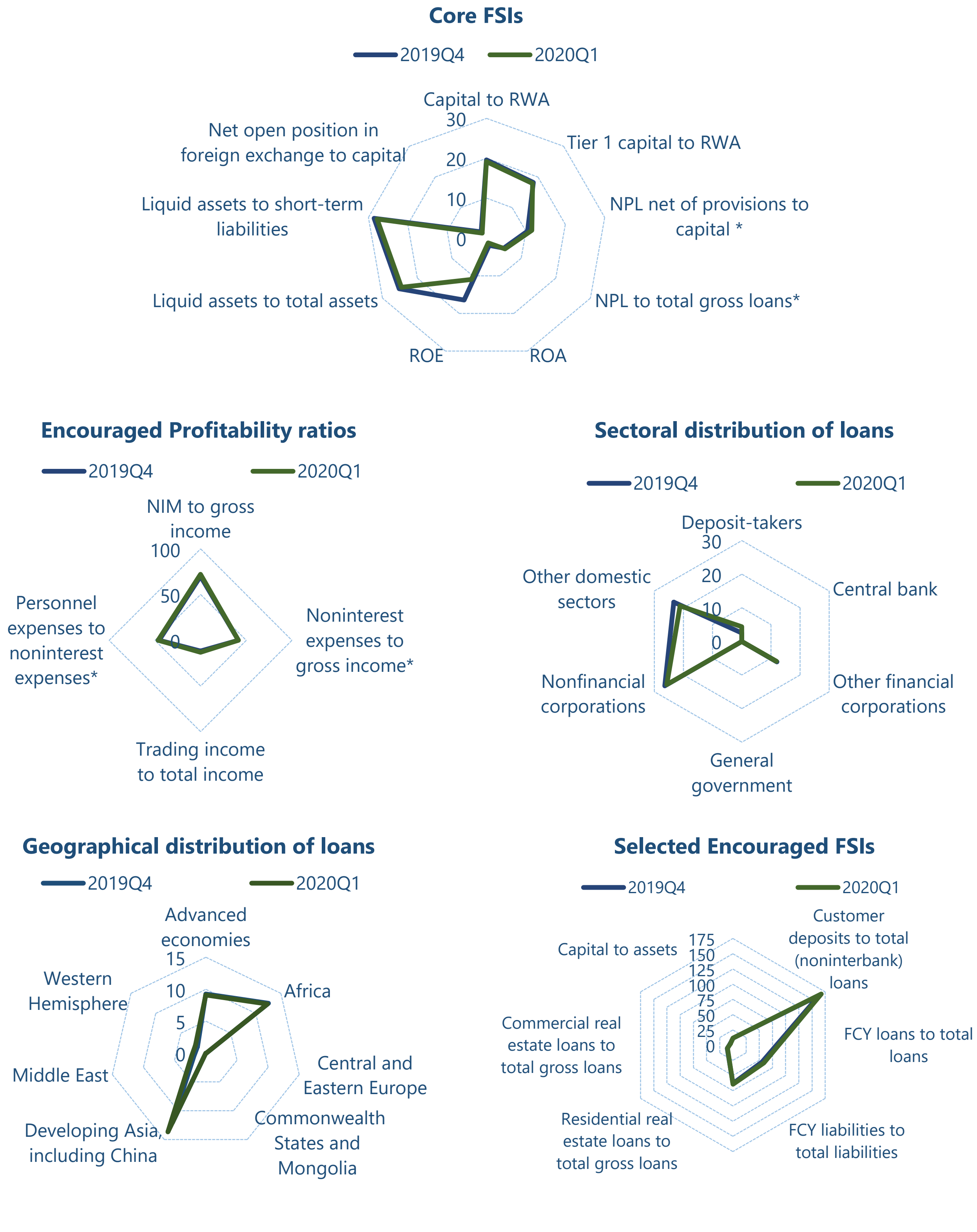
[5] FSIs are calculated on a domestic consolidation basis using the Financial Soundness Indicators Compilation Guide (2006) of the International Monetary Fund. Figures in this section may not match those provided in other sections.

[6] These comprise 19 banks and 6 non-bank deposit taking institutions and are all regulated by the Bank of Mauritius.

Chart 4.10: FSI Radar Panel



Source: Bank of Mauritius

Box 2: Responses of Banks to Questionnaire on the COVID-19

1. A survey was sent out to banks on 03rd April 2020, comprising both qualitative and quantitative questions on how the COVID-19 pandemic and the subsequent lockdown affected banks' activities and operations. Risk areas that were covered by the survey included credit quality, profitability, liquidity, capital adequacy, as well as AML/ CFT and other operational risks.

2. Most banks have reported that the pandemic and the subsequent lockdown have curtailed their operations, and that their major revenue clusters have taken a hit. Key areas that were reported to be most likely affected included net interest income (due to opportunity loss of impaired credit and moratoriums and declining dollar yields), declining trade finance income, and commissions and fees.

3. Banks are anticipating a worsening of their economic performances in general, going forward. They are broadly anticipating a curtailment in credit, increased impaired credit in affected sectors (namely tourism, manufacturing and trade), declining profitability and reduced capital adequacy buffers. Many banks have reported that they expect recovery to be rather sluggish, and are as much concerned with local growth prospects as with foreign growth perspectives.

4. Most banks have undertaken stress tests in order to unearth areas of vulnerability and to determine their resilience to the pandemic and to its aftermath.

5. Regarding liquidity, most banks have indicated that they currently have sufficient liquidity coverage whilst some banks anticipate a decline in their LCR (especially Foreign Currency), which would nonetheless continue to meet the regulatory requirements.

6. Banks with a relatively important share of investments in their Total Assets are quite concerned about the potential impact of a deterioration of the external outlook on their investment portfolios. Several banks are concerned with the potential decline in yields on local and foreign investments, which may affect their funding and lending activities.

7. Most banks indicated that restrictions on physical movements have put several strains on their activities. For instance, many client services have had to be curtailed. Working from home engendered cyber security issues. It was also highlighted that trade financing could not operate properly. Some banks have underscored that the completion of their financial audits within the predetermined audit cycle had to be put on halt. International banking and correspondent banking perspective were also deemed to be affected during the confinement period.

8. Banks voiced out some concerns in conducting Know Your Customer and Due Diligence exercises when on-boarding new clients. Identifying suspicious transactions had also become challenging since teams were working on skeleton basis. Actions undertaken ranged from temporarily accepting digital Customer Due Diligence to implementing web-based AML/CFT systems protocols, and undertaking enhanced risk-based transaction monitoring.

9. Banks have reported that they have contingency plans to ensure business continuity, going forward.

5.Stress Testing the Mauritian Banking System

The resilience of the Mauritian banking system against macroeconomic shocks was assessed through several stress testing exercises. The model developed by the Bank enables detailed scenario analysis as well as sensitivity analysis to be performed, i.e., an assessment of how banks fare with shocks engineered to credit portfolios, interest rate, exchange rate and liquidity. Plausible scenarios have been designed to assess the resilience and soundness of the banking sector. The stress testing framework has been applied to all nineteen banks along with two NBDTIs, operating in Mauritius (together referred as "Sample Institutions").

5.1 Scenario Analysis: Solvency Risk

The Sample Institutions had robust capital position during the period under review. The CAR for the Sample Institutions stood at 19.1 per cent as at end-March 2020. To assess the resilience of the Sample Institutions to macroeconomic shocks, three scenarios have been built: a historical and two (medium and severe) adverse macroeconomic risk scenarios. These scenarios have further been investigated through three case studies as detailed in Table 5.1.

Table 5.1: Scenarios

Stress scenarios	Historical	Medium Shock	Severe Shock
Case Study 1 shocks (decrease in Interest rate and depreciation of MUR) (percentage point)			
Interest rate	-0.8	-0.9	-1.2
Exchange Rate	-4.4	-5	-10
Case Study 2 shocks (increase in NPL) (percentage)			
NPL Shocks	2	8	11
Case Study 3 shocks (combination of Case studies 1 and 2)			
Interest rate	-0.8	-0.9	-1.2
Exchange Rate	-4.4	-5	-10
NPL Shocks	2	8	11

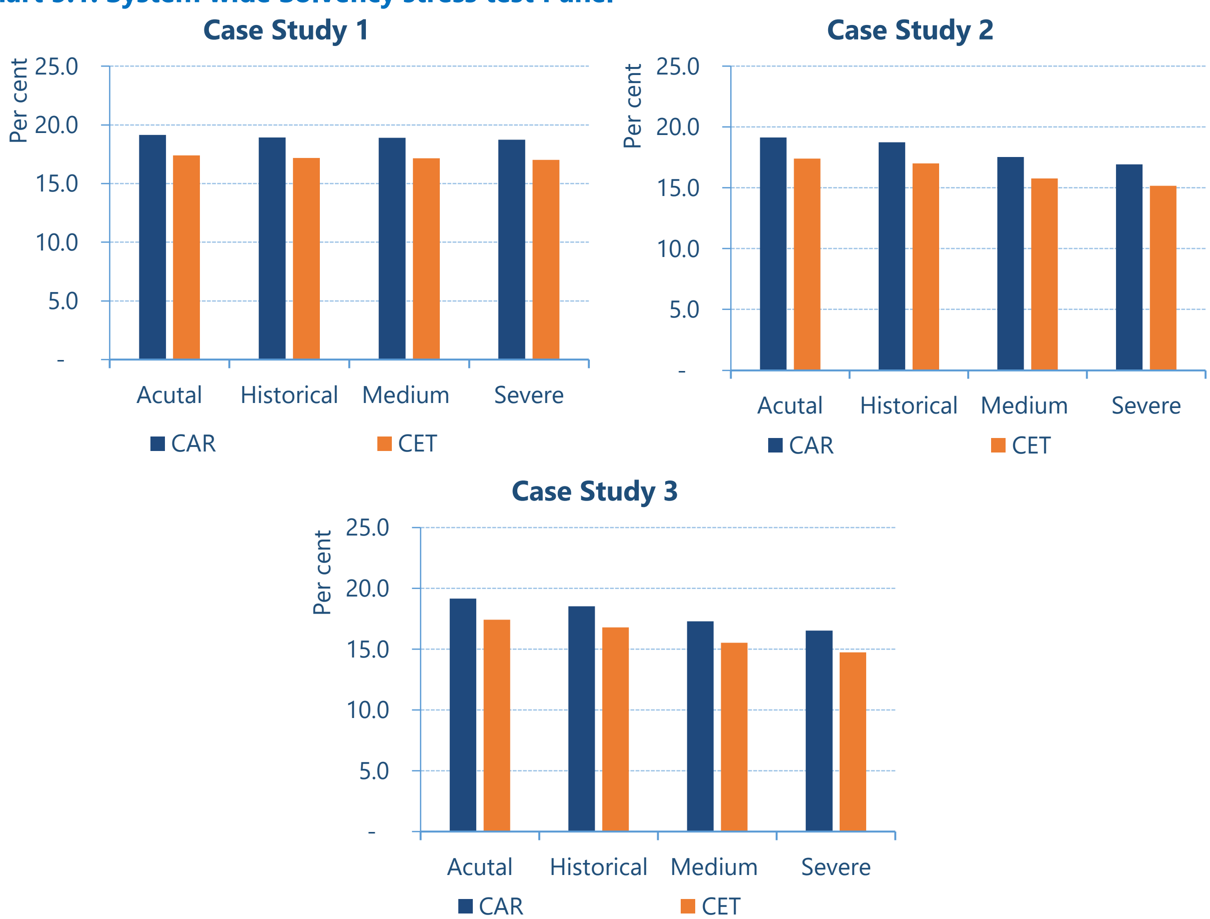
Source: Bank of Mauritius

The historical shock scenario was based on the truncated downward standard deviations derived from the historical values of each of the aforementioned macroeconomic variables, spanning a period from the first quarter of 2009 to the first quarter of 2020. The medium and severe scenarios were both based on hypothetical shocks. To better reflect the constraints and realities of the Mauritian macroeconomic situation, a Vector Auto-Regression model in its various formats, reduced-form, recursive-form and structural-form, was executed to provide basis for the statistical relationships between macroeconomic variables. Based on these findings, the *directions* of shocks as applicable to the stress testing exercises under medium and severe scenarios were worked out. However, the *magnitudes* of the proposed shocks were all hypothetical and reflect possible developments to macroeconomic variables, going forward[7].

[7] It is interesting to note that econometric regression results would typically fail to yield robust results in times of severe crisis such as the COVID-19 pandemic. This is because they are based on historical data which may or may not have an autoregressive feature. During the COVID-19, there are two effects: first, the economic relationships

Chart 5.1 provides a diagrammatic illustration of the outcomes on the Sample Institutions' post-shock CAR and CET1 ratio, following the materialization of combined shocks for each given scenario and case study. As is apparent, notwithstanding the magnitude of the impact, the Mauritian banking sector remains resilient. All three case studies indicate a decline in system–level CAR, as from the historical scenario. The system-level CAR under the severe stress scenarios declined as follows: from 19.1 per cent to: 18.7 per cent (case study one); 16.9 per cent (case study two) and; 16.5 (case study three). In all cases, the Sample Institutions were nevertheless still complying with regulatory minimum of 11.875 per cent (10 per cent minimum plus phased-in 1.875 per cent CCB) as of the first quarter of 2020. Chart 5.1 also illustrates the impact of the combined macroeconomic shocks on the CET1 ratio under each of the three case studies. The outcome demonstrated that banks displayed resilience even in the harshest scenario.

Chart 5.1: System wide Solvency stress test Panel



Source: Bank of Mauritius

between variables may fundamentally change. This is the foundation of the so-called *'Lucas Critique'* in the literature; and second, historical data will be of rather limited use for future analysis. At the time of running the stress tests, the lockdown period was over in Mauritius and, as reported in the previous sections, there were no major disruptions noted among banks. However, risks are still there and may uncover in future months. The Vector Auto-Regression model used in this setup was simply to help affirm the statistical relationship between the key economic variables (which did not change by much during the lockdown) in the post-lockdown period. All shocks are calibrated to represent possible evolution of macroeconomic variables, going forward.

5.2 Sensitivity Analysis

A number of single-factor sensitivity stress tests, based on March 2020 data, were carried out on the Sample Institutions to assess their vulnerabilities and resilience under various scenarios. Their resilience with respect to credit, interest rate and liquidity risks was studied. Stress tests to the Sample Institutions' credit portfolios include shocks to (a) sectoral advances (i.e., shocks are administered to credit quality of specific economic sectors, namely, 'Agriculture', 'Manufacturing', 'Construction', 'Mortgage', 'Trade', 'Tourism' and 'Others', and (b) large borrowers (i.e., it is assumed that a given number of large borrowers have defaulted on their loans). As for liquidity stress tests, the impact of hypothetical deposit run-offs on banks' overall liquidity situation has been assessed.

5.2.1 Sectoral-Credit risk

Sensitivity stress tests have been conducted on the Sample Institutions' sectoral gross NPLs as at end-March 2020, to ascertain their sectoral credit risks resilience. Two sets of shocks were studied, namely (a) historical and (b) hypothetical. The hypothetical shocks have been detailed in Table 5.2.

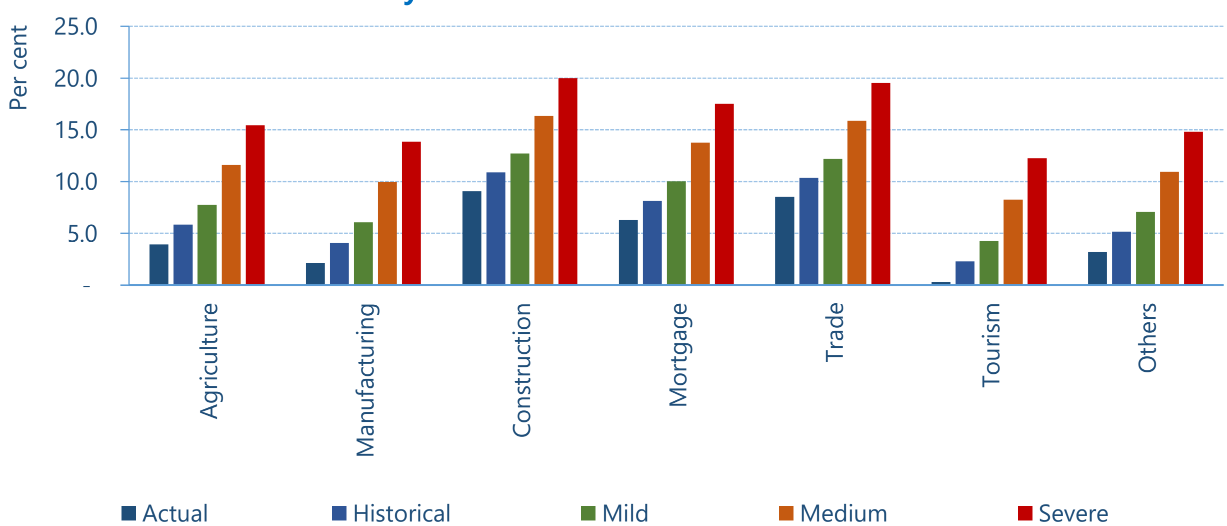
Table 5.2: Credit risk – sectoral shocks

Hypothetical shock	Mild	Medium	Severe
Shock on sector wise performing loans (per cent)	4	8	12

Source: Bank of Mauritius

The 'Construction' sector registered the highest sector wise NPL ratio at 19.9 per cent under the severe stress scenario, building on its already high NPL ratio of 9.8 per cent. Nevertheless, the results of the exercise demonstrated that the highest increase in NPL ratio was for credit allotted to 'Mortgage' and 'Tourism', both of which rose by almost 12.0 percentage points. The 'Construction' and 'Trade' sectors followed closely, with 10.9 percentage point deterioration in each of their NPL ratios. (Chart 5.2)

Chart 5.2: Sectoral credit risk - System Level NPL Ratio

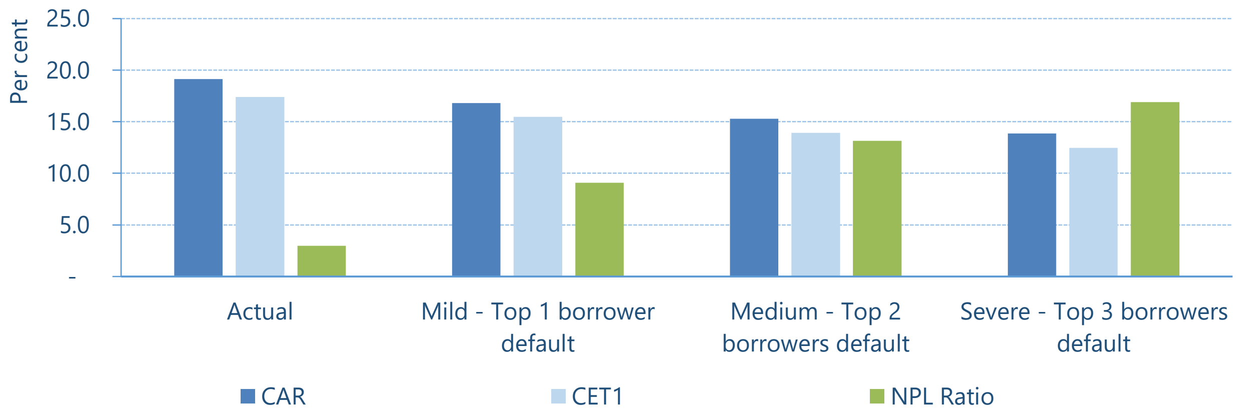


Source: Bank of Mauritius

5.2.2 Credit concentration risk

Credit concentration risk was examined by considering the impairment of the top individual borrowers according to their non-exempt advances (after set-off) for the respective Sample Institutions. Three shock scenarios were applied, whereby each subsequent shock scenario was incremented by one additional large borrower defaulting for each Sample Institutions, until a maximum of three. The stress test exercise showed that the Sample Institutions' aggregate CAR and aggregate CET1 ratios remained resilient above their regulatory minimum, even under the severe assumed scenario of default by all the top three borrowers in each of the respective Sample Institutions' credit portfolio. (Chart 5.3)

Chart 5.3: Credit Concentration Risk



Source: Bank of Mauritius

5.2.3 Liquidity risk: Impact of deposit run-offs on liquid shocks

Various banks (especially the foreign banks) have higher proportion of GBC deposits in their balance sheet. Liquidity stress tests, as detailed in Table 5.3, have been performed to assess the liquidity position of the nineteen banks in Mauritius.

Table 5.3: Liquidity risk – Foreign Currency Deposit withdrawals

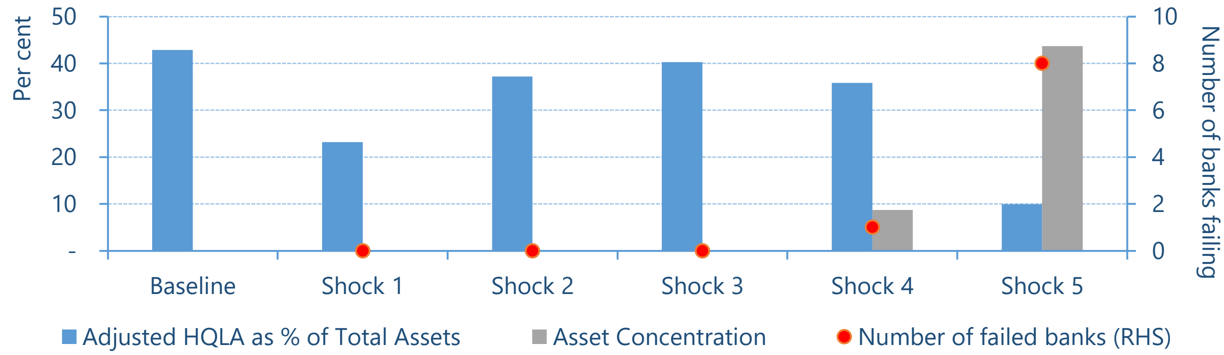
Shocks	Description
1	35 per cent one-off foreign currency deposit withdrawal
2	Largest GBC depositor withdrawal for each respective bank
3	Riskiest GBC depositor withdrawal for each respective bank
4	Aggregate of Shocks 2 and 3
5	Aggregate of Shocks 1, 2 and 3

Source Bank of Mauritius

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

Results showed that when Shocks 1, 2 and 3 were applied on a mutually exclusive basis, the Adjusted HQLA of all banks would remain resilient. However, one bank seems to be vulnerable should, both, its largest GBC depositor and riskiest depositor (Shock 4) withdraw their respective FCY deposits. Furthermore, when Shock 5 was applied, eight banks failed the test. These banks consisted of around 44 per cent of the bank asset concentration. (Chart 5.4)

Chart 5.4: Liquidity risk – Foreign Currency deposit shocks and impacts using Adjusted HQLAs

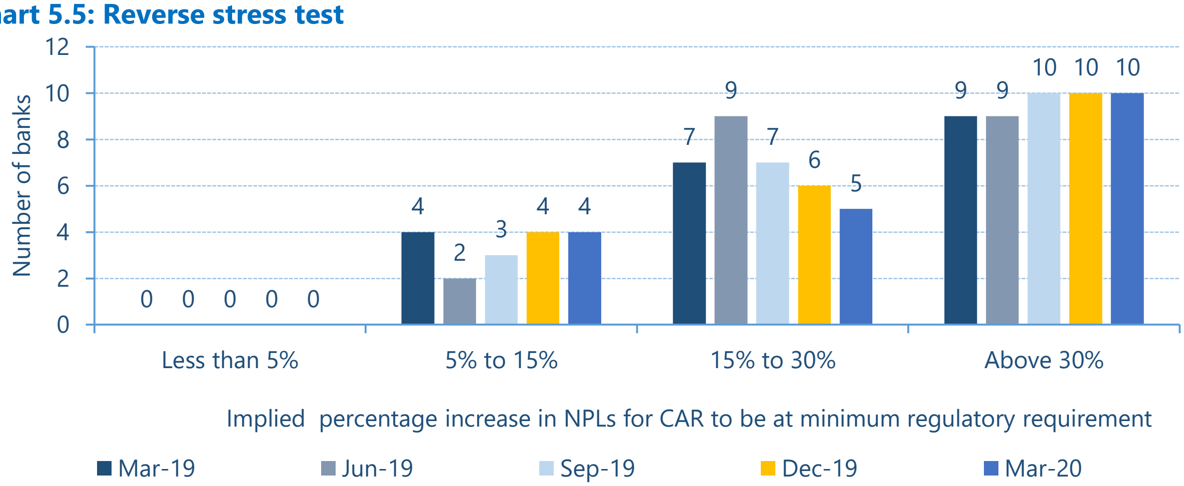


Source: Bank of Mauritius

5.2.4 Reverse stress test

In order to have a more rigorous stress testing framework, a reverse stress test exercise was performed. The reverse stress test investigated the percentage increase in NPLs that each bank had to experience, for their CAR to decline to the minimum regulatory limit. The implied increase in NPL was based on each banks' performing loans. As at end-March 2020, fifteen banks would have to experience more than 15 per cent increase in their NPL for their CAR to fall to the regulatory minimum (Chart 5.5). The four banks that were in the '5 to 15 per cent bucket' accounted for approximately 17 per cent of the market share.

Chart 5.5: Reverse stress test



Source Bank of Mauritius

6. Non-Bank Financial Institutions[8]

The COVID-19 pandemic and the lockdown that followed in Mauritius pose credit-related and market-related risks to the activities of Non-Bank Financial Institutions (NBFIs). On the credit front, the inability of companies most affected by the COVID-19 crisis to repay their debt obligations may cause a deterioration in the balance sheets of NBFIs which provided these credit facilities. The latter includes entities involved in Insurance, Leasing, Credit Finance, and to some extent Factoring activities. Furthermore, stock prices around the world have come down since the outbreak of the pandemic. In Mauritius, the SEMDEX has dropped by 27 per cent in the first quarter of 2020. As a result, NBFIs holding equity investments may have suffered a financial blow, which could potentially affect their solvency. In addition, those forming part of local conglomerates could face enhanced risks that controlling interest shareholders may be tempted to withdraw money from these NBFIs to bridge any funding gaps in other subsidiaries. In line with good regulatory and supervisory practices, a risk-based approach is used by the FSC to monitor and contain the said risks in the NBFI sector.

6.1 Life Insurance Industry

The Life Insurance industry is the largest sub-sector under the NBFIs sector in terms of assets. At the start of 2020, Life Insurers had an aggregated investment of MUR10.2 billion in debt securities other than those issued by the Government of Mauritius and by the Bank, representing around 13 per cent of their Total Assets. An amount of MUR5.9 billion relates to loans given to households, MUR1.8 billion to loans given to corporates, while the remaining MUR2.4 billion constituted of investments in corporate bonds. The largest life insurers have a relatively large degree of solvency margin and are expected to be able to absorb any foreseeable increase in default interest payments caused by the COVID-19 situation, though one life insurer of medium size is displaying some signs of vulnerability to credit risk.

Life Insurers also hold equity investment in companies operating in various industries. The fall in the market value of these investments due to the COVID-19 crisis could lead to a deterioration of the percentage solvency margin maintained by Life Insurers. The latter indicator has been assessed under three scenarios, namely Best, Average and Worst case scenarios that provide numerical hypothetical projected falls in equity investment. To be conservative, a fall in the RWAs was assumed to have a direct impact on solvency (i.e., no allowance is given for investment linked insurance contracts). The results of the scenario testing demonstrated that two Life Insurers may face a moderate shortfall in their minimum capital required. A third company was added under the FSC's increased monitoring due to the absence of latest valuation of its assets.

All Life Insurers have been requested to complete a questionnaire on the impact of COVID-19 on their solvency, liquidity and sustainability concerns. Depending on the answers they provided, some may be required to furnish an updated Risk Management Framework and their Own Risk and Solvency Assessment in view of the current COVID-19 crisis. Risks and potential vulnerabilities that have been identified are being closely monitored by the FSC. The latter has also designed a new data collection

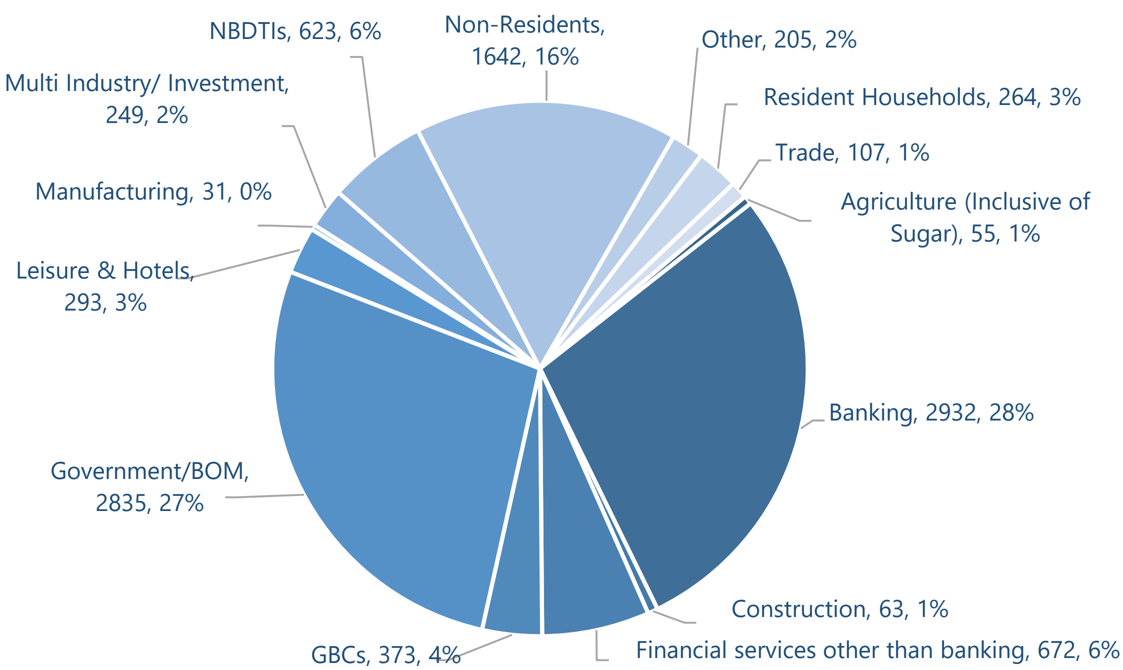
[8] This segment has been contributed by the Financial Services Commission (FSC). Analysis for this section covers the first quarter of 2020, unless otherwise specified.

instrument to improve oversight on Life Insurers in respect of the risks associated to the COVID-19 crisis.

6.2 General Insurance Industry

General Insurance companies seem to be relatively less exposed than Life Insurers to the risks related to the COVID-19 crisis because they hold relatively smaller technical reserves and, hence, are less dependent on assets investment performance (Chart 6.1). However, the surrender of policy contracts by corporates and individuals keen on so doing in order to curtail expenditures during times of income shortfalls, could present liquidity risks to the insurers.

Chart 6.1: Exposure of Equity and Debt Assets of General Insurers by Industry (MUR Million)



Source: FSC

6.3 Global Business Sector Developments

Mauritius has a sizeable GBC sector, with aggregated assets valued at USD719.6 billion[9] representing approximately 53 times the size of the Mauritian GDP. Contribution of the GBC sector to the GDP of Mauritius was estimated at 5.8 per cent in 2019 and has produced a y-o-y growth of 3.8 per cent. As at December 2019, direct employment in the GBC Sector was around 6,000.

GBCs are relatively more exposed to global developments than to developments taking place in the domestic economy. The impact of the COVID-19 pandemic on the GBC sector is very much unknown at this stage, given the uncertainties tied to the duration of the pandemic. Much is also largely

[9] Consists of aggregated GBC1s / GBCs assets valued at USD601 billion as at 30 Jun 2019 and aggregated GBC2 assets valued at USD118 billion extracted from their financial summaries with financial year ending 2018.

dependent on the way the pandemic is handled by key partner countries, both, from countries of origin as well as countries that are the ultimate target markets. US-based companies hold around 40 per cent of total direct investment inward made through GBCs. Considering that the US has been severely hit by the COVID-19, a slowdown in new investment and newly licensed GBCs may be witnessed, going forward. During the first quarter of 2020, the number of GBC licenses issued in March 2020 started showing signs of slowdown compared to January and February 2020. However, no abnormality was detected in terms of number of GBCs being wound up during the first quarter of 2020 (Table 6.1). The two main target markets of GBCs are India and Africa, representing respectively 35 per cent and 39 per cent of total live GBCs. While contagion seems to be relatively contained in these parts of the world, many observers believe that developing countries may be more affected in the longer run.

Table 6.1: GB Licences issued for first quarter of 2017 – 2020

	2017	2018	2019	2020
January	130	67	74	102
February	119	95	95	107
March	147	110	72	67
Total	**396**	**272**	**241**	**276**

Source: FSC

FATF and EU

The recent decision by the FATF to place Mauritius in the list of 'jurisdictions under enhanced monitoring' (the so-called 'grey list') and by the EU to place Mauritius in the so-called 'black list' could have an impact on GBC activities, going forward. However, the Mauritian authorities are committed to upgrade the country's classification by taking all necessary steps to: address any deficiencies in existing enforcement mechanism; and to uphold the country's adherence to international norms and best practices. The list of deficiencies and measures taken are underscored in Section 2.2 of this report.

Annex A: Financial Stability Indicators

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

Per cent

Financial Soundness Indicators (Core)	Dec-17	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
Capital-based							
Regulatory capital to risk-weighted assets	18.6	19.2	19.5	19.8	19.8	19.6	19.2
Regulatory Tier 1 capital to risk-weighted assets	17.3	17.8	18.1	18.3	18.5	18.2	17.9
Non-performing loans net of provisions to capital	16.6	13.9	13.0	12.8	11.6	10.4	11.5
Asset Quality							
Non-performing loans to total gross loans[c]	7.0	6.5	6.3	6.0	5.8	4.9	5.3
Sectoral distribution[d] of loans to total loans[c]							
Interbank loans	1.6	2.2	3.1	4.3	3.1	2.5	4.4
Central bank	-	-	-	-	-	-	-
General Government	-	-	-	-	-	-	-
Other financial corporations	3.8	11.8	11.4	11.4	12.2	12.1	11.9
Non-financial corporations	33.1	26.7	26.8	25.7	26.2	26.4	25.7
Other domestic sectors	21.8	22.0	22.6	22.6	23.0	23.4	21.1
Non-residents	39.7	37.3	36.0	36.0	35.5	35.6	36.8
Earnings and Profitability							
Return on assets	1.6	1.7	2.2	2.1	2.0	1.9	1.2
Return on equity	16.0	15.0	18.4	17.4	17.2	16.4	11.0
Interest margin to gross income	69.6	72.9	73.7	73.7	73.3	70.3	72.1
Non-interest expenses to gross income	42.9	39.6	38.9	40.4	42.8	41.3	41.4
Liquidity							
Liquid assets to total assets	22.1	22.5	22.4	21.0	21.6	25.2	24.6
Liquid assets to short-term liabilities	28.9	25.6	25.5	23.9	24.5	28.5	27.8
Sensitivity to Market Risk							
Net open position in foreign exchange to capital	3.3	2.1	3.6	2.8	1.9	2.1	1.7

Financial Soundness Indicators (Encouraged)	**Dec-17**	**Dec-18**	**Mar-19**	**Jun-19**	**Sep-19**	**Dec-19**	**Mar-20**
Capital to assets	10.1	11.6	11.9	12.0	11.8	11.3	11.3
Value of large exposures to capital	224.4*	249.7	232.5	250.6	237.9	238.1	244.8
Customer deposits to total (non-interbank) loans	153.4	147.7	151.5	151.4	154.0	163.6	167.8
Residential real estate loans to total loans[c]	10.2	10.5	10.7	11.0	11.1	10.8	10.5
Commercial real estate loans to total loans[c]	3.9	4.6	4.3	4.2	4.7	5.0	4.7
Trading income to total income	10.2	10.2	9.3	7.7	10.4	11.9	13.8
Personnel expenses to non-interest expenses	49.5	49.3	49.0	47.2	46.2	45.4	46.6

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

[b]Other Depository Corporations refer to Banks and Non-Bank Deposit-Taking Institutions that are all licensed by the Bank.

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

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

** 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. Based on previous Guideline, the corresponding ratio for large exposures would have been 171.8 per cent for the quarter ended December 2017.*

Note: Figures may not add up due to rounding.

Source: Bank of Mauritius

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Acronyms

AML/CFT	Anti-Money Laundering and Terrorist Financing
Bank	Bank of Mauritius
CAR	Capital Adequacy Ratio
CCB	Capital Conservation Buffer
CET1	Common Equity Tier 1
COVID-19	new coronavirus 2019
DBM	Development Bank of Mauritius
EMEs	Emerging Market Economies
EU	European Union
FATF	Financial Action Task Force
FSC	Financial Services Commission
FSIs	Financial Soundness Indicators
GB	Global Business
GBCs	Global Business Corporations
GDP	Gross Domestic Product
GFC	Global Financial Crisis
GWAS	Government Wage Assistance Scheme
HQLA	High Quality Liquid Assets
IMF	International Monetary Fund
ISP	Investment Support Programme Ltd
KRR	Key Repo Rate
LCR	Liquidity Coverage Ratio
MERI1	Currency-Weighted Nominal Exchange Rate
MIC	Mauritius Investment Corporation Ltd
MUR	Mauritian Rupee
NBDTIs	Non-Bank Deposit-Taking Institutions
NBFIs	Non-Bank Financial Institutions
NPLs	Non-Performing Loans
RWAs	Risk-Weighted Assets
SEAS	Self-Employed Assistance Scheme
SIC	State Investment Company
SMEs	Small-and-Medium Enterprises
STC	State Trading Corporation
UK	United Kingdom
US	United States
USD	dollar
WEO	World Economic Outlook
y-o-y	year-on-year

Glossary

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

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

Key Repo Rate is the policy rate used by the Bank of Mauritius to signal changes in its monetary policy stance.

MERI1 is the Mauritius Exchange Rate Index, a nominal effective exchange rate, based on the currency distribution of merchandise trade.

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

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

Percentage point is the arithmetic difference of two percentages.

SEM-10 is an index launched by the Stock Exchange of Mauritius on 02 October 2014. It is designed to meet international standards and provide a larger and more attractive investible benchmark for both domestic and foreign market participants and comprises the ten largest eligible shares of the Official Market, measured in terms of average market capitalization, liquidity and investibility criteria.

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.

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