BANK OF MAURITIUS

Financial Stability Report

August 2014

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FINANCIAL STABILITY REPORT

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The Bank publishes the Financial Stability Report twice a year, as required by the Bank of Mauritius Act 2004. The Bank releases the Report in February and August. This issue of the Financial Stability Report refers to information for the semester ended 30 June 2014 unless otherwise stated.

Acknowledgement

This Report was prepared by a team from the Economic Analysis Division comprising Ms N. Nabee (Chief), Ms N. Mihdidin and Mr K. Pitteea (Analysts); Mr B. Kwok Chung Yee, (Analyst) - Off-site Division; and Ms R. Tengur (Graduate Trainee) provided assistance to the team. Ms M. Heerah-Pampusa, (Head) - Economic Analysis Division, reviewed the Report.

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The Report is available in PDF format on the Bank's website at *https://www.bom.mu* under the menu item *Research and Publications*. The Bank of Mauritius welcomes any comment or suggestion on this publication, which may be sent to publications.ead@bom.mu.

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Preface

Financial stability is the resilience of the financial system to respond to adverse shocks, while continuing to function smoothly and supporting the ability of households and firms to use their financial assets with confidence. A stable financial system contributes towards broader economic growth and rising living standards of all people. The Bank of Mauritius has the mandate to ensure the stability and soundness of the financial system of the country. It achieves this objective through delivering on its core functions, notably including effective supervision and regulation of banks, ensuring the orderly functioning of money and foreign exchange markets, and management of reliable clearing, payment and settlement facilities. The Bank collaborates with several domestic, regional and international bodies to promote financial stability.

The Report reviews international and domestic macro-financial developments and examines potential risks to the stability of the financial system. It provides a focus on banking sector developments and vulnerabilities that may affect its overall soundness. It also highlights measures taken by the Bank and other regulatory authorities to mitigate financial risks. Through this Report, the Bank seeks to enhance awareness on the soundness of the Mauritian financial system.

1. Executive Summary

Since the issue of the February 2014 FSR, economic and financial conditions in advanced and emerging markets have continued to improve and financial stability risks have moderated. The global economy appeared on track for sustained growth though there are increasing divergences in the pace of recovery across countries and regions. Faster growth in the US and UK contrasts with sluggish prospects in the euro area, where the enduring effects of the crisis recently compounded by geopolitical risks limit the growth potential. Market turbulence in some vulnerable emerging market economies, brought by the beginning of the US Fed asset-purchase tapering programme, abated. However, the outlook for emerging economies remains subdued relative to past developments.

Monetary policy remains accommodative in major advanced economies but there are widespread expectations that the normalisation of interest rates in the US and UK will start in the near future. The process entails risks to financial stability, particularly since the low interest rate environment coupled with subdued volatility in financial markets appears to have given rise to excessive risk-taking, rising debt levels, and has led to over-pricing of various financial assets. A tightening of monetary policy stance could affect repayment capacity and bring increased volatility as well as significant price adjustments. Decoupling among advanced economies may further exacerbate vulnerabilities through its potential impact on major currencies, which could affect fragile emerging economies.

The domestic economy withstood global headwinds and continued to record positive growth. Statistics Mauritius projected growth to be slightly higher at 3.5 per cent in 2014, in line with a general pick-up in global economic activity. Unlike several emerging market economies, the impact of the US Fed tapering on domestic financial markets has been limited. The rupee exchange rate has been stable and the domestic stock market has performed well. External vulnerabilities arising from the large current account deficit prevail, especially as a large portion of the deficit is financed by debt-creating flows. There is also a concern that normalisation abroad may lead to a reallocation of foreign investors' portfolios. To partly mitigate those risks, the Bank has, through the Operation Reserves Reconstitution programme initiated in June 2012, accumulated gross official international reserves to Rs121.4 billion at end-June 2014, equivalent to six months of import cover.

Fiscal consolidation is on-going to meet the statutory debt-to-GDP ratio of 50 per cent by 2018, and efforts are being pursued to lengthen Government debt maturity profile and reduce rollover risks and costs. Financial stability risks from Government finances appear low although there are some interest rate and exchange rate risks regarding debt.

The banking sector was resilient, well-capitalised and generally profitable during the year ending March 2014 while activity grew appreciably. Banks operated with ample funding from domestic and international sources. Liquidity risks were low, but significant excess liquidity on the domestic money market led to worries about the effectiveness of the monetary policy transmission mechanism. Based on stress tests conducted by the Bank, the banking sector appeared to be resilient to adverse shocks affecting the credit quality of banks' loan portfolios. It is estimated that a majority of banks would not require additional capital injection under the tested scenarios.

Since banks can have a systemic impact on financial stability and the real economy because of their size, interconnectedness, and complexity, the Bank initiated action to identify domestic-systemically important institutions and determine an applicable capital surcharge. The Bank also started the implementation of Basel III to reinforce the regulatory framework, improve banks' soundness and strengthen financial stability. As a first step, banks need to maintain higher capital standards and capital conservation buffers are being introduced in a phased manner.

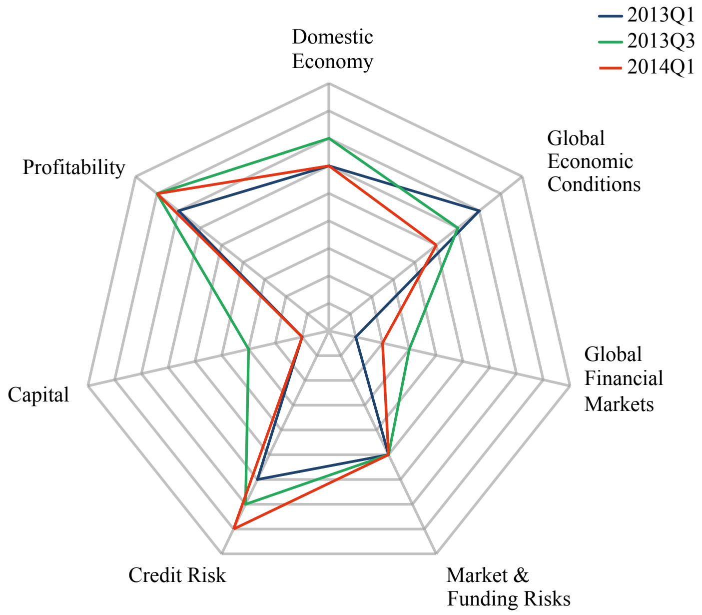
Credit remained an important area of risk. Although credit expansion slowed recently, the high growth rates recorded in previous quarters led to a large accumulation of debt in the household and corporate sectors. The Bank is vigilant over the shift towards consumption loans by households. Banks' asset quality deteriorated, with rising NPL recorded in some sectors. Excess liquidity could accentuate credit risk in the banking sector if banks lower their credit standards. There are sustained concerns about the construction sector where NPL increased to 8.2 per cent as at end-March 2014. The implementation of macroprudential measures induced banks to adopt a more cautious approach to lending to this sector. Cross-border exposures, mainly to India, also need to be carefully monitored due to concerns about declining asset quality in the Indian banking sector.

Large credit concentration suggests another potential source of risk to which the Bank remains vigilant, the more so as the balance sheets of some corporates have shown some signs of vulnerabilities. The introduction of sectoral limits, effective July 2014, is expected to mitigate those risks gradually.

Non-bank deposit-taking institutions remained sound and were well-capitalised. Their activities grew steadily, with total assets recording growth of 10.0 per cent as at end-March 2014. The insurance sector also recorded sound performance in 2013, with latest data from the FSC showing total assets growing by 13.0 per cent.

Overall, the financial system is assessed to be sound and resilient. Looking ahead, a key challenge for the domestic financial system will be related to the process of interest rate normalisation in some advanced economies and its spillover effects on global financial markets. Excess liquidity in the banking system, decline in asset quality, and rising indebtedness of some large corporates will also be carefully monitored to ensure financial stability.

Financial Stability Map



Note 1: Lower vulnerability closer to the center.

Note 2: For further information on the methodology used in the financial stability map, see Financial Stability Report February 2014.

2. International Environment

Enhanced global economic and financial settings since the publication of the February 2014 FSR helped to contain the threats to global financial stability. Volatility in financial markets has been subdued. Liquidity and credit conditions were generally easier and banks generally strengthened. Though the fragile situation in the euro area continues to be a concern, the various steps taken by the ECB should contribute to support the European financial sector and economy in general. But global risks remain, including from the divergent recovery among advanced economies and normalisation of interest rates expected in the near future. Exit from the low interest rate environment, which may have led to excessive risk-taking, may be a source of financial markets vulnerability both in advanced and emerging economies with spillover effects on output growth.[1]

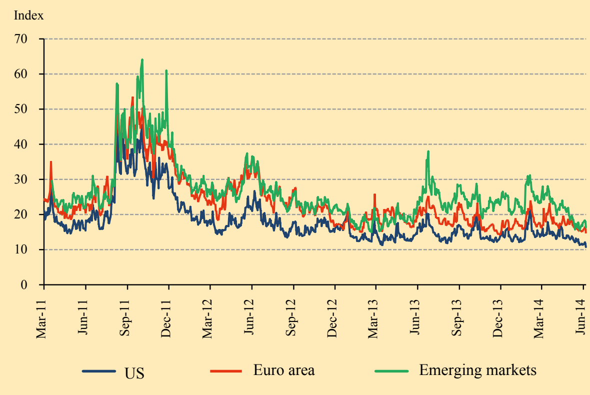
Since the issue of the February 2014 FSR, risks to global financial stability have somewhat moderated as economic and financial conditions in advanced and emerging market economies have improved. Currently, there are widespread expectations surrounding interest rate normalisation in the near future in the US and the UK, where relatively faster recovery is taking place. Normalisation would represent a key source of vulnerability both for advanced and emerging economies, though it would have different implications for them.

Advanced Economies

In major advanced economies, recovery continued though a decoupling was observed between the euro area, where growth remained sluggish, and the US and UK economies, which were rebounding more strongly. In the US, firming activity led the US Fed to further scale down its asset-purchase programme, while reviewing its forward guidance to take into account a broader set of macroeconomic variables. Concurrently, strong growth in the UK was prompting markets to anticipate an increase in the key policy rate, possibly by the end of 2014. In contrast, weak economic conditions in the euro area as well as deflation worries forced the ECB to take extraordinary steps to sustain bank lending and boost the economy in general. These included a cut of 10 basis points in the main refinancing rate; forward guidance that interest rates would remain low for an extended period; and negative interest rate on funds deposited at the ECB.

Economic recovery, accommodative monetary policy as well as improved communication on forward guidance by major central banks helped to improve market sentiment and reduce financial markets volatility (Chart 2.1). In parallel, the protracted period of low interest rates raised risk appetite across asset classes and might have led to excessive risk-taking by investors in search of higher yields. Major equity indices rebounded on favourable corporate earnings, robust growth dynamics in the US and UK, and measures taken by the ECB to boost growth and address deflation concerns. Reflecting the possibility of a shift in policy, the US and UK ten-year sovereign bond yields started trending upwards in 2014H1. In the euro area, movements in the ten-year yields were driven by the pace of recovery across countries. German bund yields evolved in line with yields

Chart 2.1: Financial Markets Volatility



Source: Thomson Reuters.

[1] *Sources: Financial Stability Reports of the ECB, BoE, RBI and SARB, Annual Reports of the US FSOC and the BIS, and July 2014 IMF WEO Update.*

in the US and UK whilst the ten-year sovereign bond yields in the peripheral euro area moved downwards (Chart 2.2).

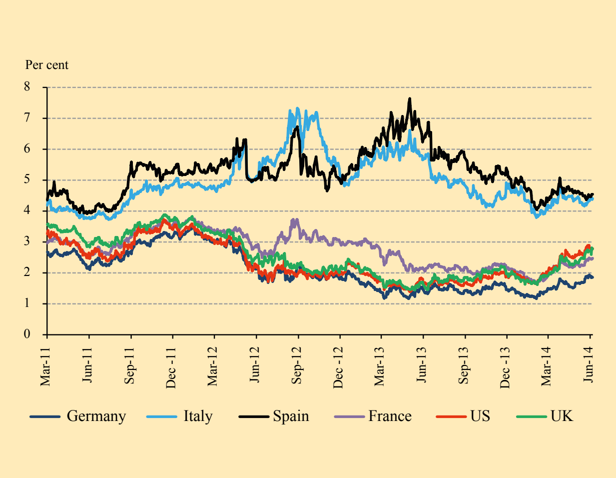
Foreign currency markets moved broadly in line with international developments. The US dollar initially depreciated against other major currencies in early 2014 on the back of weaker-than-expected data releases that fuelled fears that US economic growth might be slowing. However, it recouped losses as the economy bounced back. The euro, which had benefited from US dollar weakness, thereafter lost ground on monetary policy easing by the ECB. The Pound sterling strengthened against the US dollar amid firming growth in the UK economy and expectations of an increase in interest rate.

Conditions in the banking sector in advanced economies were reflective of their economic situation. Large banks in the US continued to recover and recorded higher profits. Results of the Comprehensive Capital Analysis and Review for US bank holding companies released in March 2014 showed that projected losses in the adverse and severely adverse scenarios were around 30 per cent and 50 per cent of banks' Tier 1 capital, respectively. Credit conditions were generally easier. The April 2014 Senior Loan Officer Opinion Survey on Bank Lending Practices showed that, on balance, banks eased their lending policies on business loans and experienced stronger demand for these types of credit (Chart 2.3). Results with regard to household loans were mixed, with banks loosening standards on consumer credit card and auto loans but tightening conditions on mortgage facilities.

In the UK, strengthening economic activity bolstered banks' resilience and credit conditions. Their capital positions largely improved as they sought to rectify shortfalls identified by the Financial Policy Committee. Nonetheless, UK banks' average profitability was relatively subdued as costs related to past misconduct remained a drag on their profits. The BoE Credit Conditions Survey showed that demand for credit by households and corporates increased significantly in 2014Q2. Banks expected to increase the supply of mortgages and business loans in 2014Q3.

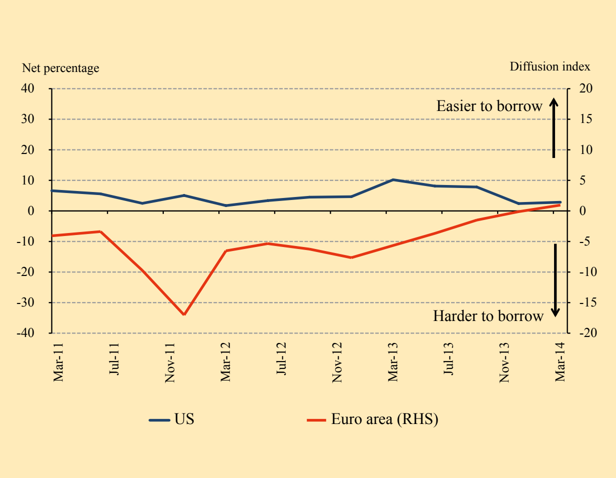
Banks in the euro area consolidated their capital positions while funding markets continued to strengthen. However, profitability remained weak, weighed down by rising loan loss provisioning, high litigation costs faced by some banks, and marked declines in trading revenues. With deterioration in asset quality mostly recorded by banks in stressed countries, progress in balance sheet repair remained uneven. The Bank Lending Survey carried out by the ECB in April 2014 indicated that cross-country disparities in lending supply conditions remained substantial although demand in general could pick up as a result of banks applying more favourable lending standards.

Chart 2.2: 10-Year Yields on Government Bonds



Source: Thomson Reuters.

Chart 2.3: Credit Conditions in US and Euro Area



Sources: ECB and US Fed.

The outlook for euro area financial institutions is still uncertain given the possibility of renewed stress. The recent financial difficulties faced by one bank in Portugal and resulting collateral damage revived concerns about the health of European banks. In-depth reforms towards the creation of a banking union are nonetheless on-going. The agreement reached in April 2014 on the proposed Single Resolution Mechanism should help to reinforce the regulatory and supervisory framework by reducing the link between banks and their sovereigns.

Emerging Economies

In emerging economies, the bouts of financial markets turbulence caused by the reduction of the US Fed asset-purchase programme at the beginning of 2014 abated. Markets reacted positively to counter-policy measures adopted by affected countries to mitigate the fallouts from tapering. Emerging markets equity indices recovered somewhat while exchange rates stabilised. However, prospects for growth in emerging economies remained muted, with the July 2014 IMF WEO Update pointing to a less optimistic outlook for several of these countries.

The banking sector across emerging economies continued to face a number of challenges. As growth slowed in China, borrowers' ability to service their debt weakened and non-performing loans increased considerably. Nevertheless, by drawing on reserves, Chinese banks were able to absorb credit losses and maintain high capital ratios. In India, liquidity and profitability pressures continued to weigh on the banking sector, although marginal improvement was noted in asset quality and capital adequacy levels. In addition, efforts towards balance sheet repair were maintained via deceleration of credit growth and a decline in Tier 1 leverage ratios of commercial banks. In South Africa, profitability of banks generally declined since the onset of the global financial crisis. Credit growth remained strong despite declines in the ratio of impaired advances to total loan book.

Within Sub-Saharan Africa, various initiatives have been undertaken to consolidate financial stability in the region. Box I provides details.

Box I: Regional Initiatives in Sub-Saharan Africa

The outbreak of the global financial crisis exposed several fault lines in the financial system that required intervention. This triggered an ambitious programme of reforms by international standard setters. However, as emerging markets and developing economies were at varying levels of development and had different specificities, it was widely recognised that a-one-size- fits-all approach would be counter-productive.

Against this backdrop, in November 2010, the Financial Stability Board (FSB), which is an emanation of the G-20, took the decision to extend outreach beyond its membership and announced the formation of Regional Consultative Groups (RCGs). In 2011, six RCGs were set up, among which the RCG for Sub-Saharan Africa, of which Mauritius is an active member. The objective was to create a level playing field by taking on board the diversity of the different regions and financial systems in the formulation of global policy measures. The voice of each RCG is heard through its co-chairs at the FSB Plenary Session. A few RCGs have already formed working groups to address region-specific issues and presented their reports to the FSB Plenary. In Sub-Saharan Africa, a working group has been set up to address the deficiencies in home-host cooperation and information sharing which have been identified as potential risks for the region.

In July 2013, the Governor of the Bank of Mauritius was appointed co-chair of the RCG for Sub-Saharan Africa for a period of two years. So far, five meetings of the RCGs have been held.

Discussions within the RCG have focused on vulnerabilities and financial stability issues in the region. They included, *inter alia*, the impact of US Fed tapering on Sub-Saharan Africa; the rise of Pan-African banking groups and their associated risks; constraints in ensuring effective supervision of these groups; and deficiencies in home-host cooperation as well as information sharing.

The main reforms in which the FSB is engaged, namely, 'ending the too-big-to-fail issue', 'transforming shadow banking', 'making derivatives markets safer', and 'reducing reliance on credit rating agencies', are of direct relevance to Mauritius. The Bank drew extensively from the work of the FSB and the Banking Committee on Banking Supervision for setting guidelines for dealing with domestic systemically important banks. A reference system is now in place in Mauritius to assess the systemic importance of our banks. The workshop organised for members of the RCG for Sub-Saharan Africa in May 2014 to provide guidance on the key attributes of Effective Resolution Regimes for Financial Institutions will be very beneficial to us in modernising our existing resolution framework.

Our participation in the meetings has enabled us to benefit from the sharing of experiences with other jurisdictions in the region on a range of issues. Other issues that have been discussed earlier related to the benefits of the regulatory reforms and the main challenges and constraints facing Sub-Saharan Africa in their implementation.

In addition, the FSB has provided guidance on other important issues such as compensation practices, international cooperation and information exchange. Lately, the FSB has come up with a Legal Entity Identifier which assigns a unique identification code to financial market participants and provides an accurate picture of their exposures.

At each meeting, a session is earmarked for regional financial stability issues. The topics for discussions include, *inter alia*, the impact of the US Fed tapering on Sub-Saharan Africa, the rise of Pan-African banking groups and the associated risks and constraints in ensuring effective supervision of these groups. The participation of the International Monetary Fund enhances the debate by offering a macro perspective of the vulnerabilities and issues related to financial stability.

Challenges Ahead

Looking ahead, risks to global financial stability remain. Exit from non-conventional monetary policy in some major advanced economies, and the subsequent normalisation of interest rates might exacerbate vulnerabilities in the global financial system. There are signs that the low interest rate environment might have increased demand for higher risk investments in financial markets. Moreover, debt and property prices increased rapidly in several economies and there are associated concerns about borrowers' ability to repay when interest rates rise.

In its 2014 Spillover Report, the IMF highlighted the risks that uneven recovery across countries could pose to global financial stability. In particular, there is a risk that the normalisation process could increase financial markets volatility, which would impact negatively on vulnerable emerging markets. This might in turn affect advanced economies through trade and financial channels. In addition, the decoupling of growth paths and divergent monetary policy in the US and UK, on the one hand, and the euro area, on the other, may have repercussions on major currencies. These might cause problems for economies with balance sheet vulnerabilities and significant foreign exchange exposures.

3. Domestic Macroprudential Assessment

The domestic economy performed relatively well considering the global economic environment and the mild pace of recovery in main export markets, in particular. Financial markets were not significantly affected by the US Fed tapering, with continuing capital inflows, stable rupee exchange rate, and buoyant stock market. The country's external reserves were considered to be adequate. Private sector credit growth decelerated but, the large accumulation of credit as a result of substantial credit growth in previous quarters is a matter of concern for certain sectors. Some sectors, like construction, appear particularly vulnerable in view of rising NPL. The banking sector remained resilient, well-capitalised and profitable. Implementation of Basel III started with phased-in increases in capital and the introduction of counter-cyclical buffers. Overall, risks to financial stability remain - a potential source being the expected normalisation of interest rates in some advanced economies - but the Bank has taken several actions to mitigate those risks. The Bank remains vigilant to adverse developments that may have a negative bearing on the financial system.

3.1 Macro-Financial Conditions

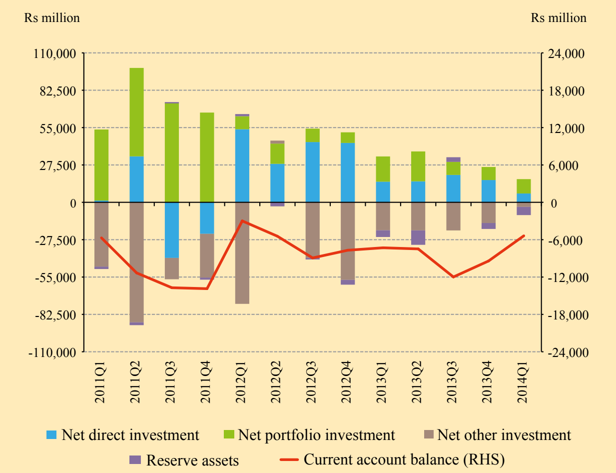
The performance of the domestic economy was considered to be rather fair against the global backdrop, recording y-o-y real GDP growth of 2.4 per cent in 2014Q1 compared with 3.8 per cent in 2013Q1. Statistics Mauritius projected growth to be slightly higher at 3.5 per cent in 2014 as main export markets gradually recover. It anticipated that the improvement in economic activity would be mainly led by the *'accommodation and food service activities'*, *'manufacturing'* and *'financial services'* sectors, while *'construction'* is expected to continue being a drag on growth.

As a small open economy, Mauritius is subject to a number of external vulnerabilities that may have a bearing on its growth path and domestic financial conditions. The anticipated normalisation of interest rates in some advanced economies, which may have financial stability implications domestically, warrants monitoring.

Unlike several emerging market economies, the impact of the US Fed tapering on domestic financial markets and the external sector has been minimal so far. The current account deficit, inclusive of cross-border transactions of GBC1s, narrowed to 6.1 per cent of GDP in 2014Q1. The deficit continued to be largely financed by inflows on the direct and portfolio investment accounts (Chart 3.1). Nonetheless, the persistent large current account deficit poses sustainability concerns considering the low savings rate, the more so as a reversal in investor sentiment towards Mauritian assets is possible as normalisation gets initiated elsewhere. This underscores the importance of adopting structural reforms to enhance competitiveness and reduce reliance on external financing.

Volatility in the domestic stock market was relatively low during 2014H1. Foreign investors were net purchasers of domestic stocks, with net inflows of Rs132.0 million as against net outflows of Rs256.0 million during 2013H2 (Chart 3.2). They showed a preference for banking stocks, with net purchases of Rs196.0 million, whilst they disinvested a net amount of Rs179.0 million from the leisure and hotel sector. The SEMDEX, which had trended upwards and tracked major indices during 2013H2, stabilised at around 2,100 points during 2014H1. Banks' and hotels' share prices, on average, went down by 0.7 per cent and 1.2 per cent, respectively, while those of insurance companies increased by 5.9 per cent (Chart 3.3).

Chart 3.1: Financing of the Current Account

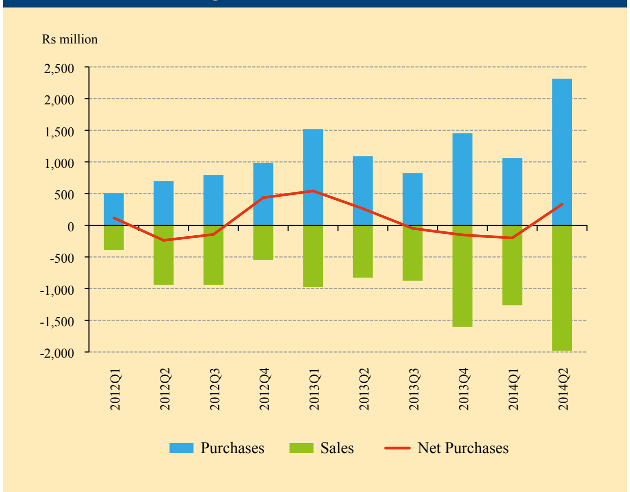


The nominal effective rupee exchange rate, as measured by MERI2, remained fairly stable during 2014H1, reflecting international currency movements as well as domestic demand and supply conditions. As part of its Operation Reserves Reconstitution (ORR) programme, the Bank intervened quite substantially on the domestic foreign exchange market to purchase foreign currencies. This helped to reduce exchange rate volatility and contain rupee appreciation against the euro. On a dealt basis, the rupee depreciated marginally by 0.1 per cent against this currency. It also depreciated against the US dollar in 2014Q2 as the latter recovered in international markets and maintained a depreciating trend against the Pound sterling, which was supported by firming growth in the UK, for the past year or so (Chart 3.4).

Reserve Adequacy

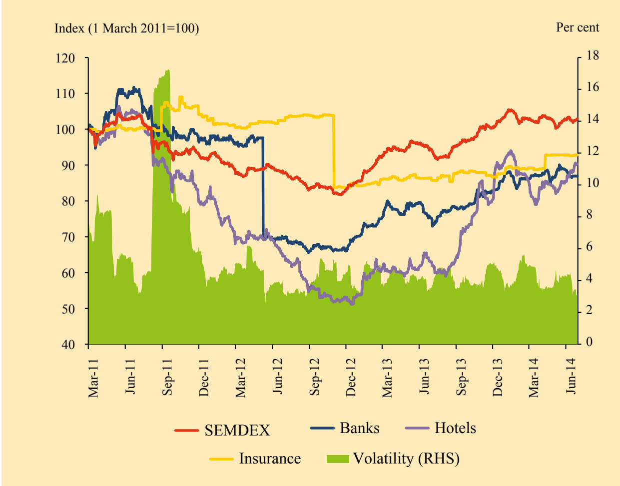
The implementation of the ORR programme led to a significant increase in gross official international reserves, which stood at Rs121.4 billion as at end-June 2014. Import cover, based on the value of imports of goods f.o.b. and non-factor services for the year 2013, increased from 5.2 months as at end-December 2013 to 6.0 months (Chart 3.5). Reserves accumulation is deemed important as it cushions the economy against external shocks and supports financial stability. In its 2014 Article IV Mission Report, the IMF assessed that the levels of reserves appeared comfortable against traditional thresholds. Box II gives an overview of different methods used to assess the adequacy of international reserves.

Chart 3.2: Transactions by Foreign Investors on the SEM



Source: Stock Exchange of Mauritius.

Chart 3.3: SEMDEX and Share Price Indices



Source: Stock Exchange of Mauritius.

Chart 3.4: Exchange Rate Movements

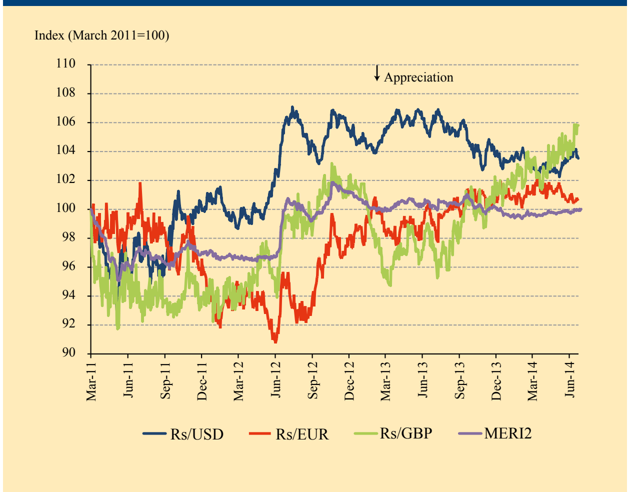


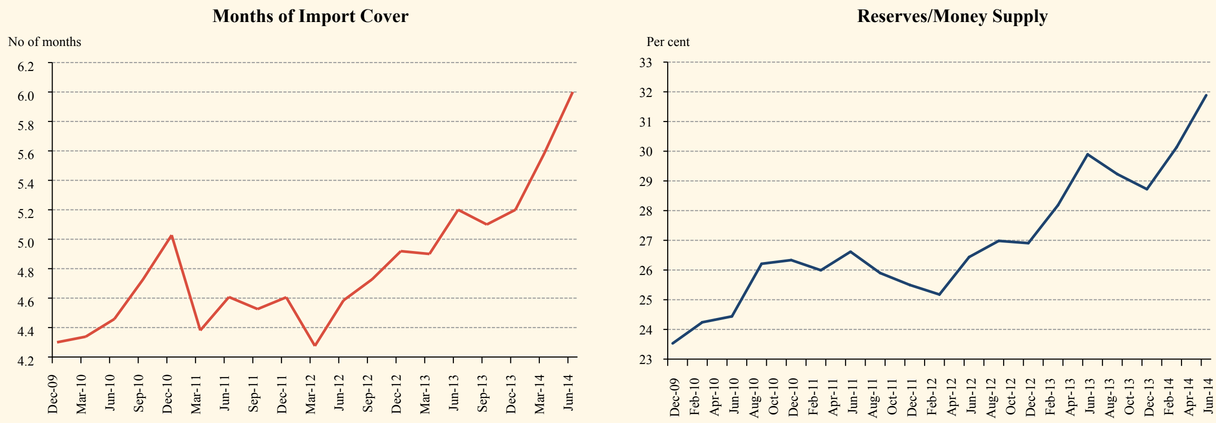
Chart 3.5: Gross Official International Reserves and Import Cover

Box II: The Adequacy of Reserves in Mauritius

Gross official international reserves have grown rapidly since the Bank embarked on the Operation Reserve Reconstitution (ORR) programme in June 2012. Since then, the import cover has moved from 4.5 months to 6.0 months of import of goods and services as at end-June 2014. This Box assesses reserves adequacy through various methods.

Traditional measures of reserves adequacy suggest that international reserves should at least be equal to three months of imports of goods and services, or around 15-20 per cent of the money supply. In Mauritius, the level of reserves comfortably meets these two benchmarks (Chart I). Both ratios increased significantly in the wake of the ORR programme.

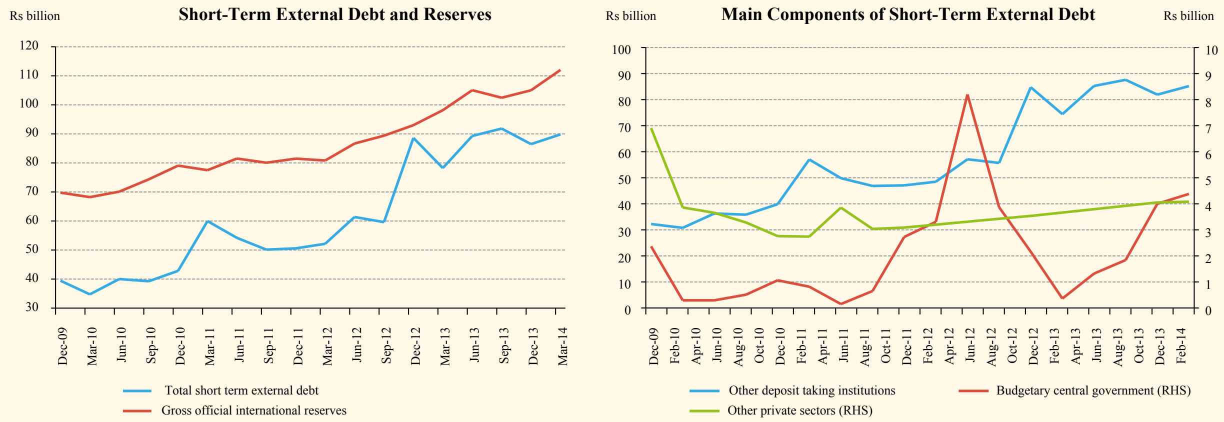
Chart I: Import Cover and Reserves to Money Supply



The Guidotti ratio, which measures the level of reserves relative to short-term external debt, is another useful indicator of the adequacy of reserves. It provides a means to assess whether a country is able to meet its foreign currency obligations in the absence of capital inflows. As a rule, a Guidotti ratio of at least unity, which implies that international reserves are at least equal to total short-term external debt, indicates that reserves are adequate.

In Mauritius, short-term external debt has grown quite significantly over the past few years, driven mainly by debt of banks and non-bank deposit-taking institutions, which account for around 95 per cent of total short-term external debt. The short-term external debt of the Budgetary Central Government makes up around 1 per cent of the total (Chart II).

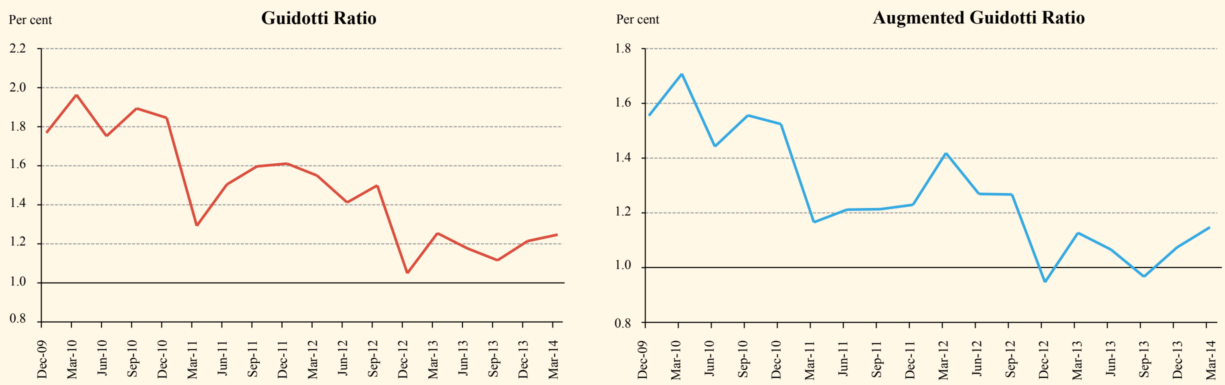
Chart II: Short-Term External Debt and Gross International Reserves



Note: Total short-term external debt comprises those of general Government, public corporations, monetary authorities, private sector, other deposit taking institutions and extra budgetary units.

Notwithstanding the increase in short-term external debt, the Guidotti ratio has remained above unity, providing some assurance that, in the absence of capital inflows, the country would have sufficient reserves to meet its short-term foreign currency obligations. However, given the relatively faster pace of increase in short-term external debt, the Guidotti ratio has trended downwards (Chart III).

Chart III: Guidotti Ratios



The concept of the Guidotti ratio could be extended to assess whether reserves would be adequate to cover other external financing needs, like the current account deficit and servicing of external debt, in addition to short-term external debt. This Augmented Guidotti ratio would thus provide a supplementary gauge of the adequacy of reserves. Including the current account deficit and servicing of external debt in the computation of the Guidotti ratio did not fundamentally change its overall trend. The Augmented ratio declined over the past few years, but stayed mostly above unity.

The different indicators of the adequacy of reserves suggest that international reserves of the country may be comfortable. The rapid increase in short-term external debt which translated into declining trends in the Guidotti and Augmented Guidotti ratios may pose some concerns. However, a large portion of the short-term external debt of other deposit taking institutions consist of borrowings from parent banks and affiliated companies to finance their cross-border activities. This type of borrowing is considered to be rather balanced.

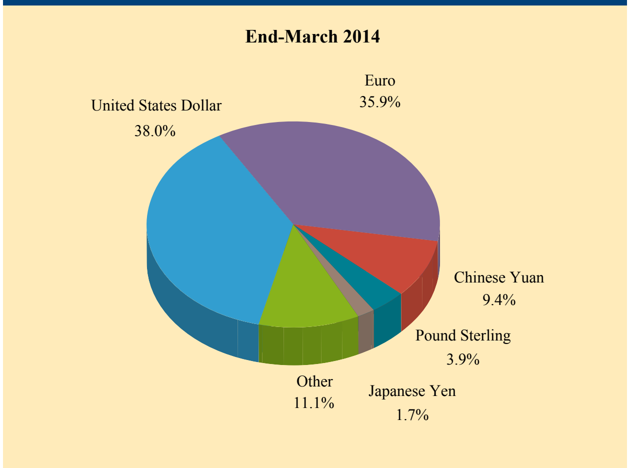
Sources: Bernard K.M (2011), "International Reserve Adequacy in Central America" IMF Working Paper No. 11/144; Greenspan A (1999), "Currency Reserves and Debt" Speech at the World Bank Conference on Recent Trends in Reserves Management, Washington D.C.

Public Sector Debt

Financial stability encompasses sustainable levels of public debt and prudent management of debt. As at end-March 2014, public sector debt, comprising debt of general Government and public enterprises, stood at 60.6 per cent of GDP. Fiscal consolidation is on-going to meet the statutory debt-to-GDP ratio of 50 per cent by 2018. It is expected that public sector debt would decrease to 56.3 per cent and 54.0 per cent of GDP in 2015 and 2016, respectively. In March 2014, Moody's maintained its credit rating of Baa1 for Mauritius, citing the *"resilience and diversification of the local economy and robust institutional capacity"*. It considered that a considerable and permanent reduction in the country's vulnerability to external volatility and shocks could exert positive pressure on the rating.

In parallel, Government continued its efforts to lengthen its debt maturity profile, and reduce rollover risks and costs. Long-term domestic debt (by original maturity) as a proportion of total domestic Government debt increased from 51.7 per cent as at end-March 2013 to 54.7 per cent as at end-March 2014.

Chart 3.6: Currency Composition of Central Government External Debt



Central Government external debt rose to 13.2 per cent of GDP as at end-March 2014, from 10.7 per cent a year earlier. It is projected to grow steadily to 15.1 per cent and 14.9 per cent by end-2015 and end-2016, respectively. The proportion of central Government external debt, denominated in US dollar and euro increased slightly to 38.0 per cent and 35.9 per cent, respectively, over the year (Chart 3.6).

Around 78.5 per cent of central Government external debt carried floating interest rates, 18.2 per cent fixed rates, and 3.3 per cent was interest-free. The external debt-service ratio, which was 3.6 per cent in 2013, is expected to hover in the range of 4.2 per cent to 4.7 per cent between 2014 and 2016. Given this profile, Government external debt might be subject to interest rate and foreign exchange risks, especially as the US and UK are poised to gradually start reversing their accommodative monetary policies while the euro area may need to keep an easier stance.

3.2 Credit Growth and Credit Risks

Total credit extended by other depository corporations and other financial corporations is computed from returns submitted to the Bank and from the MCIB database, respectively. This figure presently excludes facilities extended by credit unions and hire-purchase companies. It is expected that the recent amendment to the Banking Act 2004 with regard to credit unions will enhance data coverage (Box III).

Total credit stood at around Rs541.8 billion as at end-March 2014. Banks play a dominant role in the allocation of credit as they account for around 97 per cent of total credit. Credit extended by other financial corporations, including insurance companies, represented 2.2 per cent of total credit (Chart 3.7). Around 75 per cent of credit extended by other financial corporations was channeled to households while total arrears amounted to some Rs2.5 billion.

Box III: Credit Unions

In December 2013, the Banking Act 2004 was amended to require credit unions, registered under the Co-operatives Act 2005 and having total assets exceeding Rs20 million, to be licensed by the Bank in order to accept and deploy deposits. A period of 6 months was granted under section 14E(2) of the Act for existing credit unions to submit an application for a licence from the Bank. The Bank issued a Communiqué in May 2014 inviting qualifying credit unions to apply for a licence. Twenty-nine applications were received by the deadline, in June 2014. In August 2014, a Memorandum of Understanding was signed between the Bank and the Registrar of Co-operative Societies, setting out the framework of their co-operation to ensure effective supervision of credit unions.

Banking Sector Credit

Credit extended by banks grew by 1.0 per cent as at end-March 2014 compared with 9.2 per cent a year ago. This slowdown reflected a deceleration in credit extended by banks to the private sector in Mauritius and a contraction in cross-border credit, possibly due to uncertainties surrounding the DTAA with India (Chart 3.8). Despite moderate credit growth, banks in Mauritius remain substantially exposed to credit risk as loans and advances represent the major share of banks' total assets.

Credit to the private sector, which represented for 44.3 per cent of total bank credit, grew by 5.2 per cent compared with 13.1 per cent in the preceding year. The major share of private sector credit was channelled to corporates. Households borrowed 28.3 per cent of banks' credit to the private sector (Chart 3.9).

Chart 3.7: Credit by Type of Institutions

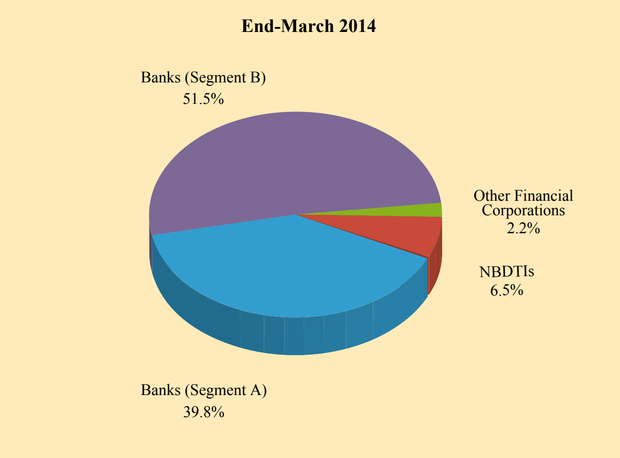
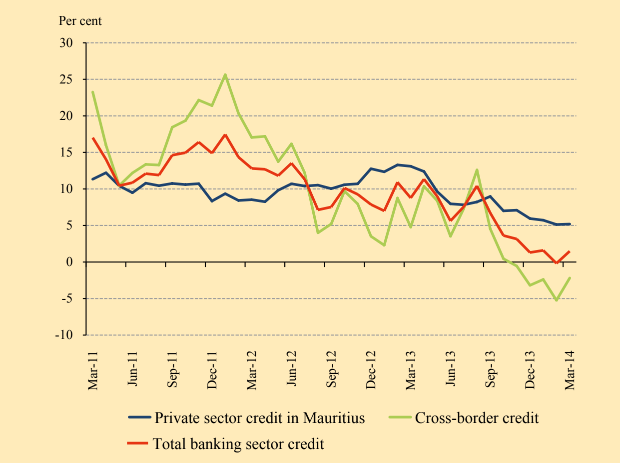


Chart 3.8: Y-o-y Credit Growth



Credit to the private sector represented 73.2 per cent of GDP. The decline in private sector credit growth was reflected in a fall in the credit to GDP gap (Chart 3.10). From a sectoral perspective, the concerns that had been raised regarding the significant accumulation of credit to the construction sector remained though there was a decrease in credit growth and construction credit to GDP gap. Notwithstanding excess liquidity in the system and the low interest rate environment, it would appear that the implementation of macroprudential policy measures announced by the Bank in October 2013 may have already started to impact positively on credit allocation to the construction sector.

Non-Performing Loans

Reflecting difficulties faced by some economic operators, asset quality of banks deteriorated further since the February 2014 FSR, reaching around 4 per cent of total bank credit as at end-March 2014. The ratio of NPL to private sector credit stayed above 5 per cent over the year while the ratio of NPL to cross-border credit increased to 2.5 per cent, from 1.9 per cent a year ago (Chart 3.11). The continued rise in NPL over the past quarters is a matter of concern. The Bank remains vigilant about rising NPL in the banking sector.

Chart 3.10: Private Sector Credit to GDP Gap

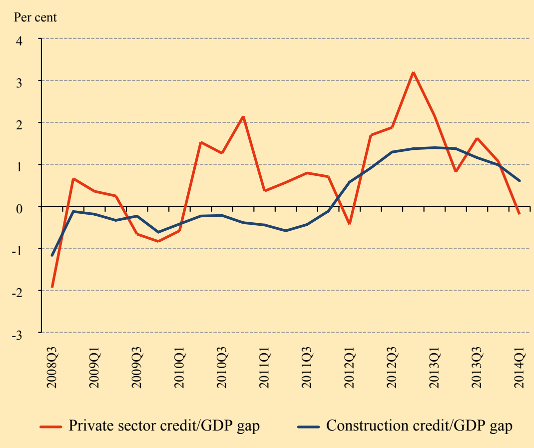


Chart 3.11: Non-Performing Loans of Banks

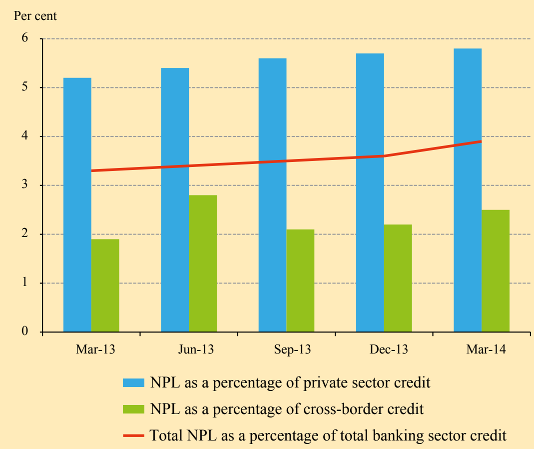
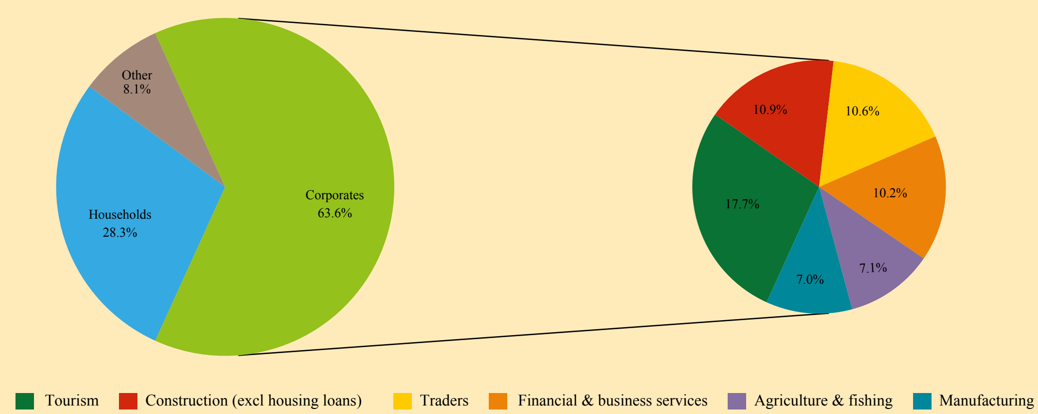


Chart 3.9: Credit Allocation to Households and Corporates

End-March 2014



Rising NPL are generally accompanied by a higher level of specific provisions, which depend on the realisable value of collaterals. Over the year to end-March 2014, loan loss provisioning by banks increased by 14.1 per cent compared to an increase of 21.5 per cent in NPL. The relatively lower rise in loan loss provisioning resulted in a decline in the coverage ratio to 44.8 per cent, from 47.7 per cent a year earlier (Chart 3.12). To ensure adequate portfolio provisioning in some sectors against potential rise in NPL and, as part of the set of macroprudential measures, banks have been required to make additional portfolio provision in the *housing, commercial, residential and land parceling* segments of the construction sector as well as in the tourism and personal sectors effective 1 July 2014.

Household Sector Credit

The household sector witnessed rapid growth over the past years and represents a key component of banks' balance sheets. Between March 2009 and March 2014, the ratio of household credit to GDP increased from 13.9 per cent to 20.7 per cent. Growth in credit extended to households moderated recently, but remained robust. As at end-March 2014, credit grew by 12.9 per cent compared with 17.1 per cent a year earlier (Chart 3.13).

The momentum in housing credit continued to decline but growth was still higher than in several other sectors. As at end-March 2014, growth reached 9.1 per cent, from 17.1 per cent a year earlier. While access to housing credit eased through relatively low interest rates and competitive mortgage schemes offered by banks, appetite for housing loans may have been affected by rising construction costs and anecdotal evidence that property prices may be overvalued. The recent decline in residential building permits tends to corroborate the fall in housing credit growth, though there may a lag of some quarters between the time when permit is granted and when credit is disbursed (Chart 3.14).

Concurrently, households have showed a preference for consumption loans, which grew by 19.3 per cent as at end-March 2014 compared with growth of 17.2 per cent a year earlier. This type of credit may constitute a higher risk for banks, particularly when they are not adequately collateralised or unsecured. NPL in the *personal* sector, as an indicator of the quality of consumption loans remained high despite a drop to 9.1 per cent as at end-March 2014, from 9.8 per cent a year earlier. The growing switch from housing into consumption amid signs of lower growth of household disposable income calls for greater vigilance. The implementation of macroprudential measures since January 2014 is expected to reinforce the resilience of the banking sector to potential risks that may arise from the housing market.

Chart 3.12: Non-Performing Loans and Coverage Ratio

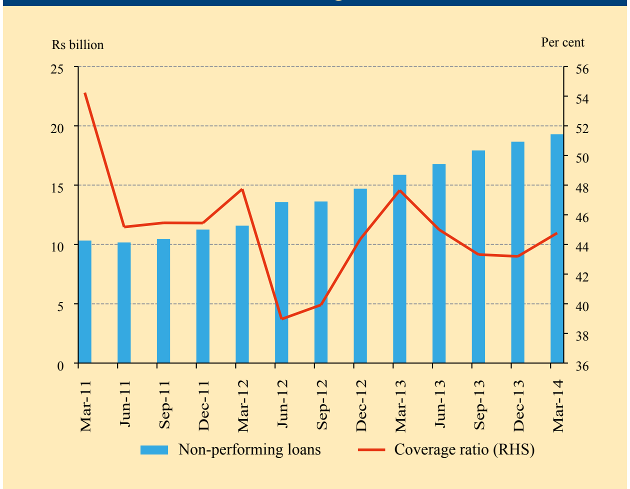
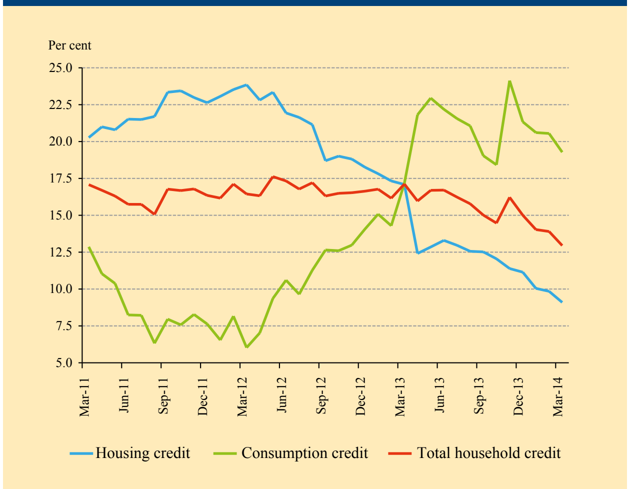


Chart 3.13: Y-o-y Growth of Household Credit



Corporate Sector Credit

Credit growth to the corporate sector was on a declining trend over the past year, falling to 3.1 per cent as at end-March 2014 (Chart 3.15). Despite this decline, the accumulation of credit over the years resulted in high outstanding credit in some sectors. A number of large corporates had recourse to the restructuring of their debt. Credit remained concentrated among a few large conglomerates. Most corporates in Mauritius borrow from banks operating in the domestic market, though some of them have issued bonds – total issuance is estimated at around Rs3.5 billion. In the current economic environment, highly leveraged corporates represent a risk to financial stability.

The slowdown in corporate credit growth mainly reflected a deceleration in the *construction (excluding housing loans)* sector. From a high of around 35 per cent recorded in the last quarter of 2012, growth in credit to *construction* fell to 7.3 per cent as at end-March 2014. Conditions remained subdued for construction, which is expected to contract for the fourth consecutive year. A few commercial property developers have encountered

Chart 3.14: Housing Credit and Residential Building Permits

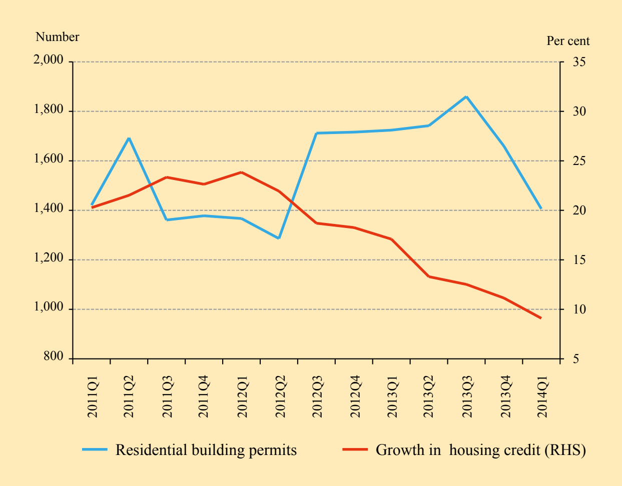
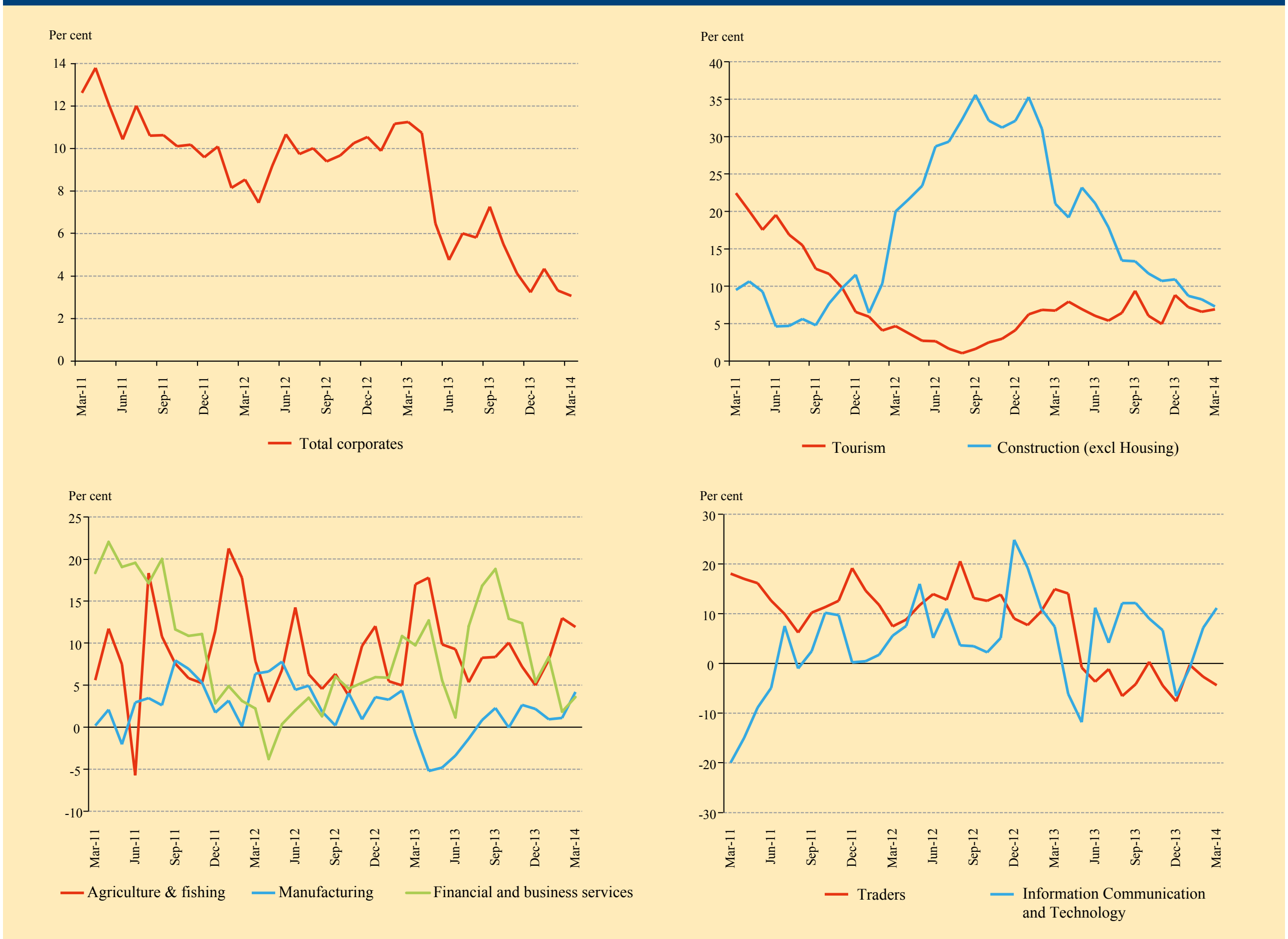


Chart 3.15: Y-o-y Growth of Credit to Corporates



financial hardships as they were unable to sell their properties. There is anecdotal evidence of excess supply in the market as demand continues to be buffeted by external headwinds. The NPL ratio for the *construction* sector increased to 8.2 per cent as at end-March 2014, from 7.9 per cent a year earlier. The implementation of macroprudential measures induced banks to adopt a more cautious approach to lending to this sector. The LTV ratio provides a buffer for banks against the risk of contraction in property prices.

Credit to the *tourism* sector grew by 6.9 per cent as at end-March 2014, from 6.7 per cent a year earlier. A large portion of outstanding corporate credit, representing about 25.5 per cent, was channelled to this sector. This was the result of substantial credit growth prior to, and in the immediate aftermath of the crisis as the hotels increased their capacity and upgraded their infrastructure. As the crisis endured, some hotels also had to restructure their debt. Overall, the sector was able to withstand the downturn but, with weak cash flows and low profitability, the ability of some hotels to service their debt has somewhat come under pressure. The NPL ratio doubled to 2.8 per cent as at end-March 2014.

Credit data on other sectors was mixed. *Manufacturing* sector credit rebounded, with growth of 4.2 per cent as at end-March 2014 as against a contraction of 0.8 per cent in the preceding year. Credit growth to the *financial and business services* sector dropped from 9.7 per cent to 3.6 per cent while credit to traders contracted by 4.4 per cent as against growth of 14.9 per cent a year earlier. These sectors represented 10.0 per cent, 14.7 per cent and 15.2 per cent of total corporate credit, respectively. *Manufacturing* and *traders* recorded the largest expansion in NPL ratios, with respective increases of 1.4 percentage points and 1.2 percentage points (Chart 3.16).

Foreign currency loans, used mainly for the import of raw materials and consumption goods, accounted for 21.7 per cent of corporate sector credit. The *tourism* sector borrowed 37.9 per cent of its credit facilities in foreign currency. Foreign currency denominated loans in the *manufacturing* , *construction* and *traders* sectors accounted for 24.1 per cent, 4.3 per cent and 9.7 per cent, respectively, of their total credit. Foreign exchange risk arising from these exposures is considered to be manageable as revenues are, in most cases, also denominated in foreign currencies.

Rising NPL pointed to deterioration in asset quality in some key sectors where banks also have relatively large credit concentration. The introduction of sectoral limits, effective July 2014, is expected to mitigate these risks gradually over time. Based on March 2014 data, it is estimated that banks have reasonable leeway to support development of these sectors (Chart 3.17).

Chart 3.16: NPL as a percentage of Sectoral Credit

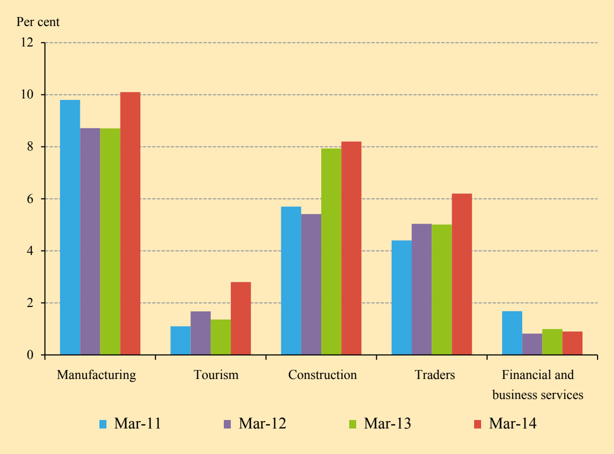
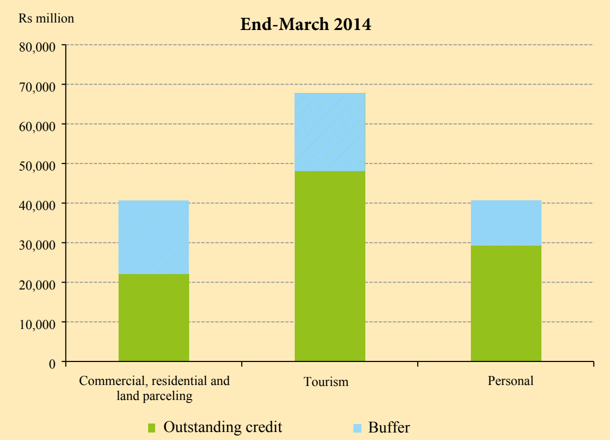


Chart 3.17: Sectoral Credit Limits and Buffer

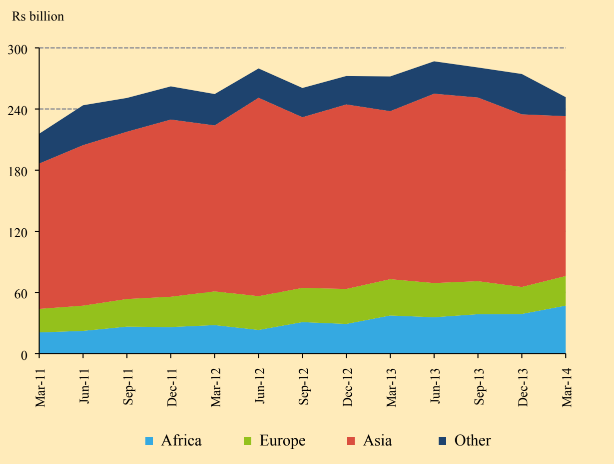


Note: The buffer represents the difference between outstanding credit and sectoral credit limit.

Cross-Border Exposures

Cross-border exposures of banks operating in Mauritius (excluding GBLH) constituted around 49.6 per cent of banking sector credit. As at end-March 2014, a significant share of cross-border credit (60.2 per cent) was channeled to Asia (Chart 3.18). Although attempts were made to diversify cross-border activities towards other jurisdictions, cross-border loans remain concentrated in India, which represented around 89.7 per cent of the total credit to Asia. Recently, concerns have been raised about credit quality in India and banks would have to exercise caution. Data from the Reserve Bank of India pointed towards declining asset quality as NPL in the Indian banking sector almost doubled and the amount of restructured loans increased significantly.

Chart 3.18: Cross-Border Credit



Credit granted to the African continent went up steadily over the past years given increasing opportunities to invest there and the conclusion of a number of double tax avoidance treaties. Cross-border credit gives rise to country and foreign exchange risks, which need to be managed carefully. Although the asset quality of banks' offshore portfolios remained sound, a mild deterioration was noted recently. NPL as a percentage of credit extended outside Mauritius increased to 2.5 per cent as at end-March 2014, from 1.9 per cent a year earlier. Excluding GBLH, the ratio of impaired loans to total cross-border loans stood at 1.0 per cent in Asia, 2.4 per cent in Europe and 1.1 per cent in Africa.

Concentration of Credit

Large credit exposures refer to total exposures to a customer or a group of closely-related customers that are above 15 per cent of the capital base of a bank. As a percentage of total banking sector credit, large exposures increased to 31.7 per cent as at end-March 2014 compared with 25.0 per cent in the preceding year. Correspondingly, the overall credit concentration - computed as the ratio of aggregate large exposures to the capital base of all banks - increased from 182.4 per cent to 207.4 per cent (Table 3.1). As at end March 2014, credit extended to the ten largest borrowers accounted for 33.9 per cent of total large credit exposures, down from 40.0 per cent a year earlier. This credit represented 70.3 per cent of banks' total capital base (Table 3.2).

Table 3.1: Concentration Risk

	Percentage of aggregate large exposures to capital base	Percentage of aggregate large exposures to total credit facilities
Mar-13	182.4	25.0
Sep-13	200.3	28.3
Dec-13	209.9	30.5
Mar-14	207.4	31.7

Although credit concentration indicators remained below prudential limits, the upward trend in the volume of large credit exposures in the banking sector suggests a potential source of risk. The Bank remains vigilant to credit concentration risk, the more so as the balance sheets of some large entities operating in the domestic sector have shown signs of vulnerabilities.

3.3 Banking Sector

3.3.1 Balance Sheet Structure

The domestic banking sector is large in relation to the size of the economy. The rise in banks' total assets as a percentage of GDP from 272.1 per cent to 279.7 per cent over the past five years provides an indication of the systemic importance of that sector. Assets held by domestic-owned banks represented 41.9 per cent of total banking sector assets while subsidiaries and branches of foreign-owned banks held 51.4 per cent and 6.6 per cent of total assets, respectively. (Chart 3.19). The two largest domestic-owned banking groups hold a major share of banking sector assets. To reduce their complexity and provide a mechanism to

Chart 3.19: Banking Sector Assets

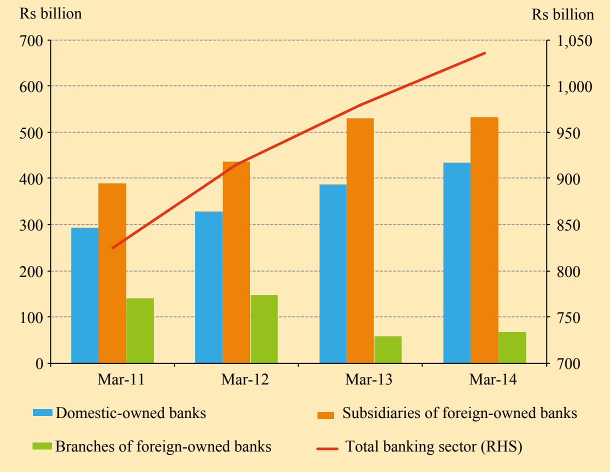


Chart 3.20: Components of Banks' Assets and Liabilities - March 2014

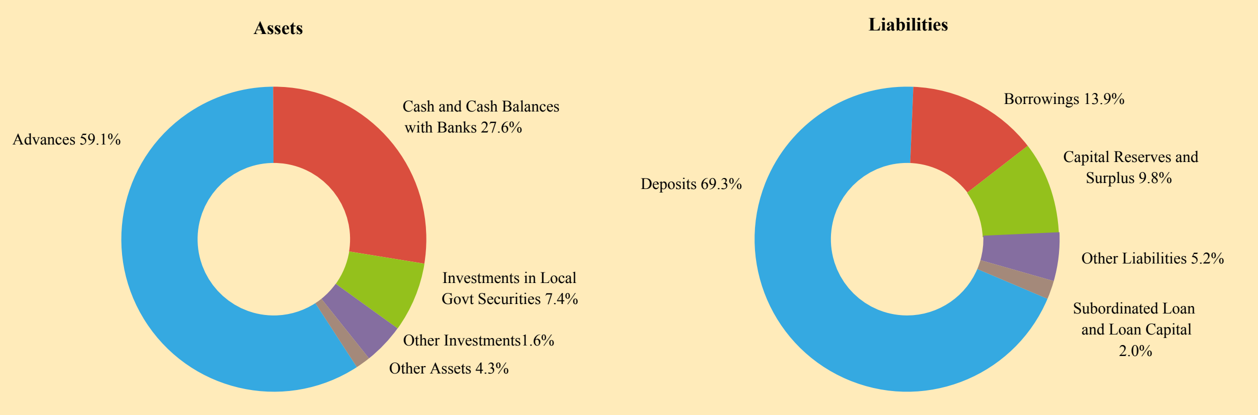


Table 3.2: Exposure of Banks to Ten Largest Borrowers

	Ten largest borrowers (Rs million)	Ten largest borrowers to total large exposures (Per cent)	Ten largest borrowers to total capital base (Per cent)
Mar-13	69,315	39.8	73.0
Sep-13	71,271	35.5	71.0
Dec-13	72,434	33.5	70.7
Mar-14	74,833	33.9	70.3

facilitate their orderly resolution, an amendment was brought to the Banking Act 2004 in April 2013 (Box IV).

Total assets of banks increased by 5.8 per cent as at end-March 2014, from 7.1 per cent a year a year ago. Segment A and Segment B assets, which represented 41.4 per cent and 58.6 per cent of total assets, grew by 9.7 per cent and 3.1 per cent, respectively. Over the year to end-March 2014, banks shifted slightly out of advances into cash and cash balances. The share of advances to total assets declined to 59.1 per cent while the proportion of cash and cash balances with banks increased to 27.6 per cent (Chart 3.20). These changes in balance sheet structure reflect the declining trend in credit as well as the significant amount of excess liquidity in the banking system.

Box IV - Factors Motivating the Restructuring of Banks

As part of reform initiatives taken to strengthen the domestic banking sector, the Bank examined the corporate form adopted by banking groups in Mauritius. Some banks were organised under the Bank-Subsidiary model whereby the bank was the parent of all subsidiaries of the group. It was observed that a potential vulnerability under such a corporate form arose as a result of the commingling of financial and non-financial activities within the group. These banks were therefore called upon to undertake a restructuring of their operations with a view to segregating these two types of activities.

Banks with significant interests in non-banking activities are exposed mainly to the primary risks of their business namely credit and market risks. However, these banks also assume the business risks of their non-financial activities. In the case where the non-financial activities face financial strain, these banks might be compelled to support them beyond normal commercial considerations to safeguard their own reputation. In so doing, the banks may undermine their own financial soundness.

Additionally, problems faced by the affiliates may trigger a loss of confidence in the bank itself because of the close association. The Bank-Subsidiary model has an implicit safety net which is extended to the non-bank operations of the group. If failure of an associate non-bank threatens the financial soundness of bank, the regulator may be forced to rescue both the bank and its associate.

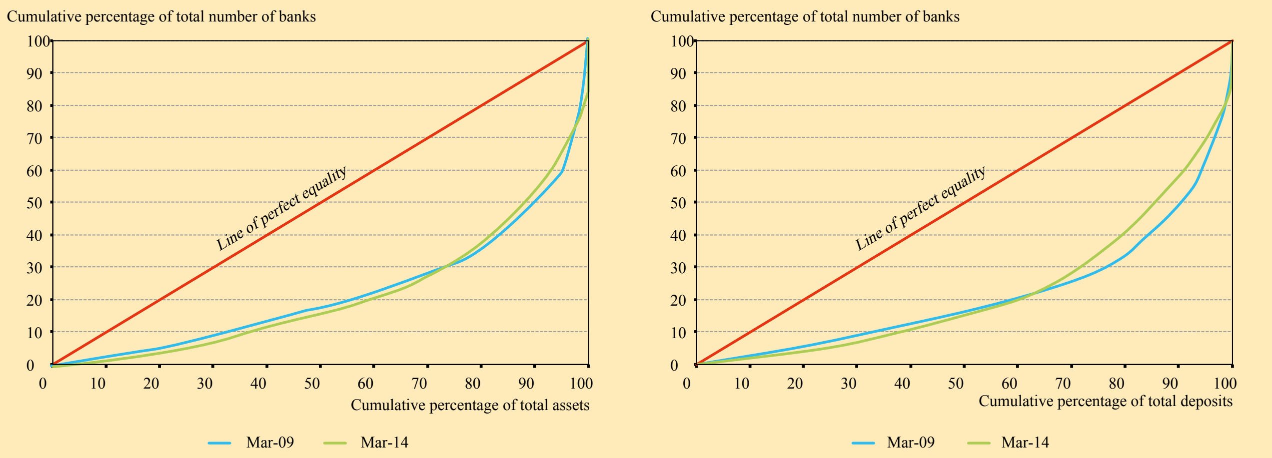
The separation of banking activities from non-banking activities will limit the risk of contagion from non-banking business to the bank, and will allow management to focus on their core business of banking. Above all, this measure is expected to enable efficient resolution of financial institutions by reducing the complexity of structures.

3.3.2 Market Concentration

The banking sector in Mauritius displays a relatively high degree of concentration despite an increasing number of banks in operation. Market concentration, as measured by the HHI Index for total assets, remained high at 1,083 as at end-March 2014. The four largest banks in Mauritius hold more than 50 per cent of total assets, reflecting an oligopolistic structure. As depicted in the Lorenz curve, this is again found in the distribution of deposits mobilised by banks (Chart 3.21).

Banks can have a systemic impact on financial stability and the real economy because of their size, interconnectedness, and complexity. In this perspective, the Bank issued a guideline for dealing with domestic-systemically important banks (Box V).

Chart 3.21: Distribution of Banks' Total Assets and Deposits



Box V: Domestic-Systemically Important Banks

The failure of a large bank, with a high degree of interconnectedness, can have substantial adverse impact on the stability of the domestic financial system. In this context, the Basel Committee on Banking Supervision (BCBS) recommended that all national authorities should undertake an assessment of the systemic importance of banks operating in their jurisdiction.

In recognition that some large banks in Mauritius are 'too-big-to-fail', the Bank has, effective 30 June 2014, issued a *Guideline for dealing with Domestic-Systemically Important Banks* (D-SIBs). The guideline sets out the assessment methodology used by the Bank for classifying an institution as being systemically important. Institutions identified as D-SIBs would be required to hold an additional capital surcharge depending on the degree of systemic importance. Only banks with total Segment A assets representing at least 3.5 per cent of GDP would be considered for assessment.

The Bank will use an indicator-based measurement approach to identify D-SIBs and determine the applicable capital surcharge. This approach is calibrated on the methodology developed by the BCBS to evaluate the capital surcharge for Global-Systemically Important Banks (G-SIBs) as well as work undertaken by the Financial Stability Board. It also takes into account the specificities of the local jurisdiction. Five equally-weighted parameters have been chosen to identify D-SIBs and determine the magnitude of the capital surcharge:

1. **Size**: to measure the market share of a bank relative to the sector.
2. **Interconnectedness**: to evaluate the connection between a bank and other financial institutions.
3. **Substitutability/financial institution infrastructure**: to determine the degree to which the services provided by a single bank can be substituted by another bank.
4. **Structure and complexity**: to assess the costs and time needed to resolve a complex bank in case of failure.
5. **Large exposures**: to appraise the extent to which a bank has significant exposure to large groups.

The fifth parameter 'Large exposures' replaced the parameter 'Cross-jurisdictional activity' that forms an integral part of the determination of the capital surcharge for G-SIBs as the Bank sought to focus on the domestic market. This parameter would supplement existing regulatory measures on credit concentration used to mitigate the risk to financial stability posed by the level of exposures to large groups.

Banks which are assessed as D-SIBs would be required to hold a loss absorbency capital surcharge ranging from 1.0 to 2.5 per cent of risk-weighted assets, depending on the bucket where the sum of the weighted scores of the five parameters would be situated. The capital surcharge would be implemented in a phased manner starting January 2016 and would consist entirely of Common Equity Tier 1 capital (Table I).

Table I: Loss Absorbency Capital Surcharge for D-SIBs

Bucket	1 January 2016	1 January 2017	1 January 2018	1 January 2019
5				3.5%
4	0.625%	1.25%	1.875%	2.5%
3	0.5%	1.0%	1.5%	2.0%
2	0.375%	0.75%	1.125%	1.5%
1	0.25%	0.5%	0.75%	1.0%

3.3.3 CAMEL Rating

The latest published CAMEL ratings showed that the performance of individual banks operating in Mauritius remained stable and sound. As at end-December 2013, a majority of banks maintained their ratings. Two banks were upgraded compared to their end-June 2013 position whilst three banks were downgraded (Chart 3.22). Overall, fourteen banks were classified in the 'satisfactory' category and six banks were assigned a 'fair' rating, while one bank remained in the 'marginal' category.

3.3.4 Regulatory Capital

The banking system was considered resilient and well capitalised. Banks strengthened their capital positions, with total regulatory capital rising by 10.2 per cent during the year to end-March 2014. Tier 2 capital accounted for most of the rise in regulatory capital, as some banks issued new subordinated debt to finance their expansion. Tier 1 capital, the main component of banks' capital base and composed mainly of common equity, increased by 4.2 per cent due to accumulation of retained earnings. As a proportion of risk-weighted assets, Tier 1 capital, dropped from 15.5 per cent to 14.9 per cent. Branches of foreign-owned banks maintained the highest regulatory Tier 1 capital, followed by subsidiaries of foreign-owned banks and domestic-owned banks (Chart 3.23).

The aggregate capital adequacy ratio (CAR) stood comfortably above the minimum statutory requirement of 10 per cent. As measured under Basel II, CAR rose by 200 basis points to 17.2 per cent as at end-March 2014. At this level, it is estimated that a majority of banks hold reasonable capital buffer to withstand adverse conditions. The Bank started the shift to the Basel III framework after extensive consultation with the banking sector. As a first step, capital standards were reviewed for implementation in a phased manner effective July 2014 (Box VI).

Chart 3.22: CAMEL Rating of Banks

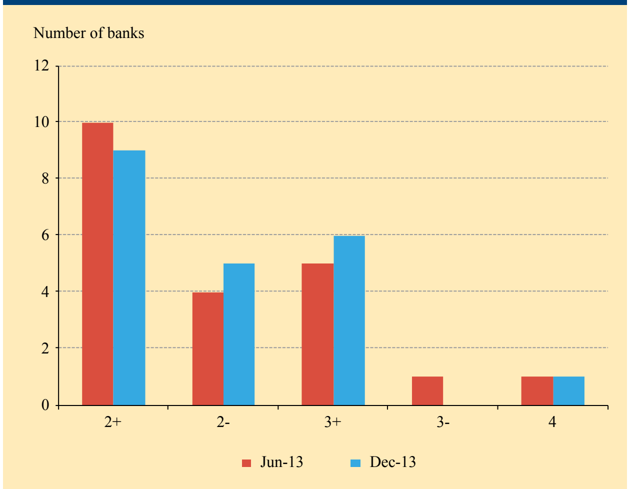
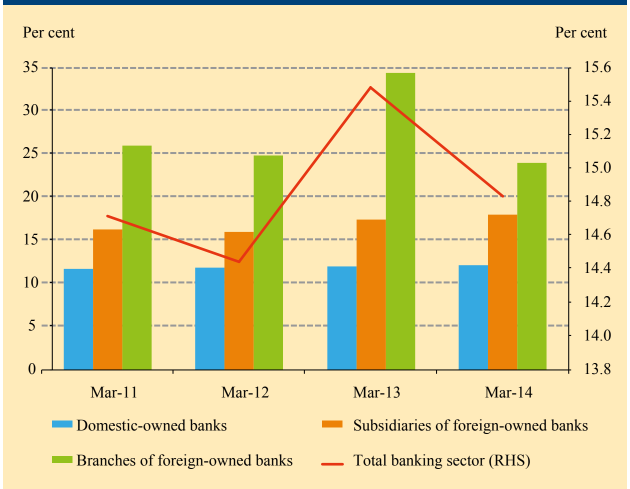


Chart 3.23: Tier 1 Capital Ratio



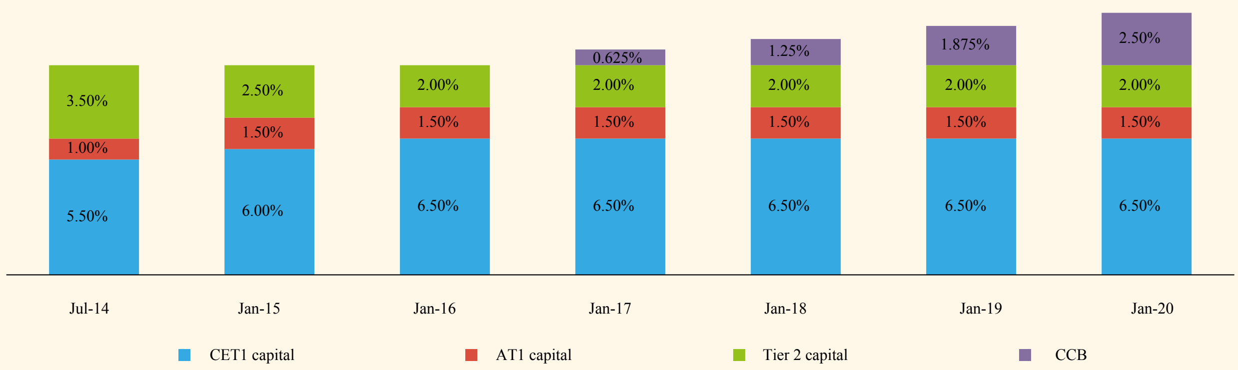
Box VI: Implementation of Basel III in Mauritius

In the context of the implementation of the Basel III framework, banks in Mauritius are required to maintain higher capital standards effective 1 July 2014. The new framework is aimed at making banks sounder and strengthening financial stability. It targets individual banks from a microprudential perspective and, at the macroprudential level, it addresses system-wide risks that can build up across the banking sector, as well as the procyclical amplification of these risks over time.

Basel III would bring significant changes to the amount and quality of capital that banks hold. Under its new definition, Tier 1 capital would be composed predominantly of Common Equity Tier 1 (CET1) capital and a thin portion of Additional Tier 1 (AT1) capital. In general, Tier 1 capital would allow an institution to continue its activities and help prevent insolvency. Components of Tier 2 capital are being simplified and reduced to ensure that senior creditors would have priority on their claims if a bank fails.

The capital standards of Basel III would be implemented in a phased manner (Chart I). The following objectives are set for 1 January 2020: capital adequacy ratio would remain at 10 per cent of Risk-Weighted Assets (RWA); CET1 capital adequacy ratio would be set at 6.5 per cent; AT1 capital adequacy ratio would be set at 1.5 per cent. The combined CET1 and AT1 capital adequacy ratios would bring the Tier 1 capital adequacy ratio to 8.0 per cent. Tier 2 capital would be reduced to 2 per cent of RWA. Capital instruments that no longer qualify as AT1 capital or Tier 2 capital would be phased out over a ten-year horizon beginning 1 July 2014.

Chart I: Phase-in Arrangement for the Implementation of Basel III in Mauritius



Banks would also be required to build up a capital conservation buffer (CCB) during normal times, to be used during periods of stress when banks could incur losses. The CCB would be composed solely of CET1. Any drawdown from the CCB would have to be replenished by reducing discretionary distributions of earnings, which include retaining dividend payments, share buybacks, and eliminating discretionary bonus payments to staff. Banks may choose to raise new capital from the market as an alternative to conserving internally-generated capital.

The CCB would be phased in gradually beginning 1 January 2017 at 0.625 per cent of RWA and would be increased by an additional 0.625 percentage points each year to reach its final level of 2.5 per cent of RWA on 1 January 2020. The minimum capital adequacy ratio, inclusive of CCB, would be brought to 12.5 per cent by 1 January 2020.

As a primary exercise, the *Guideline on the Scope of Application of Basel III and Eligible Capital* sets out transitional arrangements for implementing those elements of the Basel III capital framework, as well as the limits and minima of the different components of capital. The focus of the guideline has been to raise the quality, consistency and transparency of the capital base. Guidelines on other components of Basel III would be rolled out at a later stage.

The leverage ratio of the banking sector increased to 7.4 per cent compared with 5.8 per cent a year ago, indicating that banks kept a reasonable balance between the size of their balance sheets and equivalent risk-weighted assets. Branches of foreign-owned banks maintained the highest leverage ratio in terms of Segment A assets, followed by domestic-owned banks and subsidiaries of foreign-owned banks.

3.3.5 Financial Performance

Despite a challenging operating environment, the banking sector remained broadly profitable, with pre-tax profit - measured as the sum of pre-tax profit of the preceding four quarters - rising by 14.4 per cent to Rs16,342 million as at end-March 2014 (Chart 3.25). A few banks that had previously reported losses returned to profitability. Overall, the improvement in banks' profitability was supported by increases in revenue from both segment A and B activities.

Banks conducting mainly Segment A activities have generally earned high and stable profits for the past years. High profits have provided shareholders with a satisfactory return on their investment and have enabled banks to build up more equity capital through retaining earnings. During the year to end-March 2014, the level of pre-tax profits generated from Segment A activities rose by 10.4 per cent to Rs6,835 million (Chart 3.26). Several factors contributed to this improvement. On the revenue side, the increase in profit in segment A was largely supported by robust growth in net fees and commission income (5.6 per cent), followed by increases in net interest income (3.7 per cent). On the expenses side, a significant decline of 54.1 per cent in impairment charges was partly offset by higher staff costs. Reflecting the oligopolistic market structure, the two largest domestic banking groups recorded more than 80 per cent of total Segment A profits (Chart 3.27).

Chart 3.24: Leverage Ratio

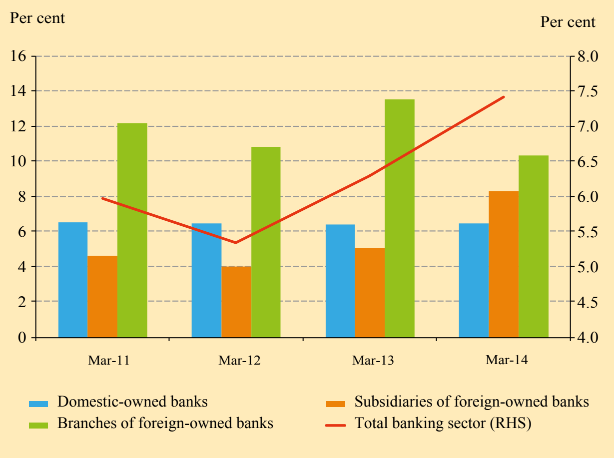
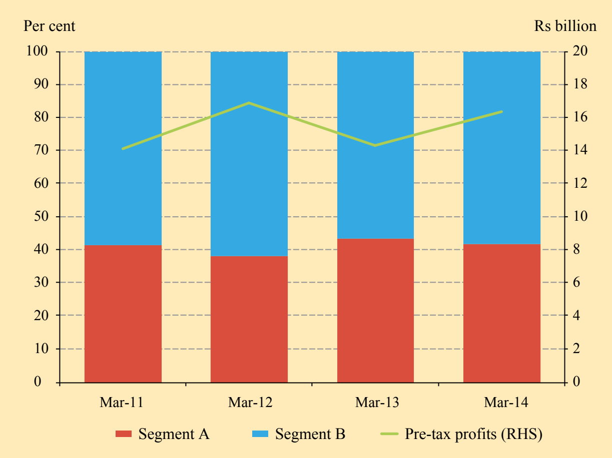


Chart 3.25: Pre-Tax Profits



The level of pre-tax profits generated from segment B activities rose by 17.4 per cent to Rs9,507 million over the year to end-March 2014, after a contraction of 22.8 per cent in the preceding year (Chart 3.28). The improvement in Segment B profits resulted mainly from a reduction of 50.5 per cent in credit impairment charges. Net interest income and non-interest income rose by 1.2 per cent and 16.6 per cent, respectively, whereas on the expenses side, non-interest expenses rose by 13.1 per cent. The growth in Segment B profits was uneven across banks. Some foreign-owned banks operating mainly in the global business sector recorded a strong rise in profitability while others saw their profits being pulled down by the low level of interest rates prevailing internationally and the contraction in their cross-border activities.

Return on Assets

The annualised pre-tax Return on Assets (ROA) for the banking sector, as measured by the ratio of pre-tax profit to average assets, improved marginally to 1.3 per cent as at end-March 2014, from 1.2 per cent as at end-March 2013 (Chart 3.29). A number of subsidiaries of foreign-owned banks primarily involved in cross-border activities posted higher ROA. Despite a decline in the ROA of domestic-owned banks, the additional revenue generated through net interest income and fees and commission income continued to bolster their earnings. Branches of foreign banks recorded a decline in their ROA.

Chart 3.27: Cumulative Distribution of Segment A Profits

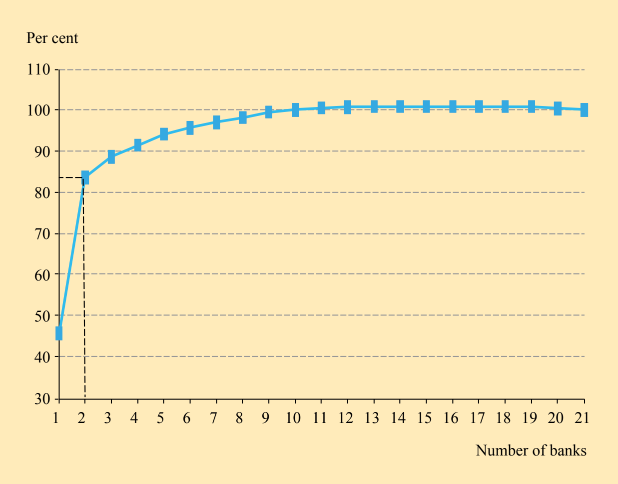


Chart 3.28: Components of Segment B Profits

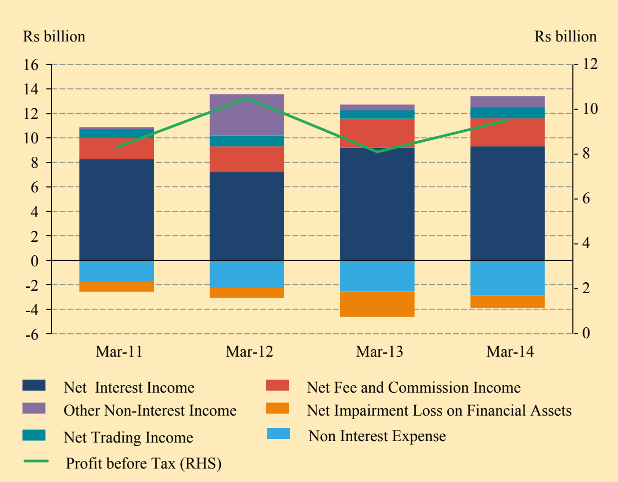


Chart 3.26: Components of Segment A Profits

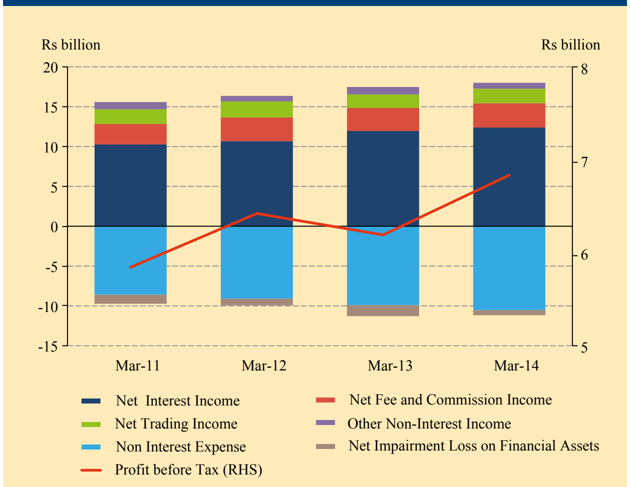
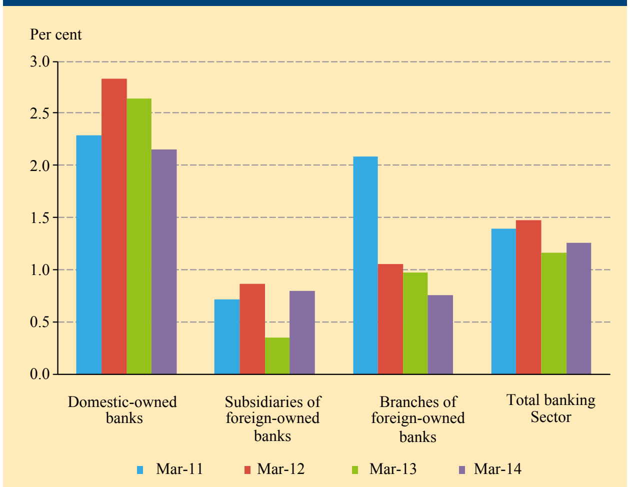


Chart 3.29: Return on Assets



Return on Equity

Banks' Return on Equity (ROE), as measured by the ratio of pre-tax profit to average equity, declined marginally from 15.4 per cent as at end-March 2013 to 15.2 per cent as at end-March 2014 as the increase in shareholders' funds was relatively higher than the rise in profitability. Domestic-owned banks generally continued to post higher ROE than their foreign-owned counterparts (Chart 3.30).

As at end-March 2014, 41.1 per cent of banks' total assets (excluding branches of foreign owned banks) contributed to generate an ROE of more than 20 per cent compared with 44.5 per cent a year earlier (Chart 3.31).

3.3.6 Funding and Liquidity

Funding and liquidity risks were considered low as banks operated with ample funding from domestic and international sources during 2014H1. In the domestic market, excess liquidity rose substantially to Rs10.2 billion compared with Rs4.9 billion, on average, during 2013H2 (Chart 3.32). Several factors contributed to this build-up, notably the decision to accumulate foreign exchange reserves through the ORR programme; Government's recourse to external financing; and Government deposits with banks. The slowdown in credit growth also contributed to the rise in excess reserves.

Excess liquidity exerted downward pressure on banks' cost of funding. In the interbank money market, the weighted average overnight rate dropped to 1.27 per cent as at end-June 2014, from 3.0 per cent as at end-December 2013. Weighted yields at primary auctions of Government securities also trended downwards. The overall weighted yield on Treasury Bills fell by 116 basis points to 2.48 per cent, while the weighted yield on 3-Year Treasury Notes decreased by 90 basis points to 4.06 per cent.

From a financial stability perspective, the increase in excess liquidity might not represent a positive development since it distorted the monetary transmission mechanism and created other sources of vulnerability in the financial system.

Chart 3.31: Dispersion of Total Assets of Banking Sector by ROE

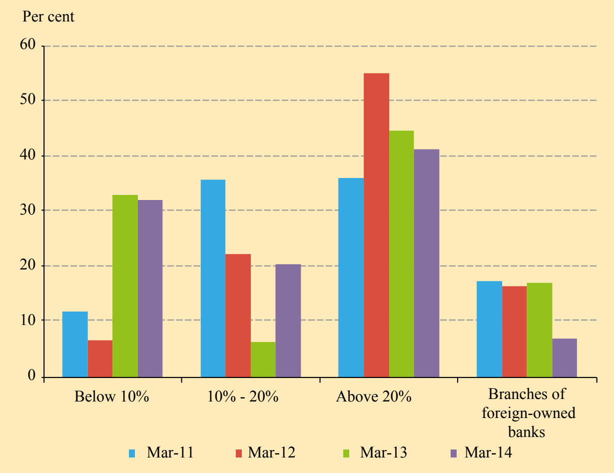


Chart 3.30: Return on Equity

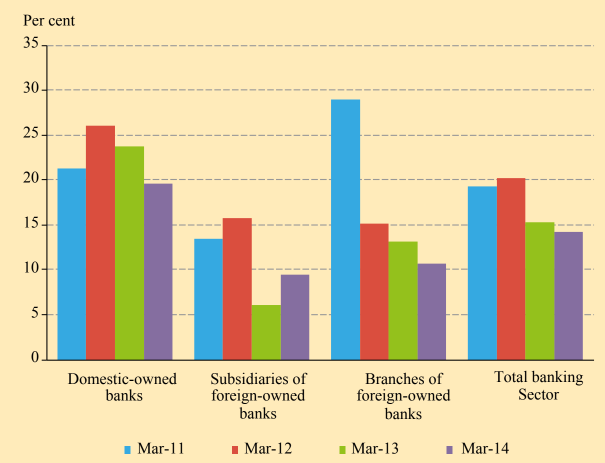
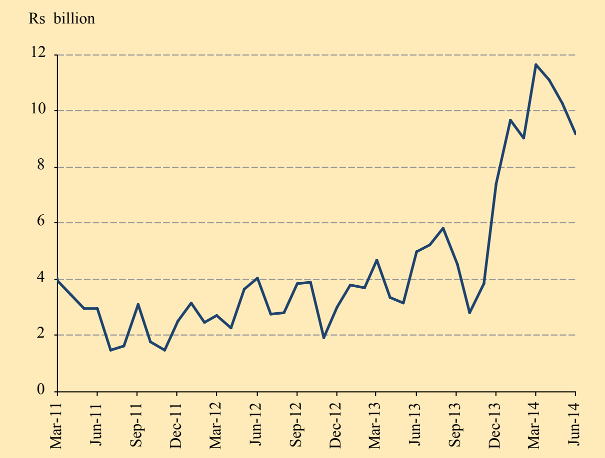


Chart 3.32: Banks' Monthly Average Excess Reserves



In response to the risks associated with persistently high excess liquidity, the Bank took corrective actions by lifting the cash reserve ratio requirement on rupee deposits from 8.0 per cent to 9.0 per cent; it issued Bank of Mauritius securities for a total of 17.3 billion, it conducted a reverse repurchase transaction with banks for Rs1.0 billion; coordinated actions with the Ministry of Finance and Economic Development resulted in an amount of Rs4.0 billion of government securities being front-loaded in 2014H1; while and savings and inflation-linked savings bonds were introduced to encourage national savings.

Banks' balance sheets showed that they relied mainly on deposits from customers rather than short-term wholesale funding to finance their core lending business. Deposits mobilised from customers rose by 3.5 per cent over the year to end-March 2014. They represented 65.6 per cent of total liabilities in the banking sector (Chart 3.33). Wholesale funding, notably deposits and borrowings from banks which rose by 18.7 per cent and 36.2 per cent, respectively, together represented 17.2 per cent of banks' total liabilities. Recently, the two largest domestic banks had recourse to the issuance of subordinated instruments to fund some of their cross-border activities. As at end-March 2014, subordinated debt accounted for 2.0 per cent of banks' funding.

Cross-Border Funding

Funding conditions in overseas financial markets remained stable and liquid as banks were able to source sufficient funding in foreign currency from abroad to finance their international business. Excluding deposits mobilised from GBLH, banks' cross-border deposits as a percentage of total liabilities rose from 7.0 per cent as at end-March 2013 to 12.2 per cent as at end-March 2014 (Chart 3.34). Most of the cross-border deposits originated from Europe although the shares of cross-border deposits from Africa and America are rising. To mitigate foreign exchange risk, cross-border deposits are mainly invested in assets denominated in the same currency.

Cross-border borrowings represented 12.9 per cent of banks' total liabilities as at end-March 2014 compared with 13.3 per cent a year earlier. Most of these borrowings were sourced from parent banks and related entities of foreign-owned banks as part of their treasury operations. Domestic-owned banks also borrowed from their correspondent counterparts to take advantage of low interest rates prevailing in major international markets. As a percentage of total liabilities, borrowings from banks in Europe dropped to 6.8 per cent, from 7.6 per cent a year ago, while borrowings from Asia increased from 3.2 per cent to 3.6 per cent (Chart 3.35).

Chart 3.33: Changes in Banking Sector Liabilities

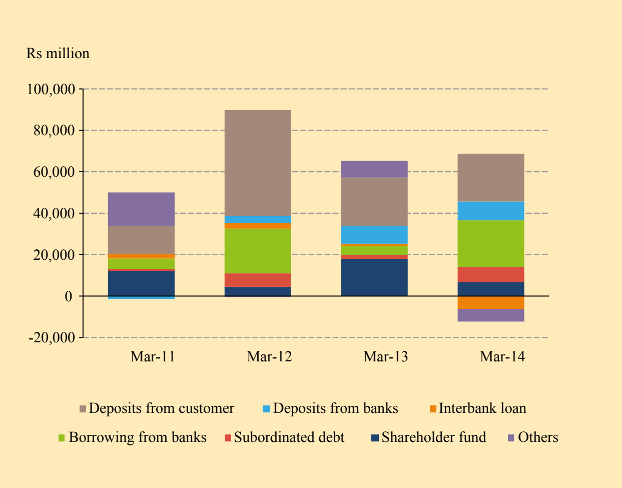
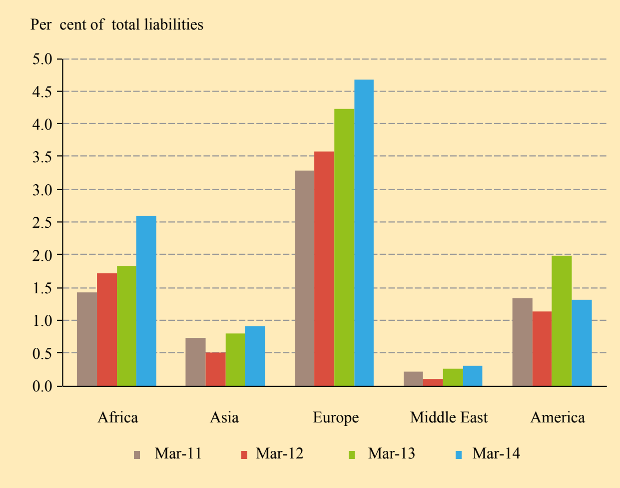


Chart 3.34: Cross-Border Deposits



Stress Testing

As at end-March 2014, the distribution of credit exposures in key sectors of the economy was generally concentrated among banks with CAR of above 12 per cent (Chart 3.36). A stress test was conducted to assess the ability of banks (excluding branches of foreign-owned banks) to absorb potential shocks on their credit portfolio in the event of a general economic downturn under a baseline and an adverse scenario. The impact of the stress test varied among banks, depending on the composition and quality of their credit portfolios as well as the amount of capital they hold.

The baseline scenario assumed a mild deterioration in economic environment and financial conditions of banks whereby banks would incur loan losses on their credit portfolios ranging between 2 per cent and 5 per cent, depending on assessment of vulnerability in specific sectors. Under this scenario, banks' CAR is estimated to fall from 17.2 per cent to 16.3 per cent.

The adverse scenario simulates the impact on capital adequacy of a sharp deterioration in economic environment and a significant increase in NPL, ranging between 10 per cent and 15 per cent in key sectors of the economy. Under this scenario, banks' large losses resulted in a drop in their CAR to 11.2 per cent.

Given that domestic-owned banks as well as subsidiaries and branches of foreign-owned banks operate above the minimum capital requirement, it would appear that a majority of banks might not require additional capital injection under the baseline and adverse scenarios (Chart 3.37).

As at end-March 2014, the ratio of liquid assets to deposits rose to 50.1 per cent, from 40.5 per cent a year earlier. A liquidity stress test indicated that most banks would, on average, sustain a drawdown of more than 15 per cent from their deposit base. Therefore, in the short- to medium-term, the risk that banks would run short of liquidity is assessed as low. Moreover, system-

Chart 3.36: Sectorwise Distribution of Credit by CAR

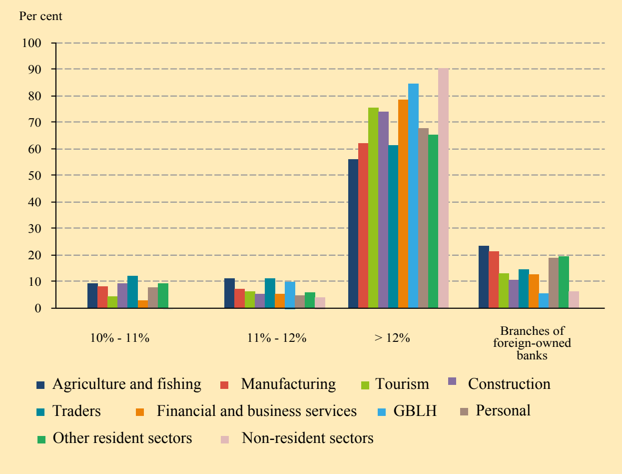


Chart 3.35: Cross-Border Borrowings

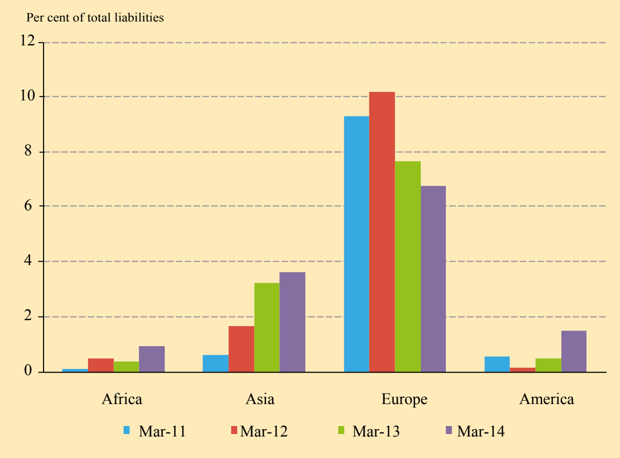
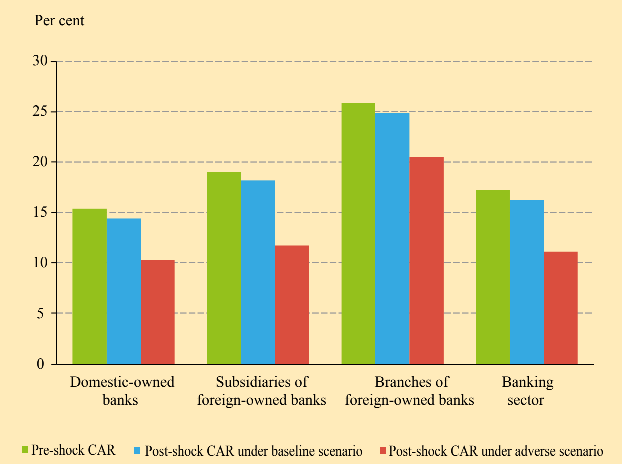


Chart 3.37: Pre and Post-shock CAR



wide risk arising from interbank contagion would be limited given the low volume of transactions conducted in the interbank money market.

3.4 Non-Bank Deposit-Taking Sector

As at end-March 2014, there were eight NBDTIs mainly engaged in mobilisation of deposits and granting of leasing and loan facilities to individuals and corporates. Since the February 2014 FSR, the overall performance of NBDTIs has remained sound and stable. Activities grew steadily and, as at end-March 2014, their total assets were equivalent to 5.7 per cent of total banking sector assets and represented 15 per cent of GDP.

Balance Sheet Structure

As at end-March 2014, total assets of NBDTIs grew by 10.0 per cent compared with 5.4 per cent a year earlier, led by increases of 15.7 per cent and 13.4 per cent in loans and leasing facilities, respectively. These two components made up 74.7 per cent of total assets. Deposits, which accounted for 61.3 per cent of total liabilities, recorded a lower growth of 5.1 per cent compared with 6.3 per cent a year earlier (Chart 3.38).

Liquidity

Over the year to end-March 2014, NBDTIs maintained liquidity ratios above the statutory minimum of 10 per cent. The overall ratio of liquid assets to total assets dropped from 14.2 per cent to 11.9 per cent and the ratio of liquid assets to total deposits fell to 19.3 per cent, from 22.1 per cent a year ago (Chart 3.39). The decline in the liquidity ratios primarily reflected faster growth in total assets, led by growth in credit extended to *personal*, *tourism* and *traders* sectors, relative to liquid assets.

Chart 3.38: Y-o-y Growth of Total Assets and Deposits

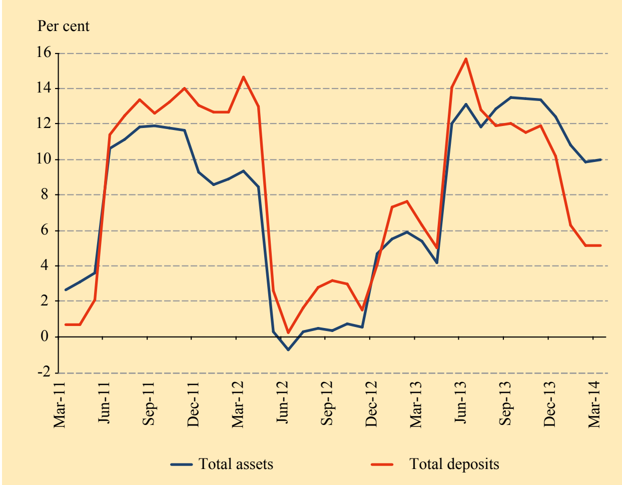


Chart 3.39: Liquidity Indicators of NBDTIs

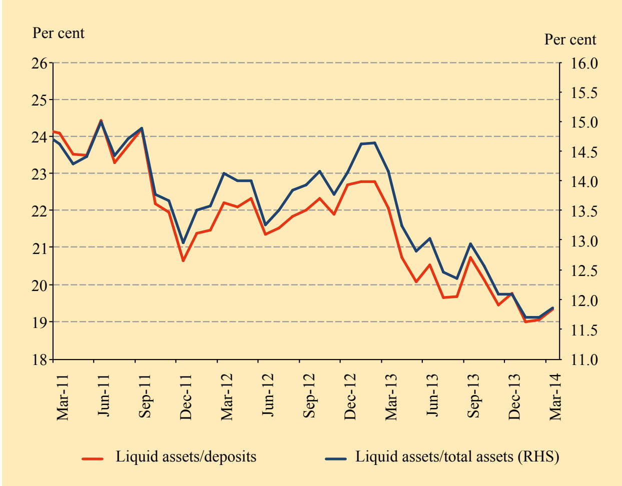
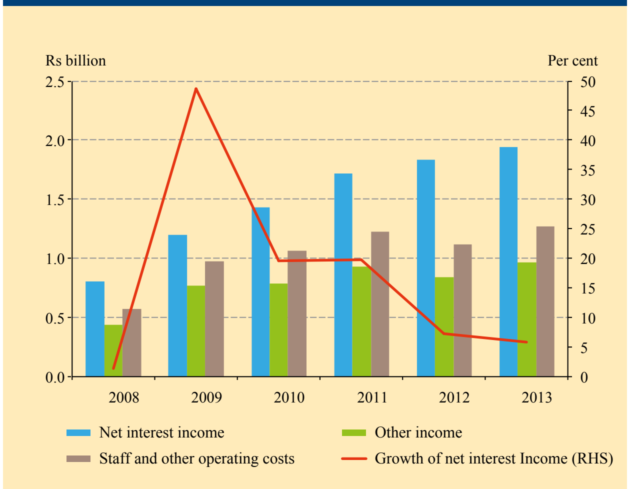


Chart 3.40: Revenue and Expense of NBDTIs



Profitability

Net profit of NBDTIs increased by 7.7 per cent in 2013 compared with 18.4 per cent in 2012. Interest income, derived mainly from loans and leases, increased by 4.8 per cent in 2013 as against a contraction of 0.3 per cent in 2012. Interest expense, incurred mostly on deposits and borrowings from banks and financial institutions, rose by 4.0 per cent compared with 5.2 per cent. As a result, growth of net interest income fell from 7.1 per cent to 5.7 per cent (Chart 3.40).

The ROA of NBDTIs fell marginally by 0.1 percentage point to 3.1 per cent, while their ROE increased by 1.2 percentage points to 19.1 per cent (Chart 3.41).

Capital Adequacy

NBDTIs are well-capitalised, with a CAR of 25.2 per cent as at end-March 2014 compared with 24.3 per cent a year earlier. At the current level of capitalisation, it is considered that NBDTIs will be able to withstand moderate shocks to their balance sheets and absorb losses that may arise from NPL. Assets of NBDTIs remained concentrated in the 50 per cent and 100 per cent risk-weight buckets, which accounted for 46.9 per cent and 22.6 per cent of total assets, respectively

Sectoral Credit and NPL

Credit extended by NBDTIs, which accounted for 7.6 per cent of total credit extended in Mauritius, grew by 12.9 per cent as at end-March 2014, from 7.3 per cent a year earlier. Credit was channelled mainly to the *personal* and *construction* sectors, which represented 66.3 per cent and 17.1 per cent, respectively, of total NBDTIs' credit. *Traders*, *manufacturing*, *tourism* and *financial and business services* sectors were collectively allocated 9.2 per cent of total NBDTIs' credit.

Asset quality improved, with the overall ratio of NPL to total credit falling by 0.4 percentage point to 5.1 per cent as at end-March 2014. The NPL ratio in the *construction* sector dropped compared to a year ago, but remained the highest among all sectors, at 21.4 per cent. The *personal* sector recorded an NPL ratio of 0.6 per cent (Chart 3.42). Loan loss provisioning went down over the year, leading to a lower coverage ratio of 40.5 per cent, from 45.7 per cent as at end-March 2013.

3.5 Insurance Sector

The insurance sector is an important component of the domestic financial system. It recorded sound performance in 2013 and accounted for 32.8 per cent of GDP. Total assets in the insurance sector grew significantly by 14.5 per cent to Rs120.3 billion in 2013. This represented a penetration rate of around 5.8 per cent. Gross premium grew by 9.8 per cent to Rs22.1 billion.

Chart 3.41: ROA and ROE of NBDTIs

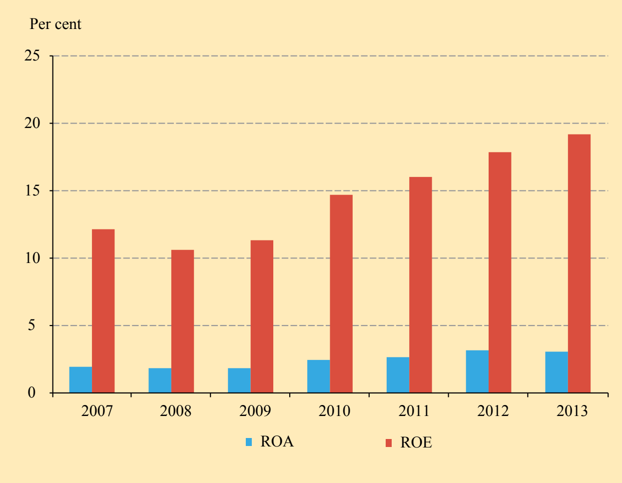
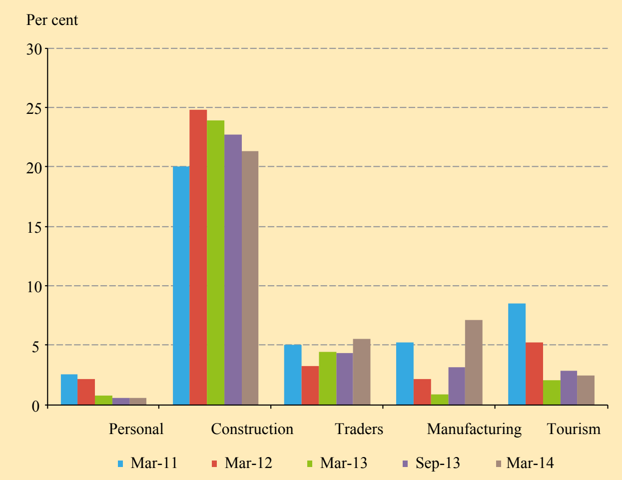


Chart 3.42: NPL as a ratio of Sectoral Credit

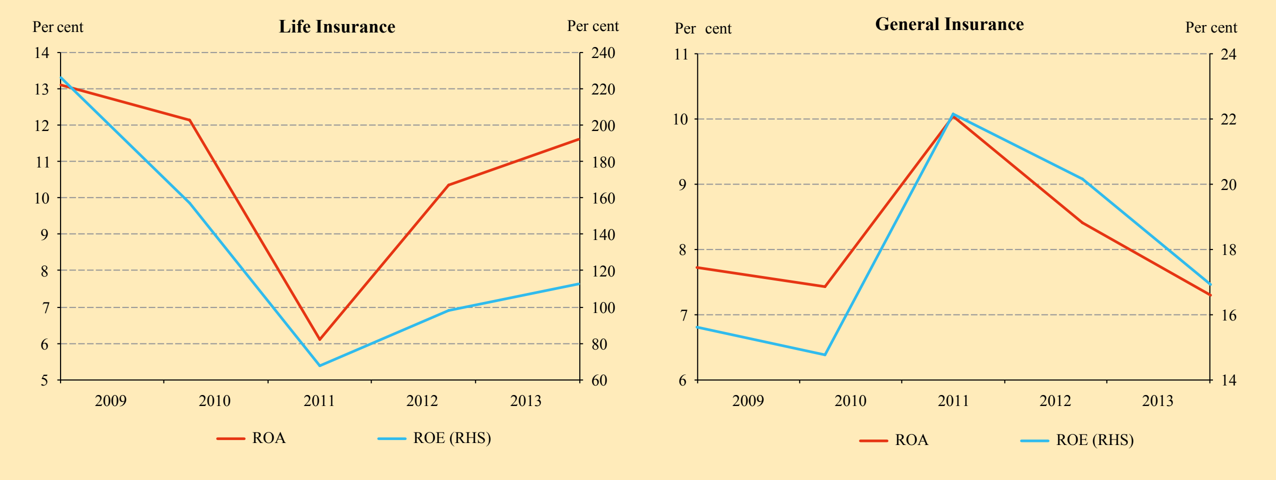


Life insurance is the main constituent of the insurance business. Total assets in this cluster increased by 14.9 per cent to Rs106.4 billion; net premiums went up by 7.1 per cent to Rs14.5 billion; however, investment in equities and debt securities dropped to 18.7 per cent and 12.5 per cent of total assets, respectively. Slightly more than one third of life insurers' investment was in Government debt securities. Profitability improved, with increases in ROA and ROE to 11.6 per cent and 112.6 per cent (Chart 3.43). The claims and expense ratios edged up, indicating that insurers were collecting more premiums to cover claims/expenses (Chart 3.44).

The combined ratio measures claims losses and operating expenses against premiums earned for general insurance. The combined ratio increased by 3 percentage points in 2013, reaching 87 per cent (Chart 3.44). This is explained by the higher growth in total expenses (14 per cent) than in net earned premium. A combined operating ratio over 100 per cent indicates unprofitable underwriting results.

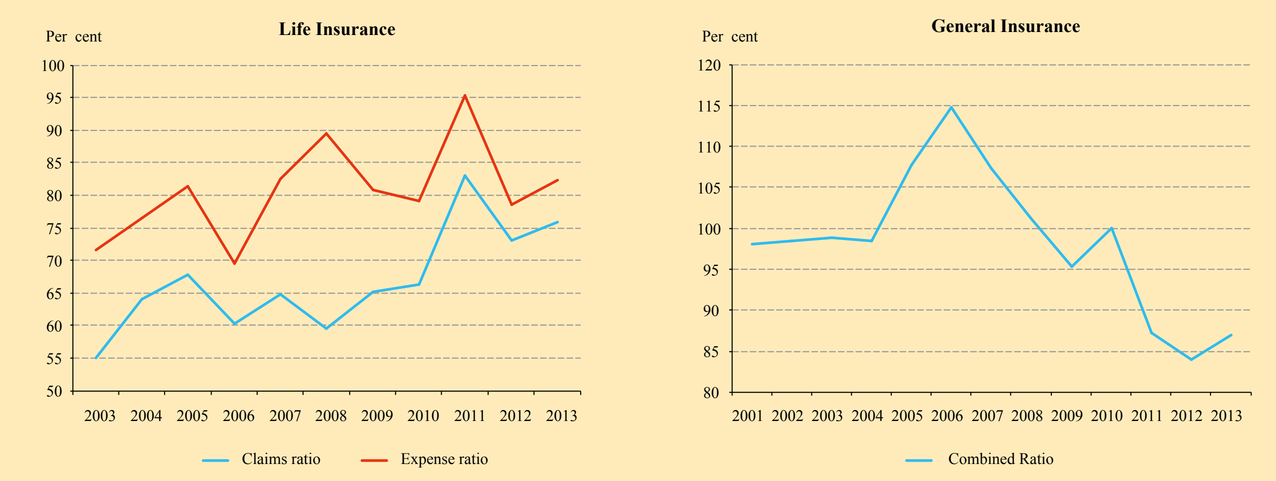
In the general insurance sector, total assets increased by 12.0 per cent to Rs13.9 billion; total net premiums rose by 10.9 per cent to Rs4.3 billion. The investment portfolio of general insurers was largely unchanged, with more than half invested in locally-listed securities. The ROA and ROE declined to 7.3 per cent and 16.9 per cent, respectively (Chart 3.43).

Chart 3.43: ROE and ROA



Source: Financial Services Commission

Chart 3.44: Claims and Expense Ratios



Source: Financial Services Commission

Concentration remained high in the insurance sector. In the life insurance industry, market share was concentrated among three insurance companies, with one of them holding almost 50 per cent of market share. The general insurance sector was concentrated among four insurance companies.

Both the general and long term insurance segments were solvent in 2013. The sector appeared to be well capitalised, with ample buffer to weather shocks that might affect its soundness. The average solvency ratio for general insurance declined from 318 per cent in 2012 to 282 per cent in 2013, whilst it went up from 182 per cent to 218 per cent for life insurance.

Reinsurance ceded marginally compared with the previous year. General insurers reinsured 38 per cent of gross premium, with the most reinsured classes being engineering, property and guarantee.

Financial stability also involves assessing the interlinkages between banks and insurance companies. Relative to the size of the banking sector, assets of insurance companies held with banks are not considered significant, and contagion risks are deemed to be moderate. In 2013, insurance companies held Rs10 billion in terms of cash and deposits at banks and invested Rs5 billion in the equity of locally-listed banks. Their loans and overdrafts from banks amounted to Rs613 million and Rs280 million, respectively.

3.6 Key Challenges Ahead

The financial system is assessed to be robust and sound. However, there are a number of risks that may potentially jeopardise financial stability. The expected normalisation of interest rates in some advanced economies and its spillover effects on global financial markets may represent a source of vulnerability for the domestic financial system. In particular, the likelihood for increased volatility in capital flows and in major currency exchange rates could adversely impact on current account financing and evolution of the rupee. Moreover, the weak performance in the euro area may continue to drag down growth of export-oriented sectors.

The rise in household debt and balance sheet vulnerabilities of some large corporates could have direct effects on the soundness of banks through a rise in NPL. Excess liquidity could accentuate credit risk in the banking sector if banks lower their credit standard. While the implementation of the LTV and DTI limits would help to mitigate credit risk associated with housing loans, the recent tendency for households to shift to consumption loans, which are often unsecured, may become a source of concern if sustained. In the same vein, accumulation of credit and rising NPL in the construction sector remain a major risk that the Bank has addressed through the introduction of macroprudential measures. The subdued outlook for this sector indicates that continued vigilance is required.

Cross-border exposures of domestic banks remained significant. The recent increase in NPL from exposures to some Indian corporates as the Indian economy slowed down suggests that banks should remain prudent in their cross-border activities.

The Bank continues to monitor global and domestic developments. In light of potential sources of vulnerabilities, the Bank has taken several initiatives to reinforce the resilience of the banking system, including phasing in Basel III capital standards, addressing the issue of domestic-systemically important banks, and simplifying the corporate structure of complex banks. Work is on-oing to strengthen the regulatory framework and maintain financial stability.

Annex I: External Indicators

		Mar-13	Mar-14
		Rs million	
Gross External Debt [1]	as at end	49,328	60,769
External Debt Service	year ended	6,624	7,945
Exports of Goods	year ended	82,022	89,172
Exports of Goods and Services	year ended	182,554	191,024
Imports of Goods and Services	year ended	229,035	237,678
Gross Official International Reserves [2]	as at end	98,149	112,018
GDP at market prices	year ended	348,930	370,365
Broad Money Liabilities	as at end	348,246	371,778
Indicators		*Per cent*	
I. Solvency			
Gross External Debt/GDP		14.1	16.4
Gross External Debt/Exports of Goods		59.9	68.1
Gross External Debt/Exports of Goods and Services		45.9	31.8
External Debt Service/Exports of Goods		8.0	8.9
External Debt Service/Exports of Goods and Services		6.2	4.2
II. Reserve Adequacy			
Reserves/Imports of Goods and Services		42.9	47.1
Reserves/ Broad Money Liabilities		28.2	30.1
Reserves/Gross External Debt		199.0	184.3

1 Gross external debt outstanding as at end of period comprises general Government, public corporations, monetary authorities and private sector.

2 Gross Official International Reserves as at end of period comprises gross foreign assets of the Bank of Mauritius, reserve position in the IMF and the foreign assets of Government.

Annex II: CAMEL Rating of Banks*

Bank	Jun-13	Dec-13	Change
ABC Banking Corporation Ltd	3+	3+	↔
AfrAsia Bank Limited	2+	2-	↓
Bank of Baroda	2+	2+	↔
Bank One Limited	3+	3+	↔
Banque des Mascareignes Ltée	3+	3+	↔
BanyanTree Bank Limited	3+	2+	↑
Barclays Bank Mauritius Limited	2-	2-	↔
Bramer Banking Corporation Ltd	3-	3+	↑
Century Banking Corporation Ltd	4	4	↔
Deutsche Bank (Mauritius) Limited	2+	2+	↔
Habib Bank Limited	2+	2-	↓
HSBC Bank (Mauritius) Limited	2+	2+	↔
Investec Bank (Mauritius) Limited	2+	2+	↔
Mauritius Post and Cooperative Bank Ltd	3+	3+	↔
P.T Bank Internasional Indonesia	2+	2+	↔
SBI (Mauritius) Ltd	2-	3+	↓
Standard Bank (Mauritius) Limited	2-	2-	↔
Standard Chartered Bank (Mauritius) Limited	2-	2-	↔
State Bank of Mauritius Ltd	2+	2+	↔
The Hongkong and Shanghai Banking Corporation Limited	2+	2+	↔
The Mauritius Commercial Bank Limited	2+	2+	↔

* *1: Strong* *2+ and 2-: Satisfactory* *3+and 3-: Fair* *4: Marginal* *5: Unsatisfactory*

Annex III: Financial Soundness and Macroeconomic Indicators

Core Set of Financial Soundness Indicators	Mar-13	Sep-13	Dec-13	Mar-14
Capital Base				
Regulatory capital to risk-weighted assets	17.4%	16.9%	17.3%	17.6%
Regulatory Tier 1 capital to risk-weighted assets	15.9%	14.8%	15.1%	15.3%
Non-performing loans net of provisions to capital	11.8%	12.9%	12.7%	12.8%
Asset Quality				
Non-performing loans to total gross loans	3.9%	4.1%	4.2%	4.4%
Sectoral distribution of loans to total loans				
Interbank loans	*0.5%*	*1.1%*	*0.3%*	*0.1%*
Other financial corporations	*1.3%*	*1.2%*	*1.2%*	*1.3%*
Non-financial corporations	*33.5%*	*33.5%*	*34.7%*	*34.9%*
Other domestic sectors	*20.5%*	*21.0%*	*21.6%*	*22.0%*
Non-residents	*44.2%*	*43.2%*	*42.2%*	*41.7%*
Earnings and Profitability				
Return on assets	1.2%	1.1%	1.2%	1.3%
Return on equity	15.7%	13.5%	14.1%	15.6%
Interest margin to gross income	69.8%	71.3%	68.6%	68.9%
Non-interest expenses to gross income	41.5%	43.7%	43.9%	42.5%
Liquidity				
Liquid assets to total assets	19.1%	17.5%	22.5%	22.6%
Liquid assets to short-term liabilities	27.9%	26.5%	31.0%	30.7%
Sensitivity to Market Risk				
Net open position in foreign exchange to capital	2.2%	2.3%	2.1%	3.1%
Encouraged Set of Financial Soundness Indicators				
Capital to assets	8.6%	8.1%	8.8%	9.3%
Value of large exposures to capital	171.7%	186.9%	195.9%	196.5%
Customer deposits to total (non-interbank) loans	134.2%	130.4%	137.0%	134.3%
Residential real estate loans to total loans	7.1%	8.5%	8.7%	8.9%
Commercial real estate loans to total loans	7.4%	6.7%	6.9%	7.2%
Trading income to total income	3.1%	4.6%	8.8%	10.2%
Personnel expenses to non-interest expenses	49.3%	51.5%	52.2%	52.0%

Annex III: Financial Soundness and Macroeconomic Indicators (Continued)

Macroeconomic Indicators	Mar-13	Sep-13	Dec-13	Mar-14
Headline inflation	3.6%	3.5%	3.5%	4.0%
Year-on-year inflation	3.6%	3.3%	4.0%	4.5%
Key Repo Rate (end of period)	4.90%	4.65%	4.65%	4.65%
Total Public Sector Debt/GDP (end of period)	58.1%	59.5%	60.0%	60.6%
Total Public Sector External Debt/GDP (end of period)	10.7%	12.6%	12.9%	13.2%
Import coverage of Gross International Reserves (No. of months)	4.9	5.1	5.2	5.6
Deposits/Broad Money Liabilities*	93.0%	93.0%	92.8%	93.3%
Household Debt/GDP (end of period)**	19.5%	20.3%	20.7%	20.7%
Corporate Debt/GDP (end of period)**	52.5%	52.2%	51.6%	51.0%
	2013Q1	2013Q3	2013Q4	2014Q1
Real GDP growth***	3.8%	3.4%	2.7%	2.4%
Unemployment rate	8.6%	8.0%	7.5%	8.0%
Current account deficit/GDP	8.6%	13.2%	9.3%	6.1%

** Rupee and foreign currency deposits from domestic banks.*
*** Debts contracted with banks only.*
**** Percentage change over corresponding period of previous year.*

1. *FSIs are calculated on a domestic consolidation basis using the Financial Soundness Indicators Compilation Guide of the International Monetary Fund. Figures may be slightly differerent from other parts of this Report.*
2. *As from June 2012, figures include Non-Bank Deposit-Taking Institutions.*
3. *Total loans include advances to non-residents.*
4. *Figures may not add up due to rounding.*

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Acronyms

AT	Additional Tier
BoE	Bank of England
CAMEL	Capital, Asset, Management, Earnings and Liquidity
CAR	Capital Adequacy Ratio
CCB	Capital Conservation Buffer
CET	Common Equity Tier
DTAA	Double Taxation Avoidance Agreement
DTI	Debt-to-Income
D-SIBs	Domestic-Systemically Important Banks
ECB	European Central Bank
US Fed	Federal Reserve
FSB	Financial Stability Board
FSC	Financial Services Commission
FSR	Financial Stability Report
GBCs	Global Business Companies
GBLH	Global Business Licence Holders
GDP	Gross Domestic Product
G-SIBs	Global-Systemically Important Banks
H1	First Semester
HHI	Herfindahl-Hirschman Index
IMF	International Monetary Fund
LTV	Loan-to-Value
MCIB	Mauritius Credit Information Bureau
MERI	Mauritius Exchange Rate Index
NBDTIs	Non-Bank Deposit-Taking Institutions
NPL	Non-Performing Loans
ORR	Operation Reserves Reconstitution
Q1	First Quarter
RCG	Regional Consultative Group
ROA	Return on Assets
ROE	Return on Equity
RWA	Risk-Weighted Assets
SARB	South African Reserve Bank
SEM	Stock Exchange of Mauritius
WEO	World Economic Outlook
Y-o-y	Year-on-year

Glossary

Basis point is a unit equal to one hundredth of a percentage point.

Capital Adequacy Ratio is a measure of the amount of a bank's capital expressed as a percentage of its risk weighted credit exposures. Banking regulators require a minimum capital adequacy ratio so as to provide banks with a cushion to absorb losses before they become insolvent. This improves stability in financial markets and protects deposit-holders.

Capital conservation buffers are aimed at ensuring the build-up of capital buffers outside periods of financial stress.

Coverage ratio measures a bank's ability to absorb losses from its non-performing loans.

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

Dealt exchange rate is the weighted average rupee selling rate derived from transactions of US$30,000 and above, or equivalent.

Fiscal consolidation is a policy aimed at reducing government deficits and debt accumulation.

GBC1s are resident corporations which conduct business outside Mauritius. The law has recently been amended to allow them to transact with residents provided that their activities in Mauritius are ancillary to their core business with non-residents.

Leverage ratio is used to calculate the financial leverage of a company to get an idea of the company's methods of financing or to measure its ability to meet financial obligations. It is meant to evaluate the company's debt levels.

Loan loss provisioning is undertaken by banks to make allowance for defaulted loans or credits. The loan loss provisioning represents an amount set aside in the event that the loan defaults.

Loan-to-value ratio is a lending risk assessment ratio that financial institutions and others lenders examine before approving a mortgage. It is calculated as the ratio of the loan amount to the value of the collateral used for the loan.

MERI2 is the Mauritius Exchange Rate Index, a nominal effective exchange rate introduced in July 2008, based on the currency distribution of merchandise trade and tourist earnings.

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.

Segment B activity is essentially directed to the provision of international financial services that give rise to foreign source income.

Segment A activity relates to all banking business other than Segment B activity.

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

Solvency ratio is a measure of a company's ability to pay its long term and short term debts. It is calculated by dividing the sum of net after-tax profit by the sum of short term and long term liabilities.

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

Tier 2 capital is the second part of the two-tier risk based standard commonly used by regulators to assess a financial institution's capital adequacy. It is supplementary bank capital that includes revaluation reserves, general provisions, and subordinated debt. Tier 2 capital comes as second rank and is less reliable than Tier 1 capital.

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

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