Monetary Policy and Financial Stability Report

September 2018

Table of Contents

FOREWORD

The Bank of Mauritius is issuing its third edition of the Monetary Policy and Financial Stability Report.

In compliance with Section 33(2) of the Bank of Mauritius Act 2004, the Bank has to publish twice a year a "Statement on Price Stability" and a "Statement on the Stability and Soundness of the Financial System". This third issue of the Monetary Policy and Financial Stability Report contains the two statements.

In line with its mandate*, the Bank's assessments of risks to financial stability with a view to identifying and mitigating vulnerabilities in the domestic financial system are underlined in this report. This report also presents an evaluation of monetary and financial stability, recent and expected inflation trends as well as inherent and potential risks to price and financial stability. It aims to enhance the public's understanding of the policies applied to achieve the mandates of the Bank. The analysis provides insights into the resilience of the domestic financial system and financial market infrastructure to developments on both the domestic and international fronts.

Unless otherwise stated, this edition relies on information and financial data available up to the end of September 2018.

** Section 4(1) of the Bank of Mauritius Act 2004 confers onto the Bank the mandate to maintain price stability and to promote orderly and balanced economic development. The Bank conducts monetary policy while having regard to the best interests of the economic development of the country. The Monetary Policy Committee decides on the appropriate monetary policy stance through changes in the Key Repo Rate. Concurrently, the Bank intervenes on the domestic interbank foreign exchange market with a view to removing undue volatility in the rupee exchange rate.*

As prescribed at section (2)(b) in the Bank of Mauritius Act 2004, another primary object of the Bank is to ensure the stability and soundness of the financial system of Mauritius. A stable and sound financial system is a prerequisite for proper intermediation and allocation of funds in the economy, thereby being conducive to economic and financial development. The Bank undertakes to align the regulation and supervision of financial institutions falling under its purview with international best practices.

1. Executive Summary

The global economy remained robust in the first half of 2018, supported by relatively favourable financial conditions. The growth momentum in advanced economies was broadly maintained on the back of accommodative monetary policy and, specifically for the US, expansionary fiscal policy. The economic outlook continued to be generally favourable in emerging markets and developing economies (EMDEs), despite the recent upswing in commodity prices, rising interest rates in the US and geopolitical developments.

However, global growth which appeared to be synchronised at the beginning of the year, has become uneven across countries and regions. In the US, relatively easy monetary conditions so far as well as tax cuts have generated positive extra mileage to investment prospects in the world's largest economy, which bodes well for its economy. The policy rate in the US is expected to go up by one percentage point by the end of 2018 to prevent overheating of the economy. In the Euro area, in contrast, growth is projected to slow gradually this year. Though the European Central Bank (ECB) has announced that it will revisit its forward guidance on quantitative easing, interest rates should remain unchanged well into 2019.

Over the medium term, risks to the global growth outlook have tilted to the downside. There are incipient fears that a greater-than-required tightening of interest rates in the US may potentially stifle the growth momentum. In addition, rising protectionist sentiment in some of the world's major economies, following announcement by the US of imposing trade barriers on its partners and potential retaliation by China, may trigger trade wars and prove to be a major hazard to trade prospects and, by ricochet, to global growth. Further, geopolitical tensions in East Asia and the Middle East may coalesce to impact negatively on business and consumer confidence. Although global inflation could increase somewhat, driven by higher oil prices and idiosyncratic factors in a number of countries, underlying inflation pressures are likely to continue being relatively subdued amid gradually rising resource utilisation and a balanced oil price outlook.

Domestic growth momentum is sustained, led by continued strong performance of the construction sector and other key tertiary sectors, including distributive trade, accommodation and food service activities, and financial and insurance activities. Activities of the global business sector appeared to have been relatively unaffected so far, following the amendments to the Double Taxation Avoidance Agreement (DTAA) between Mauritius and India in May 2016. The gap against potential output has been narrowed down in the process.

It is assessed that spare capacity in the economy will decline gradually as a result of the recovery in the tourism and construction sectors and sustained performance of financial services. Substantial public sector investment, through the implementation of major long-term projects such as the Metro Express and the Road Decongestion Programme, is expected to partly offset the projected decline in private investment in 2018.

At the May 2018 MPC, Bank staff projected real GDP growth at market prices of 4.0 per cent in 2018. Further ahead, low interest rates and favourable funding terms domestically alongside a relatively positive global economic environment are expected to stimulate private investment and support the improvement in key sectors of the economy. Resilient business confidence, taken together the execution of smart city projects as well as the construction of new hotels by the private sector, also point to a positive economic outlook. The improvement in the labour market and rise in wages following the implementation of the minimum wage policy are expected to provide further impetus to household consumption, going forward, and boost growth. Nonetheless, headwinds to domestic growth prospects may originate from delays in the implementation of major public infrastructure projects and a less-than-stellar export performance against a backdrop of looming trade war and geopolitical tensions on the international scene.

The beginning of 2018 was characterised by adverse climatic conditions, which had a non-negligible impact on prices of fresh vegetables. Added to this disruption was the hike in domestic petroleum prices. Headline inflation therefore increased from 3.2 per cent in September 2017 to 5.0 per cent in April 2018, whereas y-o-y inflation rose from 3.5 per cent to 3.7 per cent over the same period. The transitory effects of poor weather at the beginning of the year have now dissipated, and inflation has receded.

Looking ahead, the moderate inflation outlook in main trading partner countries as well as relatively contained domestic demand pressures are likely to keep inflation subdued in Mauritius. The rupee exchange rate dynamics are expected to contribute mildly to domestic inflationary pressures, given the relatively stable rupee and weak estimated exchange rate pass-through to the CPI. Spare capacity in the economy currently would make importers and producers cautious in passing on the full extent of any rupee depreciation to domestic prices. At the May 2018 MPC, headline inflation was projected at about 4.0 per cent for 2018 and was forecast to drop to around 3.8 per cent in 2019. It was anticipated that core inflation measures would remain contained around their current levels over the forecast horizon. With demand and supply pressures under control over the projection horizon, upside risks to the inflation outlook were assessed to be fairly limited.

The current account deficit is estimated to have deteriorated from 5.4 per cent of GDP in the second half of 2016 to 7.3 per cent for same period in 2017, reflecting a worsening of the balance of trade. In 2018, the deficit in the current account is expected to continue widening, as a result of a higher merchandise deficit, which is expected to supersede the surplus in the services account. This growing deficit of the current account is expected to be financed by financial flows. The Bank conducted sterilised foreign exchange market interventions to address any potential misalignment of the domestic currency with regard to macroeconomic fundamentals and curtail undue volatility in the rupee exchange rate.

Monetary policy has remained broadly accommodative. At its September 2017 meeting, the Monetary Policy Committee (MPC) unanimously decided to loosen monetary policy by 50 basis points to 3.50 per cent, in a bid to provide a boost to investment and stimulate economic activity. At its subsequent meetings, the MPC voted to maintain the Key Repo Rate (KRR) unchanged. The MPC's neutral stance on the KRR was mainly focussed on supporting domestic economic growth, while domestic inflationary pressures appeared subdued.

To effectively implement the monetary policy stance taken by the MPC, and with the objective of bringing short-term money market rates in line with the KRR, the Bank stepped up its efforts as from 2018H1 to remove liquidity in the banking system through the conduct of open market operations. These took the form of weekly issues of Bank of Mauritius Bills of up to one-year maturity, and issues of Bank of Mauritius Notes as and when needed. In this context, the Bank also came up with a new instrument, namely, the three-Year Bank of Mauritius Golden Jubilee Bond that was proposed to retail customers from mid-March to mid-June 2018. Through these operations on the money market, the Bank succeeded in reducing the supply of reserves down to the level of demand for reserves at the target interest rate, which resulted in the overnight interbank interest rate and short-term yields rising close to the KRR. Between end-December 2017 and the beginning of August 2018, the net issue of Bank of Mauritius instruments increased from around Rs70 billion to about Rs92 billion.

Since the last Financial Stability Assessment made in June 2017, risks to domestic financial stability emanating from the global economy have declined as growth is still expected to be robust despite mounting uncertainty. This should support the tradeable sectors, such as tourism, manufacturing and financial services. Non-tradeable sectors, such as construction, whose performance directly affects asset quality of Mauritian banks in view of their relevance and importance in banks' loan portfolios, are also expected to maintain healthy momentum.

Indebtedness of households, as measured by the debt-to-disposable income ratio, has remained mostly unchanged below 50 per cent. At its current level, household indebtedness points towards limited financial stability risks. The relaxation of the LTV ratio, and subsequent repeal in the 2018-2019 Budget, for first time home buyers, in part, helped support the growth momentum of household credit. In spite of higher credit facilities supplied to and availed by households, the household credit-to-GDP gap has stayed into negative territory in 2017 and through to 2018Q1. A number of macroprudential policy measures (e.g., Debt-to-Income ratio, additional portfolio provisioning, enhanced risk weights) are in place to prevent build-up of vulnerabilities with regard to banks' exposure to households. With the cut in the KRR in September 2017, interest rates on housing, personal and professional credit have declined and contributed towards lower debt service cost of households. Nevertheless, close monitoring of the evolution of banks' exposure to households and any resulting NPL that may emerge following payment delinquency must be pursued for early detection of any pocket of vulnerabilities and timely remedial actions.

Against a backdrop of improving business confidence and economic activity, banks' exposures to domestic corporates - which account for around 68 per cent of total private sector credit - increased as the result of higher credit extended to operators in almost all key sectors of the domestic economy. During 2017, several corporates also issued bonds to the public via both public offerings and private placements estimated at MUR 11.5 billion compared to the amount of MUR 8.2 billion raised in 2016. In the absence of raising such type of capital, bank credit to corporates would have been higher as would have leverage ratios. Nonetheless, corporates have accumulated more debt and were more leveraged compared to the previous year. Overall, corporate leverage - measured by the debt-to-equity ratio - was higher for operators in the tourism, distributive trade and manufacturing sectors and lower for those operators in the construction and sugar-linked sectors.

On an aggregated basis, corporate debt-to-equity ratio was estimated at about 39 per cent in 2017 compared to 37 per cent in 2016. Most of these corporates listed on the SEM have seen marked increases in their share prices in 2017, reflecting increased optimism in business activity in general. Profitability of corporates has improved while cost of debt as measured by interest expense to total debt ratio has remained rather unchanged. The cut in the KRR in September 2017 provided a relief to the cash flow of corporates in Mauritius while the expected improvement in economic activity should help consolidate their financial position. Notwithstanding the improvement in growth of credit, the corporate credit-to-GDP gap has remained in negative territory in 2017, albeit the gap has been closing with the improvement in credit growth. Return on equity of selected listed corporates on the domestic stock market, in general, improved in 2017.

Overall, the financial system is assessed to be sound and resilient. Total assets held by the banking sector grew by 3.5 per cent as at end-June 2018, thereby translating into expanding balance sheet sizes. More ventures into cross-border activities helped support balance sheet size expansions mainly through higher foreign assets. As at end-June 2018, the aggregate Capital Adequacy Ratio (CAR) for the banking sector in Mauritius stood at 17.2 per cent compared to 17.7 per cent and 17.5 per cent as at end-December 2017 and December 2016, respectively. Capital adequacy of banks therefore remains comfortably above the current regulatory minimum of 10 per cent, exclusive of capital requisites to be made for Capital Conservation Buffer and D-SIB charges that are being phased in until 2020.

Results from the macro-based stress testing model developed internally at the Bank show that the banking system as a whole remains resilient to severe but plausible shocks being engineered to some of the main macroeconomic variables such as growth rate, interest rates, and the exchange rate. The ongoing implementation of capital buffer consolidation in a phased manner in line with the Basel III framework will contribute towards strengthening banks' capital against shocks. Similarly, D-SIB charges imposed on banks in a phased manner will help add an extra layer of certainty by consolidating capital buffers of the systemically important banks. Banks in Mauritius are therefore well poised to deal with risks, and avail of enough safeguards to absorb losses in the event of a crisis.

The profitability of banks remained at a healthy level. Banks' return on assets remained broadly positive, standing at 1.5 per cent as at end-June 2018 while return on equity improved from 13.6 per cent in December 2016 to 14.8 per cent as at end-June 2018. Following a period of deterioration in the overall asset quality of banks' portfolios during 2015 and 2016, asset quality of banks improved subsequently, with the ratio of NPL to Gross Loans (NPL ratio) declining from 6.8 per cent in 2016 to 6.3 per cent in 2017 before rising slightly to 6.5 per cent in 2018H1. Construction had the highest NPL ratio, followed by other cyclical sectors such as tourism and financial services. Better sectoral prospects for construction during 2017 and 2018 somewhat appeared to contain its NPL ratio compared to previous years. Banks appeared to factor in the effects of high levels of impairments on their bottom-line results by fielding adequate provisions as shield. The coverage ratio, which measures the ratio of

Specific Provisions to NPLs, moved from 48.8 per cent as at end-December 2016 to around 49.7 per cent as at end-December 2017 and further up to 56.4 per cent as at end-June 2018, in view of higher provisioning by banks.

Banks in Mauritius were required to move to IFRS9 as from January 2018. Under the new framework, the recognition of credit impairment is based on forward-looking assessments or the expected loss framework as opposed to rules which were based on an incurred loss framework. Under IFRS9, losses may be recognized at an earlier stage of a downturn. It is therefore imperative that banks enhance the quality of their assets and closely manage credit risk exposures to mitigate any adverse impact of the new accounting standard on their overall level of provisioning. Nonetheless, the coverage ratio indicates that the banking sector can avail of a relatively safe margin in the form of adequate buffer against future losses that might arise.

The proportion of bank credit extended to the ten largest borrowers as at end-December 2017 increased compared to end-December 2016. Although credit concentration indicators appear to be well contained within their prudential limits, vigilance must nonetheless be exercised because corporates may be subject to unexpected deteriorations in view of their cyclicality. As at end-December 2017, the banking system was assessed to be well-funded and liquid. The Bank of Mauritius continues its efforts to diligently monitor the liquidity situation of banks through enhanced liquidity monitoring tool, liquidity gap analyses, following up on implementation of banks' stress testing models and requiring banks to report their liquidity contingency backup plans.

A number of initiatives has been taken over the year 2017 and beginning of 2018 to enhance stability of the financial system. The minimum capital requirement of banks which was Rs200 million since 2004 was increased to Rs400 million to improve the resilience of banks. The supervisory process at the Bank is being overhauled, with the onset of effective consolidated supervision, conglomerate supervision, and risk-based supervision, with the benefit of technical assistance from international institutions. The Bank has also issued and updated numerous Guidelines in line with international best practices, after due consultation with the banking industry.

PART 1

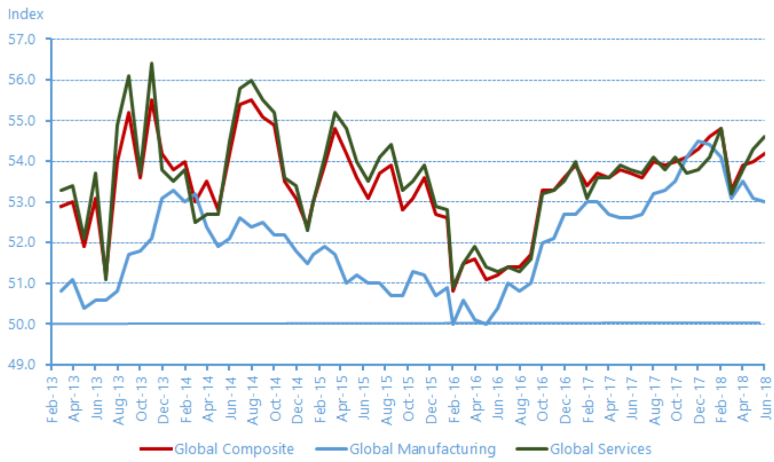
STATEMENT ON PRICE STABILITY

2. External Economic Developments

Global economic activity continued to expand at a solid pace in 2018H1 although growth has become uneven across advanced and emerging economies in the wake of increasing interest rate differentials between the US and several key economies, simmering trade tensions and domestic idiosyncratic factors. While global growth is forecast to remain robust, mounting uncertainty given recent developments have increased downside risks to this outlook in the medium term. Global inflation has increased, mainly on the back of rising oil prices, but inflationary pressures over the medium-term are expected to remain relatively mild.

Global growth was broadly stable and robust during 2018H1, albeit the outlook had somewhat weakened following developments in the global financial markets and geopolitical events. Prominent signs of global economic activity such as the Purchasing Managers Index indicate that there have been signs of a slowdown in global manufacturing and export-oriented sectors since the beginning of 2018, although these indicators remain robust by historical averages (Chart 2.1).

Chart 2.1: Global Purchasing Managers' Index



Source: Markit.

The closing of the output gap in several developed economies ostensibly contributed towards global inflation rising moderately, supported by gradually tightening labour markets, especially in the Euro area and in the US. Oil price hikes have also had a non-negligible toll on global inflation rates since the beginning of 2018, compared to same period in 2017. Subdued oil supply against a backdrop of continued rises in demand from advanced and emerging markets have helped to support the oil price momentum. However, the outlook for oil prices over the short to medium term is quite balanced, which points to a rather muted global inflation outlook, the more so that wages are not increasing in line with the tightening of labour markets, especially in advanced economies.

For quite some time, monetary policy has been broadly accommodative in advanced economies. While this stance helped buttress short-term global growth objectives and facilitated capital inflows into emerging markets and developing economies alike, it also presented policymakers with a dilemma: how to balance the need to sustain growth momentum in the short-term, while containing the attended financial stability risks that could potentially emerge - and with potentially pernicious impact on assets, equities, and currency markets globally - if monetary conditions were suddenly tightened in the developed world.

Recent economic developments in the developed world have demonstrated the end of the quantitative easing cycle. Policy normalisation is proceeding at different speeds and intensities, albeit in a rather gradualist fashion. While the cyclical upturn in advanced economies may prove to be stronger and more long-lasting than previously anticipated, a tightening of global financial market conditions may take its toll on global growth rates, as years of low interest rates come to an end with potentially damaging effects on asset markets worldwide, and on growth. A tightening of global financial conditions may directly affect emerging economies through sudden stops in capital inflows and through reversal of carry-trade strategies, notwithstanding the improved resilience of their economies (Table 2.1).

Table 2.1: Monetary Policy Stance

	Policy rate as at June 2018 *(Per cent p.a)*	Change since (basis points)	
		Dec 2016	Dec 2017
Developed economies			
United States	1.75	+125	+50
Euro Area	0.00	0	0
United Kingdom	0.50	+25	0
Japan	-0.10	0	0
Emerging Market and Developing Economies			
South Africa	6.50	-50	-25
China	4.35	0	0
India[1]	6.25	0	+25

[1] *India lowered the repo rate by 25 basis points in August 2017 but increased it by same magnitude in June 2018.*

Global financial stability conditions have also tightened, especially in emerging markets. Risk appetite and investor confidence somewhat appear to have embarked on a new cycle, following years of increased confidence and tolerance for risk-taking behaviour. Sentiment has been dampened by geopolitical developments with potential detrimental effects to global trade, and global growth prospects. The decision by the Trump administration to impose tariffs on Chinese imports has resulted in escalated tensions between the US and China as the latter threatens to retaliate. While global consumption and investment prospects so far seem not to have suffered any hard braking following these developments, the impact on peripheral countries that are highly dependent on economic powerhouses engaged in trade war, may be hard to ignore, should a fully-blown trade war manifest itself. Already, the impact on global financial markets has already been felt as equities markets seem to have taken a modest backseat, given their sensitivity to global business and financial conditions, including trade growth and patterns. The non-oil commodities markets especially metals, have already begun to take a hit. Overall, although the global growth outlook for 2018 remains healthy, it is widely believed that, going forward, risks to the downside have increased.

The US economy's growth momentum during 2018 continues unabated

Growth remains robust in the US. Based on high frequency indicators, momentum appears to have gathered strength in the second quarter of 2018. Exports and investment have been the main engines of growth since the beginning of 2018, while consumption spending has also picked up due to the delayed timing of personal tax cuts which have shifted spending into the second quarter of the year and the alleged effect of higher net worth. Consumption and investment sentiment seem to be positive. Labour market conditions remain tight, with unemployment dipping to its lowest levels since the early 2000s. Growth prospects into the second half of 2018 may nonetheless face headwinds. Although the combined effect of personal tax cuts and the removal of spending caps may provide impetus to growth, developments in international trade may constitute a drag going forward, especially if followed by retaliatory measures from trading partners. Fiscal policy which has, so far, remained broadly supportive of the economic stance, may not necessarily continue to do so sustainably, going forward. Medium-term prospects for inflation have edged up mainly on the back of temporary supply shocks, to which potential upticks have been added, namely moderate wage growth, as well as a closing of the output gap. As such, monetary policy normalisation may continue to define monetary stance for quite some time. In fact, due to the robust outlook for growth and inflation, it is expected that the US Federal Reserve (US Fed) will continue to raise rates in a gradualist fashion in 2018 and 2019.

Upbeat investor market sentiment about US economic growth prospects, aligned with portfolio re-engineering by global investors from emerging markets assets towards US-based assets, have helped sustain the dollar's strength.

Advanced Economies are facing a positive outlook, despite a few dark spots

Growth in the Euro area remains moderate and supported by positive consumption and investment sentiment, despite a few hindrances plaguing the exports sector. Growth over the past two years helped reduce slack, albeit some spare capacity still remains. Labour market reforms enacted in recent years in a number of member countries have helped put the lid on unemployment rates. However, wage rate growth did not translate into unit labor cost hikes in recent years. Inflation the in Euro area remains rather subdued. Growth is forecast to pick up in the second quarter of 2018, but to stall in 2019 compared to 2018.

The announcement of the slowdown in asset purchase program by the ECB until December 2018 and possible end of asset purchases after that period marks an end to the accommodative monetary policy stance pursued by the ECB. Although ECB policy rates are expected to remain unchanged for much of 2019, a fear remains that a more protracted withdrawal of asset purchase may ostensibly shave off a few digits from projected medium-term growth prospects. Subdued productivity growth and population ageing may also stymie the growth momentum. Overall, labor market conditions, concerns about fiscal policy sustainability, and the fallouts of trade wars and protectionist measures being administered elsewhere in major hotspots of the world, may combine to hold back growth in the Euro area.

The UK is expected to face the economic consequences of Brexit uncertainty through: deteriorating external balance situation; declining asset prices; and tightened conditions facing households and corporates. The resulting higher cost of financing for households and corporates was triggered by the relatively higher cost of wholesale funding affecting UK banks. The Pound sterling which has become more perceptible to shifts in market sentiment since the UK government's Brexit announcement has lost some value since the beginning of the year and remains below its 2015 peak levels. The depreciation of the Pound sterling has helped give a fillip to UK equity markets as many corporations, especially those with overseas operations, have recorded improved performance.

Growth prospects in Emerging Markets are benign but not impervious to risks emanating from elsewhere

Emerging market economies, as a whole, enjoyed relatively strong economic prospects. However, the heterogeneity of that particular category of countries masks important country-specific vulnerabilities. Overall, emerging market economies face two main challenges: on the one hand, emerging trade tensions between the US and China have weighed down on the prospects for commodities trade and have negatively impacted upon equity markets in many emerging markets. On the other, monetary policy normalisation in the US has contributed towards enhancing volatility in emerging market currencies and resulted in tighter financial market conditions. Indeed, a stronger dollar may prove to be detrimental to those emerging markets that have contracted significant corporate and government debt, a large portion of which is denominated in dollars, especially if they have an unhedged position or do not perceive revenues in dollar. Furthermore, global investors' appetite for the assets of emerging market economies may nosedive, with potential detrimental effect for their exchange rates.

Oil prices have escalated on the back of supply-side shocks

While the recently observed oil price hikes have helped support economic recovery in many oil-producing nations, oil importers have been toying - to varying degrees of success - with a broad arsenal of measures, ranging from exchange rate policy to reserve management, to address the shock. The recent oil price increases can be vindicated on grounds of temporary supply factors, namely sanctions against Iranian exports and Venezuelan crisis, all set against a backdrop of continued demand growth. US oil shale drilling has recently taken a back seat due to hindrances affecting pipeline supply. Going forward, oil analysts expect price outlook to be broadly balanced for oil. On the one hand, further geopolitical tensions in oil producing countries may continue sustain oil price hikes. On the other hand, commitment by OPEC countries to end the current agreement which consists of curtailing oil supply, may contribute towards appeasing any oil price hike tensions.

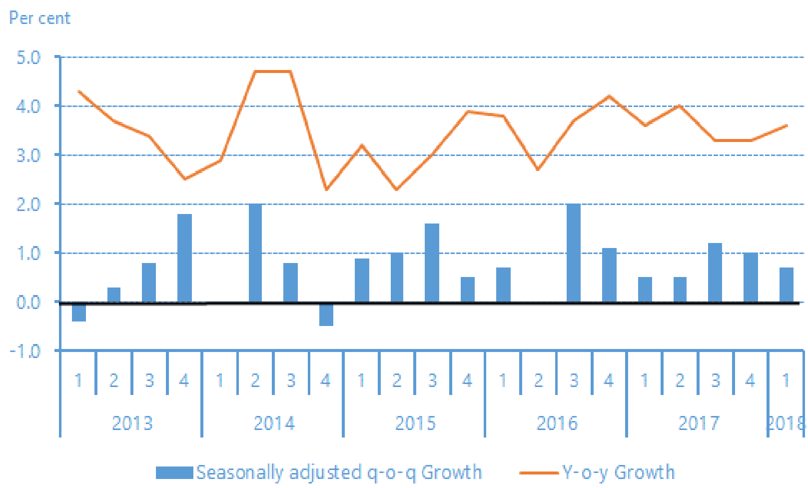
3. Domestic Economic Developments

Real output growth was sustained in the domestic economy, largely driven by domestic demand whilst external demand continued to be a drag on growth. The construction and other tertiary sectors have performed strongly since the last MPFSR. The labour market continues to improve, with a continuous fall in the unemployment rate. Going forward, growth in 2018 should be underpinned by the sustained recovery in these key sectors, consumption spending and the expected surge in public investment spending. Broadly accommodative monetary conditions would also contribute to maintaining the growth momentum.

3.1 Domestic Output[1]

Domestic economic growth moderated to 3.3 per cent in the last two quarters of 2017, from 4.0 per cent in 2017Q2, before rebounding to 3.6 per cent in 2018Q1. A slowdown in final consumption expenditure and investment spending primarily drove GDP growth lower in 2017H2, but the subsequent pickup in consumption growth in 2018Q1 led to the recovery in output (Chart 3.1).

Chart 3.1: Real GDP Growth Rate



Source: Statistics Mauritius.

Growth in final consumption expenditure jumped from 2.7 per cent and 2.6 per cent in 2017Q3 and 2017Q4, respectively, to 3.5 per cent in 2018Q1. This reflected higher growth of 3.5 per cent in household consumption expenditure, and of 5.2 per cent in government consumption expenditure in 2018 Q1. It is expected that in the short to medium term, household consumption will continue to be sustained by the improvement in purchasing power from the introduction of the minimum wage, negative income tax, and the introduction of a new tax band for middle income households.

[1] *Based on National Accounts statistics released in June 2018.*

Investment growth decelerated, from 6.4 per cent in 2017Q3 to 3.8 per cent in 2017Q4, and contracted by 1.5 per cent in 2018Q1. This was mainly the result of lower growth in building and construction work as investment in residential building contracted, and a large drop in investment in machinery and equipment. Whilst private investment spending is expected to contract in 2018, public sector investment is expected to soar by 23.7 per cent on account of the massive public infrastructure projects currently being undertaken.

External demand remained a major cause of concern as net exports continued to subtract from output growth. Exports of goods and services fell by 2.7 per cent in 2017H2, and further by 5.3 per cent in 2018Q1, notably driven by continued contraction in goods exports. Imports of goods and services rebounded by 5.2 per cent in 2017H2, but fell by 6.5 per cent in 2018Q1 given the decrease in the prices of petroleum products. The gradual, albeit slow, recovery in the Eurozone is expected to continue to support the recovery in domestic economic activity although there are risks that the uncertainty surrounding Brexit and the concerns regarding the trade relations between the US and China could weaken external demand further.

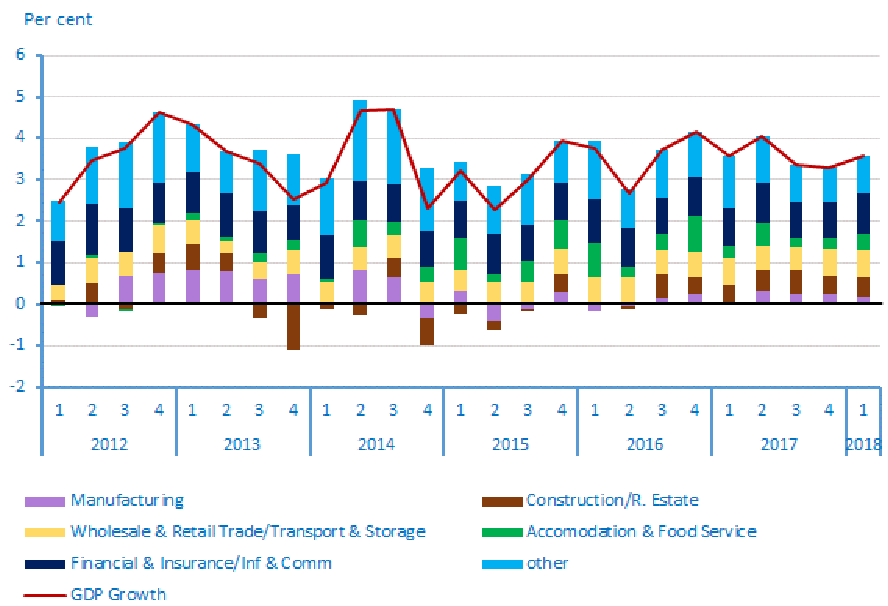
3.2 GDP by Sector

Domestic economic activity was sustained across key sectors. The 'Construction' sector remained on a robust growth trajectory, despite a slight deceleration from 8.7 per cent in 2017Q3 to 6.3 per cent in 2018 Q1. Statistics Mauritius projects the upturn in the 'Construction' sector to be sustained in 2018, with growth of 9.5 per cent. The 'Accommodation and food service activities' sector expanded at a relatively lower pace, mainly on account of base effect following the strong growth recorded in 2016. Performance in this sector continued to be driven by the recovery in tourist arrivals, which went up to 716,001 in 2017H2, from 688,763 in 2016H2 while total tourist nights spent increased from 6,626,375 in 2016H2 to 6,786,803 in 2017H2. The 'Financial and insurance activities' and 'Wholesale and retail trade' as well as 'Manufacturing' sectors maintained relatively steady growth rates.

In contrast, the 'Agriculture' sector continued to be a drag on growth, with a contraction of 4.6 per cent registered in 2018Q1. The dwindling performance of the agricultural sector can be attributed to the decline in sugar production, from 386,277 tonnes in 2016 to 355,213 tonnes in 2017, coupled with lower global sugar prices. Sugar exports as a share of total exports also declined from 10.5 per cent in 2016H2 to 9.9 per cent in 2017H2 (Chart 3.2).

Overall, Statistics Mauritius projects the domestic economy to grow by 3.9 per cent in 2018, from 3.8 per cent in 2017. Table 3.1 presents forecasts by private sector analysts.

Chart 3.2: Sectoral Real Growth Rates and Contribution to Real GDP Growth



Source: Statistics Mauritius.

Table 3.1: Comparison of 2018 Real GDP Growth Rate Projections

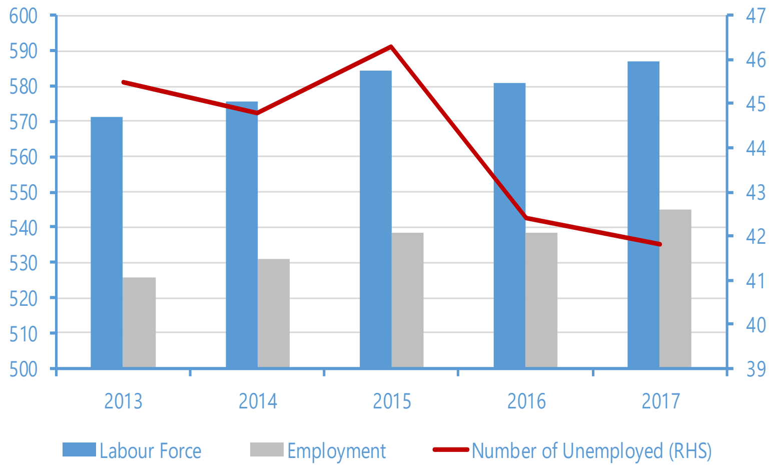
	Real GDP Growth Rate Projections
Statistics Mauritius[1]	3.9
IMF[2]	3.9
MCB Focus[3]	3.8
SBM Insights[4]	3.9
Bank of Mauritius	4.0

[1] *National Accounts -June 2018.*
[2] *IMF World Economic Outlook - April 2018.*
[3] *MCB Focus - June 2018.*
[4] *SBM Insights - May 2018.*

3.3 Labour Market and Competitiveness

The labour market improved in 2017, with a decrease in the unemployment rate to 7.1 per cent in 2017, from 7.3 per cent in 2016. The unemployment rate is set to decrease further to 6.9 per cent in 2018, on account of an increase in employment which would more than offset labour force expansion (Chart 3.3).

Chart 3.3: Main Labour Market Indicators



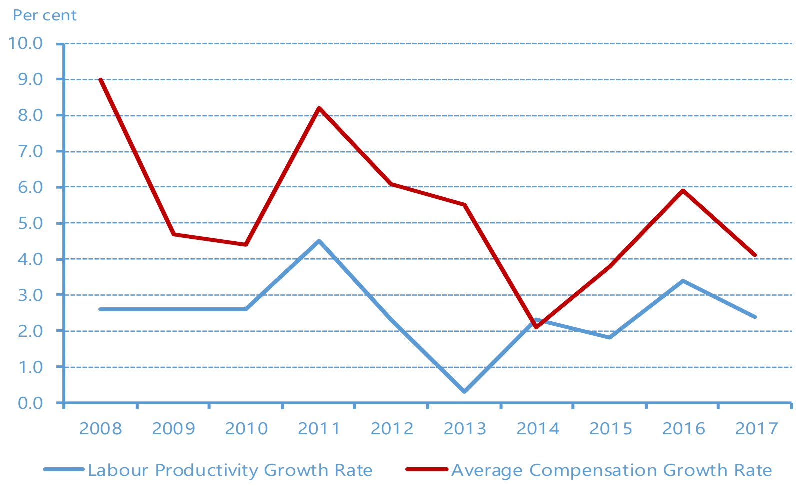
Source: Statistics Mauritius.

On a quarterly basis, the unemployment rate declined to 7.1 per cent in 2018Q1, from 7.6 per cent in 2017Q1. This reflected a marginal rise of 600 in the labour force while employment grew by 3,900, which brought down the number of unemployed by 3,300. The fall in the unemployment rate was predominantly the result of a sharp drop in youth female unemployment (16-24 years) following job creation in this segment, and lower unemployment among women in the age group of 30 to 39 years, who seem to have dropped out of the labour force altogether. The seasonally-adjusted unemployment rate fell from 7.1 per cent in 2017Q1 to 6.6 per cent in 2018Q1.

Ongoing labour market policies such as the Youth Employment Programme (YEP) and National Skills Development Programme (NSDP) seek to address skills mismatch as well as youth and female unemployment. During the fiscal year 2017/18, a further 2,500 persons were expected to be enrolled under the NSDP. Around 3,300 youth were placed with the YEP in 2017, primarily in the wholesale and retail trade, real estate and ICT sectors. The introduction of a minimum wage policy in 2018 aims at bridging income inequality and improving income distribution at the lower end. It is estimated that around 121,000 workers have been impacted by this measure. The wage rate index rose by 4.0 points from 2017Q1 to 2018Q1, mainly reflecting increases in the manufacturing and financial and insurance activities sectors.

Compensation in excess of labour productivity persisted in 2017 as average compensation rose by 4.1 per cent compared to the increase of 2.4 per cent in labour productivity. Labour productivity growth slowed from 3.4 per cent in 2016 as a result of higher employment in 2017. Higher compensation relative to labour productivity could potentially have a dampening impact on competitiveness by raising unit labour cost, which measures the labour cost of one unit of output. However, as a result of a convergence in the growth rates of average compensation and labour productivity, unit labour cost, in rupee terms, increased by 1.7 per cent in 2017 compared to 2.4 per cent in 2016 (Chart 3.4).

Chart 3.4: Average Compensation of Employees and Labour Productivity Growth



Source: Statistics Mauritius.

3.4 Fiscal Sector Developments

Fiscal performance for FY2017-18 was underpinned by a lower deficit of 3.2 per cent as a share to GDP compared to 3.5 per cent in FY2016-17. The budget deficit improved from Rs15.8 billion in FY2016-17 to Rs14.4 million in FY2017-18, due to the transfer of Special Funds, higher external grants and the lower implementation of capital projects. The deficit was financed exclusively from domestic sources.

Public sector debt rose by 3.5 per cent to Rs300.2 billion over the fiscal year to end-June 2018, and represented 63.0 per cent of GDP. The increase in debt was mainly due to the issuance of medium to long-term government bonds to lengthen the debt maturity profile. Government securities, which had been issued to remove excess liquidity from the system, stood at Rs0.9 billion as at end-June 2018, compared to Rs6.6 billion a year earlier (Table 3.2). According to the 2018-19 Budget, government's net borrowing is forecast to increase to some Rs24 billion in FY2018-19 compared to around Rs19 billion in FY2017-18.

Table 3.2: Public Sector Debt

(Rs million)

	Jun-15	Jun-16	Jun-17	Mar-18	Jun-18
1. Short-term Domestic Obligations [1]	**25,916**	**34,280**	**38,723**	**25,187**	**25,856**
2. Medium and Long-term Domestic Obligations [1]	**145,992**	**163,518**	**180,479**	**194,111**	**199,927**
3. Domestic Central Government Debt (1+2)	**171,908**	**197,798**	**219,202**	**219,298**	**225,783**
	(42.9)	*(46.9)*	*(49.0)*	*(47.2)*	*(47.4)*
4. External Government Debt	**54,711**	**53,464**	**46,231**	**44,544**	**44,538**
	(13.7)	*(12.7)*	*(10.3)*	*(9.6)*	*(9.4)*
(a) Foreign Loans	49,920	48,532	41,552	39,838	39,823
(b) Foreign Investment in Government Securities	16	128	39	29	14
(c) IMF SDR Allocations	4,775	4,804	4,640	4,677	4,701
5. Extra Budgetary Unit Domestic Debt	**24**	**24**	**24**	**24**	**24**
6. Extra Budgetary Unit External Debt	**136**	**115**	**90**	**79**	**68**
7. Local Government Domestic Debt	**0**	**0**	**0**	**0**	**0**
8. Public Enterprise Domestic Debt	**12,507**	**10,679**	**11,935**	**17,764**	**17,015**
9. Public Enterprise External Debt	**12,618**	**12,317**	**12,621**	**11,694**	**12,736**
10. Domestic Public Sector Debt	**184,439**	**208,501**	**231,161**	**237,086**	**242,822**
	(46.0)	*(49.4)*	*(51.6)*	*(51.0)*	*(51.0)*
11. External Public Sector Debt	**67,465**	**65,896**	**58,942**	**56,317**	**57,342**
	(16.8)	*(15.6)*	*(13.2)*	*(12.1)*	*(12.0)*
12. Total Public Sector Debt (11+12)	**251,904**	**274,397**	**290,103**	**293,403**	**300,164**
	(62.9)	*(65.0)*	*(64.8)*	*(63.1)*	*(63.0)*

[1] By original maturity.

Notes: (i) Short-term: Up to 12 months; Medium-term: Over 1 year but less than 5 years; Long-term: 5 years and above.

(ii) Figures in brackets are percentages to GDP.

(iii) Figures may not add up to totals due to rounding.

Source: Ministry of Finance and Economic Development and Bank of Mauritius.

3.5 Monetary Aggregates

The annual growth rate of broad money liabilities (BML) stood at 7.9 per cent in July 2018, up from 7.3 per cent in July 2017. With the exception of time deposits, all the components of BML recorded robust y-o-y growth rates. The velocity of circulation of broad money was maintained at around 1.0 in July 2018.

The annual growth rate in net foreign assets (NFA) of depository corporations (DCs) slowed to 2.9 per cent in July 2018 compared to an increase of 8.1 per cent in July 2017. This was mainly the result of a contraction of 7.2 per cent registered in the NFA of other depository corporations (ODCs) while the NFA of the Bank of Mauritius increased by 26.0 per cent following interventions to buy foreign currencies on the domestic foreign exchange market.

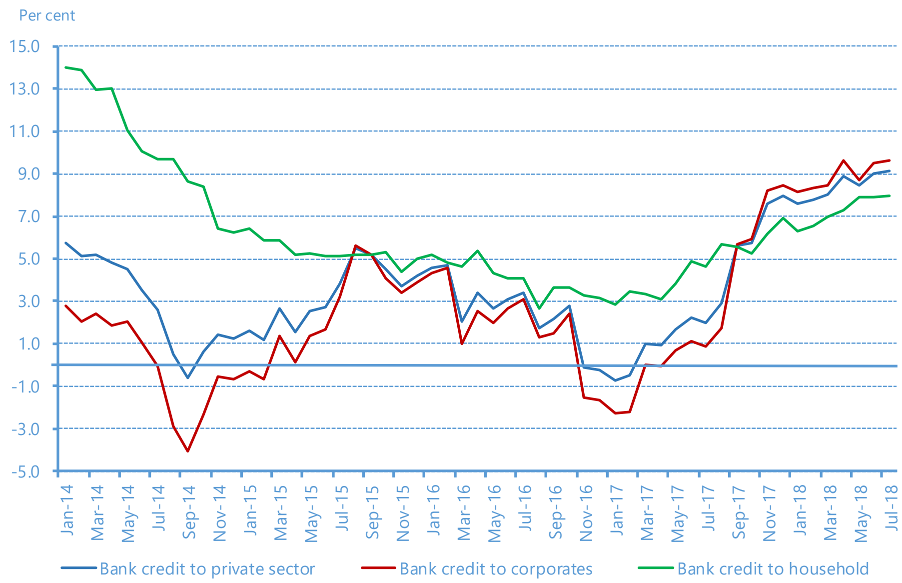
Domestic claims of DCs contracted by 2.4 per cent in July 2018, as against growth of 8.7 per cent in July 2017, largely reflecting a decline in ODCs claims on private sector caused by the change in accounting treatment of financial derivatives in banks' balance sheets. Net claims on Central Government grew from Rs60.4 billion at end-July 2017 to Rs68.1 billion at end-July 2018, while claims on other sectors, mostly made up of credit to the private sector, fell by 4.3 per cent to Rs457.2 billion.

The growth in monetary base remained robust, rising to 22.4 per cent in July 2018, from 14.6 per cent in July 2017, given a rise of 35.6 per cent in liabilities to ODCs. The increase in the monetary base, which led to a fall in the broad money multiplier to 5.3 in July 2018, mostly reflected the build-up of banks' foreign currency balances at the Bank to meet the liquidity coverage ratio requirement.

3.6 Credit Developments

Bank credit to the private sector (excluding GBCs) remained on an uptrend, with growth of 9.1 per cent registered in July 2018 (Chart 3.5). Credit to corporates expanded by 9.6 per cent in July 2018 compared to growth of 0.8 per cent in July 2017. The financial and business services, construction and tourism sectors, which registered y-o-y credit growth rates of 32.2 per cent, 11.1 per cent and 6.1 per cent, respectively, were the major sectors accounting for the expansion in credit to corporates over the year. Growth in credit to households more than doubled over the year to reach 7.9 per cent in July 2018, largely supported by a rise in mortgages.

Chart 3.5: Y-o-y Growth in Bank Credit to Private Sector [1]



[1] Excludes loans to GBC entities.
Source: Bank of Mauritius.

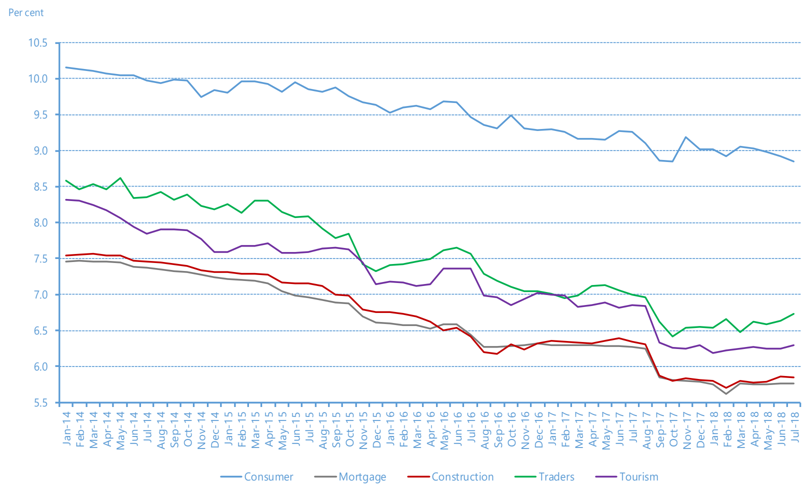
3.7 Interest Rates

Banks adjusted their deposit and lending rates in line with the cut of 50 basis points in the KRR in September 2017. Banks' Prime Lending Rates went down from a range of 6.00-8.50 per cent to a range of 5.65-8.50 per cent between end-August 2017 and end-August 2018. Lending rates applicable to key sectors of the economy - construction, traders and tourism - fluctuated in the range of 5.7 per cent to

7.0 per cent between August 2017 and July 2018, compared to a higher range of 6.2 per cent to 7.3 per cent in the corresponding period of the previous year (Chart 3.6).

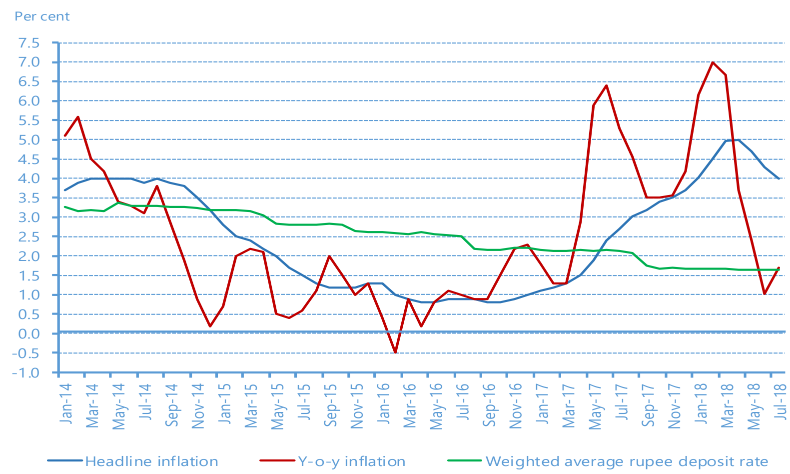
The reduction in the KRR was also reflected in the weighted average rupee deposit rate, which dropped from 2.14 per cent as at end-July 2017 to 1.65 per cent as at end-July 2018. Banks' Savings Deposit Rates fell from a range of 1.75-2.60 per cent to a lower range of 1.20-2.00 per cent over the same period, while real interest rate on rupee deposits mostly remained in negative territory throughout the year ended July 2018 (Chart 3.7).

Chart 3.6: Weighted Average Rupee Lending Rate per-Sector



Source: Bank of Mauritius.

Chart 3.7: Inflation and Weighted Average Rupee Deposit Rate

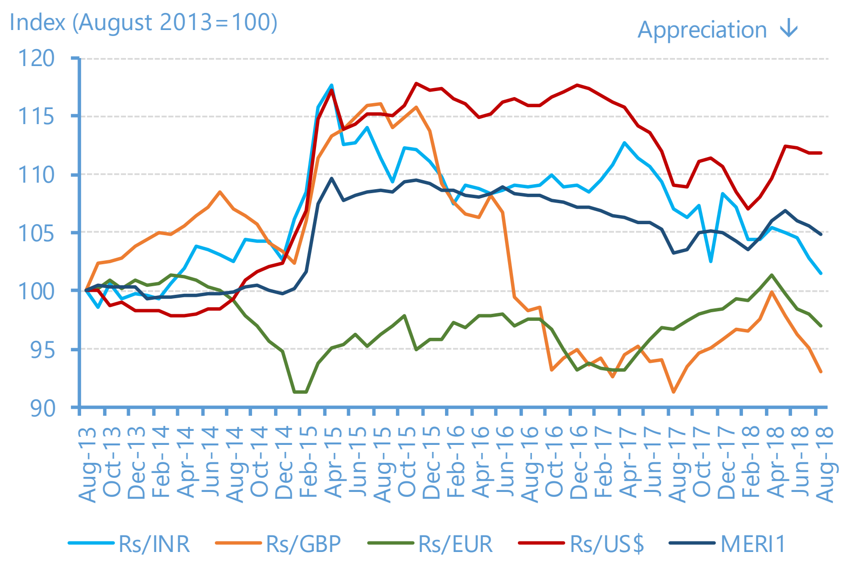


Source: Bank of Mauritius.

3.8 Exchange Rate Developments

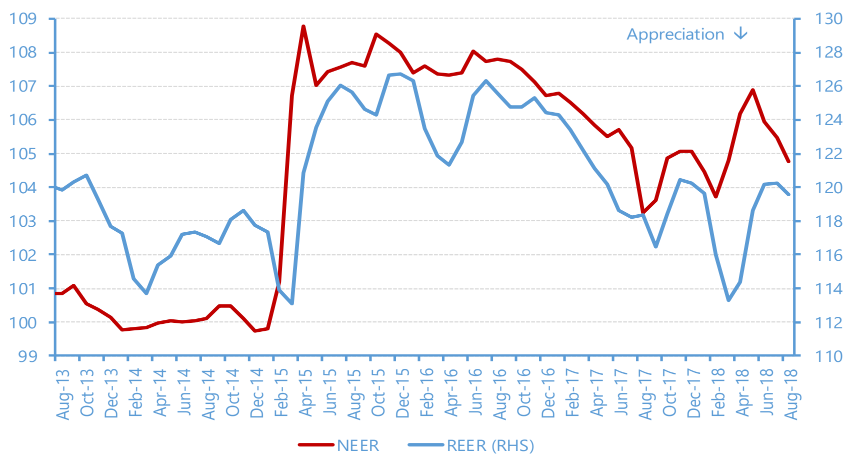
The evolution of major currencies on international markets as well as domestic demand and supply conditions continued to influence the exchange rate of the rupee. On a point-to-point weighted average dealt rate basis, between end-August 2017 and end-August 2018, the rupee depreciated by 4.4 per cent, 2.8 per cent and 5.0 per cent against the US dollar, the euro and the Pound sterling, respectively. Over the same period, the rupee depreciated both on nominal and real effective terms (Charts 3.8 and 3.9).

Chart 3.8: Exchange Rate of the Rupee and MERI1 (February 2012=100)



Note: The MERI1 is based on the currency distribution of merchandise trade and services, excluding transactions in rupees.
Source: Bank of Mauritius.

Chart 3.9: NEER and REER



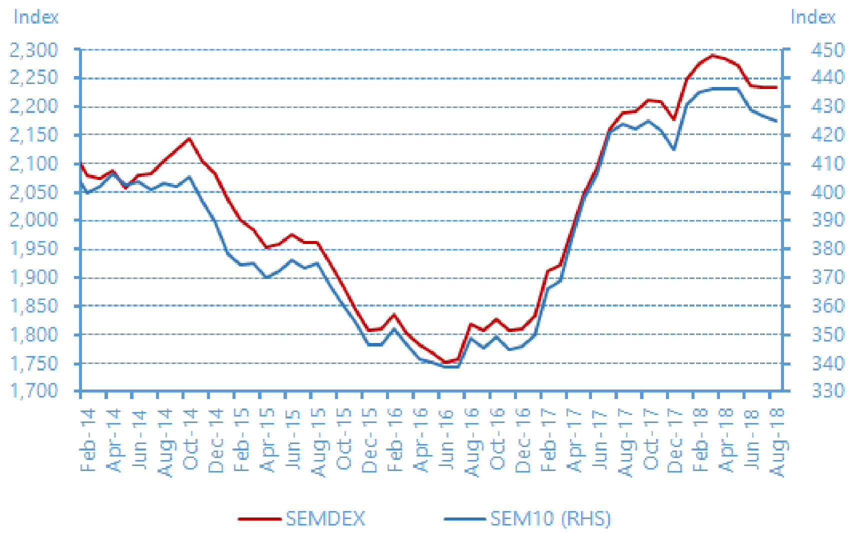
Source: Bank of Mauritius.

3.9 Domestic Stock Market

The SEMDEX recorded notable gains in 2017 and 2018H1, supported by the pickup in construction and hotel share prices consistent with the recovery in these sectors. The SEMDEX increased by 1.3 per cent between end-August 2017 and end-August 2018 while the SEM-10, which comprises the 10 most capitalised stocks on the Official Market, was up by 0.1 per cent (Chart 3.10).

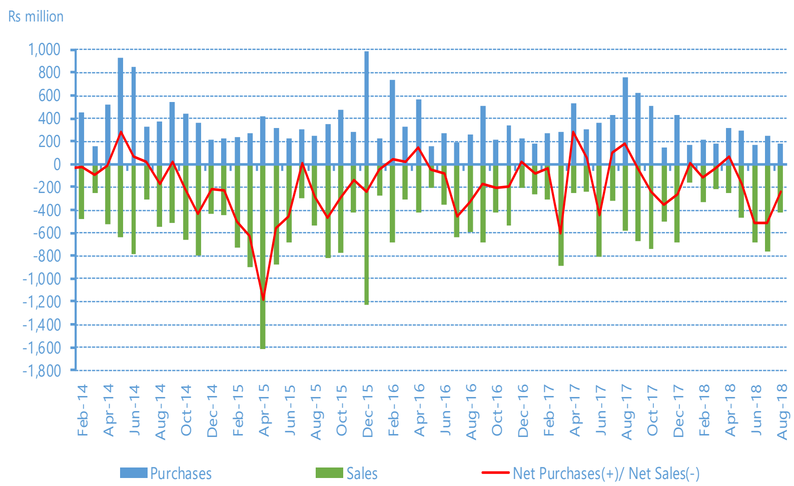
Foreigners continued to disinvest from the domestic stock market, with cumulative net sales of Rs2.7 billion during the year to August 2018 compared to net sales of Rs1.4 billion a year earlier. As a percentage of total market capitalisation, foreign investors' holdings increased to 19.3 per cent as at end-August 2018, from 13.4 per cent as at end-August 2017 (Chart 3.11).

Chart 3.10: Evolution of SEMDEX and SEM-10



Note: The SEM-10 replaced the SEM-7 index as from 2nd October 2014.
Source: The Stock Exchange of Mauritius Ltd.

Chart 3.11: Investments by Non-Residents on the SEM



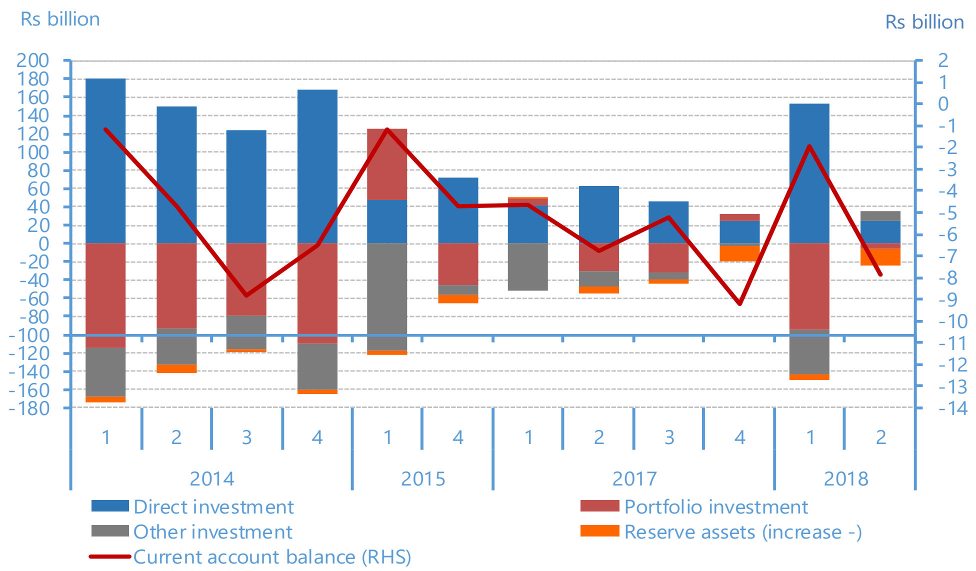
Source: The Stock Exchange of Mauritius Ltd.

3.10 Balance of Payments

The current account deficit improved in 2018H1, with preliminary estimates pointing to a decrease to Rs9.8 billion, from Rs11.4 billion in 2017H1. As a percentage of GDP, this represented a fall from 5.2 per cent to 4.2 per cent over that period. The lower current account deficit was mainly because of an improvement in both the services and current transfers accounts, which more than offset the deterioration in both the goods and income accounts. The worsening goods account reflected the combined effect of a decline in exports coupled with a rise in imports. Total exports of goods decreased by 9.8 per cent, led by all other main categories except 'Beverages & Tobacco', 'Chemicals and related products' and 'Miscellaneous manufactured goods'. Total imports increased by 1.9 per cent, with a notable rise of 24.3 per cent in the imports of 'Mineral fuels, lubricants & related products' in 2018H1.

Capital and financial flows during 2018H1 were more than adequate to finance the current account deficit, resulting in an overall balance of payments surplus of Rs25.7 billion. The direct investment account posted net inflows of Rs177.8 billion while the portfolio and other investment accounts registered net outflows of Rs100.5 billion and Rs37.9 billion, respectively (Chart 3.12).

Chart 3.12: Financing of the Current Account



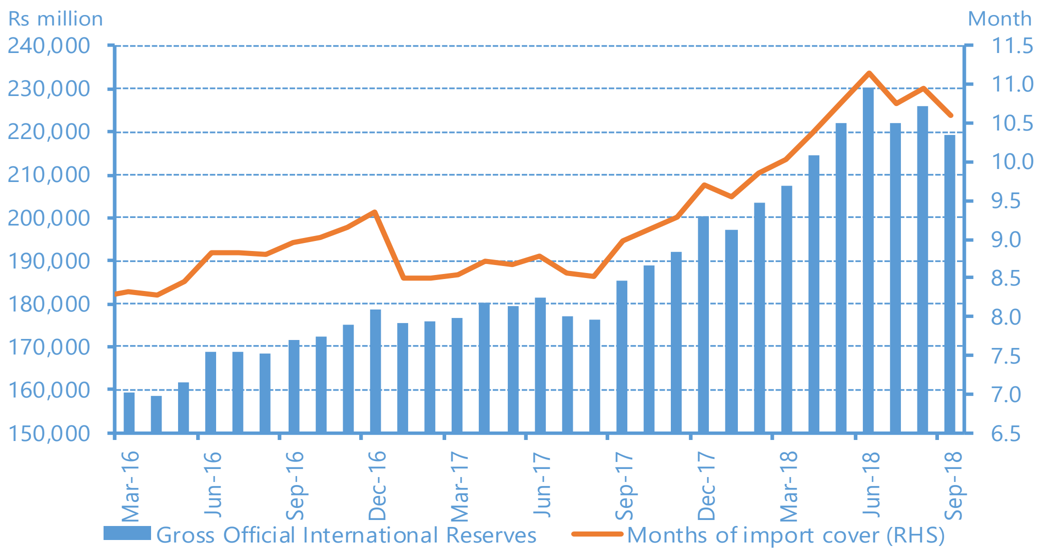
Source: Bank of Mauritius.

The country's terms of trade deteriorated to 106.1 in 2018Q2, from 114.8 in 2017Q2, as the import price index (IPI) increased from 85.3 in 2017Q2 to 93.9 in 2018Q2 and the export price index (EPI) went up from 97.9 to 99.6 over the same period. The higher IPI was the result of a rise in the import bill for all the main categories with a more pronounced spike in 'Petroleum, petroleum products and related materials' that more than offset the lower prices for 'Animal and vegetable oils, fats and waxes'. The higher EPI was driven by increases in all the main categories, which offset the fall of 8.3 per cent in 'Food and live animals' mainly on account of lower 'Sugar' and 'Fish' export prices.

Gross Official International Reserves

The Gross Official International Reserves (GOIR) of the country increased from Rs185.6 billion as at end-September 2017 to Rs219.2 billion as at end-September 2018. In US dollar terms, the GOIR increased by USD0.9 billion to USD6.4 billion as at end-September 2018. Based on the value of imports of goods (f.o.b.) and services for the calendar year 2017, GOIR of the country represented 10.6 months of imports as at end-September 2018 compared to 9.0 months as at end-September 2017 (Chart 3.13). The increase in reserves led to better reserves adequacy indicators. It also pointed to an improvement in selected external vulnerability indicators when viewed against lower gross external debt in 2018H1 (Table 3.3).

Chart 3.13: Gross Official International Reserves and Import Cover



Source: Bank of Mauritius.

Table 3.3: External Debt Indicators, December 2012 to June 2018

		Dec-12	Dec-13	Dec-14	Dec-15	Dec-16	Jun-17	Dec-17	Jun-18
		(Rs million)							
Gross External Debt [1]	as at end	79,881	88,974	79,463	89,112	85,274	79,338	77,678	76,623
External Debt Service [1]	year ended	6,896	9,847	7,642	7,898	9,624	13,755	12,629	8,616
Exports of Goods	year ended	79,658	88,049	94,776	93,290	84,456	82,250	81,317	79,620
Exports of Goods and Services	year ended	181,871	173,232	183,806	189,102	184,915	184,967	186,406	187,240
Imports of Goods and Services	year ended	226,846	225,493	229,221	230,282	229,581	239,502	248,037	248,700
Gross Official International Reserves [2]	as at end	92,988	105,009	124,344	152,902	178,858	181,339	200,368	230,496
GDP at market prices	year ended	350,644	372,397	392,062	409,893	434,765	446,568	457,445	471,003
Broad Money Liabilities	as at end	345,617	365,609	397,557	437,999	477,789	491,497	522,083	537,638
I. Solvency (Per cent)		**Dec-12**	**Dec-13**	**Dec-14**	**Dec-15**	**Dec-16**	**Jun-17**	**Dec-17**	**Jun-18**
Gross External Debt/GDP		22.8	23.9	20.3	21.7	19.6	17.8	17.0	16.3
Gross External Debt/Exports of Goods		100.3	101.1	83.8	95.5	101.0	96.5	95.5	96.2
Gross External Debt/Exports of Goods and Services		43.9	51.4	43.2	47.1	46.1	42.9	41.7	40.9
External Debt Service/Exports of Goods		8.7	11.2	8.1	8.5	11.4	16.7	15.5	10.8
External Debt Service/Exports of Goods and Services		3.8	5.7	4.2	4.2	5.2	7.4	6.8	4.6
II. Reserve Adequacy (Per cent)		**Dec-12**	**Dec-13**	**Dec-14**	**Dec-15**	**Dec-16**	**Jun-17**	**Dec-17**	**Jun-18**
Reserves/Imports of Goods and Services		41.0	46.6	54.2	66.4	77.9	75.7	80.8	92.7
Reserves/Broad Money Liabilities		26.9	28.7	31.3	34.9	37.4	36.9	38.4	42.9
Reserves/Gross External Debt		116.4	118.0	156.5	171.6	209.7	228.6	257.9	300.8

[1] *Gross external debt outstanding as at end of period excludes global business companies' and other deposit taking institutions' debts.*

[2] *Gross Official International Reserves as at end of period comprise gross foreign assets of the Bank of Mauritius, the country's reserve position in the IMF and the foreign assets of Government.*

4. Monetary Policy Decisions and Implementation[2]

From the last issue of the Monetary Policy and Financial Stability Report in July 2017 up to May 2018, the Monetary Policy Committee (MPC) met 4 times. At its September 2017 meeting, the MPC unanimously decided to cut the Key Repo Rate (KRR) by 50 basis points to 3.50 per cent per annum considering the need to stimulate investment into the productive sectors of the economy and give a boost to growth. At its subsequent meetings in November 2017, February 2018 and May 2018, the MPC voted to maintain the KRR unchanged at 3.50 per cent per annum as it viewed that the level of the interest rate was appropriate in light of domestic inflationary pressures and economic growth outlook.

In September 2017, the MPC assessed the global economic outlook to be positive notwithstanding downside risks stemming mainly from policy uncertainty in advanced economies, financial sector vulnerabilities in some countries, and rise in protectionism. Growth in the euro area and Japan had picked up amidst subsiding global inflationary pressures. However, latest available data had indicated that domestic economic activity had moderated in 2017Q1, dragged down by a decline in exports and moderation in final consumption expenditure. Over the year to 2017Q1, the current account deficit had almost doubled, reflecting both falling exports and rising imports, whilst the real effective rupee exchange rate had appreciated in the first semester of 2017. Headline inflation had risen on account of transient factors, but core measure of inflation had remained stable. The MPC was concerned about export performance, and weighing the risks to the domestic growth and inflation outlook, had unanimously decided to give a fillip to growth by reducing the KRR.

At the November 2017 meeting, the MPC viewed that the global economic outlook had improved against a backdrop of relatively easy financial conditions, while inflationary pressures had remained moderate. Domestically, economic activity had picked up, along with a substantial rise in overall investment and decrease in unemployment rate. Nonetheless, exports continued to be a cause of concern. Headline inflation had risen, partly from base effects, and core inflation was slightly up. With growth forecast to go up in 2018 whilst headline inflation would remain at around the same rate as in 2017, the MPC unanimously decided to leave the KRR unchanged at 3.50 per cent.

The MPC remained upbeat about the global economic environment at its February 2018 meeting, and noted that inflation continued to be moderate despite higher oil prices. Domestic economic activity had been sustained, with investment as one of the major growth drivers. Although growth for 2018 had been slightly downgraded, partly due to adverse weather and delays in the implementation of some infrastructure projects, it was forecast to accelerate in 2019 on continued accommodative monetary conditions. Overall, the MPC considered that the economy had delivered a commendable performance. Whilst headline inflation had gone up due to adverse climatic conditions affecting vegetable production, core inflation measures had remained contained. The majority on the MPC

---

[2] *The cut-off date was the May 2018 MPC meeting.*

voted to maintain the KRR at 3.50 per cent to keep the economy on a sustainable growth path and preserve macroeconomic stability.

When the MPC met in May 2018, risks to the global growth outlook had increased somewhat on gradually tightening financial conditions, growing worries about a US-China trade war and other geopolitical factors. Global inflation, which was still subdued, was expected to increase modestly compared to the previous year. In Mauritius, the growth momentum had been maintained, with positive contributions from key sectors of the economy. Better macroeconomic indicators as well as stronger labour market conditions and more favourable business and consumer survey results led the MPC to believe that conditions were in place to ensure a sustained growth performance in 2018. Inflationary pressures had remained contained even though headline inflation continued to be influenced by higher vegetable prices due to poor climatic conditions. Given a sustained growth performance and relatively moderate inflation outlook, the MPC unanimously voted to keep the KRR unchanged at 3.50 per cent.

The MPC reviewed the implementation of monetary policy at all its meetings. It took positive note of the decisive actions taken by the Bank since mid-December 2017 to reduce the amount of reserves in the banking system. The substantial issues of Bank of Mauritius securities had brought the supply of reserves close to banks' demand for reserves at the target interest rate. As a result, the Bank had managed to gradually eliminate the disconnect that had previously existed between the KRR and short-term money market rates. And since February 2018, in conformity with the operational framework for the implementation of monetary policy, short-term money market rates have been hovering close to the KRR.

The MPC also observed the Bank's efforts to curtail undue volatility in the rupee exchange rate and keep the rupee aligned with its macroeconomic fundamentals. The Bank intervened on various occasions throughout the period under review to purchase foreign currencies from the market. All foreign exchange market interventions were sterilised, such that they had little, or no, impact on money market liquidity.

The combination of accommodative monetary conditions and supportive fiscal measures have both contributed to uphold domestic economic activity in a mild inflation environment. The MPC will continue to monitor domestic and international economic developments to ensure that its monetary policy stance remains appropriate to sustain growth and maintain price stability.

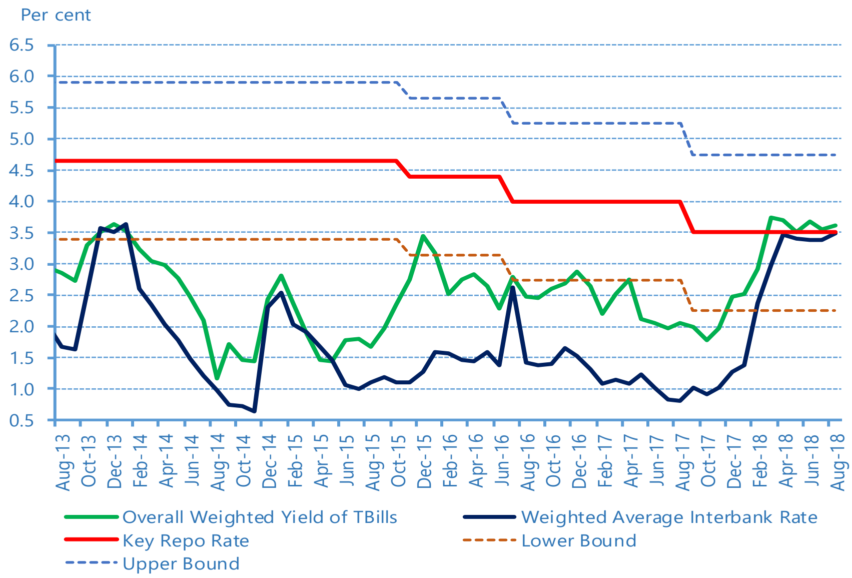
4.1 Implementation of Monetary Policy

The Bank continued to undertake substantial open market operations to remove the structural excess liquidity from the system and bring money market rates in line with the KRR, which has been at 3.50 per cent since September 2017.

Whilst liquidity over and above the cash reserve ratio requirement fluctuated between Rs8-9 billion in the first semester of 2018, it is estimated that a large part of this liquidity represented voluntary reserves kept by banks. Banks' demand for reserves was therefore greater than their required reserves at the target interest rate of around 3.50 per cent. The Bank conducted its operations on the domestic money market with a view to supplying an amount of reserves that was as close as possible to the demand for reserves.

The evolution of the 91-day Bill yield is the measure of the efficiency of the Bank's open market operations to implement monetary policy. Since the low of 1.65 per cent reached in October 2017, and the gradual removal of liquidity from the system, the yield on the 91-day Bill has consistently risen to reach 3.41 per cent at the end of February 2018. Thereafter, the Bank has successfully been able to manage liquidity in the system to keep the 91-day Bill yield at a level consistent with the monetary policy stance, that is, hovering close to the Key Repo Rate (Chart 4.1).

Chart 4.1: KRR, Money Market and Interbank Interest Rates



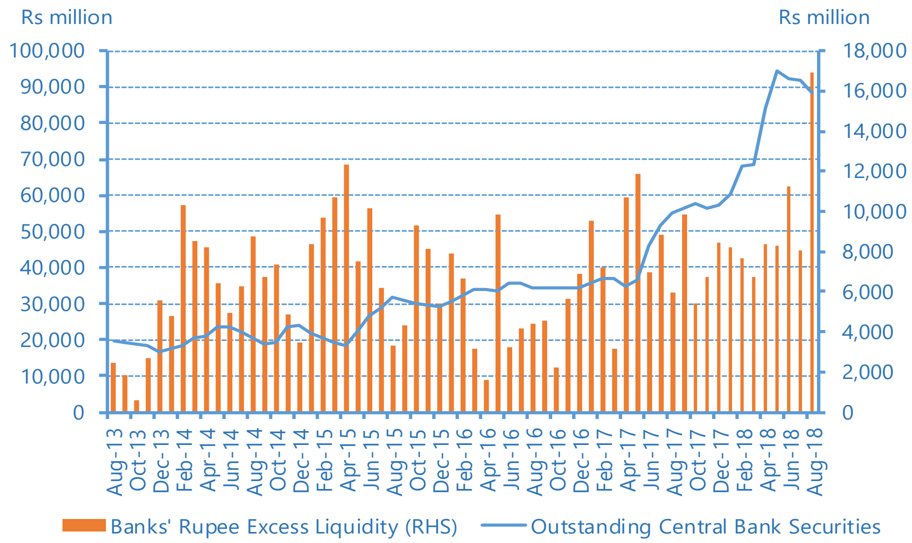
Source: Bank of Mauritius.

The Bank continued to have recourse to the issue of its own instruments in order to absorb the liquidity (Chart 4.2). As such, it issued Bank of Mauritius Bills at the shorter end of the yield curve as well as medium-term Notes of two to four years' maturity that reduced the need for frequent roll-overs. As from 15 March 2018, the Bank came up with a new instrument, the Three-Year Bank of Mauritius Golden Jubilee Bond, which was issued to retail customers over a period of three months up to 15 June 2018 for some Rs9 billion. Additionally, the Bank conducted mandatory sterilisation of foreign exchange intervention proceeds for a one-year period at deposit rates equivalent to the latest yields on the 364-day Bill.

The Bank incurred substantial costs in conducting open market operations. Between end-December 2017 and the beginning of August 2018, the net issue of Bank of Mauritius instruments increased from around Rs70 billion to about Rs92 billion. This amount included the issues of Golden Jubilee Bonds effected between March and June 2018 as well as the sterilisation of intervention proceeds.

Notwithstanding the cost incurred, the Bank clearly showed its commitment to the market that it would undertake open market operations as required to achieve the monetary policy stance. The improved credibility of the Bank with regard to the implementation of monetary policy is expected to reinforce the monetary policy transmission mechanism.

Chart 4.2: Banks' Excess Liquidity and Outstanding BOM Securities



Source: Bank of Mauritius.

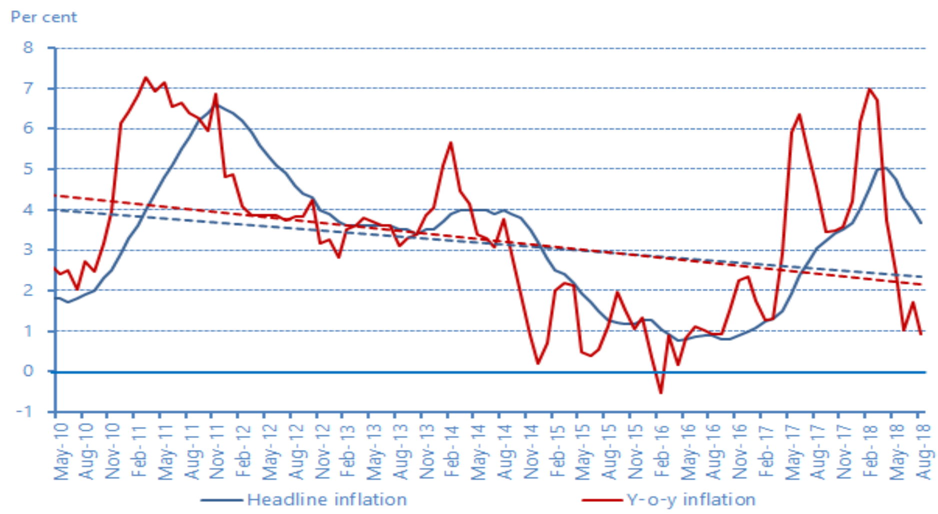
5. Inflation: Developments and Outlook

Inflation in Mauritius was mostly influenced by transitory supply factors in the form of substantial increases in the prices of vegetables amid poor weather conditions at the beginning of 2018, higher domestic prices of petroleum products and a hike in excise duties on alcoholic beverages and tobacco in 2017. However, domestic inflation eased as the impact of those shocks disappeared over time. Meanwhile, underlying inflationary measures, namely CORE1 and CORE2 did not point to any upside price pressures, and were contained within tight ranges[3]. The domestic inflation outlook remains benign.

5.1 Recent Trends

Headline inflation, as measured by the change in the average level of the CPI during a twelve-month period, rose from 1.5 per cent in April 2017 to 3.7 per cent in August 2018. Y-o-y inflation accelerated to 6.4 per cent in June 2017, from 2.9 per cent in April 2017, mostly on account of the increase in excise duties on alcoholic beverages and tobacco, before subsiding to 4.2 per cent in December 2017. It thereafter surged to 6.7 per cent in March 2018 given adverse climatic conditions that affected vegetables prices, but retreated again to 0.9 per cent in August 2018 as the transitory impact of higher vegetables prices wore off (Chart 5.1). The momentum of price changes, as indicated by the 3-month moving average seasonally-adjusted inflation, also eased in August 2018 (Chart 5.2).

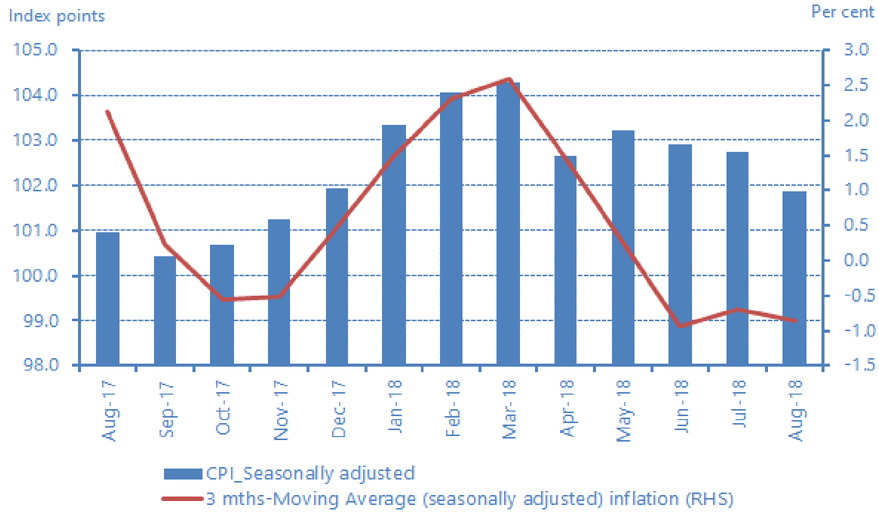
Chart 5.1: Inflation Dynamics



Source: Statistics Mauritius.

[3] *As from April 2018, the CPI is calculated on the basis of an updated basket of goods and services derived from the 2017 Household Budget Survey conducted by Statistics Mauritius. The base period for this new CPI series is the twelve-month period January 2017 to December 2017.*

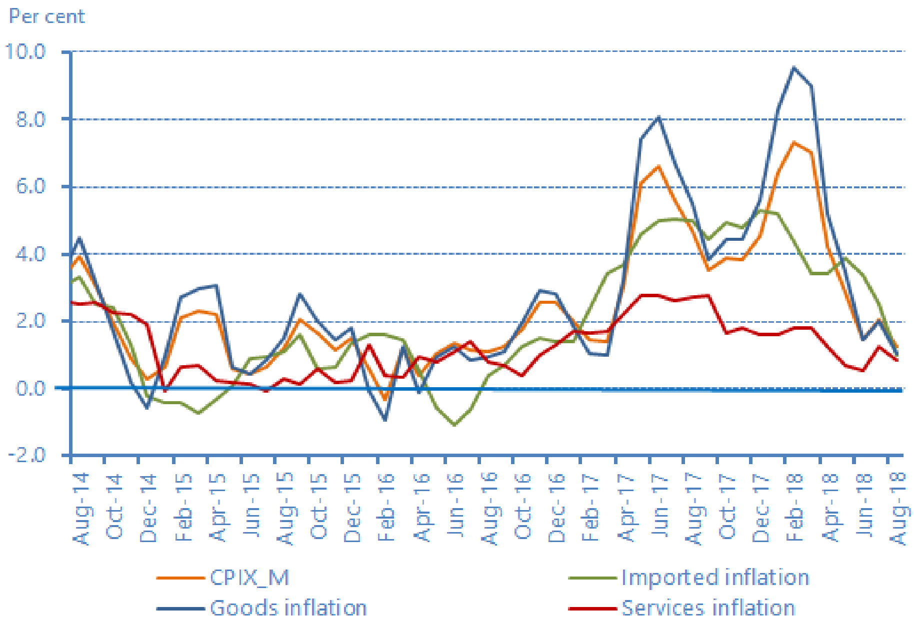
Chart 5.2: Three-month moving average (seasonally adjusted) inflation



Source: Statistics Mauritius and BoM staff calculations

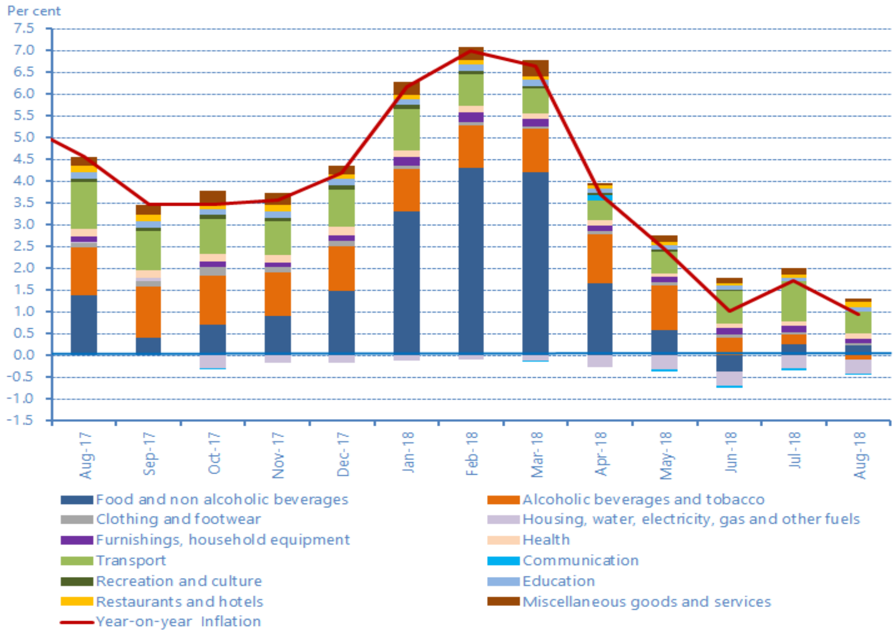
Reflecting the sharp increase in the prices of vegetables, y-o-y food price inflation surged to about 16 per cent in February and March 2018 before receding in August. Y-o-y goods inflation firmed from 3.2 per cent in April 2017 to 5.2 per cent in April 2018, mainly affected by higher alcoholic beverages, tobacco and food prices before subsiding to 1.1 per cent in August 2018. Services inflation went down from 2.2 per cent to 0.8 per cent over the same period since the impact of an increase in transport prices following the decision of the Petroleum Pricing Committee to hike petroleum prices on the domestic market gradually tapered off. Imported inflation rose from 3.7 per cent in April 2017 to around 5.0 per cent during the year, before coming back down to 1.0 per cent in August 2018, mainly reflecting the changes in petroleum prices (Charts 5.3 and 5.4).

Chart 5.3: Goods and Services Inflation (y-o-y)



Source: Statistics Mauritius and BoM staff calculations

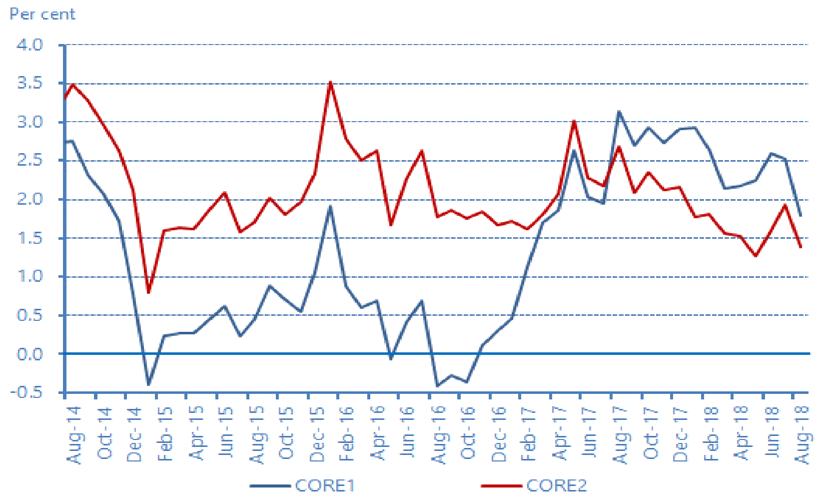
Chart 5.4: Evolution of the main divisions' contribution to y-o-y Inflation



Source: Statistics Mauritius and BoM staff calculations

Underlying inflationary pressures, as reflected in the Bank's CORE1 and CORE2 measures, remained broadly contained (Chart 5.5). Y-o-y CORE1 inflation eased from 1.9 per cent in April 2017 to 1.8 per cent in August 2018 while y-o-y CORE2 inflation edged down from 2.1 per cent to 1.4 per cent.

Chart 5.5: Core Inflation (y-o-y)

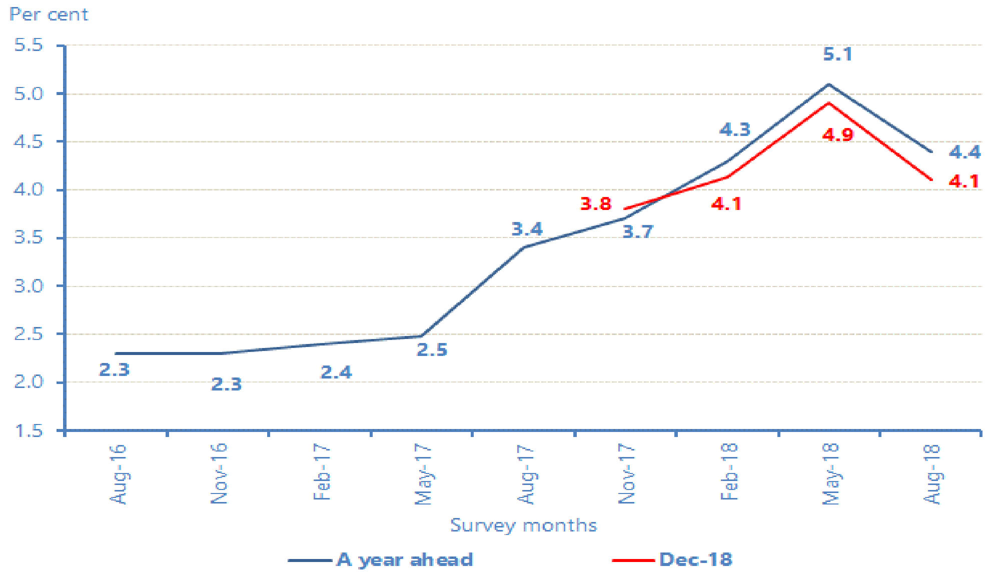


Source: Statistics Mauritius and BoM staff calculations

Inflation expectations tilted to the downside over the year to August 2018, in line with prevailing headline inflation (Chart 5.6). According to the survey conducted in August 2018, the majority of respondents anticipated the inflation rate to be between 3.0 per cent and 4.5 per cent for December

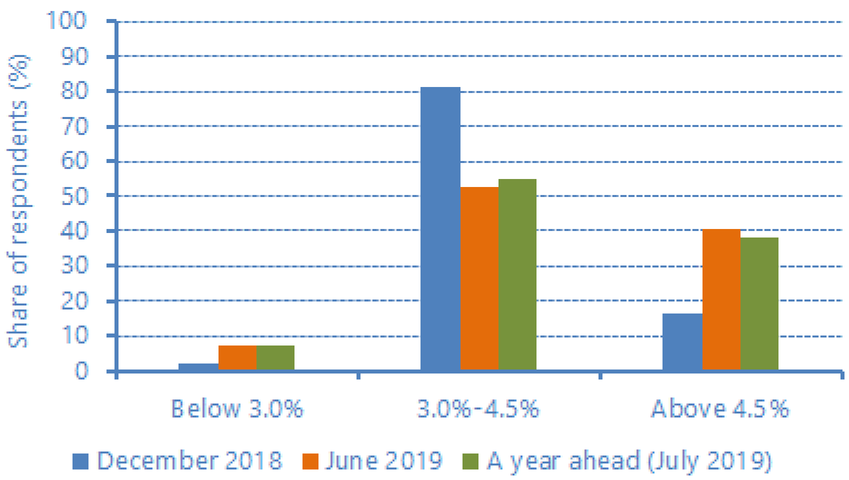
2018. The mean inflation outturns were expected to be 4.1 per cent for December 2018; 4.3 per cent for June 2019 and 4.4 per cent a year ahead - i.e July 2019 (Chart 5.7).

Chart 5.6: Inflation Expectations (mean): August 2016-August 2018



Source: Surveys and BoM staff calculations

Chart 5.7: Inflation expectations over different time horizons: Survey month of August 2018



Source: Surveys and BoM staff calculations

5.2 Inflation and GDP Growth Projections

The Bank uses a quarterly forward-looking projection model calibrated for the Mauritian economy in order to generate medium-term forecasts for real GDP growth and inflation. The model incorporates a series of assumptions regarding both the global and domestic economic as well as financial outlook.

Global growth is expected to remain solid in the short term on account of a mix of supportive monetary and fiscal policy. However, the growth paths among developed and emerging market economies are not as synchronized as had been anticipated towards the end of 2017 and beginning of 2018. Ongoing trade policy developments and tightening of financial conditions, particularly in emerging economies, have contributed to shift the balance of risks to the downside, and the medium-term outlook for the global economy has moderated slightly. In its July 2018 World Economic Outlook Update, the International Monetary Fund projected global growth to remain at 3.9 per cent in 2019, but revised down the forecasts for the Eurozone and some emerging market economies.

The global inflation outlook is mostly expected to remain benign, despite labour market tightening in developed markets, weaker exchange rates across some major emerging markets, and the recent rally in oil prices. Although global inflation could increase somewhat, driven by higher oil prices and idiosyncratic factors in a number of countries, underlying inflation pressures are likely to continue being relatively subdued amid gradually rising resource utilisation and a balanced oil price outlook.

The global economic background is consistent with a gradual, albeit different, pace of monetary policy normalsation in the US and Euro area. The US Fed, which has already tightened monetary policy at its March and June 2018 meetings, is widely anticipated to hike rates at least two more times this year. The ECB has already confirmed the end of the net asset purchase programme and could start hiking interest rates in the second semester of 2019. In the UK, however, the market appears dovish with regard to an interest rate hike given the fading effects of the weaker Pound sterling and the uncertainty surrounding Brexit.

On the domestic front, it is assumed that Government would meet its fiscal projections, in line with its fiscal consolidation objective. The implementation of public sector infrastructure projects would gain momentum over the forecast horizon and provide the necessary impetus to boost domestic output. It is also assumed that there would be no change to administered prices. Further, the relative improvement in the economic performance of main trading partners is likely to support external demand and domestic confidence levels.

5.3 Inflation Projection

In the first semester of 2018, transitory weather-related factors together with a hike in the prices of domestic petroleum products drove inflation higher, but these effects have now dissipated.

Looking ahead, the moderate inflation outlook in main trading partner countries as well as relatively contained domestic demand pressures are likely to keep inflation subdued in Mauritius. Whilst the output gap is expected to close, the increase in resource utilization is expected to be gradual, with little impact on labour market conditions over the short to medium term. The introduction of the negative income tax and minimum wage policy is also not expected to add much to inflationary pressures in the economy as they mostly affect lower income groups whose consumption patterns would tend to lead to relatively slight increases in expenditure.

The rupee exchange rate dynamics are expected to contribute mildly to domestic inflationary pressures, given the relatively stable rupee and weak estimated exchange rate pass-through to the CPI. Spare capacity in the economy currently would make importers and producers cautious in passing on the full extent of any rupee depreciation to domestic prices. Moreover, the expected improvement in domestic economic conditions coupled with sustained capital inflows into the country should provide support to the rupee in the foreseeable future.

At the May 2018 MPC, headline inflation was projected at about 4.2 per cent for 2018 and was forecast to drop to around 3.8 per cent in 2019 (Chart 5.8). It was anticipated that core inflation measures would remain contained around their current levels over the forecast horizon. With demand and supply pressures under control over the projection horizon, upside risks to the inflation outlook were assessed to be fairly limited.

5.4 Real GDP Growth Projection

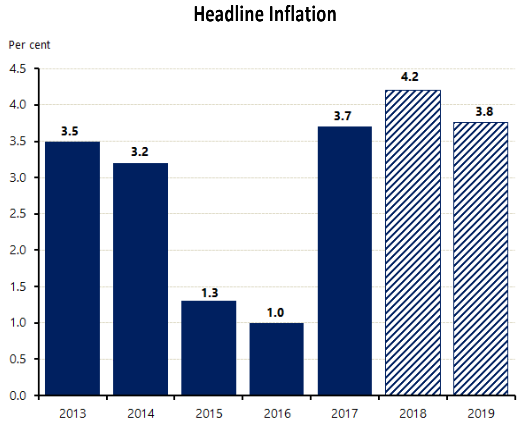
The domestic economy is gradually picking up. With potential output growth estimated at around 4.2 per cent, the output gap, measured as the difference between actual and potential output, is considered to be slightly negative (Chart 5.9). However, it is assessed that spare capacity in the economy will decline gradually as a result of the recovery in the tourism and construction sectors and sustained performance of financial services. Substantial public sector investment, through the implementation of major long-term projects such as the Metro Express and the Road Decongestion Programme, is expected to partly offset the projected decline in private investment in 2018.

Further ahead, low interest rates and favourable funding terms domestically alongside a positive global economic environment are expected to sustain private investment and support the improvement in key sectors of the economy in the medium term. Resilient business confidence, taken together the execution of smart city projects as well as the construction of new hotels by the private sector, also point to a better outlook for private investment.

The improvement in the labour market and rise in wages following the implementation of the minimum wage policy are expected to provide continued support to household consumption over the projection horizon. This will contribute to maintaining the growth momentum in the economy.

On the basis of the above assumptions, the real GDP growth forecast at the May 2018 MPC was maintained at 4.0 per cent for both 2018 and in 2019. The risks to this growth outlook emanate from potential developments in the global economy and larger-than-expected delays in some public infrastructure projects that would weigh on the domestic growth performance.

Chart 5.8: Real GDP Growth and Inflation Projections



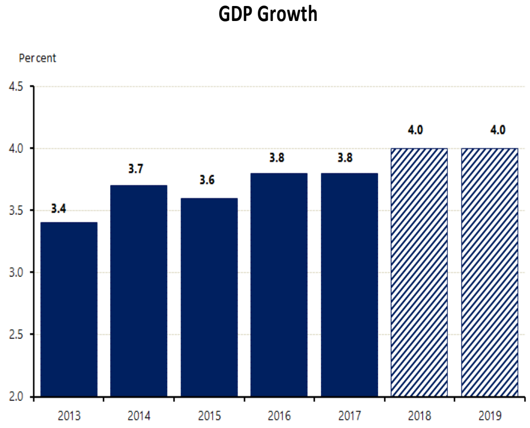
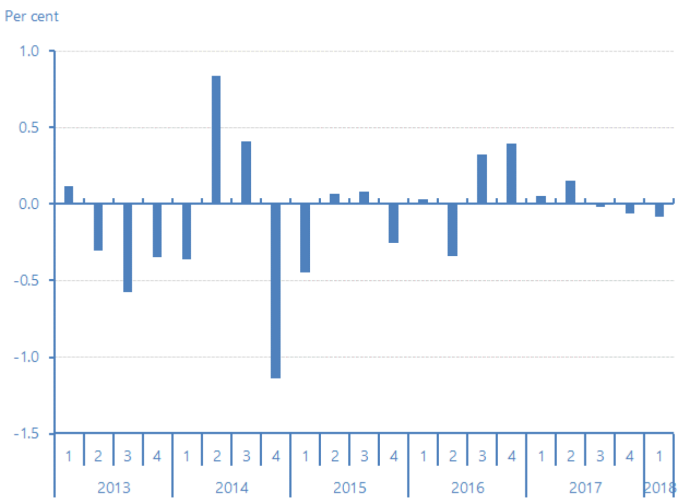


Chart 5.9: Output Gap



PART 2

STATEMENT ON THE STABILITY AND SOUNDNESS OF THE FINANCIAL SYSTEM

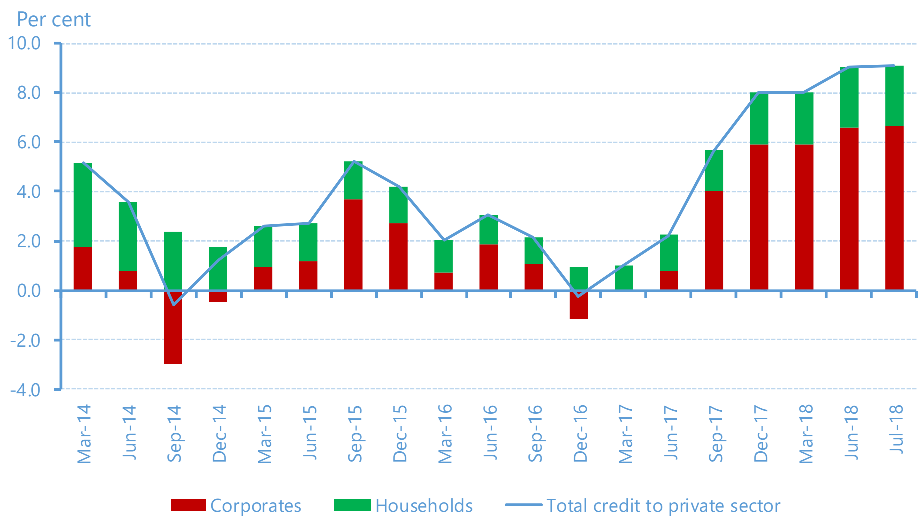
6. Debt Indicators of Households and Corporates

Bank credit to the private sector picked up as at end-July 2018, reflecting higher credit extended to both households and corporates. The rise in bank credit to households was principally driven by credit for housing purposes while the growth in credit to corporates was the result of higher credit extended to operators in almost all key sectors of the economy. Corporates have continued to issue bonds as a funding means. Notwithstanding the increase in credit to the private sector, the credit-to-GDP gap remains in negative territory.

Credit to households and corporates by banks carry non-negligible risks to financial stability as it constitutes about 20 per cent of banks' total assets. During 2018H1, credit facilities granted to households and corporates increased on the back of improving business and consumer confidence and strengthening economic activity. In addition, the Loan-to-Value (LTV) ratio, which was relaxed from 90 per cent to 100 per cent for first time home buyers in July 2017, was repealed in July 2018. Banks should establish their internal LTV limits for residential and commercial property loans based on their risk appetite as an integral part of their credit risk management policy.

The annual growth of bank credit to the private sector (excluding Global Business Corporations) picked up. Between end-July 2017 and end-July 2018, private sector credit grew by 9.1 per cent y-o-y following an increase of 2.0 per cent in the corresponding period a year earlier (Chart 6.1). The improvement in credit reflected higher credit extended to both households and corporates. Credit to households increased to 7.9 per cent as at end-July 2018, from 4.6 per cent a year earlier, while credit extended to corporates surged to 6.5 per cent following an increase of 0.7 per cent a year earlier.

Chart 6.1: Contribution to Growth of Private Sector Credit



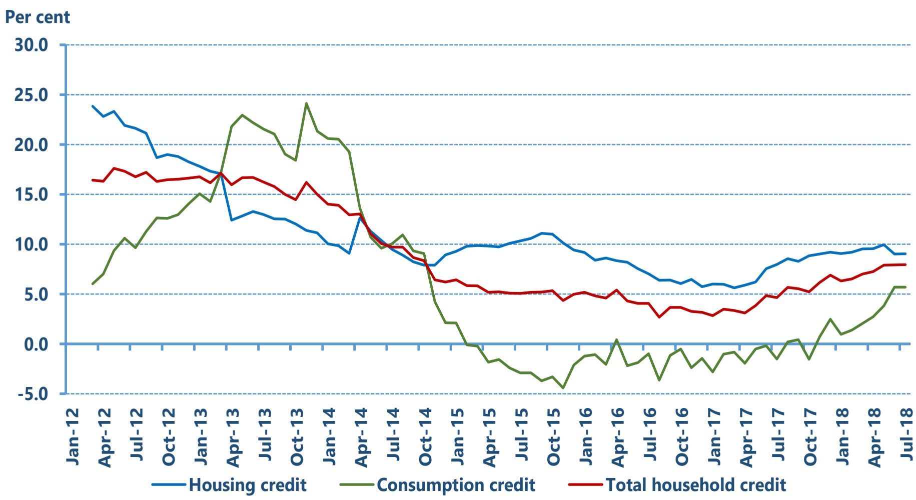
Following the increase in bank credit to the private sector, the private credit-to-GDP ratio went up from 65.2 per cent as at end-March 2017 to 66.8 per cent as at end-March 2018. Household credit-to-GDP ratio rose to 20.3 per cent as at end- March 2018, from 20.0 per cent a year earlier, as the increase in household credit was relatively higher than the increase in GDP. However, corporate credit-to-GDP ratio stayed rather flat at 44.5 per cent.

Household credit accounted for 30.5 per cent of total private sector credit as at end-July 2018 compared to 31.0 per cent, a year earlier. The share of corporate credit in total credit extended by banks to the private sector fell to 66.7 per cent as at end-July 2018, from 68.1 per cent as at end-July 2017.

6.1 Households

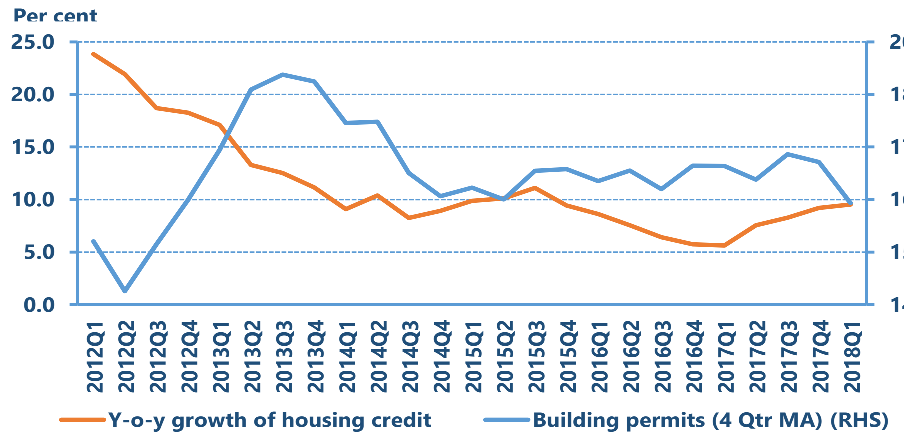
Bank credit to households grew by 7.9 per cent as at end-July 2018, compared to 4.6 per cent as at end-July 2017 (Chart 6.2). This increase was, by large, the result of higher growth in housing credit while growth in consumption credit, which had been negative for much of 2015 to 2017, turned positive, albeit relatively low, towards the end of 2017. The share of housing credit in total household credit increased to 67.7 per cent, reflecting faster expansion of credit facilities extended by banks for house construction and renovation relative to credit granted for consumption purposes. Credit extended by banks for housing purposes grew by 9.1 per cent as at end-July 2018, compared to 8.0 per cent as at end-July 2017. Residential building permits approved in 2018Q1 increased by 0.5 per cent, as against a contraction of 9.2 per cent in 2017Q4 (Chart 6.3). Credit granted for consumption purposes recovered from a contraction of 1.5 per cent as at end-July 2017 to grow by 5.7 per cent over the year to end-July 2018.

Chart 6.2: Y-o-y Growth of Credit to Households



Households in Mauritius borrow mainly in the domestic currency. Foreign exchange risk that may arise from banks' foreign currency exposure to households is therefore mitigated. As at end-July 2018, the share of rupee credit in total household credit remained flat at 96.1 per cent. The household sector does not rely much on short-term financing, as overdraft facilities availed of accounted for only about 4.3 per cent of total outstanding household credit as at end-July 2018, from 5.0 per cent a year earlier.

Chart 6.3: Number of Building Permits* and Y-o-y Growth in Housing Credit



** Building permits consist of residential and commercial permits.*

Sources: Statistics Mauritius and Bank of Mauritius

Indebtedness of households, as measured by the ratio of bank credit to households to disposable income, increased marginally to 48.9 per cent as at end-March 2018 compared to 48.8 per cent as at end-March 2017, but did not warrant any cause for concern. This increase was led by a higher expansion in household credit relative to household disposable income, which reflected improving consumer confidence as well as better domestic economic conditions.

When household debt from banks, non-bank deposit-taking institutions and insurance companies are aggregated, the measure of household indebtedness falls to 80.3 per cent as at end-March 2018, from to 82.3 per cent as at end-March 2017 (Chart 6.4). The ratio of domestic household indebtedness continues to compare favourably with countries in the region, like Namibia and South Africa (Chart 6.5).

Chart 6.4: Estimates of Household Indebtedness Ratio

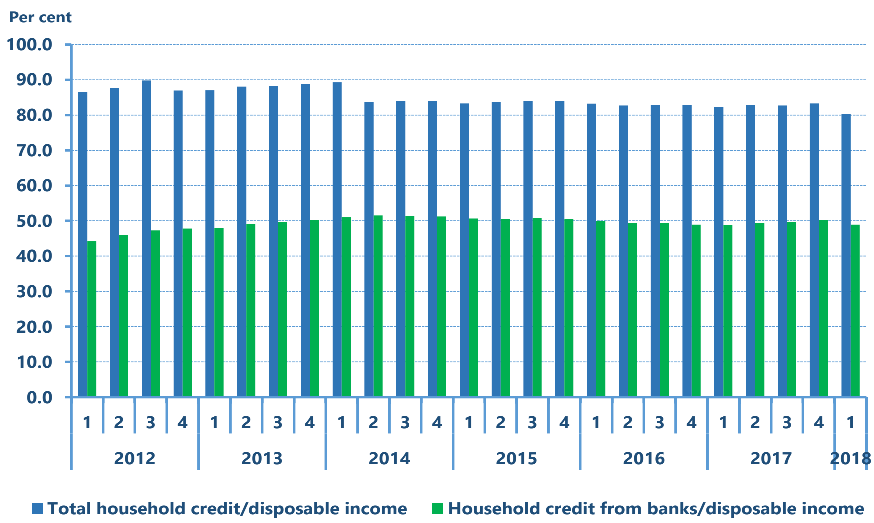
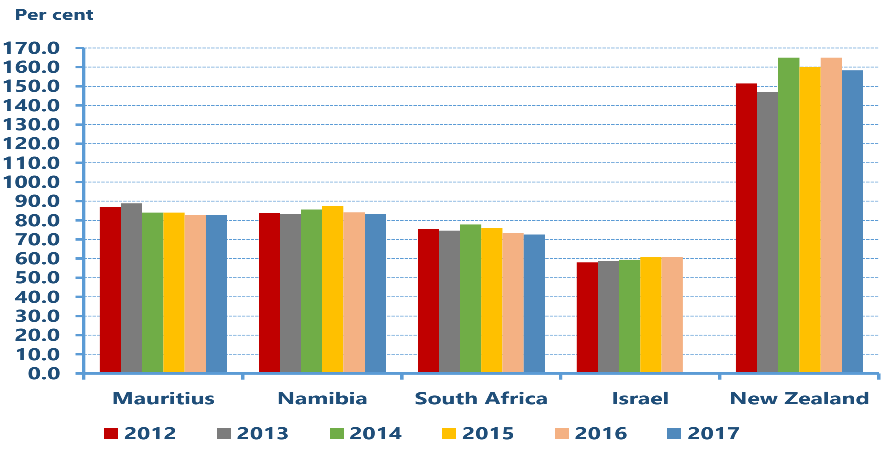


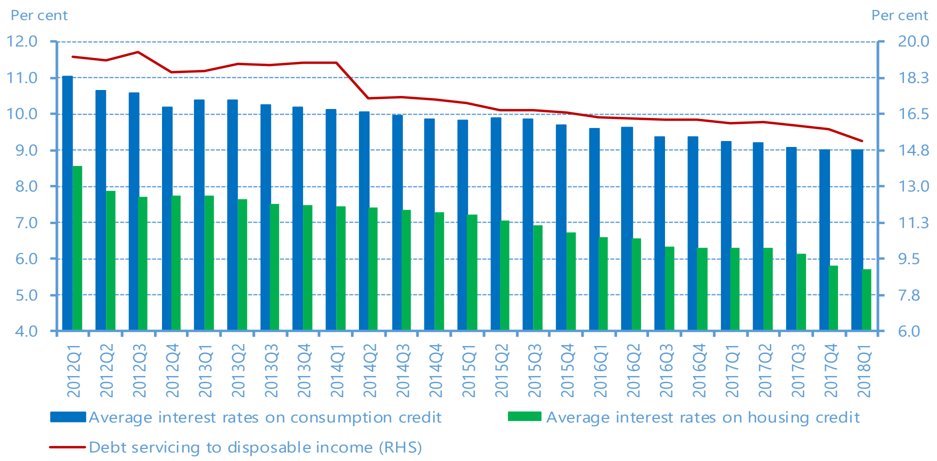
Chart 6.5: Household Debt in Selected Countries



Household Debt Service Cost

The debt service ratio - measured as the ratio of household debt service to disposable income – declined from 16.0 per cent as at end-March 2017 to 15.2 per cent as at end-March 2018 (Chart 6.6). This followed from the reduction in the KRR in September 2017, which led to lower interest rates on housing and consumption. At the regional level, the debt service cost of households was relatively higher than in comparator countries (Chart 6.7).

Chart 6.6: Household Debt Service Cost and Interest Rates



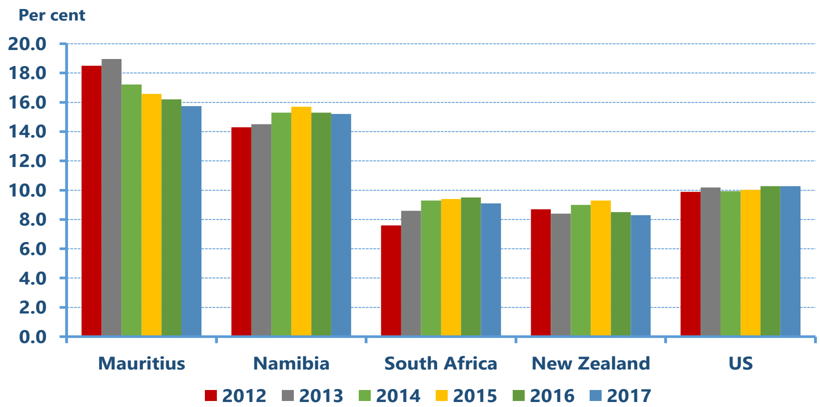
Household Credit-to-GDP Gap

The household credit-to-GDP gap[4] stayed in negative territory during 2017, notwithstanding higher growth of household credit. With household credit-to-GDP ratio rising marginally to 20.5 per cent as at end-March 2018, the household credit-to-GDP gap has been estimated at -1.6 per cent as at end-March 2018 compared to -1.1 per cent as at end-March 2017 (Chart 6.8).

Default rates on credit to the personal sector and outstanding credit card advances declined in 2017, while those on credit granted to the professional sector increased. Non-performing loans (NPL) in the personal sector fell by 7.7 per cent to Rs2,712 million as at end-December 2017 while impaired credit card advances declined by 17.2 per cent to Rs160 million. The resulting NPL ratios were thus lower in the personal sector and on outstanding credit card advances at 9.2 per cent and 6.2 per cent, respectively, as at end-December 2017 compared to 10.3 per cent and 8.7 per cent, a year earlier. In contrast, NPL arising from credit to the professional sector increased by 16.9 per cent to Rs246 million, and the NPL ratio rose to 19.4 per cent, from 16.3 per cent over the same period (Chart 6.9).

The household debt-to-disposable income ratio remained capped below 50 per cent while household debt service costs declined. These would point to limited financial stability risks arising from indebtedness of households, for the time being. The high share of housing credit in total household credit also provides some comfort as banks' exposures to households are mostly collateralised. With the removal of the limit on the LTV ratio and acceleration in housing credit, close monitoring is nevertheless warranted for early detection of vulnerabilities and threats. The Bank has already in place macroprudential tools to prevent the build-up of vulnerabilities in household leverage.

Chart 6.7: Household Debt Service Cost in Selected Countries



[4] *The credit-to-GDP gap is estimated as the percentage deviation between the credit-to-GDP ratio and an estimate of its trend using the Hodrick-Prescott filter.*

Chart 6.8: Household Credit-to-GDP Gap

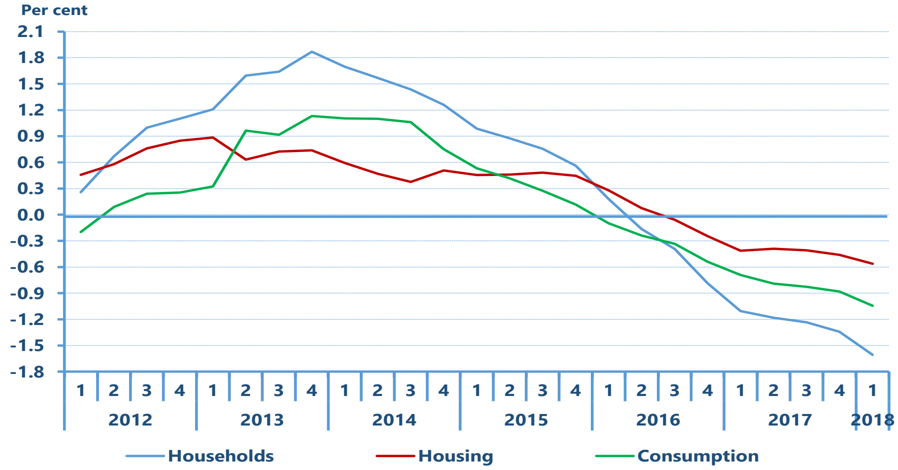
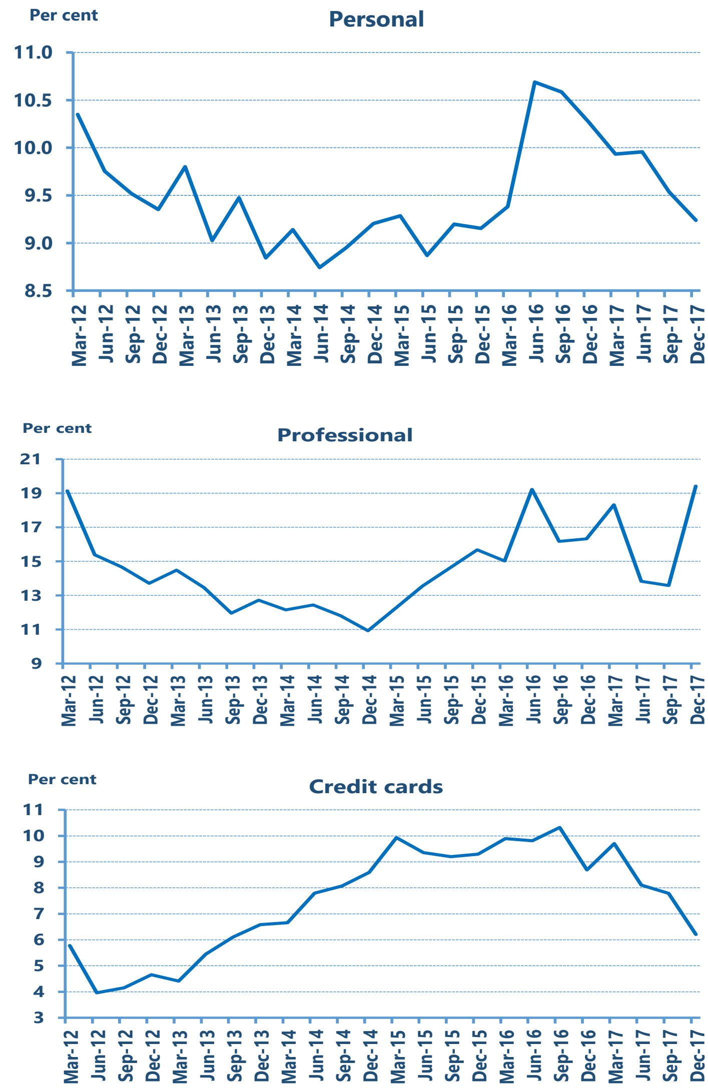


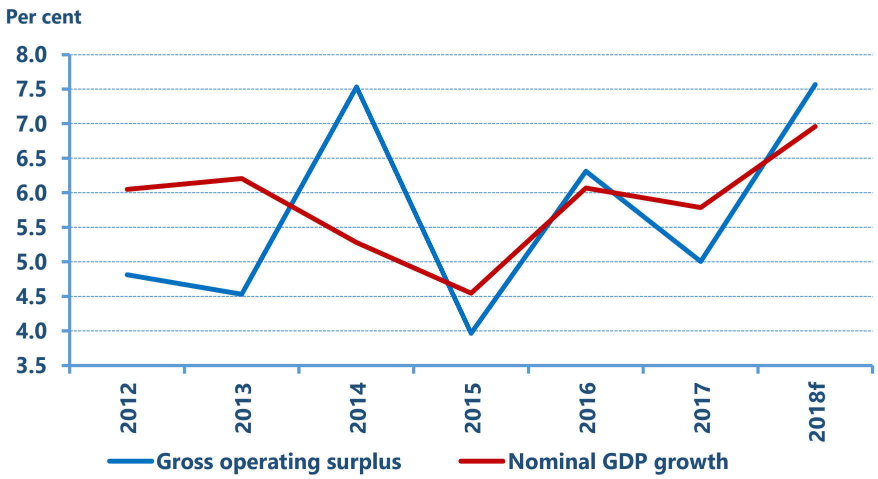
Chart 6.9: Non-performing Loans to Total Loans



6.2 Corporates

The performance of corporates in Mauritius has an important bearing on financial stability and on the domestic economy. Exposure of banks to domestic corporates accounts for around 68 per cent of total private sector credit and 16 per cent of their total assets. Gross Operating Surplus (GOS), which may be used as a proxy for the value added provided by incorporated enterprises' operating activities after deducting for labour input costs, is projected to grow at a higher rate of 7.6 per cent in 2018, following growth of 5.0 per cent in 2017. The improvement in the growth of GOS reflects higher economic activity, going forward (Chart 6.10).

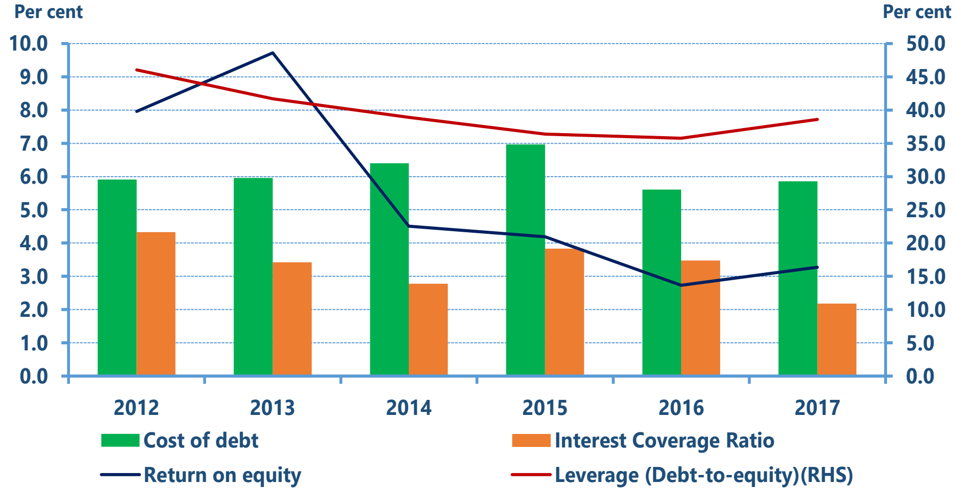
Chart 6.10: Growth of Gross Operating Surplus and GDP



During 2017, profitability of selected listed corporates on the SEM, as measured by their return on equity, increased to an estimate of 3.3 per cent in 2017, from 2.7 per cent a year earlier. The improvement in the return on equity was mainly led by operators in the tourism sector. Cost of debt, as measured by interest expense to total debt ratio, was almost unchanged at around 6 per cent in 2017. Coverage of interest payments has fallen to 2.2 per cent in 2017, from 3.5 per cent a year earlier.

With the increase in credit extended by banks to corporates in Mauritius and higher private bond issuance, corporates were slightly more leveraged compared to a year earlier. On an aggregate basis, the debt-to-equity ratio was estimated at about 39 per cent in 2017 compared to 37 per cent in 2016 (Chart 6.11). The debt-to-equity ratio is still relatively low compared to the highs of previous years. The higher leverage was the result of an increase in the debt-to-equity ratios of operators in the tourism, distributive trade and manufacturing sectors that were offset by lower ratios of operators in the construction and sugar-linked sectors. The leverage ratio has increased for two consecutive years in the tourism sector, which is still the most leveraged sector with a debt-to-equity ratio estimated at 137.7 per cent in 2017.

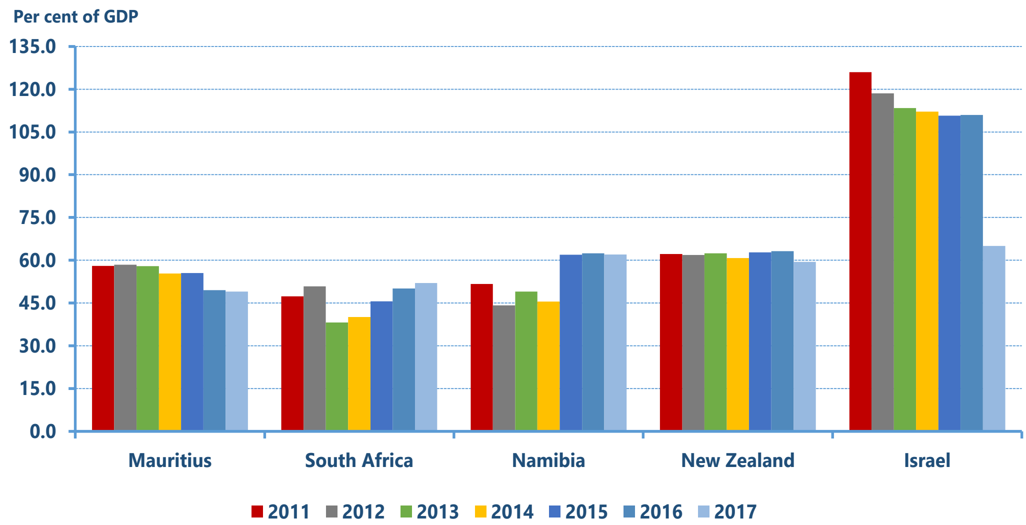
Chart 6.11: Fundamentals of Selected Listed Corporates on the SEM



Between end-March 2017 and end-March 2018, total corporate debt was lower by 4.5 per cent, driven by 5.2 per cent increase in domestic debt of corporates while external debt contracted by 4.0 per cent, mainly as a result of lower long-term external borrowings while short-term borrowings were higher. The corporate debt-to-GDP ratio was slightly lower at 47.1 per cent as at end-March 2018 compared to a year earlier. During 2017, a number of corporates have issued bonds via both public offerings and private placements that have been estimated at Rs11.5 billion, higher by 40.2 per cent compared to Rs8.2 billion raised in 2016.

The ratio of corporate debt in Mauritius as a percentage of GDP is lower than the ratio in advanced economies and regional comparators, except for South Africa. While the corporate debt-to-GDP ratio in Mauritius has remained on a downward trend since 2012, it has increased in other countries in the region like Namibia and South Africa (Chart 6.12).

Chart 6.12: Corporate Debt-to-GDP ratio in Selected Countries



Domestic debt of corporates accounted for around 93 per cent of total corporate debt as at end-March 2018 (Table 6.1). As a ratio to GDP, it remained relatively flat at 44.0 per cent as at end-March 2018 compared to 44.4 per cent as at end-March 2017. External debt of corporates, which accounted for around 6.7 per cent of total corporate debt, declined as a ratio to GDP, from 3.5 per cent as at end-March 2017 to 3.2 per cent as at end-March 2018. The lower external debt stock was reflected in the decline of external debt to Gross Official International Reserves ratio, from 8.8 per cent as at end-March 2017 to 7.2 per cent as at end-March 2018. External debt of corporates as a ratio to total export proceeds fell from 8.0 per cent to 7.6 per cent.

The annual growth of domestic debt of corporates increased to 5.2 per cent as at end-December 2017, as against a contraction of 2.2 per cent a year earlier. The improvement in credit growth was the result of higher credit extended to operators in almost all key sectors of the economy including construction, tourism, distributive trade, manufacturing as well as financial and business services. With buoyant construction activity, credit extended by banks to operators in the construction sector rose to 9.7 per cent as at end-March 2018 as against a contraction of 3.5 per cent in the corresponding period of 2017. Credit to operators in the tourism sector equally improved to 7.9 per cent as against a contraction of 4.6 per cent, a year earlier. Credit to the manufacturing and financial and business services sectors recorded double digit growth of 16.4 per cent and 30.1 per cent, respectively, as at end-December 2017. As at end-December 2016, credit to the manufacturing sector improved to 8.3 per cent while in the financial and business services sector, credit grew by 19.9 per cent. In the agriculture & fishing and distributive trade sectors, credit growth improved to 9.9 per cent and 8.5 per cent, respectively, as at end-March 2018 as against contractions of 2.8 per cent and 3.9 per cent, respectively, in the corresponding period of 2016.

Banks play a key role in channelling savings into productive investment, especially in key sectors of the economy. As at end-December 2017, the construction sector accounted for the largest share of private sector credit, at 30.2 per cent. Between end-December 2006 and end-December 2017, the share of credit extended to the construction sector almost doubled. However, the contribution of the construction sector in GDP over the corresponding period has not changed significantly. With regard to the manufacturing sector, which is the most important sector in terms of its contribution to GDP, its declining share in GDP was not adequately reflected in its share of total private sector credit.

The tourism sector, in contrast, has seen a decline in its share of total private sector credit but in terms of activity, its proportion to GDP has increased (Chart 6.13).

Table 6.1: Domestic and External Corporate Debt

	2012	2013	2014	2015	2016	2017				2018
						Q1	Q2	Q3	Q4	Q1*
	Rs Million									
Total Corporate Debt	**205,045**	**220,089**	**221,299**	**231,275**	**211,241**	**211,218**	**212,533**	**216,018**	**220,694**	**220,794**
Corporate External Debt	21,862	30,979	31,638	31,598	15,864	15,456	15,076	15,040	14,742	14,842
Short Term[1]	3,534	3,861	4,269	4,733	5,568	5,575	5,582	5,589	5,596	5,604
Long Term[2]	18,328	27,118	27,369	26,865	10,297	9,881	9,494	9,451	9,146	9,239
Corporate Domestic Debt[ǂ]	183,183	189,110	189,661	199,677	195,376	195,762	197,457	200,978	205,951	205,952
										Per cent of total corporate debt
Total Corporate Debt	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**
Corporate External Debt	10.7	14.1	14.3	13.7	7.5	7.3	7.1	7.0	6.7	6.7
Short Term[1]	1.7	1.8	1.9	2.0	2.6	2.6	2.6	2.6	2.5	2.5
Long Term[2]	8.9	12.3	12.4	11.6	4.9	4.7	4.5	4.4	4.1	4.2
Corporate Domestic Debt[ǂ]	89.3	85.9	85.7	86.3	92.5	92.7	92.9	93.0	93.3	93.3
										Per cent of GDP
Total Corporate Debt	**58.5**	**59.1**	**56.4**	**56.4**	**48.6**	**47.9**	**47.5**	**47.7**	**48.0**	**47.1**
Corporate External Debt	6.2	8.3	8.1	7.7	3.6	3.5	3.4	3.3	3.2	3.2
Short Term[1]	1.0	1.0	1.1	1.2	1.3	1.3	1.2	1.2	1.2	1.2
Long Term[2]	5.2	7.3	7.0	6.6	2.4	2.2	2.1	2.1	2.0	2.0
Corporate Domestic Debt[ǂ]	52.2	50.8	48.4	48.7	44.9	44.4	44.1	44.3	44.8	44.0

** Provisional.*

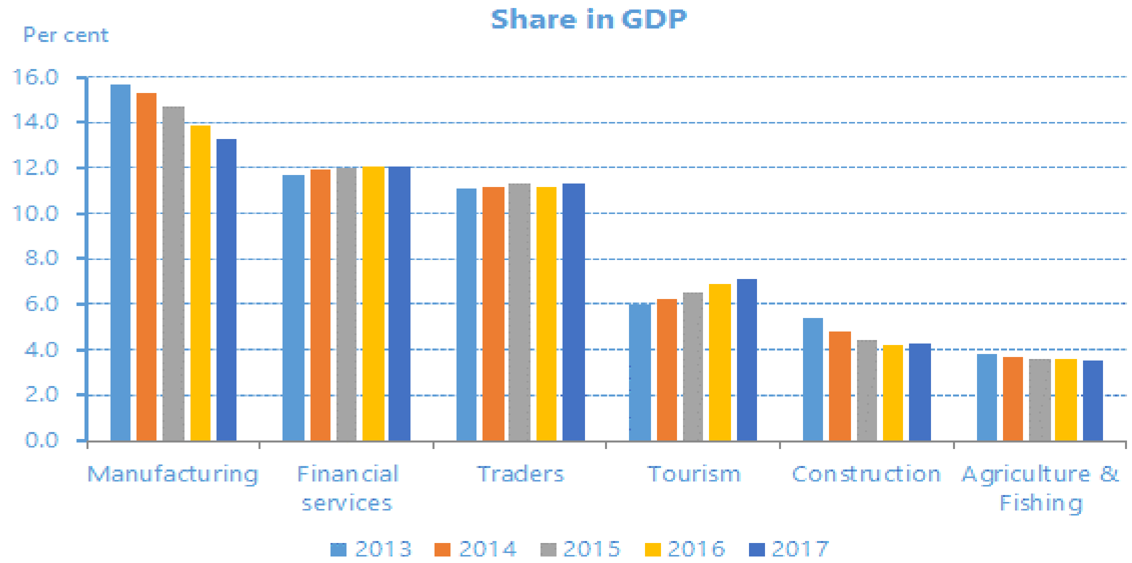
ǂ Culled from banks' sectorwise distribution of credit.

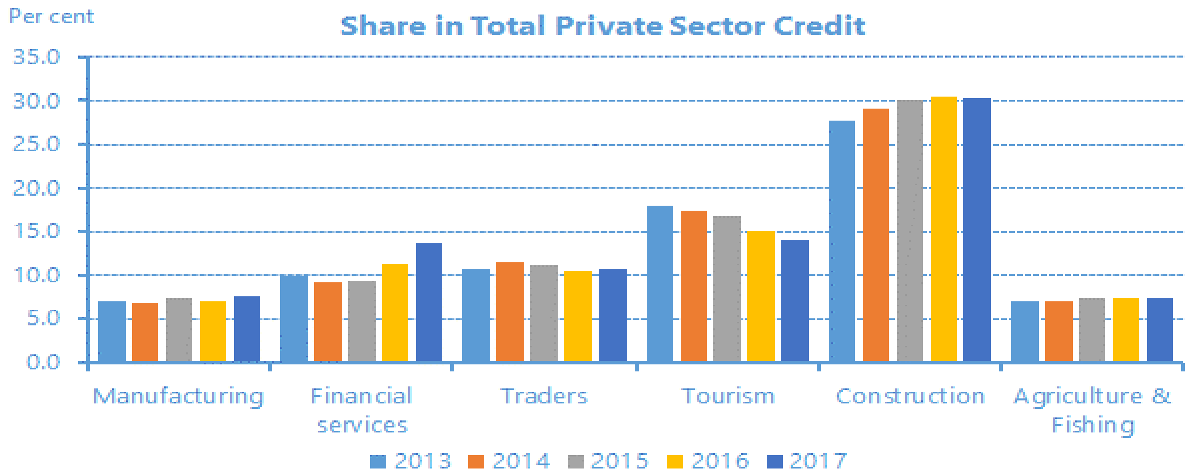
1. Refers mainly to trade credit as recorded in balance of payments statistics.

2. Excluding loans of Global Business Companies.

Sources: Mauritius SDDS country page and Bank of Mauritius.

Chart 6.13: Share of Selected Sectors in GDP and in Total Corporate Credit

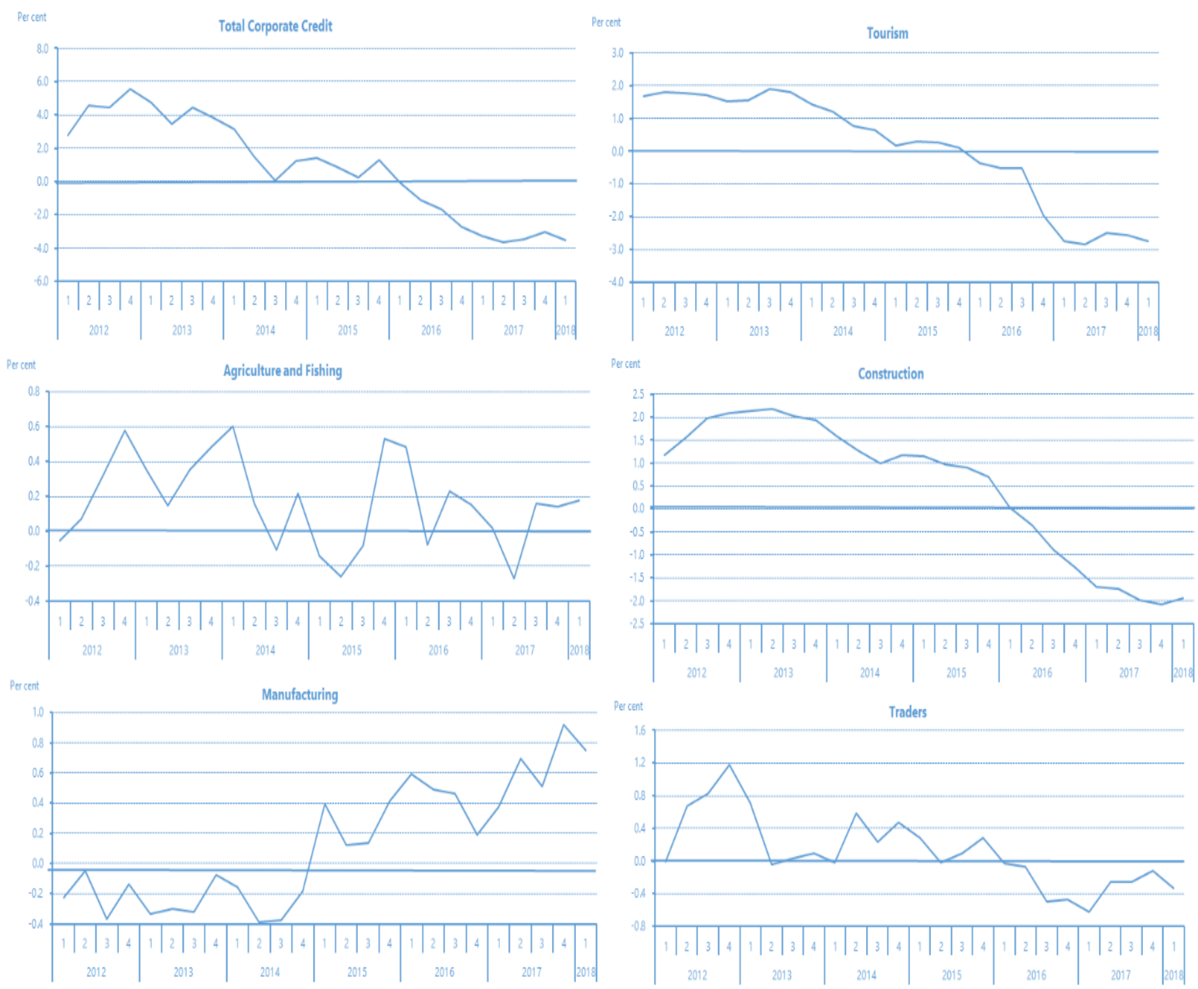




Notwithstanding the improvement in credit extended by banks to operators of the private sector in Mauritius, the credit-to-GDP gap has remained in negative territory for 2017. While the growth of nominal GDP has weighed on corporate credit-to-GDP ratio, the credit-to-GDP gap has shown incipient signs of closing, especially in the second half of 2017. As at end-May 2018, the corporate credit-to-GDP gap was estimated at -3.5 per cent, higher compared to -3.3 per cent estimated as at end-March 2017.

On a sectorwise basis, credit-to-GDP gap remained negative in key sectors of the economy, namely tourism, construction and distributive trade sectors, but was positive in the manufacturing and agriculture & fishing sectors. In the construction sector, the credit-to-GDP gap dipped further into negative territory, from -1.7 per cent as at end-March 2017 to -1.9 per cent as at end-March 2018. In distributive trade, however, the credit-to-gap closed somewhat, to -0.3 per cent, from -0.6 per cent a year earlier. As regard the tourism sector, the credit-to-GDP gap was almost unchanged at around -2.7 per cent in 2018Q1. The upward trend in the manufacturing sector is remarkable, with credit-to-GDP gap higher by 0.4 percentage point during 2018Q1. The credit-to-GDP gap estimated for the agriculture & fishing sector moved back into positive territory during 2018Q1 (Chart 6.14).

Chart 6.14: Credit-to-GDP gap



7. Developments in the Financial Sector

Mauritius has a relatively large and well-developed financial system, with various players engaged in financial intermediation activities. The financial sector comprises mainly commercial banks, Non-Bank Deposit-Taking Institutions (NBDTIs) and other financial corporations such as insurance companies, pension funds and investment funds.

Banks hold around 83.2 per cent of total financial sector assets. As at end-June 2018, 21 banks were licensed to carry out banking business in Mauritius, of which 9 were domestic-owned banks, 9 were foreign-owned subsidiaries and 3 were branches of foreign banks. Deutsche Bank (Mauritius) Limited is in the process of surrendering its banking licence and ceased the business of banking with effect from 29 June 2018. The banking sector plays a significant role in the economy and as at end-December 2017, its total assets represented around 324.8 per cent of GDP (Table 7.1).

Table 7.1: Structure of the Mauritian Financial System*

	End-2012			End-2017		
	In per cent Total assets	In per cent of GDP	USD million	In per cent Total assets	In per cent of GDP[1]	USD million
Banks	**84.3**	**355.7**	**40,209**	**83.2**	**324.8**	**43,491**
Non-Bank Deposit Taking Institutions	**3.4**	**14.5**	**1,639**	**4.4**	**17.2**	**2,305**
Insurance Companies [1]	**7.1**	**30.0**	**3,386**	**6.9**	**26.8**	**3,595**
o/w: Long-Term Insurance	*6.3*	*26.5*	*2,986*	*5.9*	*22.9*	*3,068*
General Insurance	*0.8*	*3.5*	*400*	*1.0*	*3.9*	*527*
Private Pension Schemes [1]	**2.4**	**10.1**	**1,145**	**2.6**	**10.2**	**1,365**
Investment Funds [1]	**1.2**	**5.1**	**574**	**1.1**	**4.2**	**566**
Others [2]	**1.6**	**6.7**	**729**	**1.8**	**7.1**	**933**
Total	**100.0**	**422.0**	**47,682**	**100.0**	**390.4**	**52,255**

** Excluding Global Business Companies.*

[1] *Data as at end-Dec 2017 - Provisional estimates.*

[2] *Data for this category as at end-Dec 2017 is not yet available. However, given that these companies are mainly functionaries which support the activities of financial institutions, it is unlikely that their total assets would fluctuate significantly over a one-year span. Their total assets as at end-Dec 2016 have been used as a proxy for assets as at end-Dec 2017.*

Note: The category 'Others' mainly include institutions such as Cash Dealers, Credit Unions, Insurance Brokers, Pension Scheme Administrators, Investment Dealers, Investment Advisers, CIS Managers, Registrar and Transfer Agents, Factoring and Credit Finance, Leasing, Actuarial Services and Treasury Management Companies.

Sources: Bank of Mauritius and Financial Services Commission.

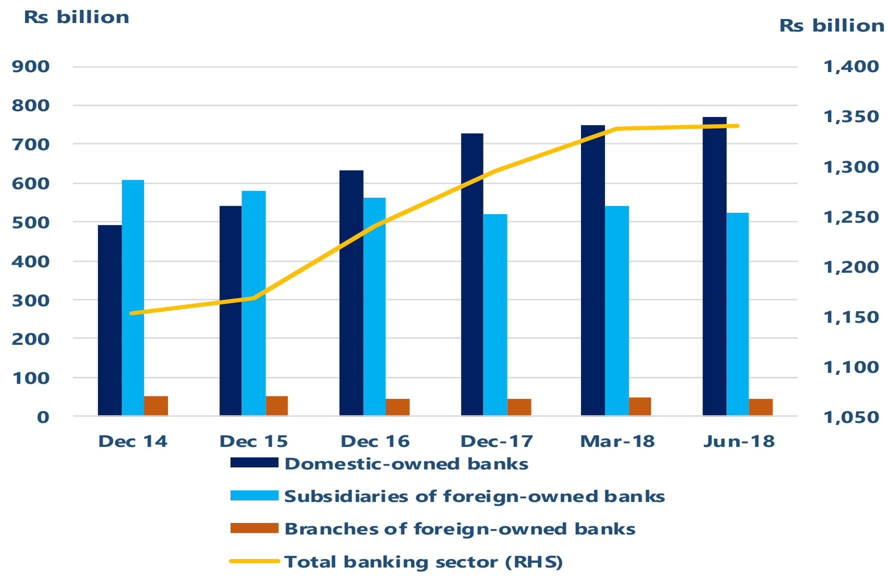
The banking landscape is relatively concentrated with the two largest banks accounting for over 40 per cent of market shares for total deposits, advances and assets. Banks, NBDTIs and cash dealers are regulated by the Bank of Mauritius whereas other financial corporations fall under the regulatory aegis of the Financial Services Commission (FSC). As at end-December 2017, NBDTIs, comprising leasing companies and finance companies, held assets equivalent to 17.2 per cent of GDP, while stock market capitalisation was about 57.7 per cent of GDP. The activities of other financial corporations in Mauritius are quite diverse. Major players include insurance companies, pension funds and investment funds which, collectively accounted for 11 per cent of the financial sector's total assets as at end-December 2017.

7.1 Banking Sector

Overview

Total assets of the banking sector grew by 3.5 per cent as at end-June 2018 and 4.4 per cent as at end-December 2017, compared to an increase of 4.1 per cent as at end-December 2016. The growth in banks' assets reflected mostly an increase of 5.7 per cent and 15.4 per cent in total assets of domestic-owned banks during the six months ended June 2018 and the year ended December 2017, respectively. The balance sheet of the subsidiaries of foreign-owned banks contracted by 7.6 per cent during the year ended-December 2017 and remained quasi stable during the first half of 2018. The balance sheet of branches of foreign-owned banks contracted by 2.4 per cent as at end-June 2018, compared to end-December 2017. Over the year ended December 2017, domestic-owned banks contributed 7.9 per cent to the growth in assets. The distribution of total bank assets reflected a similar trend to the previous year, with domestic-owned banks holding the largest share of 56.3 per cent, followed by subsidiaries of foreign-owned banks holding 40.2 per cent, and branches of foreign-owned banks holding the remaining 3.5 per cent (Chart 7.1).

Chart 7.1: Banking Sector Assets



Over the year ended December 2017, domestic assets expanded by 12.3 per cent with growth of 13.1 per cent, 10.7 per cent and 8.7 per cent recorded for domestic-owned banks, subsidiaries and branches of foreign-owned banks, respectively. In contrast, overall foreign assets decreased by 2.7 per cent. The growth of 20.6 per cent in foreign assets held by domestic-owned banks was outweighed by the contraction of 12.8 per cent in the assets held by foreign-owned banks. Foreign assets held by subsidiaries and branches of foreign-owned banks contracted by 12.5 and 21.6 per cent, respectively. The uptrend in foreign assets held by domestic banks is mainly explained by an increase in cross-border exposures while the growth in domestic assets is partly due to increases in advances to the private sector (Table 7.2).

Market Concentration

Measures of market concentration namely the Herfindahl-Hirschman Index (HHI) for total banking assets indicated a continuous increase to 1,293 as at end-December 2017 and 1,365 as at end-June 2018, and a corresponding rise to 1,389 (end-December 2017) and 1,440 (end-June 2018) in total deposits, thereby hinting at a relatively more concentrated market structure (Chart 7.2). This uptrend has been observed since 2012, although the index pointed to some stability in the concentration ratios over the period 2012 to 2014. Similarly, the Lorenz curve which depicts relative inequality in the distribution of assets and advances in the system - showing that the lines had shifted away from the line of perfect equality - indicated a further deterioration of these indicators over the five-year period ended December 2017 and six months ended June 2018 (Chart 7.3). Indeed, the share of total assets held by the four largest banks rose from 55 per cent as at end-December2012 to 60 per cent as at end-December 2017 and 63 per cent as at end-June 2018, due in part to the exit of one branch of a foreign-owned bank. Furthermore, the assets of two of the Domestic Systemically-Important Banks (D-SIBs) nearly doubled since 2012.

Table 7.2: Banks Assets by Type of Bank and Assets, 2014-2017

Growth rates of assets (Per cent)

Assets (contribution to asset growth) (Per cent)

I. Foreign Assets

	Dec-14	Dec-15	Dec-16	Dec-17
Domestic banks	42.9	32.1	15.2	20.6
Subsidiary	11.7	-8.0	-3.8	-12.5
Branch	-25.3	-13.2	-30.4	-21.6
Total	**14.6**	**-0.2**	**0.4**	**-2.7**

	Dec-14	Dec-15	Dec-16	Dec-17
Domestic banks	3.7	3.6	2.2	3.3
Subsidiary	5.1	-3.5	-1.5	-4.5
Branch	-0.8	-0.3	-0.5	-0.2
Total	**8.0**	**-0.1**	**0.2**	**-1.4**

II. Domestic Assets

	Dec-14	Dec-15	Dec-16	Dec-17
Domestic banks	8.6	9.1	9.9	13.1
Subsidiary	0.7	5.2	6.6	10.7
Branch	-3.6	6.4	-0.4	8.7
Total	**6.0**	**8.1**	**8.6**	**12.3**

	Dec-14	Dec-15	Dec-16	Dec-17
Domestic banks	2.8	2.9	3.3	4.6
Subsidiary	0.1	0.5	0.6	1.0
Branch	-0.1	0.2	0.0	0.2
Total	**2.7**	**3.5**	**3.9**	**5.8**

III. Total Assets

	Dec-14	Dec-15	Dec-16	Dec-17
Domestic banks	15.9	15.2	11.5	15.4
Subsidiary	9.6	-5.7	-1.7	-7.6
Branch	-14.6	-2.2	-12.1	-0.6
Total	**10.8**	**3.4**	**4.1**	**4.4**

	Dec-14	Dec-15	Dec-16	Dec-17
Domestic banks	6.5	6.5	5.5	7.9
Subsidiary	5.1	-3.0	-0.8	-3.5
Branch	-0.9	-0.1	-0.5	0.0
Total	**10.8**	**3.4**	**4.1**	**4.4**

Source: Bank of Mauritius staff estimates.

Note: Totals may not add up due to rounding off.

Chart 7.2: Herfindahl-Hirschman Index, 2011 - 2018

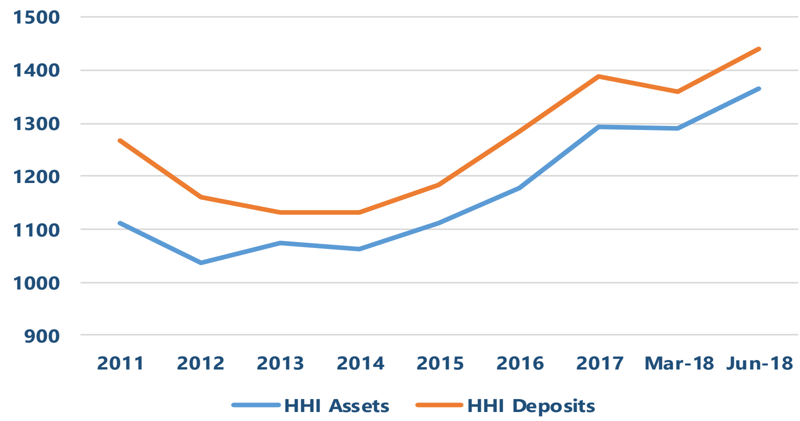
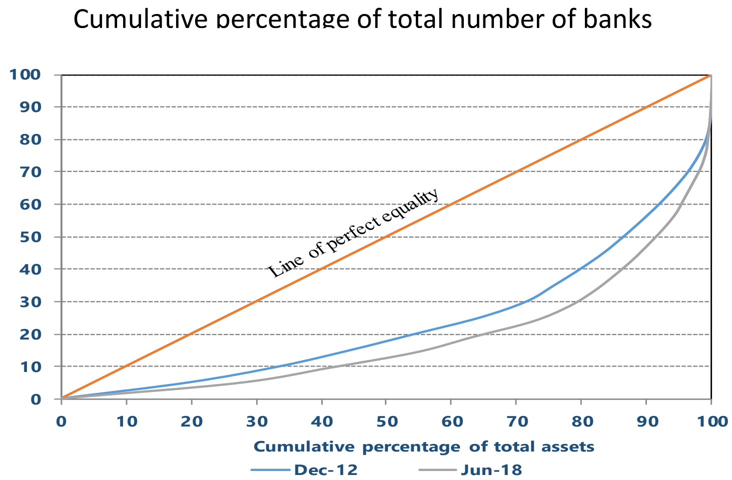
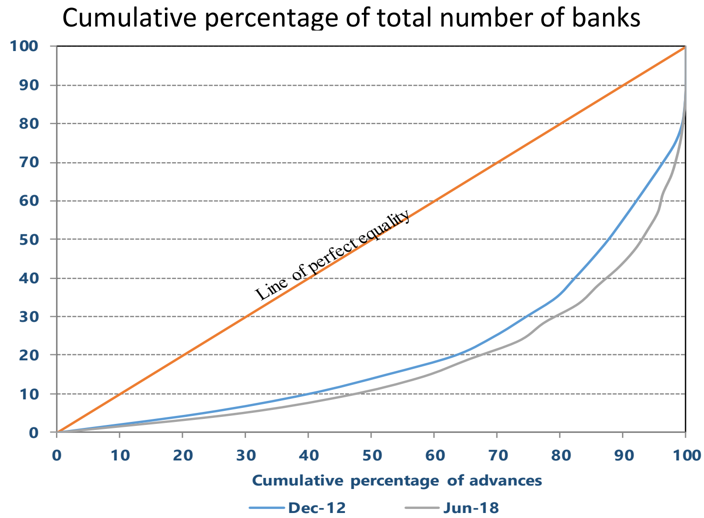


Chart 7.3: Distribution of Banks' Assets and Advances

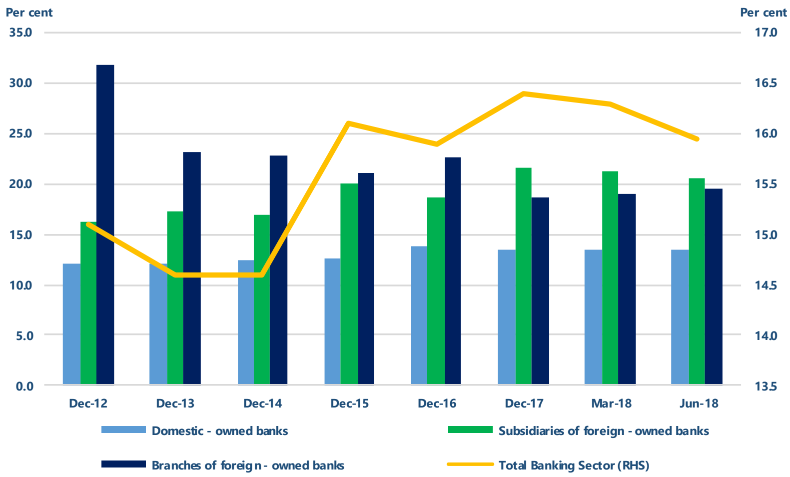




The level of capital maintained by banks in Mauritius remained comfortably above the current regulatory minimum of 10.0 per cent, exclusive of D-SIB charges and Capital Conservation Buffer (CCB) and which are being phased in until 2019 and 2020, respectively. The Capital Adequacy Ratio (CAR) for the banking sector in Mauritius increased from 17.5 per cent as at end-December 2016 to 17.7 per cent as at end-December 2017, and stood at 17.2 per cent as at end-June 2018. The capital base of the banking sector has followed an upward trend, though at a decreasing rate since 2012, reaching Rs134.5 billion as at end-June 2018.

At the current level of regulatory capital, the majority of banks maintained reasonable capital buffers to shield from potential losses under severe shocks. Tier 1 capital, which is the main component of banks' capital base, was more or less unchanged at 16.0 per cent as at end-June 2018 compared to end-December 2017 and end-December 2016. Over the five years ended December 2016, branches of foreign-owned banks have been maintaining the highest Tier 1 capital ratio until the latter trended down to 19.6 per cent as at end-June 2018, respectively; primarily on account of the exit of the branch of a foreign bank from the Mauritian banking sector. Subsidiaries of foreign-owned banks posted the highest Tier 1 ratio at 21.6 per cent as at end-December 2017 and 20.5 per cent as at end-June 2018, while Tier1 capital ratio of domestic-owned banks remained unchanged at 13.4 per cent from end-December 2017 till end-June 2018 (Chart 7.4).

Chart 7.4: Tier 1 Capital Ratio



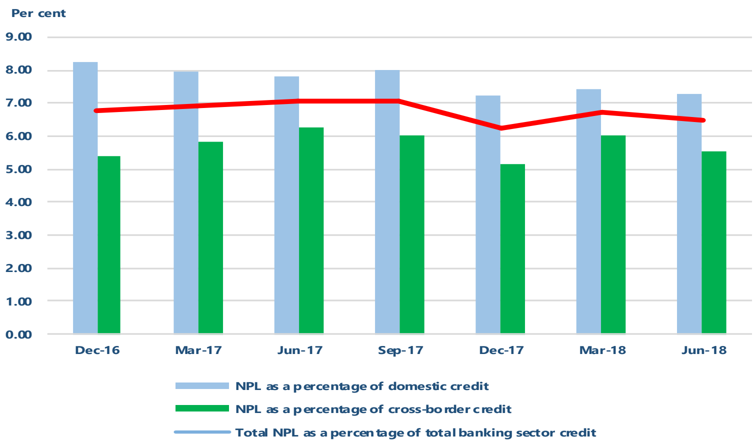
Banks are phasing in the Basel III capital framework incorporating CCB ranging from 0.625 per cent to 2.5 per cent over a four-year period beginning January 2017 in order to ensure the build-up of capital buffers outside periods of stress. Accordingly, banks have been required to keep a minimum CCB in addition to their minimum Common Equity Tier 1 capital. In line with its Guideline for dealing with D-SIBs, the Bank is closely monitoring the activities of the five D-SIBs. These D-SIBs are required to hold a capital surcharge ranging from 1.0 per cent to 2.5 per cent of their risk-weighted assets depending on their systemic importance.

Results from the Bank's Macro-based Stress Testing Framework show that the banking system as a whole continues to be resilient to severe but plausible hypothetical shocks engineered to major macroeconomic variables. Consistent scenarios involving shocks to GDP growth, inflation and real effective exchange rate affect banks differently because of their differential impact on various economic sectors to which banks are exposed to various degrees. The worst case but economically plausible scenario that was fed into the model generates a downfall in Tier 1 capital and aggregate capital components of banks but with only a reasonably mild deviation from the baseline projection. As a result, the capital and solvency positions of banks in Mauritius contain sufficient bulwark to withstand realistic macroeconomic shocks.

Asset Quality

Non-performing loans (NPL) in the banking sector cumulated to reach almost Rs44 billion as at end-December 2017 and remained quasi stable till end-June 2018. NPL ratio, which is measured as total NPL to total loans, picked up during the period 2015H2 till end-2016 and stagnated at around 7.1 per cent in 2017Q2 and 2017Q3 before declining to 6.3 per cent as at end-December 2017. Improvement was observed in the NPL ratio for credit extended within Mauritius, from 8.2 per cent as at end-December 2016 to 7.2 per cent as at end-December 2017, as well as in the NPL ratio for credit extended outside Mauritius, which dropped from 5.4 per cent to 5.2 per cent. Indeed, a reduction in the overall NPL has been observed for all banks at individual level in 2018Q2 (Chart 7.5).

Chart 7.5: Non-performing Loans of Banks



A slight worsening in the overall NPL ratio to 6.5 per cent was noted during the six months ended June 2018. This applied for NPL ratios for credit extended within and outside Mauritius, which stood at 7.3 per cent and 5.5 per cent, respectively.

Credit quality has improved in most key sectors of the domestic economy. With regard to macroeconomic indicators, while some sectors continued to perform moderately during the first three quarters of 2017 against challenging local and international conditions, several key sectors posted appreciable growth rates as per latest available official estimates, notably construction, ICT, financial and business services and tourism. As such, the declining trend in the growth of credit to private sector has subsided, with better performance recorded since end-September 2017 by key sectors of the economy on account of improved economic fundamentals and supportive monetary policy.

After the downturn in the construction sector recorded during 2015 and 2016, the sector picked up in 2017, with the NPL ratio declining from 9.2 per cent as at end-December 2016 to 7.9 per cent as at end-December 2017. Based on the latest forecasts, the performance of construction is expected to further improve on the premise of the implementation of major public investment projects announced in the 2017-2018 National Budget. The tourism sector showed some signs of deterioration during the year ended December 2016, with the NPL ratio rising to 7.9 per cent. However, the sector recovered rapidly after, and the corresponding NPL ratio declined throughout the four quarters of 2017 to reach 6.2 per cent as at end-December 2017.

The GBC sector, which faced some uncertainties in 2016 with the revision of the DTAA treaty between Mauritius and India, witnessed a recovery in its NPL ratio from 4.6 per cent as at end-December 2016 to 3.6 per cent in March 2017 and 4.0 per cent in June 2017, before it went back up to 5.1 per cent as at end-December 2017. The transport sector experienced a significant deterioration in its NPL ratio, from 6.0 per cent as at end-December 2016 to 27.3 per cent as at end-December 2017, which was caused by some idiosyncratic events impacting the subsidiary of a foreign bank. New accounting rules for recognising credit losses - specifically the IFRS 9 - have been introduced as from January 2018. Under IFRS 9, recognition of credit impairment will be based on more forward-looking assessments than under the current rules.

Accordingly, banks' loan loss provisions might increase under IFRS 9, both during implementation of the Standard as well as during downturns, because recognition of credit impairment shall henceforth be based on more forward-looking assessments than under the previous accounting standard named IAS 39. Losses may therefore be recognised at an earlier stage of the downturn. It is imperative that banks enhance the quality of their assets and closely manage credit risks to which they are exposed, with a view to better assuage the impact that this new accounting standard will have on their level of provisioning and consequently their capital.

Coverage Ratio

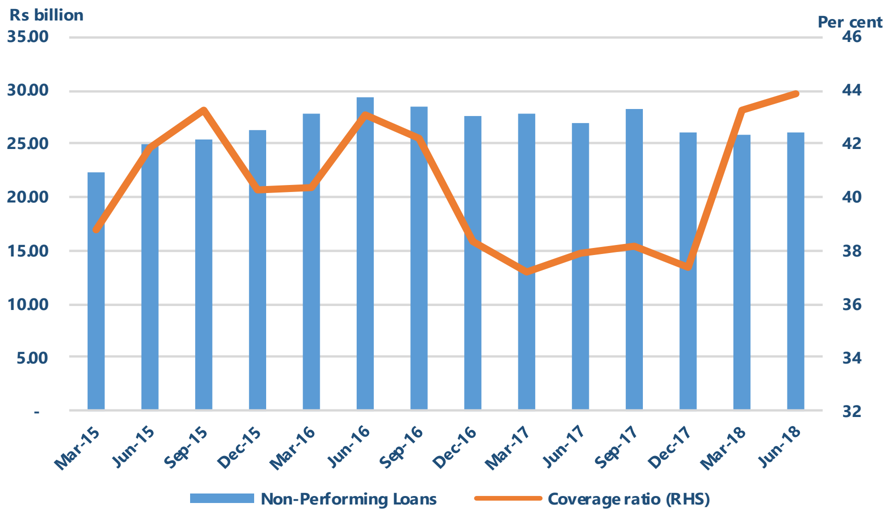
The coverage ratio, which is measured as the ratio of specific provisions to NPL, stood at 56.4 per cent as at end-June 2018 and 49.7 per cent as at end-December 2017, up from 48.8 per cent as at end-December 2016. The level of provisioning dropped to 47.9 per cent in 2017Q1 before picking up in the remaining quarters of 2017. The evolution in the overall coverage ratio during 2017 broadly mirrored that of credit extended outside Mauritius, with the corresponding level of provisioning rising from 64.5 per cent at end-December 2016 to 67.9 per cent as at end-December 2017, and further to 74.1 per cent as at end-June 2018. Compared to the high level of specific provisions charged for impaired credit outside Mauritius, the coverage ratio for impaired credit in Mauritius stood at 43.9 per cent as at end-

June 2018 and 37.4 per cent as at end-December 2017, compared to 38.4 per cent as at end-December 2016 (Chart 7.6). The overall coverage ratio increased in 2017Q4 despite a major write-off by one bank.

The coverage ratio indicated that the banking sector has an adequate buffer against future losses in the event of materialisation of NPL. The rise in the coverage ratio showed that banks have increased their buffers against potential credit defaults. Moreover, to ensure adequate portfolio provisioning in some cyclical sectors against potential rise in NPL and as part of the set of macroprudential measures, banks are required to make additional portfolio provision in the housing, commercial, residential and land parcelling segments of the construction sector as well as in the tourism and personal sectors effective 1 July 2014.

The Bank has initiated a phased roll out of a robust risk-based supervisory framework. As a first step, the Bank enhanced its CAMEL framework to incorporate risk-based and qualitative parameters.

Chart 7.6: Non-Performing Loans and Coverage Ratio

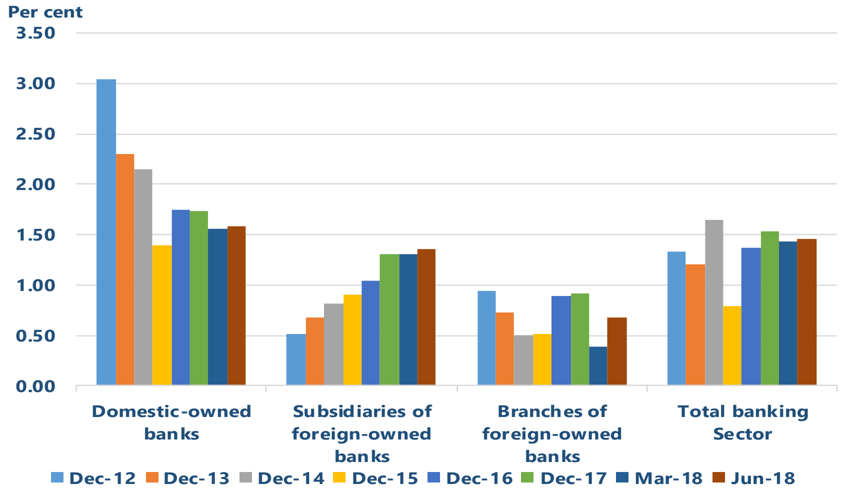


Profitability

Profitability of the banking sector improved during 2017 and 2018H1, mainly on account of an increase in net interest income. The rise in interest income, coupled with the decline in interest expense, yielded a positive net interest income, and was partly accounted for by an increase in interest income on securities, and placements and loans to banks.

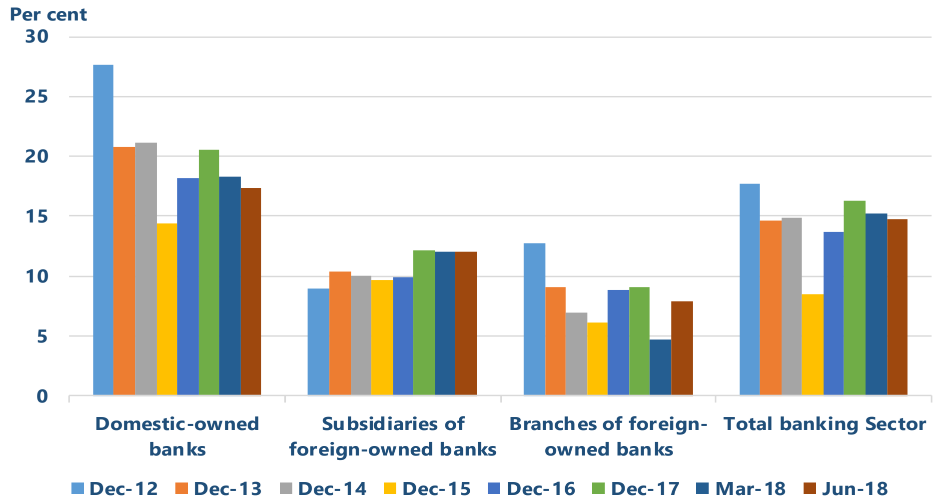
The Return on Assets (ROA) of subsidiaries of foreign-owned banks improved as at end-December 2017 and end-June 2018. The ROA of branches of foreign-owned banks improved during 2017, before falling somewhat as at end-June 2018. The ROA of domestic-owned banks remained quasi unchanged during the year ended December 2017, compared to the previous year; but a contraction was noted over 2018H1. Banks posted an increase in aggregate ROA from 1.4 per cent as at end-December 2016 to 1.7 per cent as at end-December 2017 and 1.5 per cent as at end-June 2018 (Chart 7.7).

Chart 7.7: Return on Assets of the Banking Sector



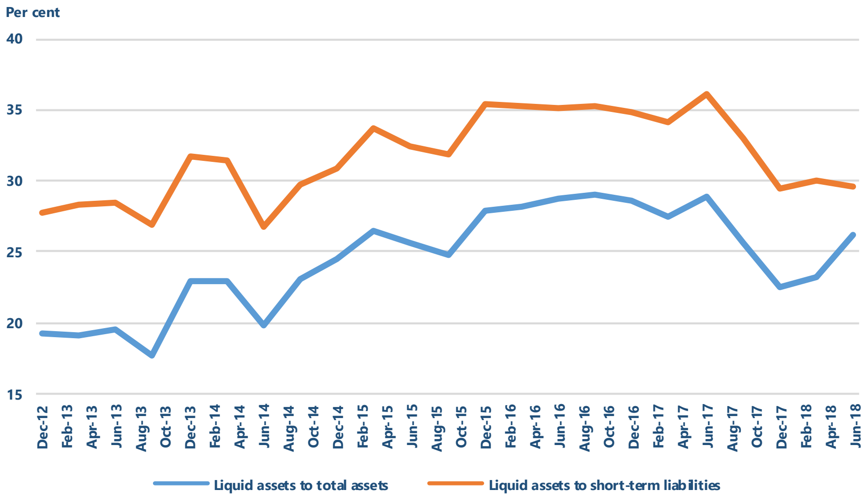
Return on Equity (ROE) for domestic-owned banks and branches of foreign-owned banks improved over 2016 and 2017, but declined during 2018H1. ROE of subsidiaries of foreign-owned banks improved as at end-December 2017 and remained quasi stable during 2018H1. The ROE of the banking sector improved to 16.2 per cent as at end-December 2017, before declining to 14.8 per cent as at end-June 2018 (Chart 7.8).

Chart 7.8: Return on Equity of the Banking Sector



Overall, the banking sector in Mauritius has remained well-funded and liquid over the year ended December 2017. The ratio of liquid assets to total assets in the banking sector and the ratio of liquid assets to short term liabilities followed a general upward trend during 2016 till June 2017. During 2017H2, overall liquidity ratio posted by banks started to decline and by end-December 2017, the ratio of liquid assets to total assets and the ratio of liquid assets to short term liabilities stood at 22.5 per cent and 29.5 per cent, respectively, compared to 28.7 per cent and 34.8 per cent, respectively, as at end- December 2016. As at end-June 2018, the ratio of liquid assets to total assets moved to 26.2 per cent and the ratio of liquid assets to short term liabilities stood at 29.6 per cent (Chart 7.9). The fall in the liquidity ratio during 2017 resulted from a decrease in transferable foreign currency deposits held by non-residents at three banks which have undertaken to channel these funds into foreign sovereign securities so as to meet the Liquidity Coverage Ratio (LCR) requirements as per the Guideline on Liquidity Risk Management. The LCR for the banking sector stood at 155.7 per cent as at end-December 2017 and 167.5 per cent as at end-June 2018. In general, the LCR of banks stayed well above the regulatory requirements for both Mauritian rupees and other major currencies.

Chart 7.9: Liquidity Ratios of Banks



Bank engaged in cross-border activities to manage their funding and liquidity risks across currencies by matching their liabilities, to the extent possible, with assets in the same currency and maturity buckets. Regulation in Mauritius does not allow an individual bank to hold a net foreign exchange exposure position of more than 15 per cent of its Tier 1 capital. The overall net foreign exchange exposure ratio has remained relatively stable over the past years. It stood at 3.6 per cent as at end-December 2017, representing a marginal increase of 0.1 percentage point compared to end-December 2016 and mainly explained by an increase in both the aggregate net foreign exchange position and capital of the banking sector.

During the year ended December 2017, the net foreign exchange exposures of subsidiaries of foreign-owned banks declined, while domestic- owned banks and branches of foreign banks were more exposed to net foreign exchange. Subsidiaries of foreign banks reported a decline in their foreign exchange position, which more than offset the marginal rise in their capital, while branches of foreign-owned banks recorded an increase in their foreign exchange exposures despite a decrease in their Tier 1 capital. Reflecting overall banking sector performance, domestic-owned banks recorded increases in both their foreign exchange position and capital as at end-December 2017. However, over the six months ended June 2018, the foreign exchange exposures of the overall banking sector fell, following that of domestic-owned banks.

Based from the balance sheets of banks, the banking sector remains well funded and liquid with fairly low currency mismatches. Banks appear to be resilient against both liquidity risk and foreign exchange stresses.

Concentration of Credit

Banks are exposed to various types and levels of credit concentration risks, amongst which, are the overexposure to a particular industry, country or type of facility. Most importantly, this category of risk includes high credit concentration to any individual or group of connected counterparties.

A large credit risk exposure to a single borrower or group of borrowers poses a potential threat to a bank's safety and soundness and hence, to financial stability. Accordingly, the Bank has issued guidelines to banks on large exposure limits, and as per the revised Guideline on Credit Concentration Risk, effective December 2017, the definition of large exposures has been revised from "sum of all exposures to a customer or a group of closely- related customer which are over 15 per cent of the financial institution's capital base" to "sum of all exposures to a customer or a group of connected counterparties which is over 10 per cent of the financial institution's Tier 1 capital". This change in definition explains the hike in both ratios of large exposures as at end-December 2017. The ratio of large exposures (over 10 per cent) to Tier 1 capital stood at 268.5 per cent and 285.2 per cent as at end-December 2017 and end-June 2018, respectively (Table 7.3).

Table 7.3: Credit Concentration Risk

	Percentage of aggregate large exposures to capital base	Percentage of aggregate large exposures to total credit facilities
Jun-15	218.3	34.2
Sep-15	207.4	32.6
Dec-15	198.6	32.8
Mar-16	208.8	35.5
Jun-16	203.8	34.9
Sep-16	197.2	32.7
Dec-16	175.2	29.6
Mar-17	164.3	27.9
Jun-17	150.0	26.4
Sep-17	173.5	29.5
Dec-17[1]	268.5	40.5
Mar-18[1]	279.3	42.0
Jun-18[1]	285.2	42.8

[1] As from December 2017, the measurement of credit concentration ratio has undergone a minor change. As flagged in Credit Concentration Risk Guideline, credit concentration ratio is now measured as the percentage of aggregate large exposures to Tier 1 capital. Based on the previous Guideline (15 percent of total capital base), the corresponding ratio for large exposures would have been 171.8 per cent, 178.3 percent and 188 per cent for the quarters ended December 2017, March 2018 and June 2018, respectively. Large exposure is now defined as the sum of all exposures to a customer or a group of connected counterparties (above 10 per cent of the financial institution's Tier 1 capital).

The ratio of aggregate exposures to total credit as at end-June 2018 is also not strictly comparable with data for 2017 as a result of the change in the definition of aggregate large exposures.

Banks' exposure limits, as defined prior to revision of the Guideline, trended up from Rs86.0 billion at end-December 2016 to reach Rs110.3 billion (91.9 per cent of tier 1 capital) at end-December 2017 and Rs109.9 billion as at end-June 2018. The proportion of the ten largest exposures to total large exposures dropped from 39.0 per cent to 33.4 per cent to 31.7 per cent over the same time period, explained by the fact that total large exposures rose by around 51 per cent while the ten largest exposures rose by only 28 per cent over the period under review (Table 7.4).

Table 7.4: 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)
Jun-15	88,703	34.2	74.6
Sep-15	87,049	35.2	73.0
Dec-15	89,146	37.0	73.6
Mar-16	102,001	39.1	85.0
Jun-16	94,043	39.0	77.0
Sep-16	94,558	42.0	79.0
Dec-16	86,035	39.0	69.0
Mar-17	87,377	41.5	68.1
Jun-17	87,606	45.0	68.0
Sep-17	95,630	42.7	74.1
Dec-17	110,340	33.4	91.9
Mar-18	109,099	32.4	90.5
Jun-18	109,910	31.7	90.3

Despite stringent regulations implemented in December 2017, the credit concentration ratio remained well below the aggregate regulatory limit of 800 per cent of the Tier 1 capital of individual banks. Nevertheless, credit concentration risk is an important element of credit risk of the banking sector in view of the particular characteristics of the Mauritian economy.

7.2 Non-Bank Financial Intermediaries

Non-Bank Deposit-Taking Sector

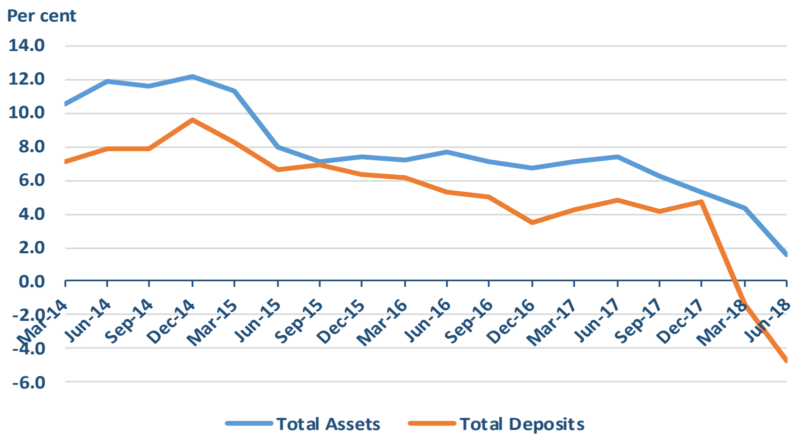
Non-Bank Deposit-Taking Institutions' (NBDTIs) mainly mobilise deposits and grant leasing and loan facilities to individuals and corporates. There were eight NBDTIs in operation as at end-June 2018.

NBDTIs remained relatively profitable over the period under review with some episodic fluctuations in net income, mainly trigged by a greater rate of growth of interest expenses as compared to interest income. The ratio of total assets of NBDTIs to total assets of the banking sector declined by 0.3 percentage point to reach 5.1 per cent as at end-December 2017. Y-o-y growth of total assets of NBDTIs stood at 5.3 per cent as at end-December 2017 and 1.6 per cent as at end-June 2018.

Deposits mobilised by NBDTIs increased by 4.7 per cent as at end-December 2017, but contracted again by 4.7 per cent as at end-June 2018 (Chart 7.10). Loan and leasing facilities as a percentage of total assets of NBDTIs declined from 71.1 per cent as at end-December 2016 to 68.5 per cent as at end-December 2017 and 68.9 per cent as at end-June 2018. Correspondingly, total deposits as a ratio of total assets dropped by 0.35 percentage point over 2017 and stood at 60.4 per cent as at end-December 2017 and 56.9 per cent as at end-June 2018.

Chart 7.10: Y-o-y Growth of Total Assets and Deposit of NBDTIs

Liquidity



During the year ended December 2017, NBDTIs experienced an improvement in their liquidity positions and held liquidity ratios well above the statutory minimum of 10 per cent. Liquidity as a ratio of total assets was up by 1.4 percentage point to 14.8 per cent as at end-December 2017. Measured as a ratio of total deposits, the liquidity position of NBDTIs improved from 16.7 per cent to 18.8 per cent over the same period. During 2017, liquid assets held by NBDTIs sustained a higher rate of growth compared to the increase recorded in their total assets and the deposit base. This resulted in the improved liquidity positions of NBDTIs and pointed to their strong position to resist potential distress.

However, a contraction of 3.6 percentage point in the ratio of liquid assets to total assets and 4.7 percentage point in the ratio of liquid assets to total deposits was noted for the semester ended June-2018 (Chart 7.11).

Capital Adequacy

The Non-Bank Deposit-Taking sector is assessed as sound and adequately capitalised during the period under review. The aggregate CAR of NBDTIs stood at 31.5 per cent as at end-June 2018. At the current level of capitalisation, NBDTIs remained in a position to face shocks to their balance sheets and absorb losses. Assets of NBDTIs were concentrated in the 50 per cent and 100 per cent risk-weight buckets, which accounted for 44.3 per cent and 19.8 per cent, respectively, of total NBDTIs' assets as at end-June 2018 (Chart 7.12).

Chart 7.11: Liquidity Indicators of NBDTIs

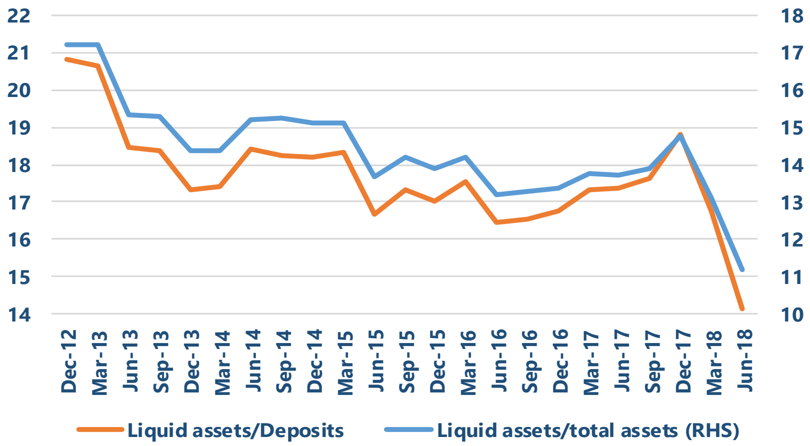
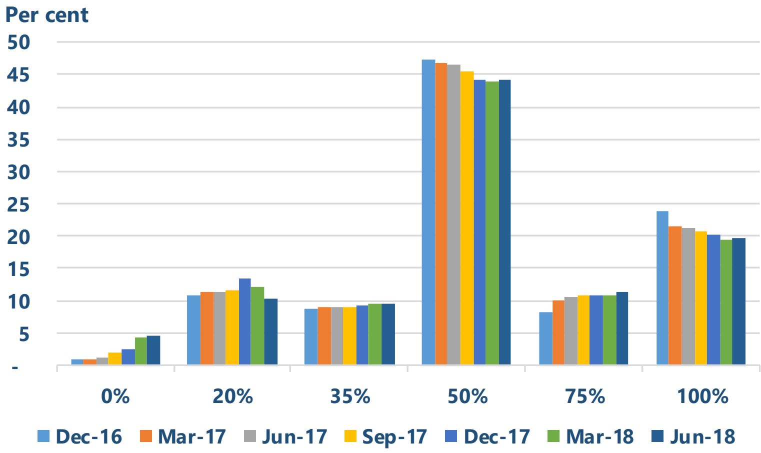


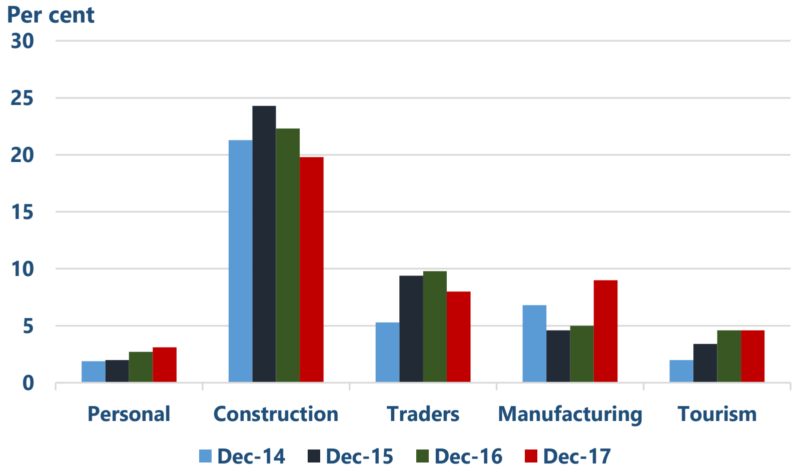
Chart 7.12: Risk Diversification Matrix of NBDTIs



Sectoral Credit and NPL

Credit growth in the NBDT sector continued to slow down compared to previous years. As at end-June 2018, credit contracted by 5 per cent compared to growth of 2.7 per cent as at end-December 2017. Credit granted by NBDTIs was mainly directed to the personal and construction sectors, with shares of 61.8 per cent and 13.4 per cent, respectively. Credit to the traders, manufacturing, transport and tourism sectors accounted for 2.8 per cent, 2.3 per cent, 1.4 per cent and 1.0 per cent, respectively, of the total credit by NBDTIs, as at end-December 2017.

Chart 7.13: NPL as a Ratio of Sectoral Credit in Key Sectors



Asset quality of NBDTIs improved slightly, with the ratio of NPL to total credit falling to 5.4 per cent as at end-June 2018, from 6.0 per cent as at end-December 2017. Impairment remained concentrated in the construction sector, with an NPL ratio at 19.8 per cent as at end-December 2017, this being an improvement compared to an NPL ratio of 22.3 per cent recorded for end- December 2016. The NPL ratios for the personal and manufacturing sectors continued to rise to reach 3.1 per cent and 9.0 per cent, respectively, as at end-December 2017 (Chart 7.13). The impairment level for other sectors, namely agriculture, ICT and traders was higher than for the personal sector, although their weightage in total credit was significantly low.

7.3 Insurance sector

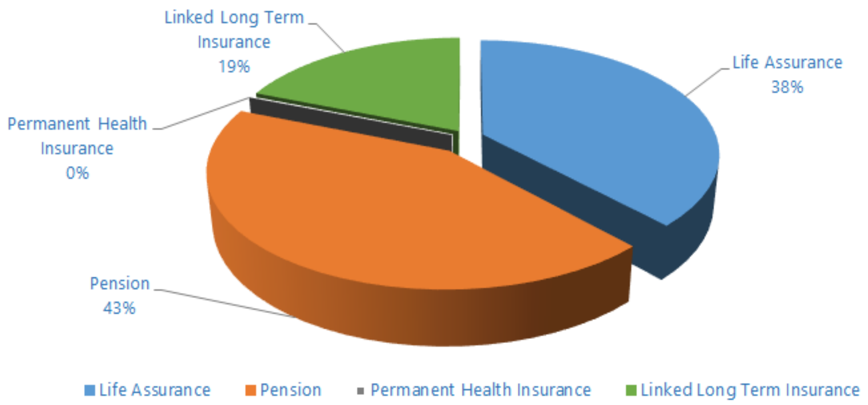
Long Term Insurance Business

In 2016, nine life insurance companies were licensed to conduct long-term assurance in Mauritius. Excluding figures pertaining to the National Insurance Company (NIC), long-term insurers' assets rose by 8 per cent over the year and stood at Rs89 billion as at end-December 2016. Other assets accounted for 30 per cent of insurers' assets, while investment in both local and overseas equities represented 25 per cent of insurers' portfolio.

Capital and reserves held in the books of long- term insurers increased by 6 per cent to reach Rs6.3 billion as at end-December 2016. The ratio of capital and reserves to the life fund remained constant during 2016 at a rate of 12 per cent. With the submission of the risk appetite statement through the Insurance (Risk Management) Rules 2016 in 2018, capital and reserves are expected to follow an upward trend.

Gross premiums witnessed a major decline of 43 per cent over the period 2014 to 2015 on account of the omission of British American Insurance (BAI) data. In terms of revenue, gross premiums of the remaining insurers rose by 10 per cent to reach Rs9.7 billion as at end-December 2016. Most of the gross premiums were attributable to pension assurance and life assurance to the tune of 42 per cent and 38 per cent, respectively, while the remaining 20 per cent pertained to permanent health and linked long term insurance (Chart 7.14).

Chart 7.14: Gross Premium Breakdown



In terms of profitability ratios, the investment income ratio measures investment income as a ratio of the company's earned premiums and compares an insurer's income derived from its investment activities to that of its operations. The long-term insurance industry's investment income ratio reached 53 per cent in 2016 compared to an average of 48 per cent for the period 2007-2016.

Surpluses are determined by the insurers' actuary on a yearly basis and the valuation of liabilities and determination of surpluses are prescribed in the Insurance (Long Term Business Solvency) Rules 2007. In addition, the surplus of the Life Fund witnessed a decline of 16 per cent in 2016 and stood at Rs4.31 billion compared to Rs 5.12 billion in 2015.

Life Fund

The life fund reached Rs54 billion in 2016, up by 4 per cent from 2015 and with an average growth of 6 per cent over the period 2008-2016 (Table 7.5).

Table 7.5: Long-Term Insurers' Assets

(MUR '000)	2012	2013	2014	2015	2016
Total Gross Premium	13,898,243	15,027,151	16,299,703	9,308,809	9,705,285
Total Gross Claims	10,050,162	11,056,547	13,007,487	7,381,796	8,048,812
Total Assets	92,640,217	106,427,903	115,245,762	86,756,513	89,378,207
Total Liabilities	82,785,496	95,792,229	104,015,424	80,729,362	83,000,562

Solvency Margin

In terms of the provisions of the Insurance Act 2005, long-term insurers are subject to a risk-based minimum capital, also referred to as 'solvency margin'. For the year 2016, the average solvency position of long-term insurers remained almost unchanged at 250 per cent compared to its 2015 position.

Claims and Expenses

The claims or loss ratio measures the percentage of claims paid in relation to premium earned. As at end-December 2016, the claims and expense ratios amounted to 85 per cent and 97 per cent, respectively, which reveal that long-term insurers earn more premium rather than incur losses or expenses. During 2016, the majority of net claims paid and payable in the long-term insurance industry pertained to life assurance policies to the tune of 44 per cent, followed by pension plans and linked long term policies for 42 per cent and 14 per cent, respectively. Life assurance policies net claims witnessed a minor decline of 1 per cent, while pension claims paid and payable rose by 20 per cent, permanent health insurance claims by 25 per cent and linked long term policies by 21 per cent in 2016.

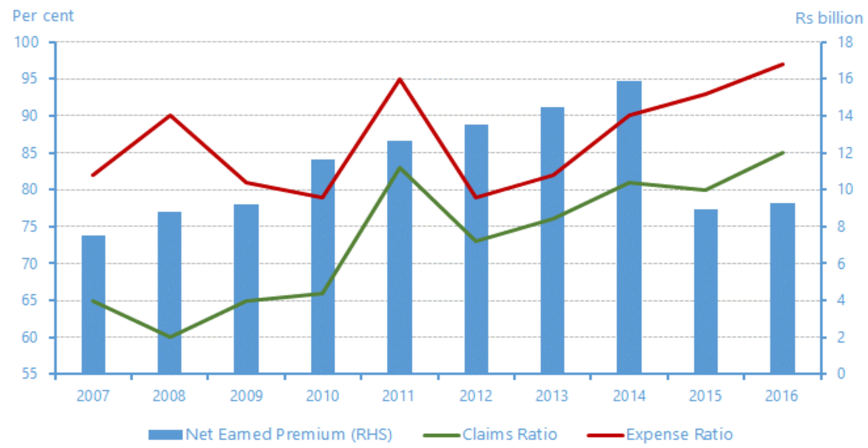
General Insurance Business

During 2016, the number of general insurance companies in operation stood at 15. Excluding figures for National Insurance Company Ltd, total assets of general insurers rose by 4 per to reach Rs16 billion as at end-December 2016. The general insurers' assets are widely spread across different asset classes, with 20 per cent accounting for receivables, 14 per cent representing equities listed locally and overseas, while assets pertaining to premium receivables and debt securities accounted for 13 per cent and 10 per cent, respectively.

In 2016, capital and reserves held in the books of general insurers showed an upward trend from 2015. Capital and reserves reached Rs48.4 billion in 2016, up by 21 per cent from 2015. Capital and reserves accounted for 58 per cent of general insurers' liabilities in 2016. Similar to long term insurers and in line with the submission of the risk appetite statement through the Insurance (Risk Management) Rules 2016 in 2018, capital and reserves are expected to follow an upward trend. In terms of revenue earned, net earned premium rose by 10 per cent to reach Rs4.9 billion in 2016, compared to an average of 10 per cent growth over the period 2007-2016. For the year ended 30 December 2017, two classes of business contributed to the bulk of net earned premiums, specifically, motor and accident and health to the tune of 58 per cent and 24 per cent in 2016, respectively, while the other classes of business contributed to the remaining 18 per cent (Chart 7.15).

The investment income ratio for general insurance companies stood at 11 per cent in 2016. Comparatively, the general insurance industry's average investment income ratio for the period 2007-2016 was 17 per cent.

Chart 7.15: Net Earned Premium



Surplus

The surplus of general insurance companies is obtained from difference between the assets available to cover technical provisions and the technical provisions. The surplus remained constant over 2015-16 and amounted to Rs7.5 billion.

Claims and Expenses

The combined ratio measures the profitability of insurance companies expressed in term of losses and expenses over earned premium. As an indicator, an investment income ratio below 100 per cent indicates that insurers are earning more premium than incurring losses/expenses. As at end-December 2016, the combined ratio stood at 86 per cent, indicating that general insurers had earned more premiums than they had incurred losses and expenses, thus indicating that they remained profitable in 2016. Furthermore, 92 per cent of net claims incurred pertained to motor and accident and health policies to the tune of 64 per cent and 28 per cent, respectively (Table 7.6).

Table 7.6: Key Indicators of General Insurers

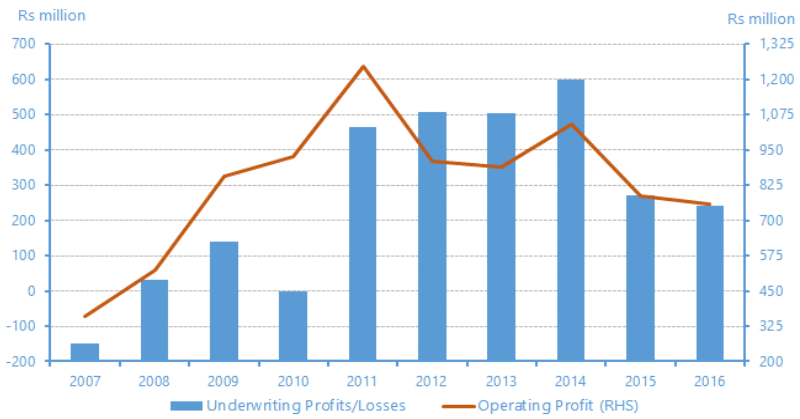
MUR '000	2012	2013	2014	2015	2016
Total Gross Premium	6,183,258	7,029,384	7,411,082	7,565,639	8,007,330
Total Gross Claims	3,073,388	4,143,128	3,913,638	3,946,659	4,453,043
Total Assets	12,404,297	13,888,355	15,066,359	16,670,355	15,920,403
Total Liabilities	7,074,637	7,836,424	8,111,588	9,111,778	8,393,691

Source: Financial Services Commission (FSC) Mauritius

Solvency Position

The solvency margin refers to the amount by which the assets of an insurance company exceed its liabilities as a buffer particularly against risks related to investment activities. As at end- December 2016, the average solvency margin for general insurance companies stood at 279 per cent compared to 8402 per cent as at end- December 2015. Over the period 2007-2016, general insurance companies realised average underwriting profits amounting to Rs255 million, with a minor decline of 11 per cent over the period 2015-16 (Chart 7.16).

Chart 7.16: Underwriting Profit/Losses and Operating Profits



Pension

Financial Position - Private pension schemes (defined benefit)

Further to the enactment of The Private Pension Scheme Act 2012 ("PPSA") on 1 November 2012 and the coming into operation of the Private Pension Schemes (Technical Funding Requirement) Rules 2013, all private pension schemes that are licensed with the FSC are mandated to submit actuarial valuation reports to the latter on a triennial basis. For financial year 2015-16, 20 private pension schemes with defined benefit arrangements had submitted actuarial valuations to the FSC. Data presented in the following tables are derived from the actuarial valuation reports submitted by the 29 private pension schemes for the financial year 2015-16.

Funding ratio - Private pension schemes (defined benefit)

The funding ratios, corresponding to financial year 2015-16, were as follows:

Table 7.7 Funding Ratio

No. of Pension Funds	Range (Per cent)
3	More than 100
3	Between 90 and 100
9	Between 60 and 90
5	Less than 60

Source: Financial Services Commission (FSC) Mauritius

Surplus or Deficit - Private pension schemes (defined benefit)

The surplus positions, corresponding to financial year 2015-16, were as follows:

Table 7.8: Surplus Position of Pension Funds for Financial Year 2015-16

	Average Surplus *(Rs million)*
Aggregate for the 29 private pension schemes	(300)
Highest value	23
Lowest value	(1875)

Source : Financial Services Commission (FSC) Mauritius

Pursuant to the Private Pension Schemes (Technical Funding Requirement) Rules 2013, defined benefit schemes are required to maintain at least 100 per cent funding ratio.

A funding ratio of 90 per cent is allowed where the rates of contributions to the scheme are such that the scheme will reach 100 per cent funding ratio in the period for which the schedule of contributions is in force and where the scheme meets the relevant requirements under section 18 of the PPSA. Compliance with legal provisions relating to technical funding would ensure that private pension schemes have adequate technical provisions to meet future liabilities.

Effect of investment return - Private pension schemes (defined benefit)

From a number of twenty defined benefit private pension schemes, nineteen reported on analysis of surplus. The analysis of surplus showed the following results regarding 'investment returns' and 'change in basis' which is the gap between the assumptions that affects the technical provisions rather than the absolute amounts.

Out of 19 defined benefit private pension schemes, 17 cases reported a poor performance in respect of investment assumptions. It was also noted that a majority of the schemes experienced surpluses in terms of contribution amounts, thus bringing down the overall deficit. Investment return performance was the major factor that resulted in the deficits of these schemes owing to exposure in equity investments which resulted negative returns or unrealised losses over the valuation time period.

The Global Business Sector

Portfolio Investment by Global Business Companies Category 1

As at end-December 2016, India remains the predominant jurisdiction for investment by GBC1 companies, accounting for about 75 per cent of the portfolio investment. The same trend was observed over the period 2015-16 with India firmly ahead followed by the competing jurisdictions namely Hong

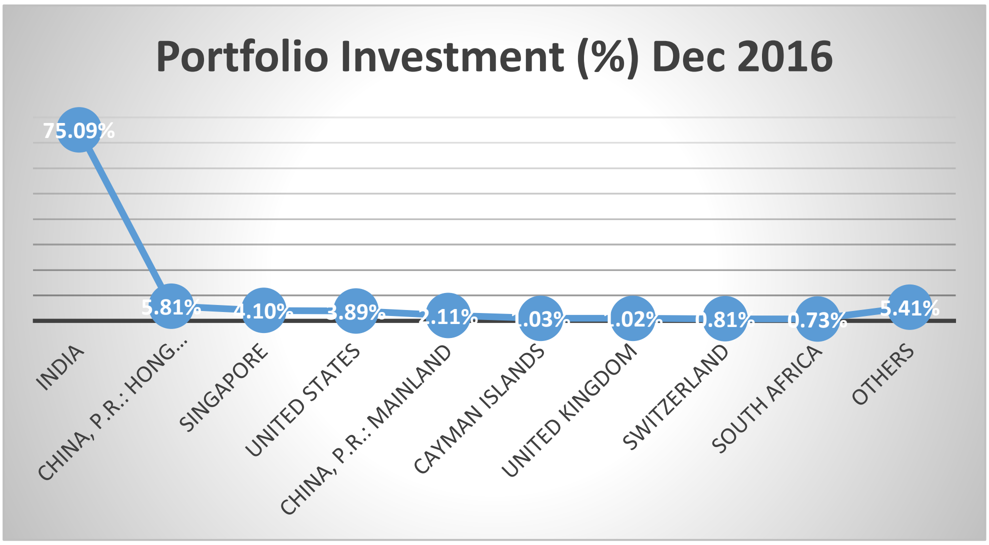
Kong, United States, China and Singapore. As at end 2016, Asian countries such as India, Hong Kong, China and Singapore constituted 87.1 per cent of overall total investments.

Foreign direct investments by Global Business Companies Category 1

Inward Investment

With regard to foreign direct investment received by GBC 1, the USA and Cayman Islands were the two main sources representing 19.2 per cent and 14.7 per cent of the total investment received respectively. A similar pattern was observed for period ending 2015 (Chart 7.17).

Chart 7.17: Portfolio Investment



Outward Investment

On the other hand, foreign direct investment outward for period ending 2016 showed that India was the main recipient for foreign direct investment accounting for 47.3 per cent of the total foreign direct investment. This was followed by Singapore representing about 10 per cent of the foreign direct investment received. For 2016, the main Asian countries received about 63.1 per cent of the total foreign direct investment.

Technical Developments

Amendment to the Securities (Disclosure Obligations of Reporting Issuers) Rules 2007

The Securities (Disclosure Obligations of Reporting Issuers) Rules 2007 were amended in October 2015 to provide for certain exemptions. Rule 8 of the Securities (Disclosure Obligations of Reporting Issuers) Rules 2007 was amended to exempt Exchange Traded Funds from the obligation as per paragraph

8(1)(a)(i) regarding publication of quarterly report containing the information as required under the Rule.

In addition, Rule 16A was amended such that the monthly filing of the list of foreign investment transactions returns by Reporting Issuers should henceforth be made to their respective securities exchange only. The objective is to ease the burden of the Reporting Issuers from filing the same information to the FSC Mauritius and the securities exchange.

Risk Outlook

Over the years, the investment profile of the GBC Sector has remained highly concentrated with respect to both portfolio and foreign direct investment exposures, with funds mostly directed to key Asian countries. The failure for the GBC sector to diversify these portfolio point to vulnerabilities that would have to be addressed and resolved in the medium to long term. Other issues refer to the unfolding trade war between China and US that may lead to trade protectionism and tense geopolitical situations across the globe. These factors are not conducive for foreign investors to embark in short/long term investment projects in Asia.

8. Risk Analysis of the Domestic Banking System

This section presents a summary assessment of the main risks to the domestic banking system. The heat map below provides a synopsis of these risks and their likely evolution over the next 6 months.

Table 8.1: Risks to Financial Stability for the Upcoming Six Months

	Risk to domestic financial stability		Expected Change*
	Jun-17	Aug-18	
Global Economy			
Global economic activity			Unchanged
Oil price			Up
Food prices			Unchanged
Volatitlity (ViX)			Down
Domestic Economy			
Economic growth			Up
Inflation			Down
Terms of trade			Down
Domestic savings			Up
Investment/GDP			Unchanged
Exchange rate			Unchanged
Household Debt Risks			
Household debt-to-disposable income			Up
Household debt service-to-disposable income			Unchanged
Corporate Debt Risks			
Corporate debt-to-GDP			Up
Return on equity			Unchanged
Leverage			Unchanged
Banking			
Large exposures			Down
Return on equity			Up
Asset quality (domestic market)			Up
Asset quality (outside Mauritius)			Unchanged

** Expected change between August 2018 and February 2019.*

Source: Bank of Mauritius staff estimates.

Risk analysis key

High		Medium		Low	
6	5	4	3	2	1

Since the last assessment made in June 2017, risks to domestic financial stability emanating from the global economy has declined amid firming global growth, especially in most trading partner countries. However, the economic outlook is becoming somewhat clouded amid mounting uncertainty. The IMF has, since its January 2018 World Economic Outlook Update, maintained world GDP growth at 3.9 per cent for 2018 and 2019. While the risk of a trade war has now materialized, the global growth path may be derailed with further intensification of the trade war. The Mauritian jurisdiction is not completely shielded from the potential impact of a global trade war. Close monitoring of related developments is warranted for timely deployment of appropriate policies. Developments related to tariffs imposition will keep investors on edge and markets subject to bouts of volatility. Oil prices have increased as well as economic policy uncertainty. Brexit uncertainties are still weighing on the UK economy. In addition, geopolitical tensions, especially in East Asia and the Middle East, might bring more uncertainties to the medium-term economic outlook. Alongside, the revolution of the cryptocurrencies in many regions of the world and the use of blockchain technology, especially in payment systems, would warrant monitoring.

Global inflation has increased gradually due to higher energy prices and led to tightening of interest rates in some countries. The US continued to tighten interest rates on the back of improving economic fundamentals and higher inflation, and is expected to raise rates again before the end of the year. The BoE eventually increased interest rates in August 2018, the first time since the financial crisis, while keeping its asset-purchase programme unchanged at GBP435 billion. In the euro area, the ECB is expected to revisit its forward guidance on quantitative easing as the economy gains traction and inflationary pressures mount.

The domestic economy has continued to improve, gradually closing the gap against potential output. After recording higher growth in 2017, growth is forecast to increase further in 2018 amid implementation of large infrastructure projects, including the metro express and road decongestion programme. Consumption expenditure remains robust and is expected to gain support with the recent implementation of the minimum wage. In 2018, the deficit in the current account would continue to be financed by financial flows, without undue pressure on the rupee exchange rate.

Higher economic activity is expected to be generated by most key sectors of the economy, including construction, distributive trade, accommodation and food service activities, and financial and insurance activities. Activities of the global business sector appeared to have been relatively unaffected so far, following amendments to the Double Taxation Avoidance Agreement (DTAA) between Mauritius and India in May 2016. Construction activities are expected to remain buoyant after rebounding in 2017 and are bound to have positive spillover effects to other sectors of the economy. Inflation has increased due to transient factors but core measures of inflation have remained rather stable, indicating that inflationary pressures were contained.

Indebtedness of households, as measured by the debt-to-disposable income ratio, has remained rather contained below 50 per cent. The increase in the household debt-to-disposable income resulted mainly from higher extension of housing credit to households by banks that dwarfed the increase in disposable income. At the current level, indebtedness of households rather point to contained financial stability risks. The removal of the limit on the LTV ratio may continue support housing credit while growth of consumption credit returns to positive territory. The Bank has already in place macro prudential policy measures to prevent build-up of vulnerabilities with regard to banks' exposure to households. With the cut in the Key Repo Rate in September 2017, interest rates on housing, personal and professional credit have declined and contributed to lower debt service cost of households. Nevertheless, close monitoring of the evolution of banks' exposure to households and resulting NPL is warranted for early detection of pockets of vulnerabilities and remedial actions.

Corporates were slightly more leveraged with banks amid the increase in the total corporate debt from banks as a percentage to GDP. However, some large corporates have continued to raise funds via the issue of bonds through public offerings and private placements. In 2017, it is estimated that listed corporates raised a total of Rs11.5 billion compared to Rs8.2 billion in 2016. In the absence of raising such type of capital, bank credit to corporates would have been higher as well as leverage ratios. Most of these corporates listed on the SEM has seen marked increases in the share prices in 2017, reflecting increased optimism on business activity in general. Profitability of corporates has improved while cost of debt as measured by interest expense to total debt ratio has remained rather unchanged. The cut in the KRR in September 2017 should provide a relief to the cash flow of corporates in Mauritius going forward while the expected improvement in economic activity should help consolidate their financial position.

Banks in Mauritius were sufficiently capitalised and held adequate capital buffers to deal with risks and to provide adequate loss absorption in the event of a crisis. The average capital adequacy ratio maintained was well above the minimum required and stood at 17.2 per cent at end-June 2018, compared to 18.0 per cent at end-June 2017. Profitability of the banks remained healthy and solid. Return on assets remained broadly stable in 2017 while return on equity illustrated marked increase from 12.8 per cent in 2016-17 to 13.0 per cent in 2017-18. Banks' exposure to concentration risk has to be kept in check. Asset quality of banks improved with the decline in ratio of NPL to 6.5 per cent as at end-June 2018, from 7.0 per cent as at end-June 2017.

Overall, the financial system is assessed to be sound and resilient. While risks stemming from the macroeconomic environment exist, pre-emptive micro and macro-surveillance measures have greatly helped reinforce the Bank's commitment towards ensuring a safe and sound financial system. A number of initiatives has been taken over the year 2017 and beginning of 2018 to enhance stability of the financial system. The minimum capital requirement of banks which was Rs200 million since 2004 was increased to Rs400 million to improve the resilience of banks. The supervisory process at the Bank is in the process of being overhauled, with the onset of effective consolidated supervision, conglomerate supervision, and risk-based supervision, with the benefit of technical assistance from international institutions. Efforts are currently in the pipeline for facilitating better coordination between the Bank and the FSC in conducting consolidated and conglomerate supervision.

The Bank has issued and updated numerous Guidelines in line with international best practices, after due consultation with the banking industry. The Guideline on Corporate Governance was recently amended to include a section on requirement for substantial activities. A Guideline on Financial Holding Companies is in the process of being introduced. Further, the Guideline on Outsourcing by Financial

Institutions was reviewed and a new section on cloud- based services included. A Guideline on liquidity risk which embraces the Liquidity Coverage Ratio (LCR) framework – an artefact of Basel III – has become effective beginning November 2017. Banks are now required to calculate their LCR in material currencies. The Bank is also concerned with mitigating AML / CFT risks in the Mauritian financial system. In that respect, a separate module is being developed on AML/ CFT risks in the Bank's risk-based supervisory framework. It is now mandatory for all banks to have a full-fledged AML / CFT software. Any new applicant for a banking license is required to provide evidence of same to the Bank before the grant of a banking license.

The Bank has been steadfast in its commitment to monitor the phased implementation of IFRS9 Expected Credit Loss framework which has superseded the incurred loss framework and which has become effective as from January 2018. Other measures in the pipeline designed to reinforce financial stability include the proposed legislation for deposit insurance scheme, a crisis resolution and management framework which is currently being examined with the assistance of the IMF and which, if implemented, will ensure an orderly resolution of bank failures with minimal recourse to public funds.

ANNEX 1: Financial Soundness Indicators[1] of Other Depository Corporations (Banks and NBDTIs[2])

Core Set of Financial Soundness Indicators	Dec-14	Dec-15	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Jun-18
								Per cent
Capital-based								
Regulatory capital to risk-weighted assets	17.1	18.4	18.2	18.5	18.6	18.2	18.6	18.0
Regulatory Tier 1 capital to risk-weighted assets	15.1	17.0	16.7	16.9	17.2	16.8	17.3	16.7
Non-performing loans net of provisions to capital	16.4	19.1	18.7	19.3	18.0	18.3	16.6	14.3
Asset Quality								
Non-performing loans to total gross loans[3]	4.9	7.2	7.8	7.9	7.8	7.8	7.0	6.8
Sectoral distribution of loans to total loans[3]								
Interbank loans	0.3	0.1	0.5	0.4	0.3	1.3	1.6	2.4
Other financial corporations	1.5	1.5	2.3	2.9	3.2	3.8	3.8	3.9
Non-financial corporations	33.6	36.8	35.6	35.7	35.6	33.7	33.1	33.3
Other domestic sectors	19.2	21.0	22.0	21.6	22.5	22.1	21.8	21.8
Non-residents	45.4	40.6	39.5	39.4	38.5	39.0	39.7	38.6
Earnings and Profitability								
Return on assets	1.4	1.2	1.5	1.4	1.5	1.5	1.6	1.5
Return on equity	15.2	12.1	13.9	13.2	14.9	14.7	16.0	14.6
Interest margin to gross income	49.0	68.5	71.5	69.2	68.8	70.2	69.6	71.5
Non-interest expenses to gross income	36.9	44.3	45.9	42.3	40.2	44.3	42.9	40.5
Liquidity								
Liquid assets to total assets	24.1	27.1	27.9	26.8	28.1	25.0	22.1	25.4
Liquid assets to short-term liabilities	30.2	34.5	33.9	33.3	35.2	32.2	28.9	28.8
Sensitivity to Market Risk								
Net open position in foreign exchange to capital	2.4	3.0	0.1	4.7	3.8	3.3	3.3	3.0
Encouraged Set of Financial Soundness Indicators	**Dec-14**	**Dec-15**	**Dec-16**	**Mar-17**	**Jun-17**	**Sep-17**	**Dec-17**	**Jun-18**
Capital to assets	9.3	10.5	10.6	10.2	10.4	10.0	10.1	11.6
Value of large exposures to capital	201.9	184.3	159.7	150.0	137.8	157.4	224.4*	233.5*
Customer deposits to total (non-interbank) loans	133.2	146.8	149.8	151.5	155.8	157.1	153.4	155.2
Residential real estate loans to total loans[3]	6.2	9.1	9.4	9.2	9.7	9.7	10.2	10.3
Commercial real estate loans to total loans[3]	5.0	5.8	4.6	4.3	4.3	4.2	3.9	4.4
Trading income to total income	35.4	10.0	9.5	10.3	8.7	12.3	10.2	8.4
Personnel expenses to non-interest expenses	40.8	50.5	47.3	49.4	49.5	49.1	49.5	49.4
Macroeconomic Indicators	**Dec-14**	**Dec-15**	**Dec-16**	**Mar-17**	**Jun-17**	**Sep-17**	**Dec-17**	**Jun-18**
Headline inflation[4]	3.2	1.3	1.0	1.3	2.4	3.2	3.7	4.3
Year-on-year inflation[4]	0.2	1.3	2.3	1.3	6.4	3.5	4.2	1.0
Key Repo Rate (end of period)	4.7	4.4	4.0	4.0	4.0	3.5	3.5	3.5
Total Public Sector Debt/GDP (end of period)	60.7	63.6	64.4	65.5	64.8	64.6	63.4	63.0
Total Public Sector External Debt/GDP (end of period)	16.0	16.5	14.7	13.2	13.2	12.6	12.5	12.0
Import coverage of Gross International Reserves (mor	6.2	7.7	9.3	8.5	8.7	8.9	9.7	11.1
Deposits/Broad Money Liabilities[5]	92.8	92.7	92.6	93.0	92.9	93.2	92.5	90.9
Household Debt/GDP (end of period)[6]	20.5	20.6	20.1	19.9	20.1	20.2	20.3	20.6
Corporate Debt/GDP (end of period)[6]	48.5	48.7	44.9	44.5	44.2	44.5	45.0	44.8
	2014Q4	**2015Q4**	**2016Q4**	**2017Q1**	**2017Q2**	**2017Q3**	**2017Q4**	**2018Q2**
Real GDP growth[4]	2.3	3.9	4.2	3.6	4.0	3.3	3.3	3.4
Unemployment rate	7.5	7.9	6.6	7.6	7.2	7.0	6.7	7.0
Current account deficit/GDP	6.0	2.1	4.0	4.4	6.0	4.6	7.4	6.5

[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 different from other parts of the report.

[2] NBDTIs refer to Non-Bank Deposit-Taking Institutions. [3] Total gross loans include commercial loans, instalment loans, hire-purchase credit*, loans to finance trade credit and advances, finance leases, repurchase agreements not classified as a deposit, and overdrafts.*

[4] Percentage change over corresponding period of previous year. [5] Rupee and foreign currency deposits from domestic banks.

*[6] Debts contracted with banks only. * As from December 2017, the measurement of credit concentration ratio has been revised to aggregate large credit exposure (above 10 per cent of Tier 1 capital) as a percentage of aggregate Tier 1 capital Based on previous Guideline, the corresponding ratio for large exposures would have been 171.8 per cent and 188 per cent for the quarters ended December 2017, and June 2018, respectively.*

Note: Figures may not add up due to rounding

List of Tables

List of Charts

Acronyms

BAI	British American Insurance
BM	Broad Money
BML	Broad Money Liabilities
BoE	Bank of England
CAR	Capital Adequacy Ratio
CCB	Capital Conservation Buffer
CPI	Consumer Price Index
DCs	Depository Corporations
D-SIBs	Domestic-Systematically Important Banks
DTAA	Double Taxation Avoidance Agreement
ECB	European Central Bank
EMDEs	Emerging Market and Developing Economies
EPI	Export Price Index
FDI	Foreign Direct Investment
FMI	Financial Market Infrastructures
FSC	Financial Services Commission
FSIs	Financial Soundness Indicators
FSR	Financial Stability Report
GBC	Global Business Companies
GDP	Gross Domestic Product
GOIR	Gross Official International Reserves
GOS	Gross Operating Surplus
IMF	International Monetary Fund
IPI	Import Price Index
HHI	Herfindahl-Hirschman Index
KRR	Key Repo Rate
LCR	Liquidity Coverage Ratio
LTV	Loan-to-Value
MERI	Mauritius Exchange Rate Index
MPC	Monetary Policy Committee
NBDTIs	Non-Bank Deposit-Taking Institutions
NEER	Nominal Effective Exchange Rate

NFA	Net Foreign Assets
NIC	National Insurance Company
NPLs	Non-Performing Loans
NSDP	National Skill Development Programme
ODCs	Other Depository Corporations
OM	Official Market
OPEC	Organisation of the Petroleum Exporting Countries
PMI	Purchasing Managers' Index
PPC	Petroleum Pricing Committee
REER	Real Effective Exchange Rate
ROA	Return On Assets
ROE	Return On Equity
SEM	Stock Exchange of Mauritius
ToT	Terms of Trade
US FED	US Federal Reserve Bank
WEO	World Economic Outlook
YEP	Youth Employment Programme

Acronyms

BAI	British American Insurance
BM	Broad Money
BML	Broad Money Liabilities
BoE	Bank of England
CAR	Capital Adequacy Ratio
CCB	Capital Conservation Buffer
CPI	Consumer Price Index
DCs	Depository Corporations
D-SIBs	Domestic-Systematically Important Banks
DTAA	Double Taxation Avoidance Agreement
ECB	European Central Bank
EMDEs	Emerging Market and Developing Economies
EPI	Export Price Index
FDI	Foreign Direct Investment
FMI	Financial Market Infrastructures
FSC	Financial Services Commission
FSIs	Financial Soundness Indicators
FSR	Financial Stability Report
GBC	Global Business Companies
GDP	Gross Domestic Product
GOIR	Gross Official International Reserves
GOS	Gross Operating Surplus
IMF	International Monetary Fund
IPI	Import Price Index
HHI	Herfindahl-Hirschman Index
KRR	Key Repo Rate
LCR	Liquidity Coverage Ratio
LTV	Loan-to-Value
MERI	Mauritius Exchange Rate Index
MPC	Monetary Policy Committee
NBDTIs	Non-Bank Deposit-Taking Institutions
NEER	Nominal Effective Exchange Rate

NFA	Net Foreign Assets
NIC	National Insurance Company
NPLs	Non-Performing Loans
NSDP	National Skill Development Programme
ODCs	Other Depository Corporations
OM	Official Market
OPEC	Organisation of the Petroleum Exporting Countries
PMI	Purchasing Managers' Index
PPC	Petroleum Pricing Committee
REER	Real Effective Exchange Rate
ROA	Return On Assets
ROE	Return On Equity
SEM	Stock Exchange of Mauritius
ToT	Terms of Trade
US FED	US Federal Reserve Bank
WEO	World Economic Outlook
YEP	Youth Employment Programme

Glossary

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

CORE1 inflation excludes food, beverages and tobacco and mortgage interest on housing loan from the CPI basket. Both headline and year-on-year CORE1 inflation measures are available.

CORE2 inflation excludes food, beverages and tobacco, mortgage interest, energy prices and administered prices from the CPI basket. Both headline and year-on-year CORE2 inflation measures are available.

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

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.

Headline inflation is measured by the change in the average Consumer Price Index (CPI) over a twelve-month period compared with the corresponding value for the previous twelve-month period.

Herfindahl-Hirschman Index is a measure of the average size of firms in relation to the industry and an indicator of the amount of competition among them. It is a commonly accepted measure of market concentration.

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

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.

Lorenz Curve is typically used to depict distributive inequalities. Curves that stretch further away from the line of perfect equality show higher inequality.

MERI1 is the Mauritius Exchange Rate Index, a nominal effective exchange rate introduced in July 2008, based on the currency distribution of merchandise trade.

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

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

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

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

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

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