LETTER TO STAKEHOLDERS

Steaming On ... in Uncharted Waters in Storm-tossed Seas

Five years of steering a Central Bank in a small, open island state and keeping the economy on an even keel

4 February 2013

Dear Stakeholder,

On 28 December 2007, from my vantage point as newly-installed Governor, I issued my first Letter to Stakeholders to plug what I felt was a gap in our communication. I saw it as a vehicle to review developments in the economic and financial landscape and to give interested stakeholders a flavour of the Bank's actions during the past year. It was the year of the Bank's 40th Anniversary celebrations. Less auspiciously, it was also the year when the first tremors of an impending global financial crisis began to be felt in specialized corners of the financial market dealing with esoteric sub-prime mortgages originating in the US.

2. Five years on, the Letter to Stakeholders is well-embedded in the calendar of publications of the Bank, with its release much-awaited, not least by the local financial press. Five additional years in the life of the institution, five years at its helm as Governor, and five years of unending crisis, to boot — surely all this requires us to pause awhile, look back over those tumultuous, challenging yet ultimately rewarding, years and take stock of the progress achieved. But, first, a brief assessment of 2012 and the perspective for 2013 may provide some context.

3. **The Global Economy** 2012 has proved far more turbulent, uncertain and painful than most economists had predicted. The European Union, hailed until recently as the *nec plus ultra* of regional cooperation, came on the brink of implosion, with the rest of the world holding its breath in anticipation of the expected global crash likely to follow in the wake of the widely-predicted "Grexit" which would bring the eurozone to an ignominious end. Across the Atlantic, the US economy was hardly in better shape, barely managing in the nick of time to surmount its "fiscal cliff" before the predicted financial catastrophe. Fortunately, emerging market economies, though wounded, managed to pull the world economy round. In such exceptional circumstances, central banking in advanced economies had to be reshaped to accommodate unconventional policy measures, which would have been clearly beyond the pale for central bankers a decade earlier.

4. So here we are, at the start of 2013, facing the same questions as in preceding years: when shall we finally see an end to the global economic crisis and a sustained rebound in growth and job creation? As we start the New Year, there are tentative signs that the global economy is finally picking up, with growth momentum building modestly and financial conditions becoming more supportive. But the transition is likely to be slow and fragile. Even as we see some global growth, the legacy of subpar performance over the recent years is expected to play a major role in influencing investment and macroeconomic performance in general in 2013 and beyond. Doubts persist over the sustainability of the timid recovery once the flood of central bank money, propping up economic activity in the advanced countries, begins to be withdrawn — as it clearly must if we are not to see an unprecedented debasement of major reserve currencies, hand in hand with runaway inflation.

5. **The Mauritian Economy** For Mauritius, the odds of surviving intact in the face of the global turmoil over the past five years were very thin at best. We have a small open economy, heavily dependent on exports to the European Union, and we have been unable to rely significantly on regional or domestic demand to pick up the slack from depressed conditions in our traditional markets. Nevertheless, we avoided recession and have come out rather well. Key factors here were the support from the fiscal stimulus at the beginning of the crisis and an appropriately accommodative, but much-maligned, monetary and exchange rate policy that have together allowed the domestic economy to continue recording positive growth rates even as some major trading partner economies were contracting. The added adaptive advantage arising from our smallness proved to be a real asset in these troubled times. In addition, our closely-regulated banking system was not drawn into the seemingly very lucrative, but high-risk, operations that proved fatal to banks in many advanced economies and we have had no banking failures or bailouts.

6. It is evident, however, that our economy is still operating below its potential. The crisis has shown up the shortcomings of the inertia in much of our trade for both goods and services, where we have seemed locked into previously successful, but fragile, strategies that have left us at the mercy of external market and policy failure. While the lesson has been learnt, many sectors have been caught wrong-footed and are now scrambling to diversify products and markets. ***(More on this issue)***

7. **My own personal experience at the Bank** The uncertainty and instability prevailing in the global economic and financial environment have kept me on my toes. It was a path full of challenges that confronted me, a path strewn with obstacles where I sometimes stumbled and where I found myself, like many fellow-governors elsewhere, regularly attacked, sometimes ridiculed, and even scorned. But I always emerged, often bruised, but more determined than ever, motivated by the unchanging desire to rise to the constantly-changing challenge, raise the profile of the Bank, and transform it into a modern and innovative institution that fulfils its mission confidently and efficiently for the sustainable development of the Mauritian economy. We had our share of achievements, small victories and successes obtained with great satisfaction.

8. The decisions and actions that I took at the Bank over the last five years have been directed towards maintaining financial and macroeconomic stability – this, as the global financial crisis revealed, is the most important function of a central bank. This overriding consideration has guided all my decisions and actions. However, given the highly uncertain and unstable global environment, flexibility and promptness in action turned out to be key elements in our decision-making. I saw the need to bring some key reforms to the organisational structure of the Bank. For operational efficiency, the Bank was restructured into a more flexible institution. New divisions were created to monitor areas that I had foreseen would be critical in the years to come, among which the Financial Stability Unit to monitor and assess the risks to financial stability and associated macro-prudential policy. Our strategies have borne fruit and the Bank's contribution to financial and macroeconomic stability has been recognised locally and internationally.

9. Let me sketch the broad outlines of the Bank's policies and actions during the past five years, which flow from this overriding consideration.

10. **Monetary Policy** At the very start of my tenure as Governor, I set out to remedy what was, to my mind, a major flaw in our approach to monetary policy decision-making. Although it had been three years since the new Bank of Mauritius Act had been enacted, with explicit provision for the creation of a Monetary Policy Committee (MPC), the interest-rate decision process had remained unchanged. One of my first moves as Governor was to establish this Committee, which was officially launched in April 2007. Soon after the first meeting, I proposed that amendments be brought to the law to enhance the independence of the MPC.

11. It was also a decisive stride towards improving governance at the Bank. I wanted more transparency and accountability at the level of the MPC and instigated a major review after it had been in operation for four years. The review resulted in two major changes, firstly in the composition of the MPC and, secondly, in the publication of the minutes of the meeting, including the voting patterns of individual members.

12. The establishment of the MPC with its enhanced transparency and accountability made monetary policy gain increasing credibility in the eyes of the public. We complemented our action by developing clear lines of communication with economic agents and adopted an open-door policy to respond to the concerns of the various economic stakeholders including real sector operators, academia, opinion leaders, and consumer associations. I held regular public consultations through press conferences and public addresses. Today, inflation expectations are well-anchored and it has become much easier to interpret and understand monetary policy decisions. The Bank has been successful in disinflating the economy and has brought down the inflation rate to less than 4 per cent in 2012 from 10.9 per cent in April 2007. (***More on this issue)***

13. **Exchange Rate Policy** Many of you will recall that the value of the rupee was in free fall in the years preceding my nomination as Governor of the Bank of Mauritius in 2007, paving the way for a one-way bet against the currency and fuelling unsustainable over-borrowing in rupees. It was clear to me that this would plague the economy with speculative transactions and constrain our move to the next stage of development. Exchange rate stability was the necessary condition that we had to satisfy if we were to stand any chance to succeed in realising the vision of our political leadership to build Mauritius into a vibrant international financial centre of repute.

14. My stance was to favour a stable currency, given our euro-biased exports and dollar-biased imports and the high exchange-rate volatility witnessed in the international forex market during the global financial crisis. A stable currency would remove foreign exchange risk, thus providing some element of certainty in doing business for both importers and exporters. To

pursue this stable exchange rate policy, the Bank continued with its methods of adjustment and fine-tuning but never shied away from doing what we assessed was right under the varying circumstances faced by the economy. More recently, the Bank has attuned its policy to mitigate further appreciation pressures on the exchange rate value of the rupee to avert the adverse potential impact of the worsening euro debt crisis on key sectors of the economy. I firmly believe that the real test of our management of exchange rate policy has emerged in the medium-term perspective over the five years for a short-run view can be very misleading, even if it makes good headlines in the media. ***(More on this issue)***

15. **Modernisation of the Financial Market infrastructure** When I took over as Governor in 2007, I discovered that the growing financial sector, in particular the offshore segment, and increasing cross-border transactions posed new and complex challenges to the existing payment system infrastructure. I realised that the financial market infrastructure needed a major overhaul to meet these demands. So the first decision that I took in this area was to replace the existing real-time gross settlement system – the Mauritius Automated Clearing and Settlement System (MACSS) – with another application that was built on a more resilient architecture and supported multi-currency transactions. The extended capability of the system has no doubt been a major contributing factor behind the appointment by COMESA member-states of the Bank of Mauritius as the settlement bank for its Regional Payment and Settlement System, whose operations we now host. We pursued our modernisation process with the implementation of the Cheque Truncation System, which provides for the bulk clearing of low-value electronic transactions. I set out, during my tenure, to extend the coverage of the Mauritius Credit Information Bureau (MCIB) to all types of credit institutions operating in the economy. The MCIB has over the years emerged as an essential risk management tool for banks in their lending activities. ***(More on this issue)***

16. Over the past years, the card-based payment method has assumed growing importance in the economy and it is expected to make further inroads on cash and cheque-based settlement. The systemic importance of card transactions may pose a threat to the stability of the financial system if left unattended. In line with our mandate to ensure the stability and soundness of the financial system, I saw the need to revisit our erstwhile hands-off approach to this sector and move to regulate it properly. The Bank will thus set up and operate a National Payment Switch (NPS) by the end of the year. The NPS is a national, multifaceted switching platform for various payment channels and it will settle the net positions of banks on the MACSS while reducing the cost of transactions and routing costs via the reduction of interconnection charges and merchant fees, in particular on domestic transactions. The NPS will therefore address the inefficiencies of the current setup and provide a level playing field to all banks and operators.

17. I also devoted a lot of attention to deepening financial markets, the other leg of the modernisation of the financial market infrastructure. Small size and lack of depth have always hampered the development of the domestic money and foreign-exchange markets. I have introduced a number of measures to bring down the surplus of liquidity and enhance both the price-discovery process and the transmission mechanism in the money market. I am particularly pleased to note the progress achieved on this front by end-2012. It is even more encouraging to

note that private initiatives have been coming forward to build on the current momentum. The current context in which Mauritius is viewed positively by international credit rating agencies, the low interest rate and inflation environment, and the prudent fiscal path and public debt levels provide increased traction to speed up the country's transformation into the long-awaited sophisticated international financial centre that would generate income and jobs for generations to come. ***(More on this issue)***

18. **Reserves Management** Reserves are strategic for a country to survive trade shocks and economic crises as they act as the first line of defence. It was clear to me that a more efficient management of these reserves would provide rich dividends to the country. Over the five years since 2008 I have found managing foreign exchange reserves an increasingly challenging task. Monetary policy worldwide turned significantly accommodative and a number of major central banks implemented quantitative easing, resulting in progressively lower yields on our reserves. I instigated a review of the Bank's investment strategy given the low profitability of operations. In an attempt to increase returns while containing risks, we reduced our exposure with foreign commercial banks (which were being de-rated), reviewed the investment horizon, invested in cash and near-cash instruments, and increased our holdings in high-yielding currencies even as we moved to include new currencies in our portfolio. In November 2009, the Bank purchased two metric tons of gold from the IMF, to diversify our portfolio further and mitigate the impact of currency volatility. Subsequently, I also increased our share of investment in fixed-income instruments. I am happy to report that the diversification strategy, coupled with enhanced operational efficiency, translated into higher net profits for the Bank: Rs395 million in FY 2011/12, from Rs258 million in FY 2010/2011, and just Rs72.4 million in FY 2009/2010. And we managed to do this at a time when many central banks and fund managers were actually making losses. In June 2012, we launched the Operation Reserves Reconstitution to maintain a more comfortable import cover and to combat unwarranted appreciation of the rupee. The Bank's gross external reserves at end-December 2012 amounted to USD3.0 billion (Rs93.0 billion), having risen from USD1.3 billion (Rs44.7 billion) at end-December 2006. ***(More on this issue)***

19. **Regulation and Supervision** At the time of my appointment as Governor, the Prime Minister, as the nominating authority, shared with me his vision of a sophisticated financial system that would contribute to make Mauritius a recognised international financial centre. This vision included a banking sector that could aspire to become a regional leader in the field. I proceeded to flesh out this vision. I imagined a vibrant, competitive, transparent, robust and profitable banking sector further extending its footprints in the region and beyond, but always well-regulated and enhancing the reputation of its home jurisdiction.

20. My assessment of the regulatory and supervisory framework in place at the time revealed that the framework was adequate although there were some areas that required strengthening to enhance the performance of the banking sector and the financial system. Some of these areas were highlighted in the report of the IMF/World Bank Financial Sector Assessment Programme team that was concluding its field visit to the country just as I was stepping into the shoes of Governor. New rules had in the meantime also been released by international standard-setting

bodies e.g. those of the Basel Committee on Banking Supervision and the International Accounting Standards Board. Armed with these, we took measures to build confidence in the integrity of the banking system and encourage banks to improve their performance. We instilled more competition in the sector by opening up to new players as part of our efforts to reduce intermediation margins and provide a fairer deal to bank customers. And we continued to strengthen our regulatory and supervisory framework to align it with emerging international best practice resulting from the global regulatory reforms triggered by the crisis.

21. It may be appropriate here to comment *en passant* on the largest fraud to have ever been unearthed in the domestic banking sector, the MCB/NPF case, a financial scandal of the bank-within-a-bank type that came to light in 2003. It has been an eye-opener for the Bank, prodding us to step up the surveillance and supervision of financial institutions under our purview. This case still awaits resolution ten years later and the perpetrators are yet to be held accountable as the various associated cases laboriously wend their way through the legal process in domestic and British courts. This stands out in sharp contrast to the rapidity with which prosecutors and regulators in major money centres have reached settlement with several universal banks for a range of crisis-related misdemeanors and malpractices, with record fines. The glaring absence of an efficient banking resolution mechanism may be a brake on our attempt to transform our jurisdiction into an international money centre.

22. Another source of concern is the dominating presence of a couple of large complex financial institutions in our banking sector and their systemic importance – the so-called Domestic Systemically Important Banks. To mitigate the systemic risks that such institutions could pose to the system, I have urged those banks to reduce the complexity of their structures by separating their banking from non-banking activities. This will enable us to clarify the regulatory perimeter and assist in efficient resolution, should the need arise, without having recourse to taxpayers' money. In the same vein, we have encouraged branches of foreign banks operating in Mauritius to convert into locally-incorporated subsidiaries that would give us more effective control and greater ability to act independently in conditions of stress. We have met with some success on this front, and the process of conversion of the branch of a major foreign bank into a local subsidiary is at an advanced stage.

23. We raised some hackles when we moved to adopt what many considered an overly intrusive approach regarding governance at the level of bank boards. A major lesson learnt from the global financial crisis was the failure of board oversight. What happens in bank boardrooms is of vital importance for the smooth functioning of, not just of the bank concerned, but also the economy as a whole. We have brought major changes to our Guideline on Corporate Governance to prescribe rotation at board level and limit the tenure of board members to six years. Domestic realities and capacity constraints dictated a flexible approach to smooth the transition to the new regime.

24. Today, our banking sector is very vibrant, well-regulated, robust, profitable and increasingly transparent. There are new financial product offerings including Islamic banking

and forex futures. It attracts growing interest from investors – three new banks have set up shop in six years. Some of our banks have set up subsidiaries in the region, with more now figuring in the Top 100 African banks. Mauritius is one of the rare countries in Africa to be Basel-II-compliant and we are now ready to move towards Basel III. There are however a few signs that are less comforting and that need to be addressed. The sustained increase in credit growth in some specific sectors could be an early indicator of incipient asset bubbles. Also, the rise in non-performing loans noted during the year does not augur well. ***(More on this issue)***

25. **Developmental role of the Bank** In the aftermath of the global financial downturn, central banks assumed, in truth, a more central role as they stepped in swiftly to shore up their economies and restore confidence in the financial system. The Bank of Mauritius did not shirk its responsibility and jumped into the fray with a number of unconventional measures to support the economic and social development of the island as the effects of the crisis began to reach our shores. These included (i) the provision in December 2008 of a Special Foreign Currency Line of Credit of USD125 million for trade financing (ii) the extension of a preferential line of credit to small sugar-cane planters faced with a sharp reduction in their revenue, and (iii) our full support to the Small and Medium Enterprises Financing Scheme – a limited form of directed lending which was initiated by the Ministry of Finance to ensure that SME's had adequate access to bank credit. More importantly, the Bank introduced a Special Facility in Foreign Currency for an amount of €600 million to help highly-indebted economic operators, in the export-manufacturing and tourism sectors, suffering from the compression of margins in depressed market conditions, the weakness of export currencies, and the mismatch between their earnings in foreign currency and their debt in rupees. The Bank made a pre-emptive move to forestall any knock-on effects on the balance sheets of lending banks, which could have posed very serious risks to financial stability in view of some inherent characteristics of the local credit landscape relating to the interconnected nature of much lending — across borrowers, sectors, and banks — which presented clear contagion risks.

26. **Financial inclusion** Good supervision cannot be dissociated from the need to ensure that the best interests of consumers of financial services are protected. As far back as 2007, two flagrant areas where the consumer was not getting a fair deal came to my attention: the high interest rates on loans and opaque fees and commissions. One of my first actions was to request all banks to publish their principal interest rates, fees, charges and commissions, using a standard template to enable customers to better compare the cost of services provided. This took effect in November 2008. In the same spirit, the indicative exchange rates of individual banks are now published daily on the Bank's website for public information since September 2009. In 2012, I initiated work to impose a cap on fees and charges for services provided by financial institutions and actually imposed the maximum allowable margin for same-day trading of forex. I also established a Complaints Desk at the Bank and made it mandatory for each domestic bank to set up its own complaints desk. Furthermore, I instituted a *Task Force on Unfair Terms and Conditions in Banking and Related Financial Contracts* — this work is ongoing. ***(More on this issue)***

27. **A new communication culture** When I joined the Bank in 2007, I was struck by the very conservative manner in which the Bank communicated, mostly to a very limited and specialized audience. No wonder that few of our countrymen could grasp the essential functions that a central bank performs in an economy. This lack of understanding made the work of the Bank less effective because the public could not relate to it or understand that it was in fact their own interests that the Bank was meant to promote. So I decided to embark the Bank on a new communication drive — not without some misgiving from some quarters which saw this central bank activism as a transgression. In the past five years, I have made 80 local addresses, held more than 35 press conferences, and given innumerable press interviews and statements in both the local and international press. ***(More on this issue)***

28. The process of increasing our dialogue with a wider range of stakeholders of the economy brought many critical issues to light which enabled us to take several initiatives to respond to the identified needs. In the course of this transformation, the Bank was able to take more-informed decisions, and its visibility increased — as did the public's understanding of our various actions. Our web site has been upgraded and all information pertaining to the activities of the Bank are posted in real-time. In parallel, we launched financial literacy programmes to increase the awareness of our citizens to enable them to make better use of available financial products and of redress mechanisms available to them. ***(More on this issue)***

29. Let me here highlight the significant improvement in the quality, frequency, and timeliness of central bank statistics which since February 2012 have met the stringent requirements of the IMF's Special Data Dissemination Standards (SDDS). We are now engaged in the process to move to the even higher SDDS+ standard. (***More on this issue)***

30. **Regional cooperation and International visibility** I have long held the view that tiny Mauritius cannot unlock its full development potential without accelerating its integration in the sub-Saharan Africa region. I have pursued this line during my mandate at the Bank which saw our increasing participation in various fora under the auspices of SADC, COMESA and the AACB to advance the regional and continental integration agenda. In 2011, I had the honour to co-chair, on behalf of fellow-Governors, the two separate inaugural Joint Meetings between Central Bank Governors and Ministers of Finance for both COMESA and SADC. I also co-chaired the first meeting of the SADC Peer Review Panel in Mauritius in October 2011. In August 2012, I acceded to the Vice-Chairmanship of the AACB and the Bank will be hosting the 37th Assembly of Governors in August 2013. In February 2012, the Bank was invited to become a member of the newly-established Sub-Saharan Africa Regional Consultative Group of the Financial Stability Board. In October 2012, we successfully launched the Regional Payment and Settlement System of COMESA, which is hosted at the Bank. ***(More on this issue)***

31. **Way Forward** Over the past years, I have been constantly griping at the slow and long-drawn-out pace at which we are embracing change in much of the economy and in many of our institutions on which we depend to accelerate growth and development. It is widely recognised that we need to be quicker on our feet, more open to the process of innovation, more agile in exploiting alternative markets and new products and services, and much more willing to change our policies and procedures. Global economic poles are irremediably shifting to new centres in the East and to the South. Nearer to us, Africa is on the move. We must be quick to engage in the competition for the opportunities offered by the resource-rich, growing and more stable African continent. A higher growth path requires us to pay greater attention to international competitiveness. We must become more productive, shedding unnecessary layers of bureaucracy and ensuring greater probity in procurement, in both the public and private sector. Economic history, as embodied in the relatively recent Asian success stories, leaves no doubt about the importance of more efficient production and ease of doing business.

32. Our monetary policy strategy will continue to be guided by our primary objective of price stability and the promotion of orderly and balanced economic development. Central bankers worldwide continue to accumulate evidence that low and stable inflation allows all economic agents to make better decisions on savings and investment — the key conditions for sustained growth.

33. Going forward, we shall continue to ensure that monetary and exchange rate policy is formulated taking into consideration the interests of all stakeholders of the economy. While the fundamentals of the economy seem fairly strong for now, I am particularly concerned about the persistently high current account deficit, which mirrors a worryingly low savings rate. As our main export markets in Europe grapple with fairly bleak economic prospects in the foreseeable future, it is vitally important that we do not reduce our structural reform efforts to raise the productive potential of the economy and prepare for the heightened competition which we are likely to encounter on foreign markets as the recovery takes hold.

34. The Bank remains ever vigilant to potential risks to financial stability that could hamper our progress to another plane of development. On the regulatory front, we are moving forward with the implementation of Basel III. We shall introduce more stringent conditions, including higher capital requirements, as we step up our endeavours to address the risks posed by Domestic-Systemically Important Banks, whose failure might entail widespread consequences for the economy. Increasing access to financial services is a key priority for the regulator and I will take all necessary measures to ensure that consumers get a fair deal. The Bank is determined to keep a tight rein on bank charges and commissions, in the light of the report of the *Task Force on Unfair Terms and Conditions in Banking and Related Financial Contracts*, which I mentioned earlier. We concluded a lengthy process of consultation with both domestic banks and international regulatory bodies before finalising draft legislation on the Deposit Insurance Scheme which we submitted to the Ministry of Finance at the end of last year. We will pursue our efforts to deepen our financial markets.

35. **Concluding Remarks** As I look back upon my years helming the Bank, I am acutely aware of the weight of responsibility that comes with being called on to ensure financial and macroeconomic stability amid the extraordinary events of the past five years. I wish to thank the Prime Minister, Dr the Honourable Navinchandra Ramgoolam, GCSK, FRCP, for having given me this opportunity to serve the nation in this capacity. My thanks also go to the various Ministers of Finance with whom I always maintained cordial personal — although occasionally tense professional — relations, my Deputy Governors, the Head of Governor's Office, and other key staff-members on whom I relied to deliver on my mandate.

36. The past five years have been tumultuous, but as I mentioned in my acceptance speech when I received the "Central Banker of the Year 2012, Africa" award, I have always maintained an unwavering focus on the statutory mandate of the Bank. My aim has also been to rejuvenate the Bank by bringing in vital improvements in line with international best practice. After 45 years, I believe the Central Bank has reached a level of maturity where it can confidently play a key role, not only in maintaining confidence in the economy, but also in accompanying the country's progress to ever-higher levels of growth, development and welfare.

Yours sincerely

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The Mauritian Economy

6.1 A highly open economy like Mauritius recorded on average, 3.5 per cent annual growth in the midst of the global crisis, from 2009 through 2012. Inflation has been brought under control, standing at less than 4 per cent in December 2012. There were a number of reasons behind the resilience of the domestic economy and this favourable performance. The principal factors were the authorities' appropriate policy response, stemming from a high level of coordination between the Bank of Mauritius and Government, a diversified economic structure and a robust and well-regulated financial sector. The domestic labour market did not experience the severe deterioration witnessed in several advanced economies – the unemployment rate stabilised at around 8 per cent. Government pursued a prudent fiscal policy stance, which contributed to put on a downward trend the country's public debt to GDP ratio. The high and rising current account deficit which mirrors a low savings rate remains a matter of serious concern, as it implies a growing dependence on foreign flows to finance the country's external deficit.

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Monetary Policy

12.1 Various amendments were brought to the enabling legislation to improve the functioning of the Monetary Policy Committee (MPC), which was set up in April 2007.

a) In 2007, the responsibility for the formulation of monetary policy, which was previously that of the Board of Directors of the Bank, was vested in the MPC. Provisions were made so that the MPC would not be subject to the direction or control of any other person or authority in the discharge of its function and would be required to publish after the meeting the gist of the monetary policy decision.

b) Following the recommendations of Sir Alan Budd, the composition of the MPC and the number of members required to constitute a quorum were reviewed in December 2011. Provisions were made for a Code of Conduct to govern MPC meetings and to enable the Chairperson to authorize a member to participate in meetings and vote through teleconferencing. The functions of the MPC were also clarified and the accountability of its members was enhanced with the publication~~s~~ of minutes of the MPC meetings and the disclosure of individual voting pattern.

c) In December 2012, the MPC was reconstituted and the total number of members was reduced from nine to eight. Explicit provisions to improve the coordination of monetary and fiscal policy were made for the MPC to take into consideration the views of the Bank, MOFED and any other appropriate institution.

12.2 For Monetary Policy Statements released prior to December 2011, click at: https://www.bom.mu/?id=11029

12.3 For the Minutes of MPC Meetings click at: https://www.bom.mu/?id=72017

12.4 During the last five years, there have been 27 interest-rate-setting meetings. Out of these 27 interest rate decisions, the Key Repo Rate (KRR) was raised on 4 occasions, cut on 9 occasions and kept on hold on 14 occasions. The MPC succeeded in bringing down steadily the

12.5 Since 2008, the Bank publishes a bi-annual Inflation Report which provides an analysis of international and domestic economic developments and an outlook for growth and inflation.

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Exchange Rate Policy

14.1 In 2012, the debate on the value of the rupee intensified with the findings of the IMF Article IV mission that the rupee was slightly overvalued, which gave rise to further calls for rupee depreciation. Following the report of the IMF, the Bank came up in June 2012 with a programme to build up its foreign exchange reserves which contributed to resist further appreciation of the rupee.

14.2 The Bank took a number of initiatives that helped the domestic foreign exchange market and, by extension the economy, to fend off the impact of the global economic crisis:

a) In 2008, the Bank offered exporters the facility to purchase their foreign exchange proceeds if they encountered difficulties in selling them to banks. Two measures of nominal effective rupee exchange rate, MERI1 and MERI2 were introduced to better track exchange rate developments. In December 2008, in the midst of the international credit squeeze, the Bank made available a Special Foreign Currency Line of Credit to banks for an amount of USD125 million to facilitate trade financing.

b) In 2009, the Bank introduced short-term foreign currency swaps in USD, EUR and GBP for a target amount not exceeding USD100 million or equivalent to enhance liquidity on the domestic foreign exchange market.

c) In 2010, following the findings of the Forensic Report on alleged foreign exchange market irregularities, the Bank agreed to sell to the State Trading Corporation (STC), at its own request, foreign currency. The aim was to contain market volatility caused by STC's significant demand at various points in time. Accordingly, the Bank intervened actively on the domestic foreign exchange market to ensure a neutral approach.

d) In June 2012, the Bank introduced the Operation Reserves Reconstitution with the objective to build up foreign exchange reserves to six months' import cover as a more comfortable buffer against potential external shocks. The Bank also introduced a Special Foreign Currency Line of Credit to the tune of EUR 600 million to export sectors through banks to support enterprises facing a mismatch between their revenue streams in foreign currency and their rupee-denominated debt repayments, thus mitigating the potential knock-on effects on the banking sector and risks to financial stability.

e) In December 2012, the Bank, after consultation with banks, imposed a cap of 3 per cent on the spread between the bid and ask rates of the rupee against the three major currencies, namely USD, EUR and GBP. This was done to curb the widening of the bid-ask spreads of banks' indicative exchange rates. A wider margin is still accepted on other currencies that are traded in lower volumes.

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Modernisation of the Financial Market Infrastructure

15.1 The Bank in collaboration with banks embarked on a Cheque Truncation project in 2007, that is, the electronic clearing of cheques using scanned images and the data code lines of the physical cheques. Dr The Honourable Navinchandra Ramgoolam, GCSK, FRCP, Prime Minister, officially launched the Cheque Truncation System (CTS) in September 2011 in the presence of Honourable Charles Gaëtan Xavier-Luc Duval, Vice-Prime Minister and Minister of Finance and Economic Development. The CTS allows faster and more secure cheque clearing and provides value added services.

15.2 Along with the CTS, a Bulk Clearing System was implemented which enables the clearing of retail payment streams, providing banks with an essential tool to better manage their liquidity requirements while contributing towards lowering the cost of payments.

15.3 The CTS has now been fully rolled out and physical exchange of cheques has ceased since Monday 4 February 2013. Banks have been invited to further the clearing process by providing this facility at branch level so as to have a full-fledged truncation system whereby consumers can benefit from a reduction in the number of days taken to clear cheques. This will result in a quicker transfer of funds.

15.4 In December 2005, when the Mauritius Credit Information Bureau (MCIB) was established, participation was limited to banks. Between 2007 to date, the Bank proceeded to gradually optimise its capability and usefulness. The scope of the MCIB was thus extended to include all types of credit institutions operating in the economy, including the public utilities and all licensees under the Information and Communications Technologies Act. The MCIB currently covers around 630,000 entities with one million live credit records.

15.5 Amendments were brought to the Banking Act 2004 to provide a framework for licensing credit information bureaus and the recognition of external credit assessment institutions. The new legal framework allows the credit information stored in the MCIB to be imparted to other registered credit rating agencies.

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17.1 The Bank took measures to bring down the level of excess liquidity in the banking sector and deepen further the domestic financial market, which included:

a) Introduction of a Special Deposit Facility.

b) Regular issues of BOM securities – first restricted to the short-end of the maturity spectrum but progressively extended to medium-term maturities.

c) The conduct of separate auctions of BOM and Treasury Bills.

d) The widening of the corridor for the KRR from +/-50 basis points to +/-125 basis points; the introduction of Overnight Facility against collateral at 150 basis points above KRR, subject to a borrowing quota communicated to banks, as well as various changes to the Cash Reserve Ratio.

e) Issue of BOM instruments of longer maturities: 91-Day, 182-Day, 273-Day and 364-Day, 2-Year, 3-Year and 4-Year compared to 28-Day and 56-Day BOM Bills.

f) Introduction of an indicative reference rate, the Port-Louis Interbank Offered Rate, known as the PLIBOR, created in conjunction with banks and Thomson Reuters.

17.2 The Bank, as agent for Government, works closely with MOFED in formulating and implementing Government's Debt Management Strategy. A Cash and Debt Management Coordination Committee comprising officials from MOFED and the Bank was set up with the main objective of monitoring Government debt issuance. In this perspective, the Bank introduced new instruments like the Seven-Year and Fifteen-Year Inflation-Indexed Government of Mauritius Bonds, the 10-Year and 15-Year Government of Mauritius Bonds but discontinued the issuance of Government of Mauritius Bonds with maturities of 7, 13 and 20 years. In addition, in October 2011, Treasury Bills with a maturity of 273 days were introduced to provide banks with a wider range of short-term instruments for better liquidity management.

17.3 In November 2011, the Bank made a significant stride to enhance efficiency in the auctioning process by:

a) Introducing single maturity auctions of Treasury Bills to enable Government to determine its preferred maturity profile.

b) Discontinuing the issue of Treasury Notes of 2-Year and 4-Year maturities. As from January 2012, only 3-Year Treasury Notes are being issued.

c) Setting up of a web-based on-line auctioning system. The system, which is currently used for the auctions of Treasury Bills, will be extended to the auctions of other Government securities in 2013.

17.4 Over the past five years, the Bank devoted considerable efforts to developing the secondary market for short- and medium-term instruments:

a) In 2007, the OTC sales of Treasury Bills to individuals were resumed to stimulate savings and provide an additional investment outlet.

b) In 2011, the Bank, after consultation with banks, introduced a cap on banks' holdings of Treasury Bills in their banking books to break their 'buy-and-hold' habits and to promote trade.

c) The Bank, in association with the Stock Exchange of Mauritius (SEM) Ltd and the Central Depository and Settlement Co Ltd, embarked on a project to trade medium- and long-term benchmark bonds on the SEM. To this effect, the Bank started to carry out auctions of benchmark 3-Year Treasury Notes and 5-Year Government of Mauritius Bonds in 2012 to build up market liquidity in these securities. Once completed, the project will enable the daily pricing of these Government securities that could be used as benchmarks for other market instruments.

d) The Bank initiated actions to review the Memorandum of Understanding of the Primary Dealer System. The minimum amount per bid for any auction of Treasury Bills was increased to Rs15 million while the minimum weekly bid amount per week was set at Rs30 million with effect from 15 October 2012. The maximum spread between the buying and selling prices of Treasury Bills on the secondary market has been narrowed down to 20 basis points.

e) Discussions are currently being held with banks on a draft Memorandum of Understanding for trading of the securities on the SEM. Amendments were brought to the BOM Act to empower the Bank to provide the exit mechanism which is critical for the development of the secondary market.

17.5 The Code of Conduct for the domestic money and foreign exchange market is currently being reviewed and will be issued shortly.

17.6 In November 2012, the Bank launched the public sale of minted gold bars of 24 carat 9999 purity of 10g, 50g and 100g weights~~.~~ This aims to promote the savings culture in Mauritius and caters for the needs of economic agents looking for new opportunities for mid- to long-term investment. To increase the product's attractiveness and ensure its liquidity, the Bank offers a buyback option under certain conditions and safe storage in its vault, free of charge for the first year.

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Reserves Management

18.1 In 2011, the Bank made an important change to an existing accounting practice that had resulted in unrealised gains, arising from the valuation of investments held by the Bank to be accounted as income, and, therefore, distributable. The Bank of Mauritius Act was amended by inserting a new subsection (1A) in section 47 prescribing that any unrealized gains or losses in any financial year arising from changes in the valuation of investments held by the Bank, should be credited to or debited from the Special Reserve Fund. Therefore, as from FY11-12, such unrealized gains or losses are transferred to the Special Reserve Fund.

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Regulation and Supervision

24.1 Over the past five years, total assets of the banking sector expanded by 34 per cent, driven by Segment A business. Non-performing loans rose from 1.9 per cent of total gross loans (September 2007) to 3.1 per cent (September 2012). Private sector credit, excluding loans and advances extended to Global Business Licence Holders (GBLHs), registered a growth of 79 per cent (at end-November 2012). Deposits, the major source of funding accounting for 70 per cent of total resources of the banking sector, grew by 27 per cent. The growth of rupee deposits and foreign currency deposits was 66 per cent and 11 per cent, respectively. Banks' after tax profits increased from Rs9.2 billion for the year ended June 2007 to Rs15.4 billion for the year ended June 2012.

24.2 Four banks have been granted a banking license from 2007 to 2012, namely Afrasia Bank Ltd, ABC Banking Corporation Ltd, Century Banking Corporation Ltd and Banyan Tree Bank Ltd. Non-bank deposit taking institutions (NBDTI) were encouraged to convert into banks and consequently, one NBDTI, namely ABC Finance & Leasing Ltd, was converted into a bank in 2010. The number of branches of banks in Mauritius increased from 180 in October 2007 to 216 in October 2012. The number of ATMs registered a growth of 24 per cent from 352 in October 2007 to 437 in October 2012. Internet banking users went up by more than three-fold over the last four years. More banks extended their operations in Asia and Africa, and seven of them rank among the Top 100 Banks in Africa in terms of assets in 2012.

24.3 In 2008, a dedicated Basel II Unit was set up at the Bank to take forward the implementation of the Basel II framework, and in 2009, the Bank successfully implemented the standardised approach of the Basel II framework. Most banks operated above the minimum regulatory capital adequacy ratio of 10 per cent and are well-positioned to make the transition to the new Basel III capital rules. A consultation paper on the implementation of the Basel III framework in Mauritius was circulated to banks in October 2012.

24.4 On-site supervision of every bank and non-bank deposit-taking institution is conducted at least once every two years. Off-site surveillance has been improved by extending the coverage of prudential returns submitted by banks. The Bank has embarked on a project to automate the whole process of data compilation from its regulatees and on a Cash Dealers Monitoring System to capture, in real-time, the transactions of cash dealers.

24.5 The CAMEL Rating is the supervisory rating of the overall condition of a bank and consists of five elements, namely Capital, Asset Quality, Management, Earnings and Liquidity. It has been used since the beginning of 2004 to make periodic assessments of the overall condition of individual banks. During 2009, the Bank thoroughly reviewed the CAMEL rating framework to make it more reflective of the functioning of a bank. The CAMEL rating goes down if banks do not comply with guidelines, laws and directives including the Guideline on Corporate Governance. The disclosure of the overall CAMEL rating of individual banks was a *première* in Africa. Mauritius has been the first country in Sub-Saharan Africa to disclose publicly the overall CAMEL rating of individual banks.

24.6 15 Guidelines were issued by the Bank in the last five years, and ten guidelines have been revised during this period. They are available on the Bank's website at https://www.bom.mu (section on Legislation, Guidelines and Compliance)

24.7 Various amendments were brought to the BOM Act, *inter alia*:

a) To allow the Bank to enter into memoranda of understanding with any public sector agency or law enforcement agency to cooperate and share information; and to disclose confidential information to those agencies for the purposes of assisting them in the discharge of their functions.

b) To enable the Bank to impose administrative penalties on any financial institution it has licensed which has not complied with the provisions of any instructions or guidelines issued by the Bank under the banking laws.

c) To provide for the setting up of an *ad hoc* Review Panel comprising an independent Chairperson, appointed by the Minister of Finance and Economic Development, who shall be assisted by the Solicitor General and the Financial Secretary or their respective representatives, to provide a safeguard to licensees of the central bank who are aggrieved by a decision of the central bank regarding capping of fees or charges, and penalties imposed under the Act.

24.8 The Bank took several initiatives to promote Islamic Banking in Mauritius:

a) In November 2007, the Bank was admitted as an associate member of Islamic Financial Services Board (IFSB).

b) In June 2008, the Bank issued a Guideline for Institutions Conducting Islamic Banking Business.

c) In May 2009, the Bank hosted the *Seminar on Islamic Capital Markets*, organised by the IFSB.

d) In September 2009, the Bank was admitted as a full member of the IFSB.

e) In 2010, legislative changes were brought to the Bank of Mauritius Act 2004 for the Bank to promote the development of the derivatives markets as well as the Islamic money market through the issue of *Shariah*-compliant instruments.

f) In October 2010, it became a founder member of the International Islamic Liquidity Management Corporation (IILM), a supranational body created to issue benchmark Islamic liquidity instruments, after having participated in its establishment.

g) In September 2012, the Bank hosted the *Seminar on the Role of Islamic Finance in the Development of Africa* organized by the IFSB.

h) The Bank is currently engaged in the development of Sharia-compliant liquidity management instruments.

24.9 In 2007, the Bank initiated specific work on financial stability and macroprudential policy issues. To further reinforce the surveillance of the entire financial system, a *Protocole d'Accord* was signed with the Financial Services Commission for the establishment of a Joint Coordination Committee. In June 2008, the first Financial Stability Report (FSR) was published. A range of Financial Stability Indicators and the results of stress tests on the performance of the banking sector are disseminated through the FSRs. In 2011, the IMF invited Mauritius to join the Financial Soundness Indicators Reference Group, which operates under the auspices of the IMF, to assess the experience of countries in compiling and disseminating Financial Soundness Indicators and to improve their usefulness for financial stability analysis. The Bank achieved another milestone in February 2012, when it participated as a member in the first meeting of the Regional Consultative Group for sub-Saharan Africa of the Financial Stability Board, a group set up to exchange views on vulnerabilities affecting financial systems and to initiate action to promote financial stability taking into account the region's characteristics.

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Financial Inclusion

26.1 The mandate of the *Task Force on Unfair Terms and Conditions in Banking and Related Financial Contracts* is to examine the terms and conditions of contracts, including fees, charges and commissions, between a consumer and a financial institution to help both parties strike a fairer deal. This exercise was carried out with the participation of the public who were invited to submit their comments to the Bank. The Task Force is preparing a Public Consultation Document where proposals for reform will be made. All stakeholders will have a chance to comment on these proposals and put forward their views.

26.2 The Banking Act was amended in 2012 to provide for additional protection of customers of financial institutions and formalise the complaints procedures in banks and non-bank deposit taking institutions.

26.3 The Deposit Insurance Scheme which will provide better protection for depositors has reached the final stages. The Bank benefitted from technical assistance from the IMF, particularly in drafting the Deposit Insurance Scheme Bill which was submitted to the MOFED for vetting and subsequent introduction to the National Assembly.

26.4 On the occasion of the Bank's 40th anniversary in 2007, a silver commemorative coin was issued and in 2008 to mark the 40th Anniversary of the independence of Mauritius, the Bank issued a gold commemorative coin. A series of three platinum coins, the 'Father of the Nation Platinum Series' featuring, on the reverse, a portrait of the late Sir Seewoosagur Ramgoolam and on the obverse, major historical landmarks, were also issued.

26.5 The Bank, as the sole issuer of currency, is committed to offer better service to the public. In 2013, the Bank will introduce polymer substrate banknotes in a few denominations which have the advantage of increased durability compared to paper substrate banknotes.

26.6 The Bank laid down the foundation stone for a new building in Rodrigues.

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A new communication culture

27.1 The public addresses given by Governor can be accessed on the Bank's website. His addresses for 2012 are as follows:

(i) Address at the Future of Financial Markets Forum in Mumbai in January 2012.
(ii) Address at the SAID Business School at the University of Oxford in February 2012.
(iii) Acceptance Speech as Governor receives the "*Central Banker of the Year 2012, Africa*" Award from The Banker Magazine, in February 2012.
(iv) "*Responding to the US FATCA: Complain or Comply*" at the Seminar on Foreign Account Tax Compliance Act, organised by Grant Thornton Mauritius in collaboration with Grant Thornton UK and the Mauritius Bankers' Association, March 2012.
(v) Address on the occasion of the welcome dinner of the *19ème Conférence des Gouverneurs des Banques Centrales des Pays Francophones*, May 2012.
(vi) Address on the occasion of the expansion of *L'Agence de la Banque des Mascareignes*, July 2012.

(vii) "*We need to shine the torch of transparency on everything connected with banking*" at the opening ceremony of the Bank of Baroda Branch, July 2012.

(viii) Address at the signature ceremony of the Agreement between the Bank of Mauritius and the Mauritius Post and Cooperative Bank in respect of the First Disbursement under the Special Line of Credit in Foreign Currency, August 2012.

(ix) *"A Central Bank in search of Anti-Fragility"* at the gala dinner hosted by the Bank of Mauritius on the occasion of the second OMFIF in Africa, November 2012.

(x) *"Moving away from a 'Male, Pale and Stale' Boardroom"* during a workshop on Corporate Governance organised by the Mauritius Institute of Directors, November 2012.

(xi) *"Past Imperfect, Present Tense and Future Conditional"* - Address on the occasion of the Annual dinner in honour of the Economic Operators, December 2012.

27.2 All publications of the Bank are available on the following links

- For Inflation Reports, click on http://www.bom.mu/?id=74008
- For Financial Stability Reports, click on http://www.bom.mu/?id=709385
- For Annual Reports, click on http://www.bom.mu/?id=40498
- For Monthly Statistical Bulletins, click on http://www.bom.mu/Default.asp?id=72038

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28.1 In 2007, the Bank launched the Monetary Policy Challenge and essay-writing competitions for Form VI students and initiated talks and lectures by eminent economists at the Bank. Officers of the Bank participated in radio and television programs, and pamphlets and other materials on issues relevant to banking and finance were issued. In 2011, the Bank launched the Financial Literacy–Essay Competition for students of Forms IV and V and started an internship programme for university students and graduates to assist them in acquiring practical experience in central banking. For the results of the Essay Competition and the Monetary Policy Challenge, click at: https://www.bom.mu/Default.asp?ID=71861

28.2 Since 2007, the Bank's Corporate Social Responsibility programmes focused on financial literacy, the conservation of the environment and promotion of sports. One activity that features prominently on this Programme is the National Inter-Club Youth Championship. The latter is now a regular event in the Bank's calendar of activities and reached its sixth edition in 2012. It has been a breeding ground for future champions in international tournaments such as the World Youth Olympic Games, Youth Indian Ocean Island Games and Youth African Games. Lately, banks joined the Bank in sponsoring this event and their contribution is highly appreciated. The Bamboo Garden project is part of the Bank's contribution to 'Maurice Ile Durable' and is being undertaken in collaboration with the Agricultural Research and Extension Unit of the Ministry of Agro-Industry and Food Security.

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29.1 The Bank was admitted as a full institutional member to the prestigious Irving Fisher Committee on Central Bank Statistics in February 2010. Since February 2012, Mauritius became the 70th member country to subscribe to the IMF Special Data Dissemination Standards. Work is under way to adapt the BoP statistics compilation to the requirements of the IMF's latest Balance of Payments and International Investment Position Manual (BMP6) by 2014. The Bank has been invited by the IMF Statistics Division to share its experience on the compilation of offshore activities statistics as a case study to contribute to the BMP6 Compilation Guide.

29.2 The Bank signed a MOU with Statistics Mauritius on 4 March 2009 which sets out the framework of co-operation with regard to the collection and compilation of statistics and the sharing of information under conditions of confidentiality.

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Regional cooperation and International visibility

30.1 The Bank hosted a number of high-level international conferences during the past five years, which culminated last year with the *19ème Conférence des Gouverneurs des Banques Centrales des Pays Francophones* and the 2nd meeting of the Official Monetary and Financial Institutions Forum held in Africa.

30.2 The Governor was awarded the title of *Central Banker of the Year 2012, Africa* by *The Banker* magazine in recognition of the effective policies implemented by the Bank during the global crisis.

30.3 Since October 2011, the Bank houses the African Technical Assistance Centre (AFRITAC) of the IMF, which *inter alia* delivers training programs, workshops and seminars to the sub-Saharan region. The AFRITAC was inaugurated by Dr Min Zhu, Deputy Managing Director of the IMF. The activities of the AFRITAC will this year be complemented by those of IMF Regional Training Centre (RTC) for sub-Saharan Africa. The Bank had the privilege of welcoming Ms Christine Lagarde, Managing Director of IMF, at the Bank of Mauritius Tower in December 2012.

30.4 The events hosted by the Bank since 2007 have been listed out in previous Letters to Stakeholders. The 2012 events were as follows:

1. In April, the Bank hosted the meeting of the SADC Committee of Central Bank Governors (CCBG).
2. The *19ème Conférence des Gouverneurs des Banques Centrales des Pays Francophones* was held in May.
3. In August, the Reserves Advisory and Management Program (RAMP), an arm of the Treasury Department of the World Bank, held a workshop in Mauritius.
4. In September, the Bank hosted a seminar of the Islamic Financial Services Board on the role of Islamic Finance in the development of Africa.
5. In November, the Bank hosted the second meeting of the Official Monetary and Financial Institutions Forum held in Africa, after Pretoria, South Africa last year.
6. The Annual Dinner in honour of Economic Operators was held in December. The guest of honour was Professor Redrado, former Governor of the Central Bank of Argentina.

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