Statement from the Governor

In keeping with the long tradition at the Bank, I am pleased to offer some comments on the economic performance of the country during the Financial Year 2007/08 (FY 08) and a cursory review of the operations of the Bank. I will also touch on some of the steps which we have taken during the year to heighten the visibility of the Bank and enhance its operational efficiency.

The year has seen sustained economic activity with real GDP recording above-trend growth of 6.0 per cent, against 5.0 per cent in the preceding year. This was mainly driven by the commendable performance in the tourism and construction sectors. Most economic indicators improved and capital formation, excluding the purchase of aircraft and marine vessel, accelerated. Unemployment continued its decline from 9.1 per cent at end-2006 to 8.5 per cent in 2007 to stand at 7.2 per cent at end-June 2008. The budget deficit dropped for the second consecutive year reaching 3.3 per cent, compared to 4.3 per cent in FY 07, as Government pursued its fiscal consolidation efforts.

During the year under review, broad money liabilities grew by 17.1 per cent while bank credit to the private sector increased by 18.6 per cent, compared to 8.6 per cent and 10.0 per cent respectively over the preceding period. Inflation eased from 10.7 per cent in FY 07 to 8.8 per cent in FY 08 but inflationary pressures continued to be a cause of concern.

On the external front, the current account deficit widened to Rs22,224 million in FY 08, from Rs17,415 million in the preceding period. The deterioration reflected the rising merchandise account deficit. This was, however, partly offset by surpluses recorded on the services, income and current transfers accounts. The current account deficit was partly financed by higher Foreign Direct Investment (FDI) net inflows and an increase in other investment liabilities. Net FDI reached Rs8,597 million in FY 08 against Rs7,851 million in FY 07. FDI, mainly from the United Kingdom, Switzerland and France, went principally into the ‘Financial Intermediation’ and ‘Hotels and Restaurants’ sectors. The overall balance of payments, excluding valuation changes, showed a surplus of Rs9,110 million in FY 08, nearly 50% higher than the surplus of Rs6,603 million in the preceding period.

A strong and stable banking sector has been the hallmark of our financial landscape over the years. It has withstood shocks and turbulence and showed solid resilience. This comes essentially from the inherent strength of the balance sheets of banks, good risk-management practices and profitable operations on the back of a benign non-performing loan portfolio — aided, I must say, by well-structured regulatory and supervisory practices of the Central Bank.

While the banking sector in other parts of the world had started showing the first signs of strain triggered by the sub-prime financial crisis in the United States, banks in Mauritius continued on a robust growth path. Deposits grew by 23.4 per cent from Rs435,154 million at end-June 2007 to Rs537,077 million at end-June 2008. Advances increased by 17.0 per cent from Rs304,536 million to Rs356,316 million during this period. The banking sector's earnings were buoyant, with aggregate profits of banks going up from Rs9,247 million in FY 07 to Rs11,351 million in FY 08. To complete this rosy picture, the non-performing loans portfolio remained static at a low level of 2.4 per cent of total advances.

The banking sector witnessed a new entrant during the year, taking the number of banks to 19 at end-June 2008. Banks expanded their local and regional reach with additional branches enlarging the network from 178 to 186 branches. Our national banking network won accolades for being the third-best in the world, and the best in Africa, from the World Bank in its "Banking the Poor" study.

The implementation of Islamic Banking got closer to reality, with the issue of guidelines by the Bank and the amendment of tax legislation to create a level playing field. The move to Basel II was an important task on which the Bank was engaged. In collaboration with banks, the final guideline on Standardised Approach to Credit Risk was issued, paving the way for the eventual adoption of Basel II as the basis for capital-adequacy assessment, after an initial year-long parallel run.

The smooth running-in of the Monetary Policy Committee (MPC) was a challenging experience as members — from outside the Bank, and indeed in one case from outside the country — were entrusted with this new collective responsibility of weighing the risks to inflation and economic growth before determining the Key Repo Rate. As provided in the Bank of Mauritius Act 2004, the Bank publishes a Monetary Policy Statement after each MPC meeting to explain the main assessments and findings of the MPC. The Statement discloses the overall voting pattern of the MPC members. In line with the practice in many central banks around the world for heightened transparency and accountability in the monetary policy decision-making process, I have initiated consultations with a view to publishing the minutes of the MPC as well as the individual votes of members.

I believe that a better and fuller understanding of real-sector issues plays an important part in the policy and regulatory work of the Bank and in monetary policy decisions. I encouraged on-going consultations with private/real-sector stakeholders. I am pleased that the regular roundtable discussions, organised prior to every meeting of the MPC, with real-sector operators have proved invaluable to gauge their perceptions with regard to specific issues as well as to gain a better understanding of the external constraints which they might be facing.

In spite of the fact that central banks are interventionist by nature and design, I have tried, as far as possible, to limit our market interventions to market-supporting measures and allowed greater free play of market forces. In the domestic foreign exchange market, the Bank has intervened to smooth out unwarranted volatilities arising either from shortage or excess of foreign exchange. Between December 2007 and April 2008, the Bank was particularly active and intervened to purchase a total amount of USD 230.0 million, EUR 46.0 million and GBP 1.0 million. From May 2008 to June 2008, the Bank intervened again, but this time on the other side of the market, and sold a total amount of USD 45.0 million to alleviate excessive demand pressure.

In the domestic money market, to reduce excess liquidity prevailing in the market and to keep overnight interbank interest rates within the corridor around the Key Repo Rate, the Bank conducted a number of reverse repos and also issued Rs14 billion of Bank of Mauritius Bills. There seemed to be a disconnect between excess liquidity, as shown by forecasts from the Bank's model, and the bidding behaviour of banks for official paper. In an attempt to tackle the problem, a new facility in the form of a Special Deposit was established in November 2007.

In April 2008, I initiated a series of operational changes in our liquidity management to strengthen the Monetary Policy Framework. Auctions of Bank of Mauritius Bills which are issued for liquidity management purposes and that of Treasury Bills were thenceforth held separately. Moreover, in an effort to enhance market liquidity, improve the price-discovery process, and develop a more effective transmission of policy decisions, the Bank worked on plans to re-introduce over-the-counter sales of Bills and Treasury Notes to the public which was done on 24 July 2008.

The number of primary dealers was also increased from five to eight to spur more competition in the secondary market. Generally, the outcome of the measures to develop the secondary market has been fairly moderate but it constitutes a good basis to build on for the coming years.

The Bank was engaged in discussions with the Treasury regarding improving debt management and its eventual take-over of the debt management functions from the Debt Management Unit of the Ministry in July 2008. We will elaborate further on this in our next issue.

In the course of my official missions, I engaged in consultations with the Bank for International Settlements and the Sovereign Investments Partnership of the World Bank with a view to enhancing the return on our foreign exchange reserves. I am happy to say that both institutions have conducted their Peer Reviews of our portfolio management and submitted their recommendations which are currently being analysed for implementation.

I did not overlook the importance of having a structured collaboration and co-ordination between our two financial sector regulatory and supervisory bodies. A *Protocole D'Accord* was signed on 12 July 2007 with the Financial Services Commission. A joint Bank of Mauritius / Financial Services Commission Co-ordination Committee was also set up to activate and expand on the existing Memorandum of Understanding between the two bodies to consolidate the supervision of the financial sector and harmonise the regulatory framework. In the same vein, I am pleased to say we have very recently entered into a formal Memorandum of Understanding with the Central Statistics Office and I hope to elaborate on this new collaborative effort in the next Annual Report.

The Mauritius Credit Information Bureau, housed at the Bank, is the only borrower information repository in the country. It has contributed to lowering the proportion of non-performing loans. To provide a complete picture of borrower information, the Bank has eliminated minimum reporting thresholds since March 2008 and started work on expanding the coverage to non-banks, in particular leasing companies, the Mauritius Housing Corporation as well as insurance and finance companies. Again, this is a subject to which I shall revert in our next Report.

The Bank continued its active involvement in regional and international fora. As the reporting year ended, we were preparing to host the 7th meeting of Governors of the Eastern Africa Sub-Regional Committee of the Association of African Central Banks in July 2008. The Bank has also been deeply engaged in the Southern African Development Community (SADC) and the Common Market for Eastern and Southern Africa (COMESA) meetings, committees and workshops to achieve macroeconomic convergence, among other goals. The Bank holds the permanent chair of the Sub-Committee of SADC Banking Supervisors. The relationships with other central banks in the region were further reinforced when the Bank had the honour to welcome Governor Y.V. Reddy from the Reserve Bank of India and Governor P. Acquah from the Central Bank of Ghana to deliver memorial lectures.

It is the practice for Central Banks around the world to commemorate milestones in their history. The 40th anniversary year of the Bank of Mauritius coincided with the 40th anniversary of the independence of Mauritius and we decided to mark this special occasion with a series of activities spanning over a period of four months. The commemorative events started on 14 August 2007 and included a Charity Dinner to aid Epilepsy and Alzheimer associations, sponsorship of the national Inter-Clubs Youth Championships, a Blood Donation day, and the turning of the first sod for the establishment of a bamboo garden in the Midlands region — the latter perhaps an unwitting precursor of the visionary project *Maurice Ile Durable* that was unveiled later in 2008 by the Prime Minister, Dr The Honourable Navinchandra Ramgoolam. Some pictorial highlights of the commemorative events are included in this Report.

The Bank also initiated a Financial Literacy Programme (FLP) aimed at raising the level of awareness among the public about the roles and functions of the Bank and of the financial system in general. The FLP, which is expected to be an on-going programme, comprised such activities as an Essay-writing Competition, a Monetary Policy Challenge, a series of Memorial Lectures and a Consumer Education week. A Banknote Design Competition was launched in preparation for a new family of banknotes, and a special silver commemorative coin marking our 40th anniversary as well as a new twenty-rupee circulation coin were launched.

To respond to the challenges thrown up by a rapidly-growing and dynamic financial sector, and to do so with greater efficiency, the Bank engaged in a major restructuring of its internal organisation. The structure is now flatter, with the creation of new Divisions within the Bank. The move to the Bank Tower, our new premises, was completed during the year under review. Plans are in hand to convert the old building to accommodate a Knowledge Management Centre, an Auditorium, a Conference Room, a Museum and a Wellness Center for employees. The development of the Rodrigues branch was a priority for us as we have explored better ways of serving the community there. The foundation stone for a new building for our Rodrigues branch was laid on 24 November 2007.

I very much regret that this Annual Report is being produced so long after the statutory deadline of October 2008 – the net result of blind adherence to well-meaning, but clearly outdated, procedures and practices, which are crying out for modernisation if we are to avoid such Kafka-esque nightmares in future.

In closing, let me record my gratitude to the Prime Minister for his continued support since he called upon me to take up the position of Governor of the Bank. A special word of thanks also goes to the Vice Prime Minister and Minister of Finance and Economic Empowerment.

I believe that the Bank has a major contribution to make to the on-going policy dialogue with decision-makers and opinion leaders in re-shaping economic strategy and enhancing the economic prospects of our country. In this exercise, I rely a lot on the dedication and professionalism of a hard core of Bank staff, led by my First Deputy Governor. I take this occasion to thank them and their colleagues for the hard work put in during the year. I have a special thought for the many staff members who retired from the Bank's service during the year, in many cases, after having served it since it started operations.

I also wish to express my thanks to all those who have contributed to the fulfilment of our mission during the year and add a special note of thanks to Chief Executives of banks, of other financial institutions, and of the Mauritius Bankers Association for their collaboration and continued support in our joint effort to raise the profile of Mauritius as a respected international financial centre. Furthermore, I wish to thank members of the Board of Directors and express my appreciation to Directors, Mr A. A. A. R. Sohawon and Mr D. A. Moodely, whose term expired in September 2007, for their dedicated service to the Bank.

At the helm of the country's Central Bank, I can assure you that the Bank will continue to play its indisputable role in promoting the economic welfare of the country.

Rundheersing Bheenick

8 July 2009