Letter to Stakeholders

3rd February 2009

Dear Stakeholders

As we begin 2009, every central bank Governor around the world must be asking himself whether the worst is over yet. Except for a few *über*bears and habitual doomsayers, no one anticipated the troubles of 2008. Now that we are caught up in a global slowdown, with most of the major economies actually in recession, we have new concerns. What are the prospects for 2009? Will the bail-out work? Why has Mauritius so far escaped the wreckage of financial systems and banking around the world? Shall we see the end of the crisis this year and if so, when?

The lessons are becoming clear and I believe it is possible to reshape the global financial system to make it do its job again in promoting development, growth in jobs and the relief of poverty. I am hopeful that the global economy will emerge fitter from this crisis. But there are no quick fixes. The ability of Mauritius and other small states to elude the immediate impact of the crisis can be put down to two broad factors; first: avoiding the worst aspects of global credit delinquency through appropriate banking regulation and supervision; second: stability and probity in accounting and banking methods, recognising risks for what they are, and reducing exposure to potential losses, rather than grabbing gold-plated opportunities for making a fast buck.

In 2007, we launched a new strategy for communication which culminated in the *End-of-Year Letter to Stakeholders*. The essential idea here is to share with you the experiences of the Bank of Mauritius, the highs and lows of the year, and also to bring to you the outlines of our future policy. This year, we continue with this tradition.[1] We present a review of developments in the banking sector in 2008, discuss some of the initiatives taken by the Bank and adumbrate a foggy outlook for the year ahead.

The year 2008 has been unprecedented in global banking history and this has deeply affected the pattern of our work at the Bank. It began with massive inflows of foreign exchange powered by portfolio flows, investments in IRS projects and gilts, causing our currency to appreciate significantly. The second part of the year saw global currency movements and the scaling down of investments by foreigners. We closed the year with a reverse situation. Between these two extremes, the Bank navigated sometimes in rough seas but despite the storms, the Bank and its many partners have consolidated the financial sector by keeping a steady course and taking some exceptional measures to protect our economy from the effects of the global turmoil.

[1] We are presenting this letter in a new computer-friendly format. Sections are segmented into principal points and detail. You can either navigate to the detail by clicking on the access points or skip the detail and read on. We hope that this will help in finding the points of special interest to you.

At the Bank, we have stepped up our vigilance and taken prompt action to sustain investor confidence and long-term financial stability by tasking a special multi-divisional cell, comprising senior officers from various disciplines, to monitor closely the evolution of the crisis.

In the midst of all these uncertainties, I must admit we have also been lucky. Our banking system has been steady and stable throughout the year, maintaining strong capital buffers and high solvency ratios, all of which have ensured its resilience. The judicious lending and investment practices of our banks have protected them from exposure to the toxic assets and complex derivative products fatally linked to the US sub-prime credits and the over-valuation of real estate. A key element in the soundness of our banking practices has been our greater reliance on deposit funding rather than on money market or external funding. These classic and simple safety measures have kept us relatively unaffected by the global financial crisis.

If banking has remained safe and secure in Mauritius, what can we say of the wider aspects of the domestic economy? Or, in U.S parlance, what about Main Street?

Mauritius has not of course entirely escaped the spillover effects of the global crisis on the real economy. Indeed, the impact is becoming increasingly visible. We are witnessing a slowdown in levels of production and investment in Mauritius. This will have knock-on effects on banking activities and there will be need for a revaluation of assets that are pledged as security. Yet, the strong performance of our banks during the past year, their solid deposit base, their low level of non-performing loans, and the continuous monitoring of all banking matters under the watchful eye of your Central Bank, comfort us in the view that we are well-placed to confront the anticipated levels of external shocks that our wider economy will face.

(Click here for further details on Performance of the Banking Sector)

In the second half of 2008, the Bank has been working closely with the Treasury to respond to the unfolding global crisis and further buffer the domestic economy. The Additional Stimulus Package announced by Government in December was prepared in consultation with the Bank as part of the closer policy dialogue between the Bank and the Ministry of Finance. Furthermore, in response to tight liquidity conditions in global credit which might have exerted an adverse impact on the cost and availability of short-term trade finance, the Bank took pre-emptive action by making available a Special Foreign Currency Line of Credit of US$ 125 million. This allowed local banks to maintain the flow of credit for international trade, which is a vital lifeline for an open economy like ours.

Regulation and Supervision
The flaws in the national regulatory systems of the major economies have been cruelly exposed by the global crisis and its attendant financial scandals. Effective and timely regulation, built on prudent, transparent and sound supervisory practices, must be at the heart of a stable financial system. In the course of last year, the Bank reviewed its supervisory structures and revisited most of its regulatory guidelines to ensure that the supervision of the banking sector remains ahead of the game and meets a high standard when gauged by international norms.

(Click here for further details on Supervisory issues)

The Bank has been actively engaged in both on-site and off-site supervision of banks. The objective is to strengthen our system-wide approach to supervision and to prevent any spillover into the system of any specific risk from individual banks. The exercise includes cross-border banks, that is, subsidiaries as well as branches of banks outside Mauritius. This is done through a mechanism of cooperation and information-sharing with home and host supervisors.

(Click here for further details on Memoranda of Understanding)

Financial Stability
Enhancing financial stability became a core task in 2008, and in this area, the Bank took two important steps during the year. First, the Bank ensured closer coordination with the Financial Services Commission through the new Joint Coordination Committee (JCC). The enhanced collaboration helps to avoid regulatory gaps and the JCC will improve cooperation on supervision, by establishing a lead regulator for each financial institution. The second initiative in the pursuit of financial stability is the publication of the Bank's very first Financial Stability Report (FSR) in line with an explicit requirement of our enabling Act. As I mentioned in the Foreword of the FSR, '*The Financial Stability Report provides a useful communication tool about existing and potential future risks to financial stability and can serve as a means of focusing efforts to mitigate the key risks*.' The FSR identified certain areas of vulnerabilities and proposed specific measures. It also unveiled the Mauritius Exchange Rate Index to track the average value of our currency against currencies of our trading partners. The FSR will be published twice a year.

(Click here for details on the Mauritius Exchange Rate Index)

Basel II
Notwithstanding some weaknesses in Basel II which have been brought to the fore by the global crisis, the Bank endorses the stand of the Basel Committee on Banking Supervision for a prompt implementation of the Basel II framework with its increased sensitive measurement of risks and enhanced market transparency.

The Bank issued various guidelines required for the implementation of the standardised approaches of the Basel II framework. The way was thus cleared for the Basel II framework to become operational as from the quarter ending 31 March 2009.

(Click here for the January 2009 Communiqué on Basel II)

Islamic Banking and Islamic Money Market
In 2008, we made significant progress in the introduction of Islamic banking in the country. We issued guidelines on Islamic banking after a process of intensive consultation through a multi-disciplinary sub-committee which the Bank spearheaded.

The *Guideline for Institutions Conducting Islamic Banking Business* became effective at end-June 2008, and amendments were brought to the Income Tax Act and other relevant Acts to take into account the specificities of Islamic banking. The Bank approved two Islamic Banking applications and we expect these institutions to start operation soon. One of these entities is headquartered in the Gulf region.

The Bank has recently embarked on another major project, the development of an Islamic money market and liquidity management framework. This will allow Islamic banking institutions to conduct interbank transactions for the management of short-term liquidity and have access to Sharia-compliant money market products. The Bank is working closely with the Islamic Development Bank in this respect. In May this year, we shall be hosting an international seminar on Islamic Capital Markets in collaboration with the Islamic Financial Services Board.

AML/CFT Measures
The maintenance of our reputation as a clean financial centre continues to be one of our priorities. The Report of the Joint World Bank–IMF Financial Sector Assessment Programme (FSAP) mission of 2007 commended the Bank on its Anti-Money Laundering and Combating the Financing of Terrorism regime.

(Click here for excerpts of the FSAP Report on Money Laundering)

Reinforced Regional Presence
I have always been a firm proponent of regional economic cooperation as I believe that building ties with other countries in the region is vital for a small country like Mauritius. In 2008, we have seen much progress on this front.

Following a decision of the COMESA Committee of Governors of Central Banks (Tripoli, Libya, November 2007), the Bank was appointed to act as the settlement bank for the Regional Payment and Settlement System (REPSS) of the COMESA Clearing House to allow cross-border payments between COMESA member-states. In April 2008, the Bank organised a workshop for all COMESA central banks on the functioning of the REPSS.

During the year, the Bank also hosted the Eastern Africa Sub-Regional meeting of Governors of the Association of African Central Banks and facilitated the Board Meeting of the African Export-Import Bank, which was held in Mauritius.

The global financial crisis also brought African Central Bank Governors together to explore the way forward.

- I attended the meeting of African Ministers of Finance and Governors of Central Banks (Tunis, November 2008), which was convened jointly by the African Development Bank, the African Union, and the United Nations Economic Commission for Africa, to assess and exchange notes on the evolving situation and to identify measures that could effectively be taken. At the end of the meeting, I was privileged to join a handful of Ministers/Governors in a teleconference with the US Treasury on the eve of the first G-20 Summit in Washington on the global crisis.
- In December I attended the meeting of francophone Governors which the Banque Centrale de L'Afrique de L'Ouest hosted in Abidjan to examine the impact of the crisis on the countries of the African Francophone Group at the IMF and the World Bank.

The comparative performance of our country in the region was very creditable, as illustrated for example, by the World Bank's 2008 '**Banking the Poor Report'**. Mauritius is the league champion in terms of financial access with over 2000 accounts per thousand adults. We came third, behind Malaysia and Singapore, in this global survey. This publication, which explores associations between banking policies and practices with the level of financial access in the selected countries, had its world-wide launch at the Bank of Mauritius Headquarters in November 2008.

Monetary Policy
The exceptional capital inflows at the beginning of 2008, to which I alluded earlier, put significant pressure on monetary matters for our small economy. They cause the rupee to appreciate and fuelled the rising rate of price inflation, already affected by the unprecedented spike in oil prices and the steady increase in prices of food and commodities. The Bank was therefore confronted with the combined challenge of combating inflation and preserving the competitiveness of the export-oriented sectors. The Monetary Policy Committee (MPC), normally set to meet on a quarterly basis, met eight times in 2008 with interim meetings having to be called to deal with rapidly-changing conditions.

(Click here for further details on the work of the Monetary Policy Committee)

With rising inflation, the Bank continued with its tight monetary policy in the first quarter of 2008. Unpredictable developments on the international scene in the second quarter, coupled with our own projected inflation, compelled the Bank to ease its stance a little in the second quarter. An expansionary budget, handed down in June 2008, coupled with a generous wage-award for the civil service which raised the spectre of wage push inflation, further complicated the situation in the third quarter before currency volatility, stock market nervousness, financial turmoil and the global economic slowdown threw things in complete disarray in the last quarter. Policy actions were coordinated with Government. During 2008, the Key Repo Rate was cut by a total of 250 basis points to stand at 6.75 per cent at the end of the year.

(Click here for evolution of the Key Repo Rate in 2008)

The decisions of the MPC, which are taken by simple majority, became mired in controversy. This, in turn, provided fertile ground for lobbyists and other pressure groups to seek to influence outcomes in their favour.

In addition to the interest rate decisions of the MPC, the Bank had recourse to other tools to respond to abnormal monetary and credit conditions. Owing to structural excess liquidity in the system, the overnight rate had remained persistently outside its set limits (the corridor) since the framework was introduced in December 2006. The Bank increased the Cash Reserve Ratio (CRR) from 4 per cent to 6 per cent in August. This resulted in the rate falling rapidly back within the limits of the corridor. However, in view of the rapidly-changing global environment, the Bank subsequently reduced the CRR first to 5 per cent and then to 4.5 per cent in December, to ensure that the system had sufficient liquidity. Another measure that I considered necessary in the circumstances was the widening of the corridor from the symmetric band of 50 basis points to a band of 125 basis points around the Key Repo Rate.

(Click here for further details on other measures aimed at strengthening the Monetary Policy Framework)

When we compare with many other emerging economies, which are as dependent on imports as Mauritius, we have little reason to be too unhappy as we have managed to keep inflation at reasonable levels. And this year, we have the extra burden of having to counter the knock-on effects of the global economic slowdown on Mauritius, especially on our export-dependent sectors such as tourism and manufacturing.

To deliver on our mandate to fight inflation, the Bank invested resources in capacity-building. In July 2008, the Bank hosted a regional seminar on Inflation Targeting, Modelling and Forecasting, in collaboration with the Centre for Central Banking Studies of the Bank of England (CCBS). Held at the Bank's

Headquarters, and attended by central banks in the region, the seminar set a new attendance record in the entire history of the CCBS.

We also published our first Inflation Report in November, to fall in line with a requirement of the Bank of Mauritius Act 2004. This report retraced the historical pattern of inflation in Mauritius, and offered valuable insights into the critical factors affecting fluctuations in prices, which may serve as a guide for the future. We intend to publish Inflation Reports twice per year.

Domestic Debt Management

An important development in 2008 was the take-over of debt management functions, both Domestic and External, from the Debt Management Unit of the Ministry of Finance and Economic Empowerment. The new arrangement, which took effect from 1 July 2008, under an agreement reached by the Bank with the Ministry of Finance and Economic Empowerment, also requires the Bank to advise on the debt management strategy. Jointly with the Commonwealth Secretariat, the Bank organized, at the end of 2008, a two-week Workshop on Debt Recording and Management for staff members of the Bank, and officers from both the Ministry of Finance and Economic Empowerment and the National Audit Office.

Domestic Foreign Exchange Market

During 2008 there were erratic movements in the foreign exchange market. This reflected rapid and substantial global fluctuations. The Bank intervened regularly on the market and by the end of the year, we succeeded in significantly dampening volatility.

(Click here for further details on Intervention on the Foreign Exchange Market)

There have been different views, some quite vociferous, on how “weak” or how “strong” the rupee should be, depending from which side of the market one is operating. Any orchestration of demand for a central-bank-led depreciation of the Mauritian Rupee fails to appreciate the serious ill effects of a highly devalued currency for a small import-dependent open economy like ours. Its consequences could be disastrous if a self-accentuating expectation is fuelled with instant pass-through into domestic inflation.

The Bank believes that both sellers and buyers should get a fair price. One way of achieving this is by reducing the cost of intermediation. The Bank has been addressing this in two ways. First, the Bank has agreed to buy and sell foreign currency directly in a structured manner from/to those in the market that have, or require them, in large quantities. Second, with a view to spurring greater competition, the Bank issued licences to 14 new Money Changers and one Foreign Exchange Dealer on a revised set of conditions.

Whilst the Bank does not target any specific exchange rate against any particular currency and is not itself in a market-maker, we do have a key role in market management. This is a matter of continual review by the IMF which commented favourably on the functioning of our interbank foreign exchange market in its 2007 FSAP Report. We can say that the foreign exchange market has functioned well in 2008.

(Click here for excerpts on Exchange Rate from the IMF)

Changes in our financial landscape
The year 2008 witnessed some significant reshaping of the banking scene in Mauritius. Two banks had new shareholders and two others merged into one, leading to three new names being added to the list of operating banks, while four were de-listed. Whereas the current trend worldwide is to effectively nationalise banks as part of the response to the credit crunch, in Mauritius we have the reverse situation – the public sector selling its majority interest in one of the banks to private sector operators.

Strengthening of interaction with the banking industry
At the apex level, collaboration between commercial banks and the Bank occurs through the quarterly Banking Committee meetings in which Chief Executives of all banks and the Mauritius Bankers Association (MBA) participate. The Banking Committee is not confined to supervision and regulation alone but covers the entire gamut of issues relating to banks. I have increased interaction with the banking industry since June 2008 when I initiated meetings with the Bureau of the MBA, comprising the Chairman, the two Vice-Chairmen and the Chief Executive, in-between the regular Banking Committees.

The Banking Committee operates a number of sub-committees to examine certain areas in detail – compliance, treasury and payments system.

Information Technology
Banking technology has been evolving rapidly and has become a key driver of financial sector efficiency. On the technological front, the Bank has embarked on various projects which are at different stages of implementation:

- The Cheque Truncation Project
- The Mauritius Automated Clearing and Settlement System
- The Regional Payment and Settlement System
- The Mauritius Credit Information Bureau

(Click here for further details on Information Technology projects)

Towards a more modern and efficient Bank
In 2008, we have moved to a new building, the Bank of Mauritius Tower. This has been a key element in the transformation of the work of the Bank now that it is properly housed and equipped with advanced information and communication technology.

(Click here for further details on the New Headquarters Building and the Regional Office in Rodrigues)

The Restructuring
A modern and efficient institution requires a workforce that has the requisite skills and knowledge. In 2008, we rejuvenated and strengthened the workforce by recruiting additional staff and promoting others in some critical functions of the Bank. To meet the need to constantly upgrade and develop skills, more than 50 officers, out of a total professional staff complement of around 125, were sent on training courses abroad. These covered a wide range of topics, such as Monetary Policy, Payment and Settlement Issues, Supervision, and Accounting and Auditing for central banks. The programme of continuing education and training will make further progress in 2009 with a special focus on International Financial Reporting Standards.

In 2009, we are organising a calendar of in-house training sessions for all levels to make the Bank an organisation in which staff are multi-skilled, flexible, adaptable, innovative and able to think laterally. Some of the courses include customer care, executive programmes for effective management and leadership, efficient communication and a better understanding of applicable law, including the Bank of Mauritius Act itself.

This year we are also targeting our Rodrigues Office for special attention. The staff will have the chance to come to the head office at regular intervals on induction courses to involve them more in the development of the Bank's operations and functions.

Bank charges – shop window for customers
Many people have complained to us about the variations in charges between banks and the difficulties in finding out what they are. This is where a central bank can help to make banking easier for the customers we all serve. We have addressed this issue during the year. Since, November 2008, information on the fees and charges relating to normal services are available, on a standard comparable template, to all customers online at http://bom.intnet.mu

Launching of Commemorative Gold Coin
To mark the 40th anniversary of the independence of Mauritius, the Bank launched a limited edition of a Commemorative Gold Coin to pay tribute to the Father of the Nation, Sir Seewoosagur Ramgoolam. The Prime Minister attended the launch event. This gold coin proved to be the fastest-seller in the Bank's

history. The whole edition was sold within a week. In 2009, we plan to launch a ‘Father of the Nation’ platinium series.

Future Projects

The Bank’s Financial Markets Function

In keeping with our modernization plan of the financial system, I will continue to encourage the development of a vibrant futures and forward market. By mid-February 2009, the Bank intends to move away from paper-based auctions of Government securities and Bank of Mauritius instruments to online auctions.

Since I joined the central bank, it has been my aim to improve the returns on our foreign exchange reserves. When I attended the International Monetary Fund/World Bank Annual Meeting in 2007 and the BIS annual meeting of Governors last year in 2008, I engaged in consultations with those bodies for a peer review of our reserves management function.

In June 2008, a team from the World Bank Treasury’s Sovereign Investment Partnership (SIP) conducted an on-site peer review of our reserve management operations. In September 2008, the BIS, which manages a part of our foreign reserves, conducted a similar review as well as an evaluation of our investment and risk-control processes. The recommendations of the BIS and SIP are under study and appropriate changes will be made to our Financial Markets operations. We will, at the appropriate time, revisit our accounting, provisioning and profit allocation policies, in consultation with our shareholder, the Government of Mauritius.

We envisage to recruit an expert with international experience in financial markets to give effect to the changes that we shall be introducing.

Special Data Dissemination Standard

In 2009, we shall graduate from the current General Data Dissemination System of the IMF, in which Mauritius has been participating since September 2000, to the Special Data Dissemination Standard. This will enable us to meet the needs of global financial markets in the provision of timely and quality macroeconomic data. We are committed to develop the quality of data in the areas where the Bank has responsibility within our national statistical system.

We are improving the coverage of the balance of payments and the international investment position through the conduct of surveys of the Global Business Licence Holders. The Bank has enlisted the collaboration of the Financial Services Commission, our sister regulator, in this exercise.

(Click here for further details on General Data Dissemination System and Special Data Dissemination Standard)

Ombudsperson for banks

I am confident that in 2009, the Bank will proceed with the appointment of an Ombudsperson for banks. As I have said on many occasions, for a small country of our size and the expected workload, a single Ombudsperson for the entire financial services sector would have been more appropriate so that the customer does not face jurisdictional issues.

Financial Literacy and Outreach Programme

We started a Financial Literacy and Outreach Programme when the Bank commemorated its 40 years in 2007. In 2008, talks were delivered by eminent financial sector personalities, including Central Bank Governors. Dr Guy Quaden, the Governor of the National Bank of Belgium, spoke on "The First Ten Years of the Euro. Achievements. Challenges. Lessons for Other Parts of the World". We also recently had a lecture on "Applicability of International Financial Reporting Standards to Central Banks" by Mr Ian Ingram, Director of Internal Finance from the European Central Bank.

The Bank also organised programmes in local languages on the local radio/television. The Bank intends to make such programmes a regular feature.

I thought I should mention here that the Bank does not have a specialised unit to take care of communications, events and functions. All events hosted by the Bank are co-ordinated by the Governor's office and organised by Staff who volunteer for the assignment.

Meetings attended by the Management

The Governor and the Bank's two Deputy Governors, the Chief Economist and the Head of Corporate Services attended a wide range of international meetings and seminars in 2008, as part of the remit of the Bank for furthering international contact and for keeping abreast of international developments with a view to improving the effectiveness and efficiency of our services.

(Click here for further details on Participation in International Meetings and Seminars)

Very sadly, 2008 witnessed the tragic loss of one of Mauritius' most reputed bankers, Mr Anil Guness, who died in the terrorist attacks in the Taj Hotel in Mumbai in November 2008 in the same week in which he last came to the Bank to attend our Banking Committee meeting. We shall miss his wise counsel and the sound judgments he brought to the work of the State Bank and within the banking sector in Mauritius and beyond.

Finally, I must emphasise that both the Management and the Board are strong in their resolve to take the Bank of Mauritius to greater heights in the days to come.

If we are to achieve our objectives, we need sufficient autonomy to do so, built on a close working relationship with the Government to ensure our polices and actions are complementary in our joint pursuit of economic and social development in this country.

2008 has been a year that will go down as a turning point in the history of global banking and finance.

Even, as the Bank wishes a very happy and prosperous year to all our stakeholders, we must all be conscious of the trials and travails that lie ahead in 2009, a year that could prove still more turbulent as the global crisis may very well intensify further. In 2009, the Bank needs to continue to be alert to the global financial and banking volatility and must be especially vigilant in protecting our interests and judiciously managing our reserves. No country has been immune to the crisis, but as light craft can in safe hands weather a storm, so this small, vulnerable and highly open economy of Mauritius may be buffeted but will maintain course and shall not be sunk.

The Bank of Mauritius will do all that is possible to ensure a safe passage through these difficult times in matters of banking and financial policy and practice.

Best wishes for 2009.

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LINKS

Performance of the Banking Sector

(Period covered in this section is October 2007 to October 2008, except where indicated otherwise)

The performance of the banking sector in terms of balance sheet growth, financial strength and profitability has been quite satisfactory. The main highlights are given below:

- The consolidated balance sheet of banks recorded a growth of 13 per cent from Rs 670.23 billion to Rs 758.95 billion. While deposits registered a growth of 13 per cent, advances rose by 29 per cent. Their liquid assets also grew by 26 per cent
- The sector-wide Capital Adequacy Ratio was 14.7 per cent as at end-September 2008
- All banks met the minimum capital adequacy requirement of 10 per cent under Basel II at the end of the year
- The aggregate profits of the sector posted a healthy growth of 22 per cent
- Return on equity improved from 22.8 per cent, as at June 2007, to 24.1 per cent by June 2008 while return on assets rose to 1.9 per cent at June 2008 from 1.7 per cent at June 2007
- As at end-September 2008, the ratio of non-performing loans to total advances was quite low at 2.1 per cent. The provision held covered 66 per cent of the non-performing loans
- The Segment B business—that is, activity that is essentially directed to the provision of international financial services that give rise to foreign-source income—representing 65 per cent of total banking sector assets, recorded a growth of 9 per cent.

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Supervisory Issues

The Bank revised its guidelines and guidance notes to banks and issued new guidelines to meet the following objectives

- Implementing the FSAP recommendation to make the guidelines legally rigorous

- Facilitate implementation of Basel II

- Introduce principle-based supervision in non-core activities like advertisement or providing functional autonomy in commercial decisions that were being referred to the Bank on case-by-case basis

- Cater for introduction of new activities like Islamic Banking

The more important revised/fresh guidelines issued include

- Guideline on the standardized approach to credit risk under Basel II
- Guideline on concentration of credit risks
- Guideline on operational risk
- Guideline on public disclosure
- Guideline on control of advertisement
- Guidance Notes on AML/CFT
- Guideline on Islamic Banking.

The guidelines are available at http://bom.intnet.mu.

Several other guidelines are under review and include those relating to management of liquidity, corporate governance, IT- enabled services, etc.

We have enhanced off-site surveillance by expanding coverage of the prudential returns submitted by banks to enable a better analysis. Further, the format of the Annual Trilateral Meetings with the management of banks and their external auditors has been revised to make them more efficient. Future plans in the area of supervision include:

- Upgrading the CAMEL rating system, the supervisory rating of a bank's overall condition based on various components, viz., **C**apital adequacy, **A**sset quality, **M**anagement, **E**arnings and **L**iquidity
- Introduction of Supervisory Review Process in accordance with the Basel II requirements.

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Extract from Financial Stability Report, June 2008

Effective Exchange Rate of the Rupee

Mauritius is a small open economy which is affected by movements in the domestic exchange rate against various foreign currencies and the path of the rupee against the trading currencies will determine the consequences on the economy. It is important that an exchange rate index is calculated based on the several bilateral exchange rates that apply to a particular currency in order to gauge the average value of that currency against others. The index excludes mistaken generalisations that can result from changes peculiar to a single currency. A weighted-average measure of the relevant bilateral exchange rates has been computed to build an 'effective exchange rate' (EER). The computation of the proposed effective exchange rate index of the Bank of Mauritius, which will be known as the MERI (Mauritius Exchange Rate Index) is described. Since two indices are being suggested, they will be termed MERI1 and MERI2. The Bank may, in future, introduce various other measures of an exchange rate index reflecting specific concerns for various sectors of the economy.

Constructing the EER: To build any EER, the following issues need to be addressed: (i) the choice and number of bilateral currencies to include, (ii) a measure of international trade to use to weigh these currencies, (iii) the use of bilateral or multilateral exchange rates, (iv) the use of arithmetic or geometric weight, and lastly (v) the base year for the index.

Which Currencies: This choice has been influenced by the importance of the currency distribution of trade flows of Mauritius with the rest of the world. While there are some merits in including services, given that Mauritius is rapidly developing into a services economy, data constraints prohibit the use of all services traded to be included in deriving the currency distribution of services traded. Nonetheless, some of the foreign exchange flows emanating from the services traded are considered. Tourist arrivals are available by country of residence, and a currency distribution of tourist receipts can be proxied using the total receipts based on the strict assumption that tourists would obviously pay for their expenditures using the currency of their respective countries. While this assumption is quite debatable, it nevertheless provides for a rational proxy.

Choosing the Measure of Trade: Traditionally, most EERs are weighted by some measures of traded goods and services, the sum of exports plus imports. The total trade of goods, that is, the sum of exports and imports of goods, has been used to derive the weights for the MERI1. The weights for MERI2 have been calculated using the total trade of goods and a proxy derived from tourism receipts. The approach that is mostly followed to derive the EER is the use of multilateral weights, whereby each currency receives a weight equal to its proportion of total trade. This method captures the impact of major currencies on trade flows. The same approach is followed for deriving MERI1 and MERI2. Further, the geometric weights technique has been used to derive the two weighted exchange rates MERI1 and MERI2.

Base Period: The choice of the base year typically reflects the most recently available data and has been chosen so that the weights characterise the structure of trade throughout the period of analysis. The base period chosen for computing the EER is January – December 2007 = 100. The approach followed is to use continually updated weights in an attempt to portray current trade patterns. That is, weights will be updated annually to ensure that they reflect the most recent structure of trade flows.

The MERI: The MERI is designed to be a summary measure of the rupee's movements against the currencies of its important trading partners. MERI1 and MERI2 differ from each other in the sense that MERI1 uses the currency distribution of trade as weights, while MERI2 includes the currency distribution of tourism receipts combined with the currency distribution of trade as weights.
Tables 1 and 2 give the weights that have been used to derive MERI1 and MERI2 respectively. Table 3 shows the MERI1 and MERI2 since January 2007, while Chart 1 plots their evolution since the same period. Chart 2 shows the monthly appreciation/depreciation of the rupee vis-à-vis US dollar, pound sterling and Euro together with the change in the MERI1 and MERI2.

Table 1: Weights for $MERI_1$

Currency	Weights
US Dollar	57.9
Euro	27.6
Great Britain Pound	8.0
South African Rand	2.6
Japanese Yen	1.8
Swiss Franc	1.2
Singapore Dollar	0.5
Australian Dollar	0.5
TOTAL	100.0

Table 2: Weights for $MERI_2$

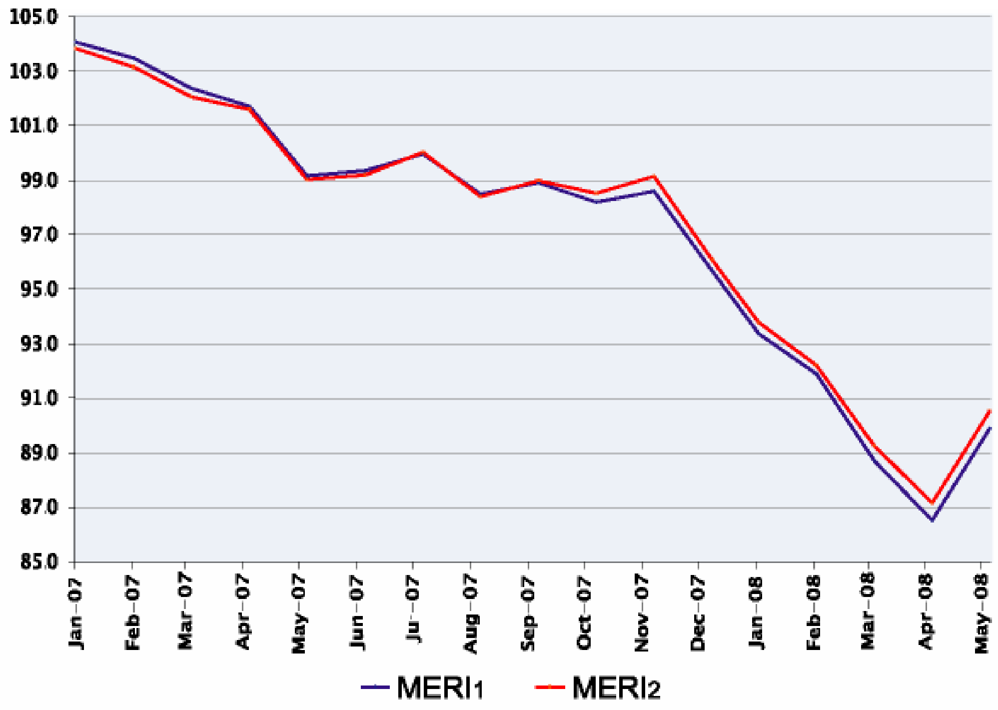
Currency	Weights
US Dollar	49.0
Euro	34.0
Great Britain Pound	8.9
South African Rand	3.9
Japanese Yen	1.6
Swiss Franc	1.4
Singapore Dollar	0.4
Australian Dollar	0.8
TOTAL	100.0

Table 3: Mauritius Exchange Rate Index (MERI)
Base Year: January – December 2007 = 100

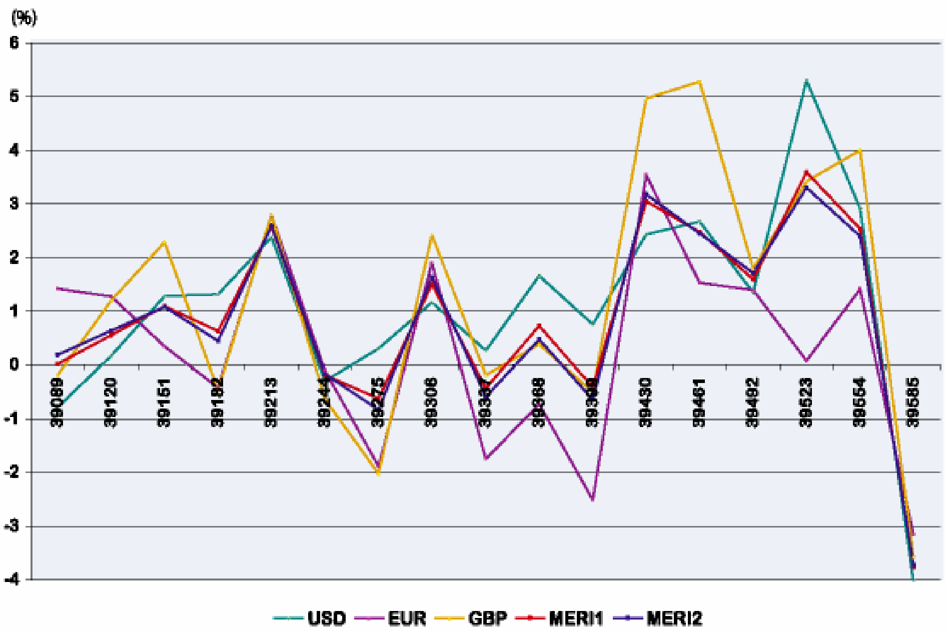
Period	$MERI_1$	$MERI_2$
Jan-07	104.1	103.8
Feb-07	103.5	103.2
Mar-07	102.4	102.1
Apr-07	101.7	101.6
May-07	99.2	99.0
Jun-07	99.3	99.2
Jul-07	100.0	100.0
Aug-07	98.5	98.4
Sep-07	98.9	99.0
Oct-07	98.2	98.5
Nov-07	98.6	99.1
Dec-07	95.7	96.1
Jan-08	93.4	93.8
Feb-08	91.9	92.2
Mar-08	88.7	89.3
Apr-08	86.5	87.2
May-08	89.9	90.5

Note:(i) An increase (decrease) in the index indicates a depreciation (appreciation) of the MERI, calculated as follows:
(Previous period index – Current period index) / Current period index
$MERI_1$: based on the currency distribution of merchandise trade excluding trade in Rupees
$MERI_{2:}$: based on the currency distribution of merchandise trade excluding trade in Rupees and tourism earnings

Mauritius Exchange Rate Index



Monthly Appreciation/Depreciation of US Dollar,Euro,Pound Sterling, $MERI_1$ and $MERI_2$



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Memoranda of Understanding

The Memoranda of Understanding entered into between the Bank of Mauritius and other authorities are listed below:

Local

Financial Services Commission

Foreign

Jersey Financial Services Commission

Commission Bancaire Française

State Bank of Pakistan

Banco de Moçambique

The Bank Supervision Department of the South African Reserve Bank

Central Bank of Seychelles

Hong Kong Monetary Authority

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January 2009 Communiqué on Basel II

On 21 September 2007, at a special meeting of the Banking Committee[*], it was decided that banks in Mauritius would be required to report as from the quarter ending March 2008, on a parallel-run basis, their capital adequacy ratio (CAR) under the Basel II framework along with their CAR under the Basel I framework.

Following on from this decision, the Bank issued a series of guidelines required for the implementation of Basel II and commenced parallel run from quarter ended March 2008, as scheduled. The Bank monitored the performance of banks under the parallel-run exercise and assessed the impact of the new framework on their capital requirements. The Bank is satisfied that the banking sector in Mauritius has made significant progress and is adequately prepared to move on to the Basel II framework.

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[*] The Banking Committee meeting is held on a quarterly basis. It is chaired by the Governor and attended by the Chief Executives of banks and the Mauritius Bankers Association.

Accordingly, in consultation with representatives of all banks in Mauritius and the Mauritius Bankers Association Ltd, the Bank has decided to do away with the parallel-run exercise and move over to the full implementation of the Standardised Approaches of the Basel II framework as from the quarter ending 31 March 2009.

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Excerpt of the FSAP Report on Money Laundering

The Bank of Mauritius is a long-established supervisory body. It was clear to the mission from meetings with the Bank and with institutions it regulates and supervises that the central bank has a thorough and professional grip on institutions. It knows its institutions and treats breaches of standards seriously.

Following its meetings with executives of the Bank of Mauritius and representatives of financial institutions that it licenses, the mission concluded that the Bank of Mauritius has adopted a very serious and professional approach to countering money laundering and terrorist financing, and that it has made strong efforts to supervise and monitor its licensees in this regard.

…The Bank of Mauritius conducts comprehensive on-site inspection of the customer due diligence measures and other AML/CFT measures of regulated entities.

…It was apparent to the mission that the Bank of Mauritius treats their AML/CFT responsibilities seriously. A significant number of institutions met by the mission appeared to have robust AML/CFT measures in place. Virtually all institutions met by the mission had been subject to an on-site inspection.

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Monetary Policy Committee

While pursuing its objective of maintaining price stability and promoting orderly and balanced economic development, the Monetary Policy Committee (MPC) raised the Key Repo rate (KRR) on one occasion (July 2008), left it unchanged on two occasions (June and September 2008), but reduced it on five occasions (February, March, May, October and December 2008) to sustain the real economy in the face of changing global financial conditions.

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Key Repo Rate

The KRR which stood at 9.25 per cent p.a in January ended the year at 6.75 per cent p.a. Other measures that are being envisaged are to move towards a higher degree of transparency and individual accountability through the disclosure of the individual votes of MPC members in the Monetary Policy Statements and the publication of minutes of MPC meetings.

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Monetary Policy Framework

To strengthen the Monetary Policy Framework, with effect from 1 April 2008, the Bank implemented a series of changes in the management of liquidity:

- an Overnight Collateralized Facility was introduced at 150 basis points above the KRR
- the maximum period of the Special Deposit Facility, introduced in November 2007 to manage the persistent excess liquidity, was extended from 14 to 21 days.

During the first seven months of the year, the Bank issued Bank of Mauritius Bills for a nominal amount of Rs 10.8 billion to mop up the excess liquidity in the system, while in the remaining period, the Bank injected Rs 24.4 billion through Repo transactions for periods ranging from 7 to 21 days to ease market conditions.

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Intervention by the Bank in the Domestic Foreign Exchange Market

(January - December 2008)

Date	Purchase/Sale	Currency	Amount (Rs million)	Weighted Average Rate (Rs)
3-Jan	Purchase	USD	6.0	28.2250
8-Jan	Purchase	USD	13.0	28.2962
10-Jan	Purchase	USD	2.0	28.5000
10-Jan	Purchase	GBP	1.0	56.6200
22-Feb	Purchase	USD	13.0	27.6885
29-Feb	Purchase	USD	22.0	27.4677
13-Mar	Purchase	USD	66.0	26.8271
13-Mar	Purchase	EUR	2.0	41.2500
25-Mar	Purchase	USD	54.0	26.4424
25-Mar	Purchase	EUR	3.5	40.9071
8-Apr	Purchase	USD	18.0	25.9000
23-Apr	Purchase	USD	36.0	25.9000
20-May	Sale	USD	10.0	27.7500
23-May	Sale	USD	10.0	27.7500
29-May	Sale	USD	10.0	27.6000
11-Jun	Sale	USD	15.0	27.2500
18-Aug	Sale	USD	25.0	27.9500
8-Sep	Sale	USD	22.0	29.0000
6-Oct	Sale	USD	20.0	29.0000
16-Oct	Sale	USD	20.0	30.1000
29-Oct	Sale	USD	30.0	31.9000
6-Nov	Sale	USD	20.0	31.7500
13-Nov	Sale	USD	15.0	31.9000
20-Nov	Sale	USD	20.0	31.9000

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Excerpts on Exchange Rate from the IMF

(i) Excerpt from Public Information Notice of 15 July 2008 issued after the IMF Article IV Consultation Mission in 2008

IMF Directors were of the view that Mauritius' managed floating exchange rate regime provides an appropriate framework for macroeconomic management. They noted the staff assessment that the real effective exchange rate of the rupee appears broadly in line with fundamentals.

(ii) Excerpt from an IMF Working Paper entitled "Mauritius: A Competitiveness Assessment", September 2008, by Patrick Imam and Camelia Minoiu

The Mauritian rupee appears to be close to its equilibrium value… Given that the exchange rate regime is a managed float, the main policy recommendations that emerges from our analysis is that interventions in the foreign exchange market should continue to be aimed solely at reducing volatility rather than affecting the trend.

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Information Technology Projects

The Cheque Truncation Project

To further modernise the payment system in Mauritius, the Bank launched the Cheque Truncation Project in collaboration with commercial banks.

During the period from 2003 to 2006, the number of cheques exchanged yearly in the Port Louis Clearing House (PLCH) was stable at around 5.2 million. Thereafter, it rose to 5.3 million in 2007, and to 5.4 million in 2008. The value of the cheques exchanged in the PLCH stood at Rs 253,883 million in 2008, representing 25 per cent of the total value transacted on the MACSS (*cf* below) and a growth of 14 per cent on the previous year.

As cheques carry intrinsic credit and settlement risks which expose the whole system to potential systemic risks, it was deemed imperative to upgrade the payment system. The cheque truncation system will:

- substantially reduce such risks with the added possibility of allowing participating banks to further reduce the risk by agreeing on large-value settlements
- provide a faster clearing cycle
- help combat signature forgery and cheque alteration
- significantly reduce the cost of clearing cheques.

A competitive international bidding was organised for the selection of a vendor for the Cheque Truncation project. Tenders have been analysed and submitted to the Board of the Bank in August 2008. At the time of writing, a decision is still awaited.

The Mauritius Automated Clearing and Settlement System

The Mauritius Automated Clearing and Settlement System (MACSS) was set up in 2000. It was the first phase of the modernisation of the payments system. It has fulfilled its objective of containing systemic risks in the payment system by providing a fast, secure and reliable means of funds transfer.

However, pressing demands of a growing financial sector and increasing cross-border transactions pose new and complex challenges to the current payment system infrastructure. In recognition of the need for a more dynamic, flexible and business-friendly payment system capable of better resisting systemic shocks and providing for international exposure, the Bank has decided to replace the existing MACCS application.

The new application will meet higher standards of performance. It will:

- be based on best international practice
- be built on a more resilient architecture
- support multi-currency transactions
- have extended settlement windows
- provide for low-cost messages.

The core application is operational as from 14 January 2009 and all advanced features will be implemented after discussions with stakeholders during the first quarter of 2009.

The Regional Payment and Settlement System

The Regional Payment and Settlement System (REPSS) is an initiative of the COMESA Clearing House to allow cross-border payments between COMESA Member-States. The Bank has been appointed to act as the settlement bank for the REPSS.

The Bank will host accounts of participating central banks. The new MACSS application will be used to carry out settlement bank functions. Domestic banks will accordingly benefit from an integrated platform enabling local as well as international payments.

The system is in its final testing phase and will be rolled out after the COMESA Clearing House has completed the country visits.

The Mauritius Credit Information Bureau

The Mauritius Credit Information Bureau (MCIB) operates through a fully-computerized on-line system, owned by and located within the premises of the Bank. Its functions are to:

- collect from participant institutions credit information on borrowers and guarantors
- collate and store this information
- make this information available to these institutions for a more informed creditworthiness appraisal.

Participation in the MCIB was initially restricted to banks connected to MACCS. To help bridge the gap of asymmetry of information between borrowers and lenders, the Finance Act 2008 amended the legal framework to allow for extension of coverage to all credit providers and utility companies.

The Mauritius Housing Company and leasing companies are already connected to the MCIB. The Bank is currently in the process of integrating institutions such as insurance companies, credit finance companies and utility companies as participants of the MCIB.

Initially, there were reporting cut-off limits of Rs 100,000 and Rs 500,000, respectively, applicable to personal borrowers and corporate borrowers. These limits were abolished, effective 1 March 2008, for a more efficient borrower assessment. To further modernize the Financial System based on international trends and promote the development of new value-added products and services, the Bank of Mauritius Act 2004 was amended by the Finance Act 2008 to authorize the Bank to sell information from the MCIB to private credit rating agencies.

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New Headquarters Building and the Regional Office in Rodrigues

The third phase of the construction of the New Headquarters Building, which started in July 2008, includes the following:

- the linking of the old vault with the new
- the construction of the ramp access to the car park
- the installation of the vault mechanical handling system
- the upgrade and linking of the various services of the old vault to the new.

It is expected that the new vault will become fully operational in the first quarter of 2009.

Renovation of the Bank’s Old Headquarters is planned to house:

- a museum of notes and coins at the ground floor level
- training and conference facilities
- the Mauritius Credit Information Bureau
- the Knowledge Management Centre
- the Bank’s stationery store and workshop.

Developments in Rodrigues include the following:

- the foundation stone of the Bank’s new Regional Office was laid in November 2007
- the Bank also obtained the lease of a plot of land at Jen Tac for the construction of staff quarters. The lease agreement was signed in December 2008.

An Architectural Competition has been launched for both projects on a Design and Build basis.

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General Data Dissemination System and Special Data Dissemination Standard

In the wake of financial crises in the 1990s and the conclusion that, at least in part, they derived from data deficiencies, intensive work started on the development of a range of standards and codes. Data standards were among the most critical. It is in this context that the International Monetary Fund introduced in March 1996 the Special Data Dissemination Standard (SDDS), covering key macroeconomic datasets.

The SDDS prescribes that countries disseminate key macroeconomic data categories covering the real, fiscal, financial, and external sectors and calls for descriptions of these statistics and of statistical practices in terms of four dimensions, namely:

- data coverage, periodicity (frequency), and timeliness
- access by the public
- integrity of the disseminated data
- quality of the disseminated data.

The SDDS has led to improvements in the macroeconomic datasets that it encompasses, much greater public awareness of data and enhanced macroeconomic datasets for policy makers. It has facilitated international surveillance and analysis by capital markets.

In parallel with the SDDS, in December 1997 the IMF introduced the General Data Dissemination System (GDDS), which is a developmental tool for macroeconomic statistics, for those countries not yet able or willing to subscribe to the SDDS. It focuses on disseminating metadata on a range of statistics and plans for improvement of the statistics. The GDDS is less prescriptive than the SDDS. It does not set future dates by which participants must complete improvements in existing practices.

Currently, around 85 per cent of the IMF's Member-Countries either subscribe to the SDDS or participate in the GDDS. SDDS subscription stands at 64 and GDDS participation at 94. The GDDS has had 100 participants since its inception, six of which have graduated to the SDDS. There are currently three African countries that have subscribed to the SDDS: Morocco, South Africa and Tunisia.

Mauritius started participating in the GDDS in September 2000. As one of 22 countries participating in the Fund's GDDS Project for Anglophone African Countries, it undertook to use the GDDS as a framework for the development of its national statistical system.

The objective in 2009 is for the country to graduate from the GDDS to the SDDS. In this context, we are already participating in the external sector modules of the Anglophone Africa project. In addition, an IMF Technical Assistance (TA) mission came in September/October 2008 to assist the Bank in preparing for the annual enterprise survey of cross-border financial flows and stocks of non-financial private sector enterprises. The results of the first Foreign Assets and Liabilities Survey were reviewed by the TA Mission, which made a series of recommendations on the way forward. The results of this survey will be disseminated soon.

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Participation in International Meetings and Seminars

During 2008, the Governor attended several meetings held in the region:

- the Bank for International Settlements Forum on Central Bank Governance (Livingstone, Zambia February 2008)
- the Meetings of the Committee of Central Bank Governors (CCBG) of SADC (Pretoria, South Africa, April 2008, Cape Town, South Africa, September 2008)
- the Association of African Central Banks Symposium and Assembly of Governors (Kigali, Rwanda, August 2008)
- the African Economic Conference on the Financial Crisis, organised by the African Development Bank, the African Union and the United Nations Economic Commission for Africa (Tunis, Tunisia, November 2008)
- the Meeting of Governors of Francophone Countries on “Global Financial Crisis” (Abidjan, Cote D’Ivoire, December 2008).

The Governor also attended:

- a Colloque International at Banque de France (Paris, France, March 2008)
- the IMF Spring Meetings and a Seminar organized by the World Bank (Washington, USA, April 2008)
- the back-to-back Bank of England Central Bank Governors Meeting and the Annual General Meeting of the BIS (London, England and Basel, Switzerland, July 2008)
- the back-to-back Governors/Commonwealth Finance Ministers Conference (St Lucia) just before the Annual General Meetings of the IMF and the World Bank Group (Washington, USA, October 2008)

He delivered a talk at the Reserve Bank of India in March 2008 on “How does a Small Open Economy faced with Unprecedented Capital Flows conduct Monetary Policy”.

The First Deputy Governor attended a number of overseas meetings and seminars as follows:

- The Islamic Financial Services Board, the World Bank Group Corporate Governance Department, and IFC Global Corporate Governance Forum Seminar on Corporate Governance Issues in Islamic Finance (Bahrain, March 2008)
- The World Bank, International Monetary Fund and US Federal Reserve Board 8th Annual International Seminar on Policy Challenges for the

Financial Sector: Financial Market Turbulence and Policy Responses (Washington, USA, June 2008

- The Offshore Group of Banking Supervisors Meeting and the XV International Conference of Banking Supervisors (Belgium, September 2008)
- The Financial Stability Institute, World Bank and International Monetary Fund Seminar on the Supervision and Regulation of State-owned banks (Mumbai, India, November 2008). He made a presentation on "Supervision and Regulation of State-Owned Banks, the Mauritian Experience".

He also represented the Governor at the following meetings/conferences:

- The 5th Islamic Financial Services Board Summit: Financial Globalisation and Islamic Financial Services (Jordan, May 2008)
- The 14eme Reunion des Gouverneurs des Pays Francophones (Luxemburg, May 2008)
- The Federation of Indian Chambers of Commerce and Industry (FICCI) – Indian Banks' Association (IBA) Conference on "Global Banking: Paradigm Shift" Theme: "Navigating sucessfully in an uncertain world," (Mumbai, India, November 2008). He chaired the working session on "Credit risk and Market risk, the Journey Ahead"
- The Islamic Financial Services Board & Institute of International Finance Conference "Enhancing the resilience and stability of the Islamic financial system" (Kuala Lumpur, Malaysia, November 2008). He chaired the working session on "Risk Management and Prudential Standards in Islamic Finance: Are They Fit to Prevent Crisis?"

The Second Deputy Governor attended an OGBS Meeting (London, UK, March 2008) and the In-house Economics Training Course of the IMF (Washington, USA, April 2008).

He also attended the Board Meetings of African Export-Import Bank (Abuja, Nigeria, March 2008) and (Abidjan, Cote d'Ivoire, June 2008).

The Chief Economist attended the following meetings:

- the Meeting of the Bureau of the Association of African Central Banks (Tripoli, Libya, May 2008)
- the Bank of Namibia Symposium (Windhoek, Namibia, September 2008)
- the Regional Financial Integration Workshop of the African Development Bank Group (Tunis, Tunisia, December 2008).

He also accompanied the Governor at the following meetings:

- the IMF Spring Meetings and a Seminar organized by the World Bank
- the Meeting of Commonwealth Governors and the Commonwealth Conference of Finance Ministers and the Annual Meetings of the IMF and the World Bank

- the Meeting of Governors of Francophone Countries on “Global Financial Crisis” .

The Head Corporate Services attended the following meetings:

- the 6^{th} General Assembly of the Islamic Financial Services Board (Jeddah, Kingdom of Saudi Arabia, March 2008)
- the COMESA Meetings on Monetary Cooperation (Cairo, Egypt, October 2008)
- the 15^{th} General Meeting of Afreximbank (Kampala, Uganda, end-October-early November 2008).

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