BANK OF MAURITIUS

Website: https://www.bom.mu

Communiqué
Excess Liquidity in the Banking System

Released at 16.00 hours on 8 February 2014

We have taken cognizance of an article in the press this morning that the Ministry of Finance and Economic Development (MoFED) has issued a communiqué on 7 February 2014 (which was not available on its website at the time of writing), which *inter alia* referred to "without however giving any blank cheque" to the central bank for the management of excess liquidity.

We wish to state that the issue of giving the Bank of Mauritius a blank cheque never arose. However, we have on several occasions requested the MoFED to meet their obligations for commitments taken to address the excess liquidity situation created by its own doing.

The current excess liquidity situation in the banking system has originated mainly from the following:

(i) Increased recourse by Government to foreign financing of its budget deficit at the expense of domestic financing as evidenced by the figures posted on the MoFED website under the caption "Statement of Budgetary Central Government Financing Operations."

(ii) 'Operation Reserves Reconstitution' (ORR), which emanated from an agreement between the Bank of Mauritius and the MoFED in June 2012 with a view to beef up our foreign exchange reserves in the midst of the global financial crisis while at the same time realigning the domestic exchange rate given the overvaluation of the rupee then advocated by the IMF; it had been agreed at that time that the MoFED would be bearing the cost of sterilising the rupee proceeds of the forex market intervention as per the Communiqué issued by the Bank on 9 June 2012.

(iii) Placement of deposits by the MoFED with commercial banks.

We wish to highlight that various IMF missions have, over the past two years in their reports, recommended that the Government should bear/share the cost of managing the excess liquidity in the banking system.

We also wish to point out that if the issue of excess liquidity in the banking system is not addressed as early as possible, this would eventually not only distort the interest rate structure in the banking system but also continue to impede the transmission of monetary policy as well as heighten the risks to financial stability. Should the Bank attend to reduce the level of excess liquidity in the banking system on its own through open market operations, it will suffer from an operational loss and will eventually have to be recapitalized by Government as provided for in the Bank of Mauritius Act 2004.

Financial Markets Operations Division
8 February 2014