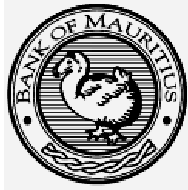

BANK OF MAURITIUS ***Communiqué***

RELEASE OF THE SECOND ISSUE OF THE BANK OF MAURITIUS FINANCIAL STABILITY REPORT

As part of its mandate, the Bank of Mauritius has to ensure the stability and soundness of the financial system. In compliance with section 33(2)(b) of the Bank of Mauritius Act 2004, the Bank of Mauritius has today released the second issue of the *Financial Stability Report.*

The global economic outlook has strongly deteriorated as the financial turmoil triggered by the crisis in the US sub-prime mortgage market in 2007 spread. The world faces a deepening economic crisis, with the slowdown in advanced economies now spreading to major emerging markets such as China, India, and Brazil. Advanced economies are now projected to contract by 2 per cent in 2009 and lower growth numbers have also been announced for major emerging economies. In many advanced countries, failures of banks and other financial institutions have necessitated interventions by Governments and central banks through massive capital and liquidity injections as well as other measures.

The current global financial turmoil is indeed an unprecedented one. By all reckoning, it is the worst crisis since the Great Depression. Clearly, despite the wide-ranging policy actions by Governments and central banks around the world, financial strains remain acute, pulling down the real economy. The January 2009 Global Financial Stability Report (GFSR) update of the IMF also notes that the risks to financial stability have intensified since October 2008 and that macroeconomic risks have risen as global growth has fallen precipitously alongside a sharp slowdown of global trade.

In Mauritius, the GDP growth rate for 2009 is estimated by the Central Statistics Office at 4 per cent, lower than the 5.2 per cent growth registered in 2008. There are already indications that the global financial crisis and economic downturn are impacting negatively on the textile and tourism sectors. The risks for a further deterioration in the trade balance and current account balance have increased, with potential downward pressures on the exchange rate of the rupee and the level of foreign exchange reserves.

In the conduct of monetary policy in 2008, the Bank was confronted with the combined challenge of combating inflation and preserving the competitiveness of the export-oriented sectors. Conducting monetary policy against the backdrop of the global financial crisis and economic slowdown is indeed a challenging task for central banks, particularly in small open economies like Mauritius. Inflation is still a source of concern in Mauritius. Headline inflation rate stood at 9.7 per cent at the end of December 2008, compared to 8.8 per cent at the end of 2007. However, on a year-on-year basis, CPI inflation has declined to 6.7 per cent in December 2008 from 8.7 per

cent in December 2007. Recent declines in food and energy prices, if sustained, and sluggish real economic activity abroad, hold out some prospects of a reduction in the inflation rate.

The global financial and economic crisis has also brought about a high level of coordination between the Bank and the Ministry of Finance and Economic Empowerment, recognizing the fact that the monetary tool kit alone is inadequate for dealing with the emerging problems. The Bank has provided inputs in the Additional Stimulus Package of Rs10.4 billion, equivalent to 3.8 per cent of GDP, unveiled in mid-December 2008 by the Government to shore up the economic performance of the economy. Normal conditions continue to prevail in the domestic money market. There is no credit crunch in Mauritius. No sector is being starved of credit.

The global financial crisis has brought financial stability issues to the forefront of policy considerations. The crisis highlights the need for strengthening financial sector regulation to ensure stability. All the banks operating in Mauritius have, so far, shown considerable resilience in terms of capital adequacy, balance sheet growth, profitability and loan delinquencies. The system has not witnessed any serious liquidity crunch either. Banks in Mauritius had an estimated average capital adequacy ratio of 15.8 per cent at the end of December 2008 against the regulatory minimum of 10 per cent. There are no indications that the Mauritian banking sector has any direct exposure to the toxic debt that has affected global financial markets, and banking soundness indicators are healthy. The banks in Mauritius do not have significant exposure to equities either by way of their investments or loans against the collateral of shares. As macroeconomic risks increase, financial strains, associated with an increase in credit risks and reduced risk appetite of banks, are likely to emerge in banks' balance sheets.

The Bank has been reviewing its existing banking guidelines to bring them in line with international best practices, taking into consideration the recent financial turmoil and the measures taken subsequently. The Bank's aim is to ensure that the banking system grows robustly and continues to conduct business consistent with sound risk management standards. The Bank has adopted a prudent approach in the implementation of Basel II. After nearly a year of parallel run during which the performance of banks under the new framework was monitored, the Bank has decided to move over to the full implementation of Basel II with effect from 31 March 2009. All banks meet the capital adequacy ratio of 10 per cent of risk weighted assets based on standardised approaches of Basel II. During 2008, the Joint Coordination Committee (JCC) between the Bank of Mauritius and the Financial Services Commission pursued its exchange of supervisory information considered vital for avoiding regulatory gaps in the system.

The insurance and Non-Bank Deposit-Taking Institutions sectors also did not witness any direct impact of the global financial crisis.

The Bank welcomes views and comments on this second issue of its *Financial Stability Report*, which is available on its website at ***http://bom.intnet.mu.***

Bank of Mauritius
18 February 2009