BANK OF MAURITIUS

Website: http://bom.intnet.mu

PRESS COMMUNIQUE

Financial Stability Report – Sixth Issue

The Bank released today its sixth issue of the Financial Stability Report. The Report focuses on global and domestic financial stability issues in the second semester of 2010.

The global recovery is ongoing but has begun to lose steam despite better-than-expected growth in early 2010. Though it appears that a double-dip recession has been avoided, the global financial system remains in a period of uncertainty and the progress towards global financial stability suffered a set-back as from April 2010. In Advanced Economies, high unemployment, weak household balance sheets and sluggish credit growth are holding back private demand while in many Emerging and Developing Economies, strong internal demand, intra-regional trade and a rebound in global trade have driven a robust recovery, with China and India in the lead. Although activity remains buoyant in emerging economies, inflationary pressures are emerging, and there are now some signs of overheating, driven partly by strong capital inflows. According to the January 2011 World Economic Outlook Update of the International Monetary Fund, global GDP growth has been estimated to be around 5.0 per cent in 2010 but would moderate to 4.4 per cent in 2011.

Notwithstanding the challenging economic environment, both internationally and domestically, activities in the domestic economy continued to improve and growth rate is estimated to have increased to 4.2 per cent in 2010 compared to 3.1 per cent registered in 2009. In contrast to many advanced countries, unemployment rate increased only marginally from 7.3 per cent in 2009 to 7.5 per cent in 2010. The deficit in the current account in 2010 was financed from the significant capital inflows without undue pressure on exchange rates. Representing the equivalent of more than 10 months of imports at end-December 2010, the level of net international reserves provides a comfortable cushion against external shocks. Total external debt as a percentage of GDP hovered around 12.0 per cent as at end-December 2010 and the external debt service ratio is forecast to lie in the range of 2.8 per cent to 3.0 per cent between 2010 and 2013. The pace of economic recovery in our major trading partners remains a source of concern to Mauritian economic operators, particularly those in the export-oriented sectors. Nevertheless, with an estimated growth rate of 4.2 per cent in 2011, the domestic economy is expected to maintain its resilience in 2011, despite uncertain international economic developments.

Household indebtedness with banks trended upwards in a declining and low interest environment, notwithstanding challenging economic conditions. A widening of the gap between growth of household indebtedness with banks and nominal GDP growth was observed and highlighted in the previous FSR. This gap has continued to widen and was driven by the relatively higher growth in banks' credit to households compared to the growth in nominal GDP. Nevertheless, household indebtedness has been principally geared towards the construction and purchase of housing units and the fact that default rate on housing loans tends to be low provides a source of comfort. Thus, the current widening of the gap may not necessarily point to increasing household vulnerabilities.

Excess liquidity continued to prevail in the banking system in the second half of 2010 and to address this situation the Bank increased the Cash Reserve Ratio and further revisited its approach to liquidity management by introducing new instruments of longer maturities. These measures helped to effectively bring the excess liquidity to a more appropriate level by the end of 2010.

The domestic foreign exchange market was characterised by higher volatility in the second half of 2010, largely reflecting the movement of major currencies on international markets and domestic supply conditions. The Bank intervened on several occasions to maintain orderly conditions in the foreign exchange market.

The banking sector, which is the major component of the financial sector, remained resilient and profitable in 2010 despite the prevailing external and internal economic conditions. Banking risks were well contained. In fact, the capital adequacy ratios stood well above the minimum regulatory level of 10 per cent and credit concentration risk, as measured by the percentage of aggregate exposures to capital base, remained well below the aggregate prudential ceiling of 800 per cent. Further, the level of Non-Performing Loans (NPLs), in and outside Mauritius is considered to be at a comfortable level and the ability of banks to absorb losses arising from non-recoverability of NPLs is considered as adequate. Stress tests were carried out and revealed that, in the event of a general weakening in economic activities in two consecutive quarters, most banks would generally be able to withhold shocks of a 15 per cent increase in NPLs to key sectors. Further, simulations also revealed that banks would generally withhold shocks of a 20 per cent increase in NPLs arising from advances secured by residential property.

The insurance sector also is considered to be in a sound condition with the industry solvency average amounting to 162 per cent.

The payment systems infrastructure in Mauritius is considered to be reasonably robust. In 2010, the operations on the Mauritius Automated Clearing and Settlement System (MACSS) were smooth and no downtime which would affect operations was recorded. All transactions were settled in real time and no payments were rejected, delayed or queued on account of system imperfections. The Bank intends to implement the Bulk Clearing System (BCS) which will reduce the need to send high volume, non-time sensitive payments on the MACSS. The BCS will bring a paradigm shift in the way payments are carried out in the country and it has a functional architecture which is compliant with World Bank and Bank for International Settlements recommendations for deferred net settlement systems.

The Financial Stability Report is available on the Bank's website at http://bom.intnet.mu.

1 March 2011