Statement from the Governor

This year, the Bank celebrates its 45th year in the service of the country, which itself prepares to celebrate the 45th anniversary of its accession to independence in March 2013. Looking back over these eventful 45 years, I can see a country that has radically transformed itself and its economy, with the Bank of Mauritius (BoM) having continuously reinvented itself to be part of this change process. At the Bank's foundation in 1967, there was one major industry, sugar. Today, the economy is well-diversified, with many pillars of growth. We have lived through times when the import cover was less than a week, unemployment hovered around 20 per cent, and our countrymen were emigrating in large numbers in search of jobs, and inflation reached 42 per cent. Today, our reserves represent 5 months of import cover; we have an unemployment rate of around 8 per cent, with 23,000 migrant workers in our country; inflation has declined to less than 5 per cent today.

At the time of independence, the rupee was tied to the British pound at a fixed parity under the "Sterling Exchange Standard". It was then pegged, first to the IMF's Special Drawing Rights, and subsequently to a basket of currencies reflecting the trade pattern of the country, before moving to a floating regime. Prior to the late 1980's, monetary policy was implemented through reserve requirements, ceilings on commercial bank credit and administered interest rates. Today, after a free float for nearly two years, we have a managed float, with BoM interventions limited to smoothing excess volatility of the rupee and, since June 2012, also combating unwarranted currency appreciation. The Monetary Policy Committee (MPC), set up in 2007, formulates and determines our hybrid inflation-targeting monetary policy. Our financial sector was underdeveloped at the time of independence when we had only five banks. Today, our banking sector has 21 banks and 216 bank branches, eight non-bank deposit taking institutions, ten money–changers and six foreign exchange dealers. We now have a radically different financial landscape, with parallel changes in the supervisory, regulatory and oversight functions of the Bank of Mauritius.

Let me come back to the present day and to the year under review. This is the fifth year of my governorship. I cannot help wonder by what twist of fate I found myself entrusted with the exalted responsibility of steering the Central Bank at such a defining moment in its history. My five years as Governor have coincided with the global financial and economic crisis. They have been five challenging years which have tested my mettle relentlessly. Alas, no *dénouement* to this crisis is in sight. The crisis will last a while and will continue to pose considerable challenges for the Bank for quite some time.

The unending saga of the euro debt crisis, and the spreading distress beyond the Eurozone periphery, heightens the risk of a second European recession in three years. The succession of temporary and temporizing solutions which we have seen, fail to come to grips with the underlying problems. Markets are unimpressed. I am convinced that, in the absence of an agreed long-term vision for the area with a full fiscal union, the Eurozone will hurtle from crisis to crisis. Economic activity lost momentum in many advanced and emerging market economies and their growth forecasts have been consistently revised downwards. The effects were also felt in the foreign exchange markets, leading the US dollar, with its safe-haven status, to appreciate against the euro. The weak outlook for global economic activity quelled inflationary pressures. Unemployment was at exceptionally high levels in the US and worsened in Europe. Against this background, most major central banks continued to implement expansionary monetary policies and breached the limits of monetary policy.

The unpredictable conditions prevailing in the global environment led the Bank to experiment with innovative policies within our mandates of price stability and financial stability. Of particular concern to us was the fact that some of our key markets were facing recessionary conditions. We felt it important to step up coordination with the Treasury and we held regular consultations with various stakeholders to ascertain the appropriateness of our responses. This *modus operandi* gave us added flexibility and enabled us to react faster and to act pre-emptively and thus contributed to maintain a fair degree of stability and confidence in the economy.

Our economy grew at a rate of 3.9 per cent in 2011, a commendable performance when viewed in the context of the sharp global economic downturn. Most of the key sectors of the economy recorded positive growth rates. At a time, when most countries have been seeing their ratings downgraded, Moody's Investors Service upgraded Mauritius's foreign- and local-currency government bond ratings to Baa1 from Baa2, with a stable rating outlook in June 2012. Inflation was on a declining trend and the rate of unemployment remained virtually unchanged. Our public sector debt to GDP ratio has hovered below 60 per cent over recent years. This is no mean feat for a small open island economy like ours.

The banking sector continued to expand and recorded solid profits in spite of the difficult global conditions. In the financial year ended 30 June 2012, profits after tax increased to Rs12.6 billion from Rs11.9 billion in the previous financial year. Banks held high levels of capital — the capital adequacy ratio of the banking sector stood at 15.9 per cent at end-June 2012. The ratio of non-performing loans to total loans (NPL) for domestic assets increased from 4.3 per cent at end-June 2011 to 5.1 per cent at end-June 2012. The NPL for overseas assets of the banking sector moved from 0.6 per cent to 1.5 per cent. The overall NPL ratio stood at 3.1 per cent at end-June 2012, up from 2.3 per cent at end-June 2011.

In the following paragraphs, I will review the main policy actions taken over the period.

- After four years of operating experience, we reviewed the functioning of the MPC. We enhanced transparency with the publication of the minutes of the MPC meetings and the pattern of individual votes beginning with the MPC meeting of December 2011. Legislative amendments severed the formal links of the MPC with the Bank's Board of Directors. The MPC was reconstituted in March 2012, with four members from the Bank and five external to the Bank, including two foreigners.

The focus of monetary policy continued to be the maintenance of price stability while ensuring a balanced and orderly economic development. I maintained a regular dialogue with stakeholders, as much to gain deeper understanding of the domestic economic outlook as to foster better understanding of the Bank's policy stance. Our monetary policy framework has gained in credibility and we have been successful in anchoring inflation expectations.

During the year under review, the year-on-year and headline inflation measures showed signs of moderation, at 3.9 per cent and 5.1 per cent, respectively, as at June 2012. The monetary policy stance was eased as from the second semester of 2011 on concerns over the intensification of the euro debt crisis and its implications for the domestic economy.

- The Bank introduced two bold measures in June 2012, in close coordination with the Treasury, to minimize the fallout from the euro debt crisis and the global economic downturn on the domestic economy. The measures targeted the sectors particularly vulnerable to the declining external demand in key markets.

We embarked on a programme to build up our foreign exchange reserves, the Operation Reserves Reconstitution. This also helped us to reduce the growing misalignment of the rupee in relation to fundamentals, as confirmed by the studies conducted by the IMF. It resulted in an increase of our gross official reserves from Rs81.5 billion at the end of June 2011 to Rs86.7 billion at the end of June 2012, thereby raising our import cover from 4.6 months to 4.9 months. As this report goes to the press, an adjustment of around 4 to 5 per cent would have been noted in the exchange rate of the rupee as measured by $MERI_1$. And we are well on the way to achieve the target of 6 months of import cover that we have set ourselves.

The second measure was the Special Line of Credit in Foreign Currency. It was a path-breaking move for a small, but innovative, central bank, prepared to use its own balance sheet in a pre-emptive bid to bail out exposed sectors ahead of troubled times. Through this measure, the Bank went to the rescue of economic operators which were directly affected by the mismatch between the currencies in which their earnings were denominated, mostly euros, and their outstanding debt in rupees. We were giving to highly-leveraged operators a unique tool to restructure their debt so that they would end up with healthier balance sheets. We were particularly concerned by the impact of euro-generated debt-servicing difficulties of operators on the balance sheets of banks.

Since the project was launched, the terms and conditions of the line of credit have been reviewed to enhance their flexibility. We have lengthened the maturity and increased the margin to make it more attractive for the intermediary banks. However, there has been a slow take-up; out of the amount of EUR600 million earmarked for this project, only an amount of EUR8.9 million has been utilized so far.

- We launched the Cheque Truncation System, which provides for the Bulk Clearing System for low-value electronic transactions, in September 2011. The next step in the modernization of the payments system will be the implementation of a National Switch on which work is proceeding.

- In April 2012, we introduced the depository system for Government securities that provides for a strict deliver-versus-payment mechanism for the issue of such securities. This mechanism is aimed at eliminating settlement risks and is in accordance with the recommendations of the Bank for International Settlements for securities settlement.

- We broadened the coverage of the Mauritius Credit Information Bureau to include insurance companies, non-bank deposit taking institutions, and utility providers, as well as the Central Bank itself. Thus, a comprehensive picture of the aggregate indebtedness of the prospective borrowers is now available, and this should, under normal circumstances, curb the level of non-performing loans in the system.

- We increased the efficiency of the financial markets through the conduct of single-maturity auctions of Treasury Bills and by holding frequent auctions during the week. We eliminated paper bids at auctions and moved to a platform where participants can submit their bids online.

  We enlarged the spectrum of instruments by introducing a 273-Day Treasury Bill as from October 2011. We introduced single-maturity auctions as from November 2011 to enable the Government to determine its debt profile. New benchmark securities — 3-Year Treasury Notes and 5-Year Bonds — were issued to enhance liquidity in the secondary market. We finalized preparations for trading these benchmark securities on the Stock Exchange to create a proper bond market for Mauritius. Concurrently, the issue of 2-Year and 4-Year Treasury Notes was discontinued in 2012.

- The Bank continued its efforts to issue new guidelines and improve existing ones, incorporating the latest developments in international best practices as recommended by international standard-setting bodies such as the Basel Committee on Banking Supervision. The latest guideline to have been issued (August 2012) is the Guideline on Corporate Governance after prolonged consultation with the industry.

- The Bank actively participated in both regional and continental fora such as the COMESA Committee of Central Bank Governors, the Committee of Central Bank Governors of SADC, and the Association of African Central Banks (AACB).

  Since February 2012, the Bank is a member of the Sub-Saharan Regional Consultative Group of the Financial Stability Board, which operates under the aegis of the Bank for International Settlements.

  In 2011, I had the honour to co-chair on behalf of fellow-Governors the two separate inaugural Joint Meetings between Central Bank Governors and Ministers of Finance for both COMESA and SADC. I also co-chaired the first meeting of the SADC Peer Review Panel held in October 2011 in Mauritius.

  The Bank hosted the 34th Committee of Central Bank Governors of SADC in April 2012 and the *19ème Conférence des Gouverneurs des Banques Centrales des Pays Francophones* in May 2012. In August 2012, I acceded to the Vice-Chairmanship of the AACB and the Bank will be hosting the 37th Assembly of Governors in August 2013.

- The Bank of Mauritius is the settlement bank for the Regional Payment and Settlement System (REPSS) of the COMESA. REPSS went live on 3 October 2012. I am delighted that this project in which the Bank has been closely involved since 2007 has finally come to fruition. REPSS is expected to stimulate intra-regional trade. I sincerely hope that it will live up to expectations, and stakeholders and commercial banks will make full use of this system.

- Our financial system continues to grow steadily, with total banking assets (Segment A) representing 107.7 per cent of GDP at end-June 2012. On 6 September 2012, we granted our 21st banking licence. This new addition to our financial landscape demonstrates the continuing interest of new operators in our banking sector.

- In June 2012, we set up a Task Force on Unfair Terms to look into the terms and conditions of financial contracts. We hope to come up with a Public Consultation Document by the end of the year. We are working simultaneously on the simplification of loan agreements. These initiatives of the Bank aim at improving the efficiency of financial services.

- I have on various occasions expressed my concern over the declining saving rate in the country. In an attempt to address the issue, the Bank proposes to provide the public with a new asset class in which to invest. The Gold Bar Project, as the initiative has been named, aims at broadening the range of savings products available to the public while promoting a savings culture. As from November 2012, the Bank will be offering for sale a range of Minted Gold Bars of 10g, 50g and 100g, with or without storage in the Bank's vault. The selling price of these Gold Bars will be set as close as possible to the price of gold on the international market. Investing in these gold bars would be an excellent hedge against inflation.

- In recent years, financial stability has moved to the top of the agenda of central banks. We have fully endorsed this new focus. After an upgrading of our banking supervisory framework which allowed us to implement Basel II as from March 2008, the Bank is now envisaging to implement Basel III. A consultative paper outlining the proposals of the Bank will be issued for consultation by the end of October 2012. Our banks have remained strong during the global financial crisis. The higher capital requirements of the Basel III framework will further enhance their ability to function under conditions of stress and help protect depositors.

- The Deposit Insurance Scheme is currently in its final stages after a lengthy process which involved intensive consultation with the banking industry and study visits by our officers to other jurisdictions. This additional safety-net will reinforce the stability of our financial system.

- Another issue that requires our attention is that of domestic systemically important banks, the so-called D-SIBs. I had drawn attention on several occasions to the fact that at least two of our banks have developed into big complex institutions, with the potential of posing a threat to the financial system in case of failure. We are currently working on a framework for the monitoring of such institutions which will be required to simplify their structures and maintain additional capital, and possibly write living wills. I am very pleased to note that already two banks, as well as one financial conglomerate, have taken the cue and are restructuring their operations so that they end up with leaner structures.

- I am pleased to announce that the net profits of the Bank rose from Rs258.4 million for the financial year ended 30 June 2011 to Rs395.3 million for the current financial year. The sustained improvement in the performance of the Bank was attributable mainly to a combination of operational efficiency and a prudent diversification strategy with respect to reserve management.

  In 2011, there was a noteworthy change in the Bank of Mauritius Act 2004 with significant impact on the accounts of the Bank. This provision allows the Bank to credit to the Special Reserve Fund all unrealized gains, arising from the valuation of investments held by the Bank, instead of treating them as distributable income, which forced the Bank to liquidate portfolio assets, which it would have been more prudent to keep, to distribute as profits.

Words of Appreciation

I am deeply indebted to all those who have supported me during my two tenures of office. I thank Dr The Honourable Navinchandra Ramgoolam, GCSK, FRCP, our Prime Minister, for entrusting me with the responsibility of leading the Central Bank at this fraught period of its history, and for giving me his support all through.

I have had very cordial relations with Honourable Charles Gaëtan Xavier-Luc Duval, GCSK, Vice-Prime Minister and Minister of Finance and Economic Development, and we have been able to join our efforts to keep the economy on an even keel. My appreciation goes to the Honourable Minister and his team.

I thank the Chairmen and the Chief Executive of the Mauritius Bankers Association, the Chief Executives of banks, and all the stakeholders for their active involvement and participation in meetings which helped us develop a fruitful collaboration and mutual understanding on the direction that our financial sector and economy need to take.

I thank my close collaborators, particularly my two Deputy Governors, the Head of the Governor's Office, and the staff of my Policy Unit, for their support all the year through. Last but not least, I thank the Staff of the Bank for their support and dedication, particularly those who have been behind the scene. Without their unflinching support and commitment, I would not have been able to function. To all of them, I dedicate the Award of Central Banker of the Year 2012 – Africa, bestowed upon me by The Banker Magazine, of the British Financial Times newspaper group, at the beginning of the year.

Looking Ahead

Looking ahead, we need to be vigilant against inflation – which is our overriding objective. But the challenging environment compels the Bank to continuously change the way in which it functions. Monetary policy has played its role and will continue to do so. But it has its limitations, and expectations are sometimes beyond what it can possibly achieve. We will pursue on our path of innovative policies. We view our mandate in a wider perspective in which other considerations such as protection of consumer interests, governance, transparency, competition and communication are assuming greater importance. This broader macroprudential focus will enable us to stabilize the economy.

My final message to my compatriots: The time has come for us to change our mindset. As I have said before, a crisis is too good to waste. Our country should dare measure up to more advanced economies. I am pleased to note that the views expressed lately by the Bank on the need for structural reforms has gained consensus. All stakeholders — public, private sector, civil society — should collaborate to move the country forward to new levels of development through more equitable and inclusive growth.

Rundheersing Bheenick
8 October 2012