45 YEARS OF CENTRAL BANKING

BANK OF MAURITIUS

Financial Stability Report

February 2013

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The Financial Stability Report is published twice a year by the Bank of Mauritius in accordance with Section 33(2) (b) of the Bank of Mauritius Act 2004. It is released to the public in February and August. The Financial Stability Report reviews global and domestic macro-financial developments and analyses potential risks to the financial system stability. This issue of the Financial Stability Report refers to information for the semester ended 31 December 2012 unless otherwise stated.

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List of Acronyms

BCS	Bulk Clearing System
CAMEL	Capital, Asset, Management, Earnings and Liquidity
CAR	Capital Adequacy Ratio
ECB	European Central Bank
ESM	European Stability Mechanism
FDI	Foreign Direct Investment
FSC	Financial Services Commission
GBCs	Global Business Companies
GDP	Gross Domestic Product
HHI	Herfindahl-Hirschman Index
IAIS	International Association of Insurance Supervisors
IMF	International Monetary Fund
LIBOR	London Interbank Offered Rate
MACSS	Mauritius Automated Clearing and Settlement System
MCIB	Mauritius Credit Information Bureau
MERI	Mauritius Exchange Rate Index
NBDTIs	Non-Bank Deposit-Taking Institutions
NPLs	Non-Performing Loans
OIS	Overnight Indexed Swap
OMTs	Outright Monetary Transactions
PE	Price Earnings
ROA	Return on Assets
ROE	Return on Equity
SEM	Stock Exchange of Mauritius
SIPS	Systemically Important Payment Systems
SSM	Single Supervisory Mechanism
Y-o-y	Year-on-year

1. Overview

The global economic outlook has stabilised following strong policy initiatives in major advanced economies, and in the euro area in particular, that clearly showed authorities' commitment to resolve the sovereign debt crisis and restore confidence to the markets. In financial markets, these actions have translated into lower funding and liquidity pressures and a rally in global equity markets while the borrowing costs of the most affected countries in the euro area have eased significantly, providing some fiscal space to their governments. In January 2013, the IMF projected world economic growth to strengthen in 2013. However, significant threats from potential adverse developments emanating from the euro area sovereign debt crisis and the US fiscal situation still exist. As long as there is no definite resolution to these concerns, investor confidence is expected to remain fragile, contributing to mitigate the economic and financial outlook for 2013 as well as keeping the risks to global financial stability substantial.

Notwithstanding weak economic activity and tougher regulation, the international banking sector improved during 2012H2, with banks consolidating their capital positions while pursuing their deleveraging processes. Interbank borrowing costs have been reduced in the wake of the ECB measures and, though lending conditions have remained subdued generally, they have eased to a certain extent in the US and UK. The progress towards the establishment of a banking union in the European Union is helping to enhance market confidence and to allay financial stability concerns.

Macroeconomic risks in the domestic economy have lessened somewhat since the publication of the August 2012 Financial Stability Report. However, they still remain dependent on the evolution of the situation in the Eurozone, in particular. The domestic economy has proved to be resilient in 2012 despite the external headwinds and is forecast to expand by 3.7 per cent in 2013.

External vulnerabilities, which may potentially have important repercussions on macro-financial stability, were perceived to be manageable. Although high by historical standards, the current account deficit, inclusive of cross-border transactions of GBC1s, moderated in 2012Q3. It continued to be financed by Foreign Direct Investment, which offset net outflows registered in portfolio investment and other investment, and helped increase momentum in various sectors of the economy. Gross official international reserves remained adequate relative to international norms and were reinforced by the Operation Reserves Reconstitution programme, introduced in June 2012 to provide additional insurance against possible external shocks, which has resulted in the import cover as at end-December 2012 increasing to 5.3 months. Gross external debt, driven by central Government and public enterprises external debt, represented only 14.3 per cent of GDP as at end-September 2012 and was not expected to pose interest rate risks in the short- to medium-term given expected accommodative monetary policies.

Government has pursued efforts towards fiscal consolidation and the budget deficit is projected to fall over the next three years. The maturity profile of Government debt is being lengthened to reduce rollover risks while financing costs, especially in the short- and medium-term maturities, have declined.

Conditions in domestic financial markets have pointed to relatively tolerable liquidity pressures. Overnight money market rates as well as yields on short- to medium-term Government instruments have dropped during 2012H2. In the domestic foreign exchange market, the rupee has reflected the evolution of major currencies on international markets as well as domestic demand and supply conditions. Partly reflecting the Bank's foreign exchange intervention, rupee volatility has fallen. The Bank introduced a prudential measure to contain the bid-ask spreads on major currencies, namely the US dollar, euro and Pound Sterling, within a limit of 3 per cent.

The financial sector has remained stable and sound despite the challenging international context. Banks in Mauritius have been resilient, with capital adequacy ratios above the minimum regulatory requirement and generally high profitability. Both the return on equity and return on assets increased as at end-September 2012. Credit growth and asset quality have generally been maintained, albeit an increase in non-performing loans in some sectors, more specifically the construction sector, has been noted, thereby warranting closer monitoring in 2013. Banks have operated in a favourable funding environment, with most of them, including foreign-owned banks, being able to rely on deposits for funding instead of wholesale short-term funding. Financial stability indicators have remained at comfortable levels and a stress test has shown that the banking sector would, by and large, be capable of absorbing a shock to credit quality. To further strengthen the soundness of the sector, the Bank has issued a Consultative Paper on the implementation of Basel III in Mauritius.

Non-bank deposit-taking institutions have also performed well, with adequate capital and stable liquidity. In the insurance industry, the low yield environment remained an important challenge. While the insurance sector is interconnected to the broader financial sector in a number of ways, its relatively small size suggests that the systemic risk to the financial sector is limited. In terms of reinsurance, it has been found that should an event, such as a large natural disaster, occur, the industry as a whole is not highly exposed to any one reinsurer.

The payment and settlement systems operated efficiently and without any major disruptions in 2012H2. Transactions on the Mauritius Automated Clearing and Settlement System exceeded the Rs1 trillion mark while the Cheque Truncation System and Bulk Clearing System provided reliable support for low value transactions.

Overall, the slow improvement in the global environment and important threats linked to a possible re-intensification of the euro area sovereign debt crisis suggest continued risks to financial stability. However, conditions in the domestic financial system are such that these risks are likely to be contained in Mauritius in the short- to medium- term.

2. The International Environment

Policy actions in major advanced economies have improved investor confidence and stabilised global economic and financial conditions. Funding pressures have eased while sovereign debt yields have come down, even for the countries most exposed to the crisis. However, persistent risks from the euro area sovereign debt crisis as well as the threats of excessive fiscal consolidation in the US in the short term remain significant and contribute to keep the economic and financial outlook fragile. Regulatory reforms undertaken in the wake of the crisis have contributed to strengthen the financial position of international banks and the progress being made by European authorities on the creation of a banking union is expected to further reinforce the role of banks as intermediaries.

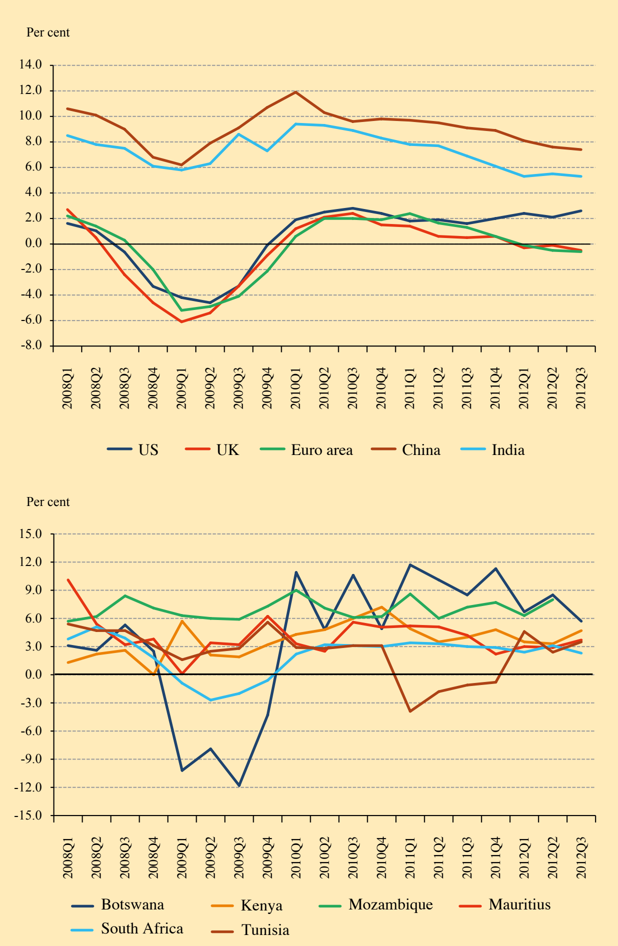
2.1 Macro-Financial Developments

Effective policy actions in the euro area and the US have lowered the risks to global financial stability since the August 2012 Financial Stability Report. Concerns over the so-called US fiscal cliff have abated, leading to a slight improvement in global economic and financial conditions in the latter part of 2012. However, downside risks from a potential re-intensification of the euro area crisis or protracted contraction of the Eurozone remain significant and uncertainty over the debt ceiling in the US persists. In its World Economic Outlook Update of January 2013, the IMF forecasts world growth to strengthen to 3.5 per cent in 2013, from 3.2 per cent in 2012.

Growth in advanced economies slowed during 2012 and the recovery is projected to be very gradual as fiscal vulnerabilities remain elevated despite on-going efforts to restore the sustainability of public finances. In the US, the economy is expected to pick up slowly amid high unemployment and, in the near term, risks of excessive fiscal consolidation loom. In the euro area, the contraction in GDP in 2012 was to some extent mitigated by growth in Germany and France. In 2013, given the large risks still stemming from the sovereign debt crisis and the tight credit conditions, it is expected that the region may struggle to return to growth. Economic conditions in the UK continue to be sluggish, with the main risks arising from subdued consumption and investment, and the euro area sovereign debt crisis. The Japanese economy has slid into recession in 2012Q3 but is expected to grow in 2013, supported by significant fiscal stimulus, further monetary easing and increased external demand from a weaker yen (Chart 2.1).

In emerging market and developing economies, growth has moderated during 2012 as demand for exports fell. In 2013, growth is expected to improve slightly as policies remain accommodative and capital inflows continue. Sub-Saharan Africa remains exposed to the European sovereign debt crisis through three main channels, notably trade links, capital flows and bank flows but the near-term outlook remains broadly positive. South Africa is expected to rebound to some extent in 2013 while many of the low-income countries within the sub-Saharan region are projected to continue to grow strongly, supported by domestic demand and investment.

Chart 2.1: Y-o-y Growth Rates of Selected Economies



Source: Trading Economics.

Reflecting the uncertainty posed by the euro area fiscal situation, Moody's downgraded Italy's government bond rating to Baa2 in July 2012 given the risks of contagion from other problem countries within the region. It also downgraded France's AAA rating by one notch to AA1 in November 2012 as structural challenges, namely lack of competitiveness, high unemployment, public debt and market rigidity, were seen to weigh on economic growth (Chart 2.2). In October 2012, Standard & Poor's downgraded Spain's credit rating by two notches to BBB-, warning that the deepening economic recession was limiting the government's options to move out of the crisis. On the other hand, greater clarity in the actions undertaken by the authorities to lead the Eurozone out of the crisis prompted Standard & Poor's to raise Greece's sovereign credit rating from selective default to B- with a stable outlook in December 2012, citing efforts by European partners to keep the country within the euro area. Elsewhere, South Africa's credit rating was downgraded by Moody's, Standard & Poor's and Fitch to reflect the deterioration of the country's economic prospects.

2.1.1 Global Financial Markets

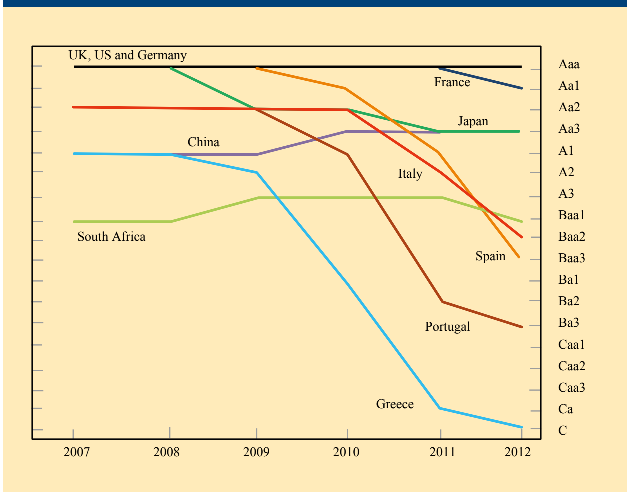
Policy actions by several central banks during 2012H2 spurred market optimism and increased risk appetite but, as long as there is no definite resolution of the euro area crisis, investor confidence is expected to remain fragile.

Decisive steps by the European Central Bank (ECB) to show commitment to resolve the crisis, in particular the announcement in September 2012 that it would stand ready to undertake Outright Monetary Transactions (OMTs) in the secondary sovereign bond market, boosted markets and helped ease funding pressures. The decision of the US Federal Reserve to conduct further asset purchases and keep interest rates at exceptionally low levels until the labour market outlook would improve as well as a further round of stimulus in Japan also contributed to the increase in market confidence, with market volatility generally subsiding in 2012H2 (Chart 2.3).

Developments in Bond Markets

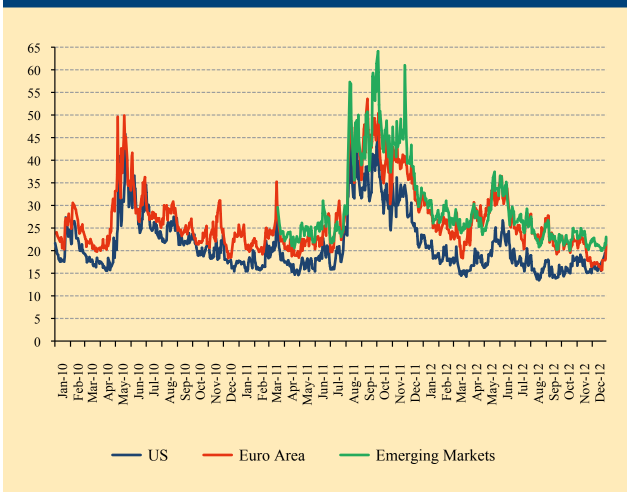
As pressures in euro area government bond markets eased following the unconventional measures adopted by the ECB, yields in the countries most exposed to sovereign risks fell, helping to contain debt servicing and the cost of borrowing on international markets (Chart 2.4). The decline in yields was particularly visible in Italy and Spain. Moody's downgrade of France had little impact on sovereign yields as it did not drastically change market's perception of risks associated to the country. Thus, within the euro area, the yield spreads of 10-year sovereign bonds vis-à-vis German sovereign bunds decreased for Italy, Spain, Greece, Ireland and Portugal while they remained broadly stable for France in 2012H2. Notwithstanding high public debt levels in the US and UK as well as fears related to the US fiscal cliff, yields on US and UK government bonds remained near historical lows.

Chart 2.2: Moody's Credit Rating of Selected Countries



Note: All data points are at year-end.
Source: Moody's.

Chart 2.3: Financial Markets Volatility



Source: Thomson Reuters.

Global Stock Markets

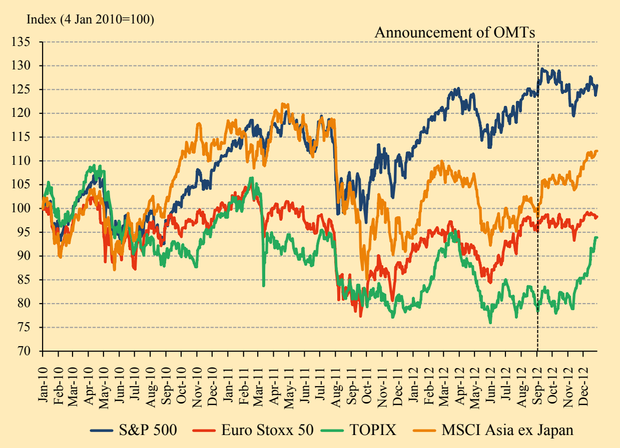
Global equity markets mostly rallied in 2012H2 as higher risk tolerance and the low-yield environment appeared to have encouraged portfolio rebalancing and prompted investors in search of higher returns to move into riskier assets. In the US, equity price indices were positively affected by a series of better-than-expected macroeconomic data releases but gains tended to be trimmed down by doubts over whether the fiscal cliff would be averted. While European stocks benefited from the ECB's strong policy initiatives, stimulus to bolster economic activity by the new government in Japan led to a rapid increase in equity price indices towards the end of 2012 (Chart 2.5). In 2012H2, equity prices increased by around 5 per cent, 8 per cent and 11 per cent in the US, euro area and Japan, respectively, and were up by more than 10 per cent in major emerging stock markets.

Evolution of Major Currencies

The evolution of major currencies during 2012H2 broadly reflected the improvement in market sentiment (Chart 2.6). As risk appetite rose, the US dollar lost some of its safe-haven status and broadly depreciated vis-à-vis the euro and Pound sterling. Its downward move was accentuated by the announcement of a fresh round of monetary stimulus by the US Federal Reserve and Moody's warning of a possible downgrade of the US credit rating if the debt problems endured. Concerns that US policymakers might not reach a deal to forestall the fiscal cliff brought some support to the US dollar but this proved to be short-lived as market optimism for an agreement increased.

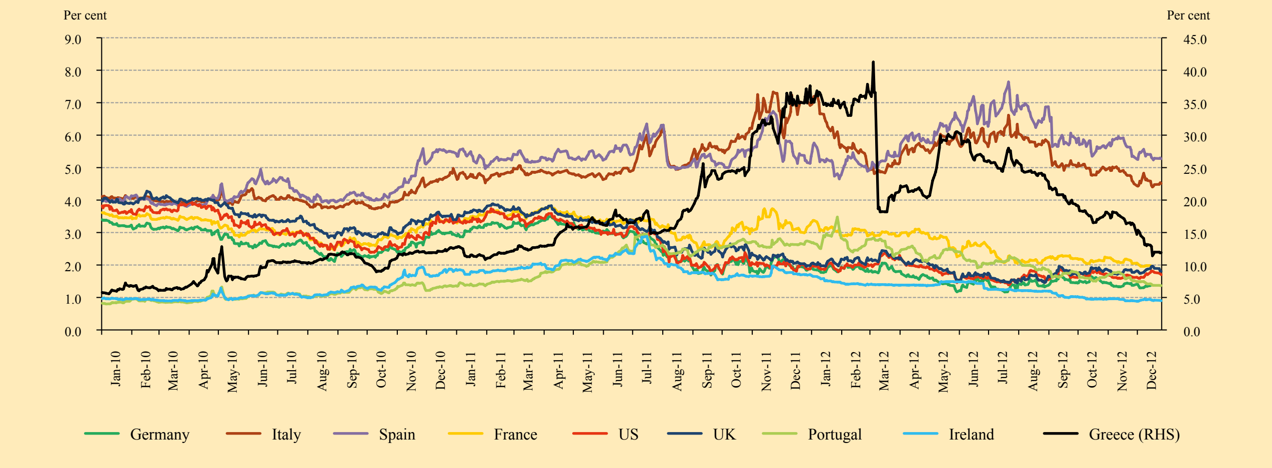
The appreciation of the euro against the US dollar was capped to some extent by the ECB's decision to cut interest rates and Moody's downgrade of Italy's credit rating in July 2012 but the single currency managed to recoup losses thereafter as markets stabilised. The Pound sterling closely tracked movements in the euro, reaching a high of US$1.6241 in September 2012 on the back of some better-than-expected UK data releases and policy announcements by the ECB and US Federal Reserve. Its gains were, however, tempered by on-going worries about the fragility of the UK economy. In contrast, the Japanese yen fell markedly during 2012H2 as the Bank of Japan embarked on massive monetary stimulus.

Chart 2.5: Global Equity Indices



Source: Thomson Reuters.

Chart 2.4: 10-Year Yields on Government Bonds



Source: Thomson Reuters.

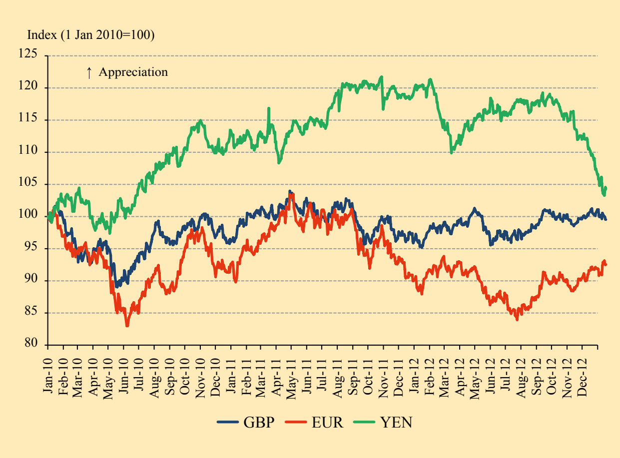
2.2 Global Imbalances

Global imbalances pose risks to financial stability through volatile and destabilising capital flows. During 2012H2, a narrowing of imbalances was noted.

Country-wise, the US current account deficit has declined as a result of the large adjustment in the US real estate market and the reduction in the excessive leverage of households and financial firms. Within the euro area, imbalances have narrowed mainly on the back of lower demand in deficit-economies of the periphery, decreases in budgetary deficits and adjustments in labour costs. There is evidence that rebalancing has also started in China where the current account surplus has narrowed markedly and foreign exchange reserves accumulation has slowed down significantly amid signs that the economy is gradually shifting from external sources of demand to domestic ones.

Looking ahead, imbalances are projected to continue to tighten given weaker demand from countries hit by the crisis and continued improvements in fiscal balances in countries with high current account deficits. However, for the adjustment process to be durable, financial sector and regulatory reforms need to be pursued as well as medium-term fiscal consolidation to ensure the sustainability of public finances.

Chart 2.6: Exchange Rate Movements against the US Dollar



Source: Thomson Reuters.

2.3 International Banking Sector

The international banking sector has improved during 2012H2. Banks have, generally, continued to strengthen their capital positions in response to market and regulatory pressures but they remain at risk from economic and financial developments. Weak economic activity and tougher regulation have undermined the performance of banks globally and, in the case of some large international banks, profitability has also been affected by regulatory fines. The process of deleveraging has eased capital and liquidity positions of vulnerable banks but is obstructing the path of revenue growth. The announcement of OMTs by the ECB has brought down interbank borrowing costs of vulnerable banks in major markets (Chart 2.7).

The financial condition of large banks in the US has gradually improved. While lending standards have eased, they remain tighter in the housing sector. Lending has remained largely concentrated among the less risky borrowers as banks face the challenge of a lacklustre economic environment and the near-zero interest rate policy, which dampen the return on capital. To ensure that systemically-important banking institutions have robust and forward-looking processes to account for system-wide risks and to withstand economic and financial stress, the US Federal Reserve launched the 2013 capital planning and stress testing program.

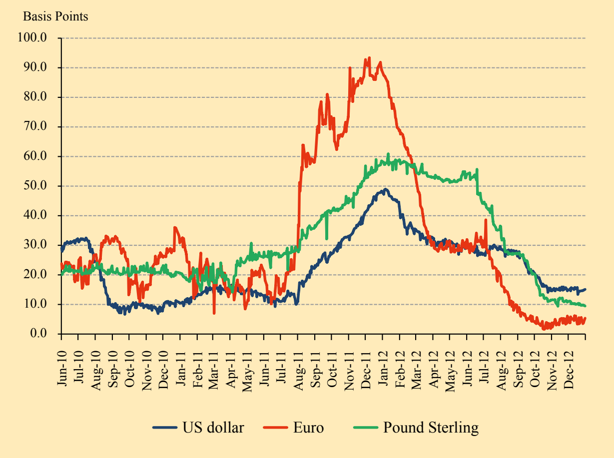
In Europe, the fragmentation of credit flows continues to weigh on financial stability by exerting further pressure on cross-border financing of vulnerable banks, mostly in the periphery. Fundamentally, fragmentation has clouded the European financial skyline as foreign banks have squeezed lending to governments in countries visibly affected by the debt crisis, causing significant divergence in borrowing rates. Business lending conditions remain tight in a number of member countries. The regulatory landscape in Europe is changing to accommodate a more unified supervisory agency and progress towards the establishment of a banking union is restoring market confidence (Box I). However, deficient growth continues to affect the profitability and asset quality of European banks as non-performing loans rise.

In the UK, the authorities have launched the Funding for Lending Scheme in July 2012 to boost credit. According to the Bank of England's *Credit Conditions*

Survey, the overall availability of credit to households and corporates increased significantly in 2012Q4 and there were expectations that it would continue to increase in 2013Q1. However, the overall demand for credit remained muted due to a lack of confidence among firms.

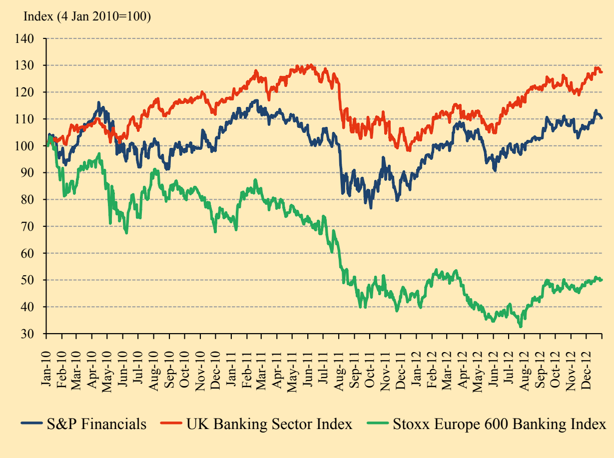
Despite the vulnerabilities of the international banking sector, banks' equity price indices in the US and Europe have been on an upward trend in 2012H2 mainly as a result of investors moving into riskier assets (Chart 2.8).

Chart 2.7: Three-month Libor-OIS Spreads



Source: Thomson Reuters.

Chart 2.8: Financial Indices



Source: Thomson Reuters.

Box I: The Euro Area Banking Union

As the euro area sovereign debt crisis intensified, the lack of coordination among the different national banking regulatory systems in place in Europe made it difficult to respond to the crisis and its contagion to sovereigns. Market funding pressures thus led to a growing fragmentation of the banking system in the euro area.

In June 2012, EU leaders concurred to deepen economic and monetary union as one of the remedies of the crisis and, in September 2012, the European Commission presented its proposals for a single banking supervision mechanism in the euro area. The need for a banking union rests on four pillars: a single rulebook, a single supervisory mechanism (SSM), a common resolution structure and shared deposit insurance. The SSM, by bringing all supervisory decisions about the euro area under the ECB and allowing supervisors to take into account externalities and general exposures to systemic risk, is considered as the most urgent component of the banking union and a crucial element in supporting economic and monetary integration.

With the ECB holding the ultimate responsibility for supervision of banks in the euro area, it is expected that the highest standards in supervision will be adhered to, thus increasing financial stability in the euro area. It is also considered that single supervision is the precondition for the introduction of potential direct recapitalisation of banks by the European Stability Mechanism (ESM). This will contribute to breaking the negative feedback loop between banks and sovereigns as the ESM loans would not add to the debt burden of countries facing intense market pressure and would ensure that capital of banking institutions is adequate both in quantity and in quality so as to cushion against future shocks.

The SSM is expected to become operational in early 2013. During the phasing-in process, it is expected that the ECB will be responsible for the supervision of banks of systemic importance by 1 July 2013 and of all banks within the euro area by 1 January 2014. Non-euro area countries of the European Community would not be fully part of the SSM but they might join the SSM by establishing close cooperation between their national authorities and the ECB.

3. Domestic Macroprudential Assessment

The domestic economy has weathered the external headwinds reasonably well in 2012H2 although the main export sectors remain at risk from economic and financial developments in the euro area. While external vulnerabilities are of general concern for a small open economy like Mauritius, they are perceived to be manageable even in the current context. Domestically, fiscal policy has been prudent and Government has been able to raise financing at reasonable rates. Financial markets have functioned properly, with the Bank's intervention on the money and foreign exchange markets containing undue liquidity pressures. Credit growth has generally been sustained but a rise in non-performing loans has been noted, thus warranting closer monitoring and action to avoid further deterioration. The banking sector has been resilient, with adequate capitalisation, funding and profitability, and has been assessed to be able to suitably withstand the impact of a shock arising from a general weakening of economic activity on its credit portfolio. The insurance sector has also performed adequately in 2012H2, posing limited risks to financial stability. The payment systems operated reliably, without any downtime. Generally, although the difficult global outlook entails financial stability risks, these are likely to be contained in 2013 as global conditions slowly improve.

3.1 The Domestic Economy

In 2012, the domestic economy performed relatively well against the backdrop of challenging global economic conditions, with growth estimated at 3.3 per cent. The '*financial and insurance activities*', '*information and communication*', '*wholesale and retail trade*' and '*manufacturing*' sectors were assessed to have contributed the most to output growth while '*accommodation and food service activities*' has stagnated. Notwithstanding the recent signs of stabilisation in the global economy, downside risks to the domestic growth outlook emanating principally from a potential re-intensification of the euro area sovereign debt crisis remain.

3.1.1 External Vulnerabilities

External vulnerabilities have important financial stability implications for a small open economy through their potential impact on economic activity, financial markets and fiscal policy. In Mauritius, the threats arising from external sources, in particular with regard to capital flows, foreign exchange reserves and external debt, are perceived to be manageable (Box II).

Box II: External Indicators

		Sep-11	Sep-12
		Rs million	
Gross External Debt [1]	as at end	43,840	49,109
External Debt Service	year ended	7,525	6,763
Exports of Goods	year ended	74,275	78,210
Exports of Goods and Services	year ended	166,427	179,701
Imports of Goods and Services	year ended	207,562	223,490
Gross Official International Reserves [2]	as at end	80,060	89,379
GDP at market prices	year ended	322,773	344,550
Broad Money Liabilities	as at end	323,566	344,131

[1] *Gross external debt outstanding as at end of period comprises general Government, public corporations, monetary authorities and private sector.*

[2] *Gross Official International Reserves as at end of period comprises gross foreign assets of the Bank of Mauritius, reserve position in the IMF and the foreign assets of Government.*

Box II: External Indicators (Continued)

Indicators	Sep-11	Sep-12
	Per cent	
I. Solvency		
Gross External Debt/GDP	13.6	14.3
Gross External Debt/Exports of Goods	59.0	62.8
Gross External Debt/Exports of Goods and Services	26.3	27.3
External Debt Service/Exports of Goods	10.1	8.6
External Debt Service/Exports of Goods and Services	4.5	3.8
II. Reserve Adequacy		
Reserves/Imports of Goods and Services	38.6	40.0
Reserves/ Broad Money Liabilities	24.7	26.0
Reserves/Gross External Debt	182.6	182.0

Balance of Payments

The current account deficit, inclusive of cross-border transactions of GBC1s, fell by 19.0 per cent to Rs10.9 billion in 2012Q3 compared to the corresponding period of 2011. As a percentage of GDP at market prices, the current account deficit moderated to 12.7 per cent compared to 16.7 per cent in 2011Q3. It continues to be largely financed by direct investment, which, inclusive of GBC1s cross-border transactions, recorded net inflows of Rs129,666 million in 2012Q3. This more than offset higher net outflows in portfolio investment and other investment (Chart 3.1).

Foreign Direct Investment (FDI) into the country has helped to increase momentum in various sectors of the economy. During the period January to September 2012, gross FDI inflows, exclusive of GBC1s, were mainly channeled to *'real estate activities'*, the bulk of which consisted of inflows into the Integrated Resorts Scheme, Real Estate Scheme and Invest Hotels Scheme. The *'construction'*, *'financial and insurance activities'* and *'accommodation and food service activities'* were among the other beneficiaries of gross FDI inflows (Chart 3.2).

Gross FDI inflows, excluding GBC1s, continued to originate mostly from Europe although total FDI inflows from that region have been consistently falling since 2010 given the sovereign debt crisis. In contrast, FDI inflows from the African region, notably South Africa, have increased over the past few years. Similarly, inflows from Asia, which have been more volatile

Chart 3.1: Financing of the Current Account Deficit

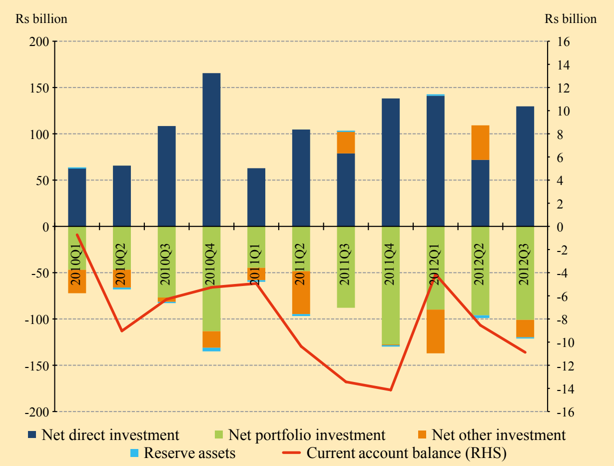
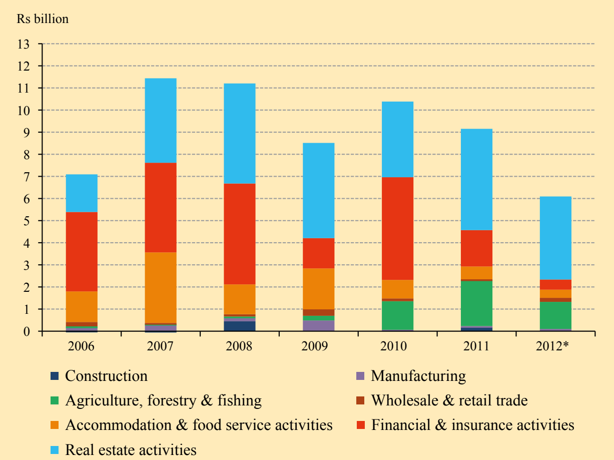


Chart 3.2: Foreign Direct Investment by Sector



* *Provisional estimates for the period January-September 2012.*

over time, have increased over the period January to September 2012 (Chart 3.3).

Reserve Adequacy

Adequacy of reserves is an important parameter in gauging the ability of a country to absorb external shocks. With the import coverage of international reserves at 4.5 months as at end-May 2012, the Bank embarked on an Operation Reserves Reconstitution programme as from June 2012 to build up foreign exchange reserves as additional insurance against possible external shocks. As at end-December 2012, gross official international reserves stood at Rs93.0 billion, representing 5.3 months of import cover, based on the value of imports of goods *f.o.b* and non-factor services in 2011 (Chart 3.4).

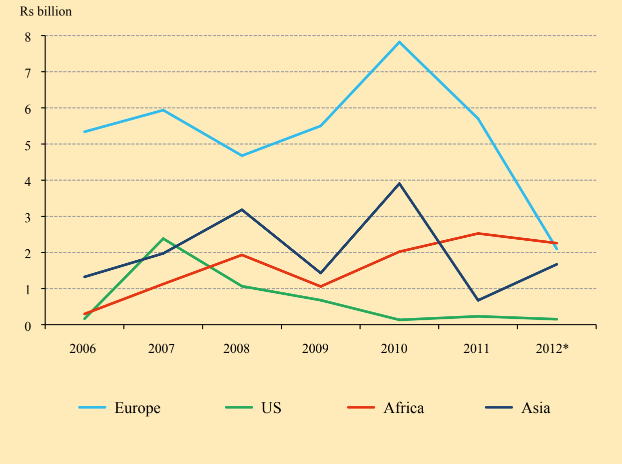
External Debt

The country's gross external debt rose by 12.0 per cent y-o-y to Rs49,109 million as at end-September 2012, driven mainly by increases in central Government and public enterprises external debt. Gross external debt represented 14.3 per cent of GDP as at end-September 2012, up from 13.6 per cent of GDP as at end-September 2011.

Reflecting Government's strategy to shift towards more foreign financing and concurrently to lengthen the maturity profile of its debt, central Government external debt stood at 9.1 per cent of GDP as at end-September 2012. It is expected to reach 9.9 per cent of GDP as at end-December 2012 and is projected to grow steadily to 11.7 per cent, 13.9 per cent and 14.3 per cent, respectively, as at end-December 2013, 2014 and 2015. As at end-September 2012, central Government external debt was mostly denominated in euros and US dollars (Chart 3.5).

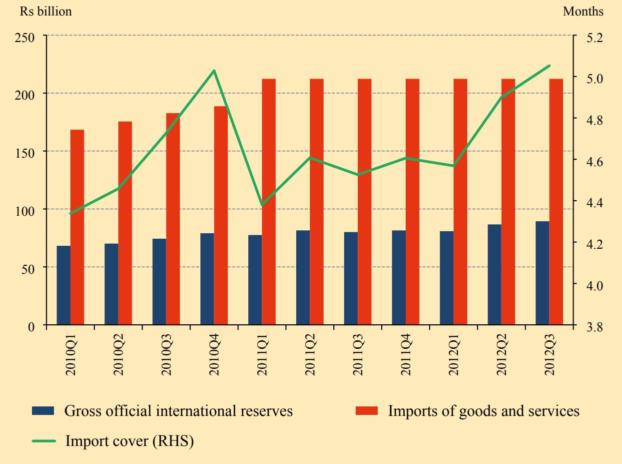
Around 69.0 per cent of central Government external debt was based on floating interest rates while 26.1 per cent carried a fixed interest rate and 4.9 per cent was interest rate-free. The profile of Government external debt is not expected to be subject to major exchange rate or interest rate risks in the short- to medium-term given that accommodative monetary policies are projected to be maintained to support growth in advanced economies. The debt-service ratio is forecast to decline from 3.6 per cent in 2012 to 3.4 per cent in 2013 and to pick up to 4.2 per cent and 5.0 per cent in 2014 and 2015, respectively.

Chart 3.3: Foreign Direct Investment by Geographical Origin



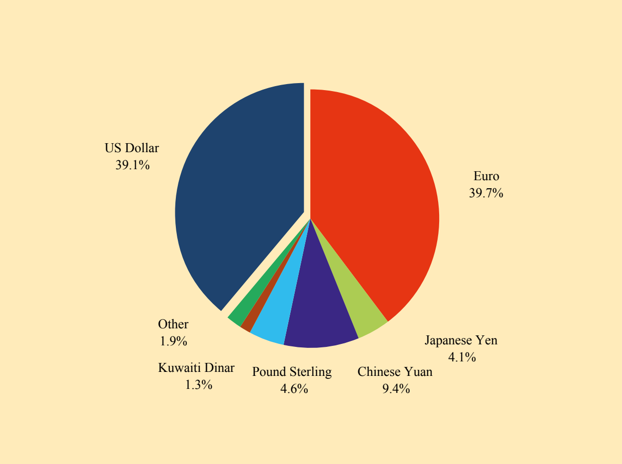
* Provisional estimates for the period January-September 2012.

Chart 3.4: Gross Official International Reserves and Import Cover



* Provisional estimates for the period January-September 2012.

Chart 3.5: Currency Composition of Central Government External Debt



3.1.2 Total Public Sector Debt

Government has pursued its efforts towards fiscal consolidation to improve debt sustainability. The budget deficit, which stood at 3.2 per cent of GDP in 2011, is estimated at 2.5 per cent in 2012, owing to lower net capital investment by Government, and further down to 1.7 per cent in 2015. The primary balance is expected to post a surplus of 0.6 per cent of GDP in 2012 as against a deficit of 0.2 per cent of GDP in 2011. Over the period 2013-2015, the primary balance is projected to remain positive, fluctuating between 0.7 per cent and 1.3 per cent of GDP.

Public sector debt, comprising debt of general Government and public enterprises, stood at 57.0 per cent of GDP as at end-December 2012. The debt-to-GDP ratio is expected to decrease to 56.5 per cent as at end-December 2013 and further down to 55.8 per cent and 54.1 per cent in the subsequent two years.

Measures undertaken to lengthen the maturity profile of Government debt and mitigate rollover risks have resulted in long-term domestic debt (by original maturity) as a proportion of total domestic government debt increasing from 42.5 per cent as at end-December 2011 to 49.4 per cent as at end-December 2012 though a significant portion of domestic Government debt is still expected to mature over the coming three years (Chart 3.6).

3.2 Financial Markets

3.2.1 Money Market

Conditions in the money market do not point to any liquidity pressures and show that Government has been able to issue debt at relatively reasonable rates. Overall excess liquidity in the banking system averaged Rs3.0 billion during 2012H2 compared to an average of Rs2.0 billion in the corresponding period of 2011 (Chart 3.7). Net redemption of Government securities, deposits of a public fund with banks, net intervention by the Bank on the domestic foreign exchange market and Government purchases of foreign currencies were the major factors that contributed to the overall excess liquidity. As part of its money market operations, the Bank renewed some of the maturing Bank of Mauritius securities for a total nominal amount of Rs843.7 million during 2012H2.

Notwithstanding a Key Repo Rate which has remained unchanged in 2012H2, short-term money market rates declined during that period. Overall interbank interest rates ranged between 1.45 per cent and 3.00 per cent compared to a range of 1.65 per cent to 4.15 per cent in 2011H2. The overnight interbank interest rate fluctuated between 1.40 per cent and 2.25 per cent while interest rates on short notice and term transactions hovered within a range of 1.80 per cent to 3.00 per cent. The overall weighted average interbank interest rate stood at 1.69 per cent in 2012H2 compared to 2.84 per cent in 2011H2.

Yields on Treasury Bills and Three-Year Treasury Notes broadly followed the same trend given excess liquidity conditions and market bidding patterns. The overall weighted yield on Treasury Bills declined from 4.59 per cent as at end-December 2011 to 2.89

Chart 3.6: Redemption Profile of Government Debt

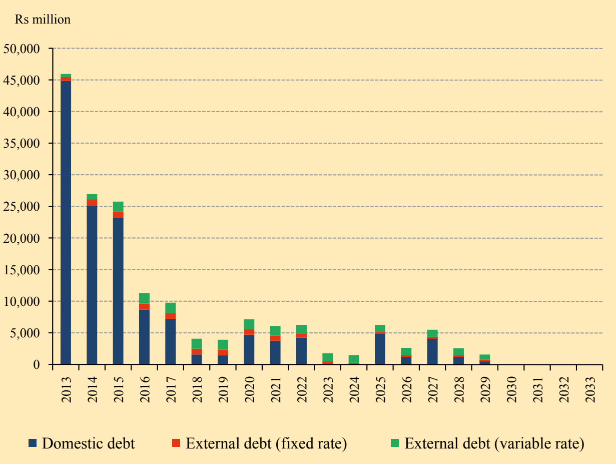
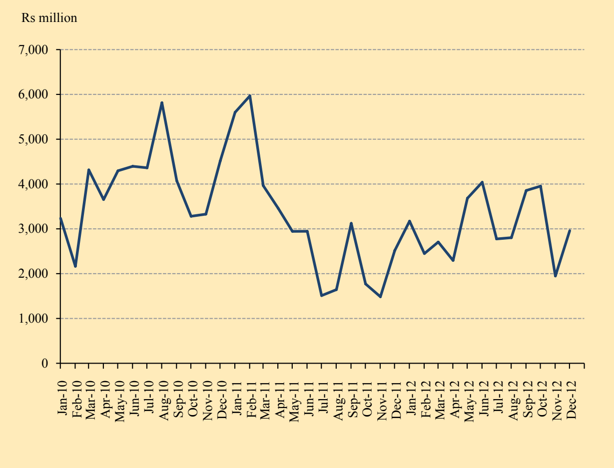


Chart 3.7: Banks' Monthly Average Excess Reserves



per cent as at end-December 2012 while the weighted yield on Three-Year Treasury Notes fell to 4.42 per cent, from 5.97 per cent over the same period (Chart 3.8). The falls in yields have contributed to a reduction in Government financing costs.

3.2.2 Foreign Exchange Market

The rupee exchange rate reflected the evolution of major currencies on international markets as well as domestic demand and supply conditions. Since the August 2012 Financial Stability Report, based on the average dealt selling rate on transactions equivalent to US$30,000 or above, the rupee has depreciated by 2.59 per cent and 1.94 per cent against the euro and Pound sterling, respectively, and appreciated by 0.99 per cent against the US dollar. In nominal effective terms, the trade-weighted value of the domestic currency, as measured by MERI1 and MERI2[1], registered depreciation of 0.57 per cent and 0.70 per cent, respectively, between July and December 2012 (Chart 3.9).

Partly reflecting alleviated conditions on international markets and the Bank's intervention on the domestic foreign exchange market during 2012H2, the volatility of the Rs/USD and Rs/EUR exchange rates have lessened (Chart 3.10).

3.2.3 Stock Market

The local stock market was largely driven by domestic factors during 2012H2, with investors maintaining a cautious mood. The SEMDEX and SEM-7 declined by 3.8 per cent and 2.4 per cent, respectively, reflecting the fall in the share prices of the three quoted hotel groups, which respectively lost 23.9 per cent, 23.2 per cent and 21.2 per cent, as the sector was buffeted by the crisis in the Eurozone. In contrast, the relatively strong financial performance of domestic banks sparked investors' risk appetite in this asset class, resulting in banking stocks outperforming the market and posting strong gains in the last quarter of 2012 (Chart 3.11).

Net foreign investment on the domestic stock market improved significantly during 2012H2, with net inflows of Rs119.1 million mainly in the *'Banks, Insurance and Other Finance'* sector (Chart 3.12). Overall, holdings by non-residents accounted for around 27.8 per cent of the total value traded on the stock market.

Chart 3.8: Yields on Government Securities

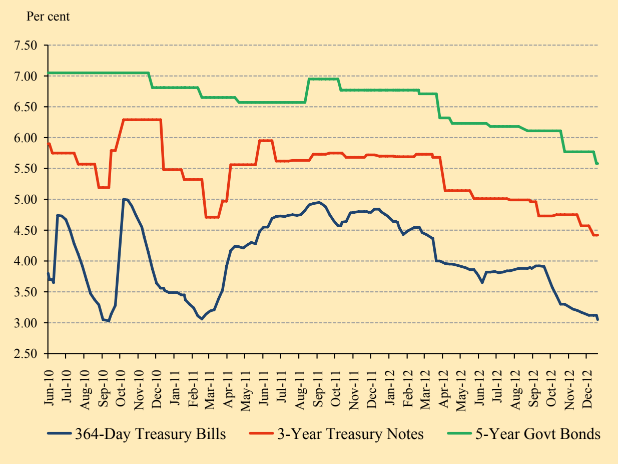


Chart 3.9: Exchange Rate Movements

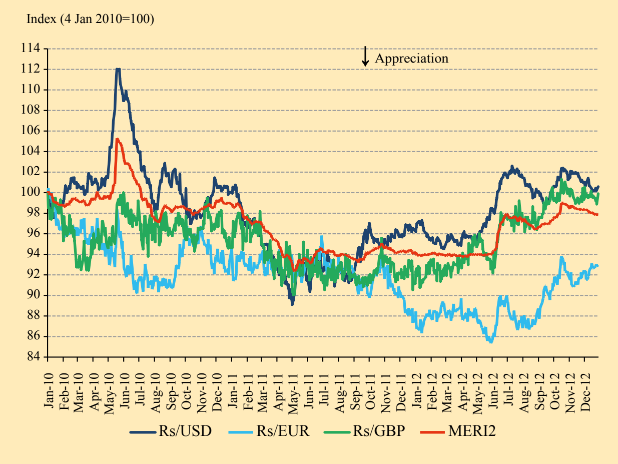
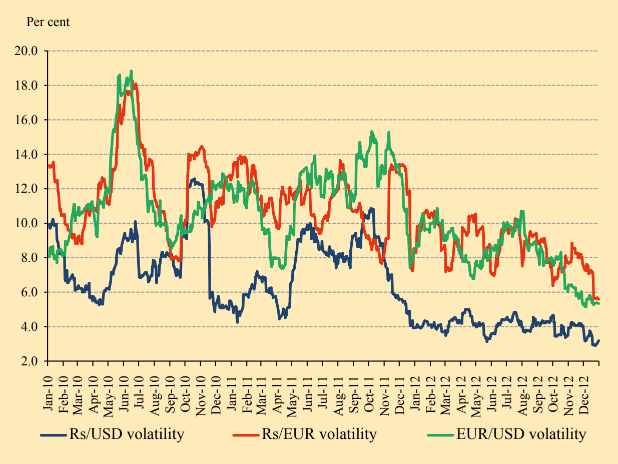


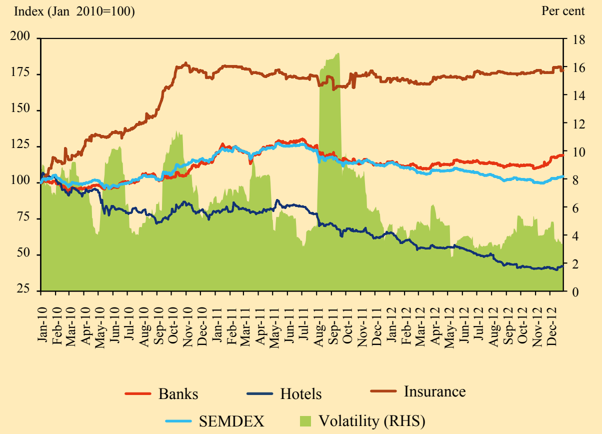
Chart 3.10: Volatility of the Rupee



[1] *The MERI is a nominal effective rupee exchange rate calculated on the basis of the rupee exchange rate against the currencies of the main trading partners of Mauritius. The MERI was introduced in the first issue of the Financial Stability Report in June 2008. The Bank is currently reviewing and updating the MERI and will release the new series shortly.*

The market price-earnings (PE) ratio rose from 10.63 in June 2012 to 11.06 in December 2012, mainly on account of a large increase in the PE ratio of the *'Industry'* sector and, to a lesser extent, in the *'Sugar'* sector. PE ratios in the *'Investments'*, *'Commerce'* and *'Leisure and Hotel'* sectors fell during 2012H2.

Chart 3.11: Share Price Indices of Banks, Hotels, Insurance, the SEMDEX and Volatility



Source: Stock Exchange of Mauritius.

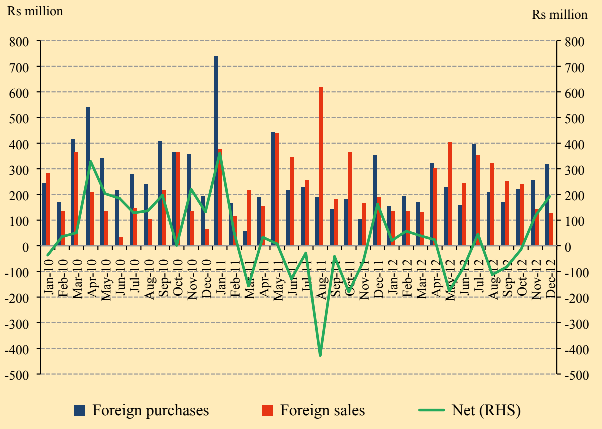
3.3 Credit Growth and Credit Risks

3.3.1 Total Credit

With loans and advances accounting for around 65 per cent of banks' total assets, the quality of credit is a major element of banks' risk assessment. Generally, credit risks in the domestic banking sector are viewed to be within manageable levels.

During 2012H2, reflecting the uncertain global and domestic economic environment, total credit growth subsided to 7.5 per cent y-o-y as at end-September 2012 compared to 14.6 per cent y-o-y as at end-September 2011. This was driven by a sharp slowdown in the expansion of credit extended outside Mauritius to 5.2 per cent y-o-y, from 18.4 per cent a year earlier (Chart 3.13).

Chart 3.12: Investment by Non-Residents on the SEM

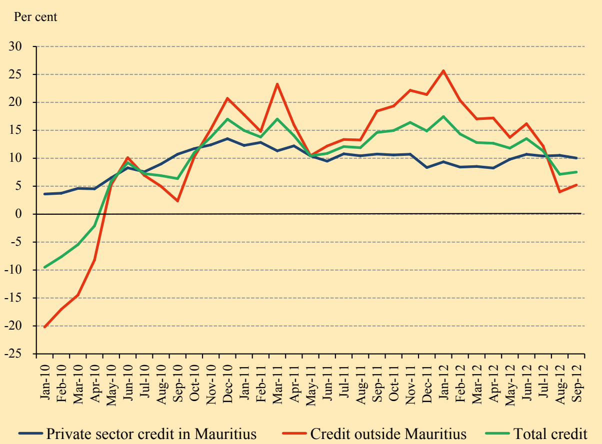


After decelerating in 2011, credit extended to the private sector in Mauritius picked up at the beginning of 2012 before stalling somewhat in 2012Q3. As at end-September 2012, credit to the private sector, which represented 49.1 per cent of total credit, expanded by 10.0 per cent, slightly lower than the growth of 10.8 per cent recorded as at end-September 2011. As a percentage of GDP, credit to the private sector increased to 72.6 per cent as at end-September 2012 compared to 70.0 per cent as at end-September 2011. Growth of credit to the private sector has remained below its long-term average since May 2011, partly reflecting the lower optimism in the economy as the euro area sovereign debt crisis intensified and possibly tighter lending conditions by banks (Chart 3.14).

Credit Quality

Non-performing loans (NPLs) on both private sector credit in Mauritius and credit extended outside Mauritius rose during the year to September 2012 due to challenging economic conditions. Overall, the ratio of total NPLs to total credit deteriorated slightly over the year but, at 3.1 per cent as at end-September 2012, is still considered reasonable (Table 3.1).

Chart 3.13: Y-o-y Credit Growth



The realisable value of collaterals on private sector credit mitigated the specific provisions required on the NPLs. Thus, even as the amount of NPLs on private sector credit rose by 30.3 per cent between end-September 2011 and end-September 2012, specific provisions grew by 14.4 per cent during this period. The coverage ratio, that is, the ratio of specific provision to non-performing loans, fell from 45.5 per cent to 39.9 per cent but is nonetheless considered as adequate buffer against future losses in the short- to medium-term (Chart 3.15).

3.3.2 Household Credit

Lending to households has increased steadily over the past years, with growth hovering at an annual average of 16 per cent over the past two years and the level of household credit in the domestic economy reaching 19.4 per cent of GDP as at end-September 2012. Housing and consumption loans, the two components of household credit, represented 59.9 per cent and 40.1 per cent of total credit to the household sector, respectively, as at end-September 2012 compared to 58.8 per cent and 41.2 per cent, respectively, as at end-September 2011 (Chart 3.16).

Given sustained demand for residential property, housing loans have increased by 18.5 per cent on average over the past five years although a deceleration in growth has been noted since 2012H2 (Chart 3.16). The quality of housing loans generally stands good in the balance sheets of banks.

Credit for consumption purposes expanded by 13.4 per cent as at end-September 2012 compared to 7.7 per cent as at end-September 2011. Of this, credit card facilities were marginal, representing only 7.6 per cent of total consumption loans as at end-September 2012. In general, the growth in consumption loans appears to have supported nominal household consumption expenditure (Chart 3.17). Overall, the growth in consumption loans is expected to maintain momentum as the recent Pay Research Bureau wage award coupled with the prevailing low interest rate environment may uphold demand for credit.

Chart 3.14: Y-o-y Growth of Private Sector Credit

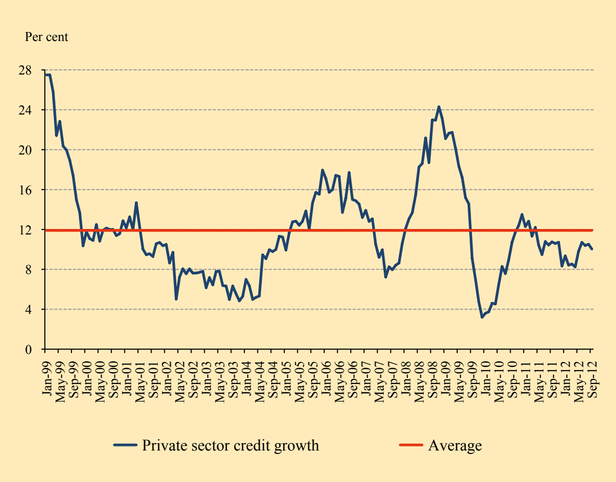


Chart 3.15: Non-Performing Loans and Coverage Ratio

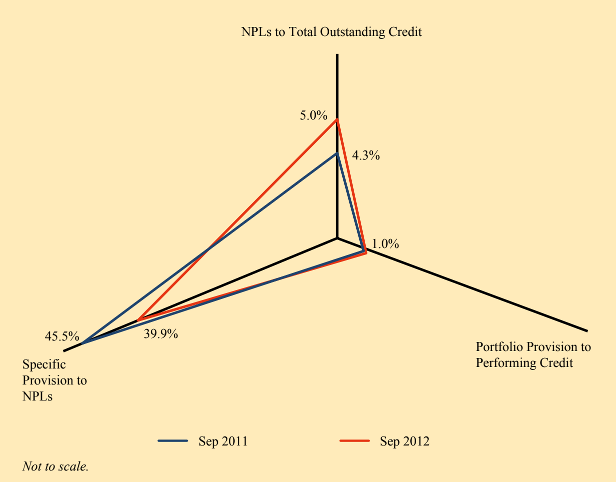


Table 3.1: Non-Performing Loans of Banks

	NPLs as a percentage of private sector credit	NPLs as a percentage of credit outside Mauritius	Total NPLs as a percentage of total credit
Sep-10	4.2	0.4	2.1
Sep-11	4.3	0.7	2.3
Dec-11	4.5	0.6	2.3
Mar-12	4.6	1.0	2.6
Jun-12	5.1	1.5	3.1
Sep-12	5.0	1.4	3.1

Generally, the financial condition of households has remained sound as most of them appear to have been able to service their debt. Moreover, the NPLs ratio of the *'personal'* sector has showed some sign of abatement, coming down to 16.1 per cent as at end-September 2012. Although this sector warrants continuous monitoring, the likelihood of a most adverse scenario whereby economic conditions weaken significantly, with sharp reductions in household income and employment, seems limited in the current context.

3.3.3 Credit to Corporate Sector

As at end-September 2012, credit to the corporate sector accounted for 70.7 per cent of total credit to the private sector compared to 71.2 per cent as at end-September 2011. The fall in business confidence over the year may partly explain the decline in corporate credit growth, which went down to 9.2 per cent as at end-September 2012, from 10.7 per cent as at end-September 2011.

The major share of corporate sector credit was directed to the *'tourism'* sector, which represented 25.4 per cent of total corporate credit as at end-September 2012. Credit to the *'traders'*, *'construction'* (excluding housing loans), and *'financial and business services'* sectors accounted for 17.0 per cent, 14.9 per cent and 14.3 per cent of total corporate credit, respectively.

Credit growth dropped significantly in three sectors as at end-September 2012 relative to a year earlier: growth of credit to the *'tourism'* sector declined markedly to 1.6 per cent, from 12.3 per cent while that of the *'financial and business services'* sector slowed to 6.0 per cent, from 11.6 per cent; and *'manufacturing'* sector credit growth moderated to 0.2 per cent compared to 7.9 per cent.

In contrast, credit to *'traders'* grew at a higher pace of 13.1 per cent compared to 10.2 per cent as at end-September 2011 (Chart 3.18). Credit growth to the *'construction'* sector (excluding housing loans) surged to 35.6 per cent as at end-September 2012 compared to 4.8 per cent a year earlier. (Chart 3.19). The IMF Article IV Consultation Mission has advised continous monitoring of developments in that sector and the associated impact on banks' balance sheets.

Some 31.1 per cent of credit to the *'tourism'* sector and 22.9 per cent of credit to *'manufacturing'* consisted of foreign currency loans. Given that both sectors derive a significant portion of their revenue in foreign currencies, it does not appear that these two sectors

Chart 3.16: Household Credit

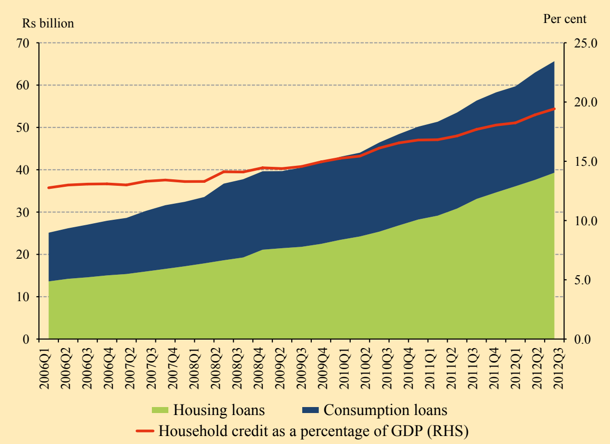


Chart 3.17: Household Consumption Expenditure and Y-o-y Growth in Consumption Loans

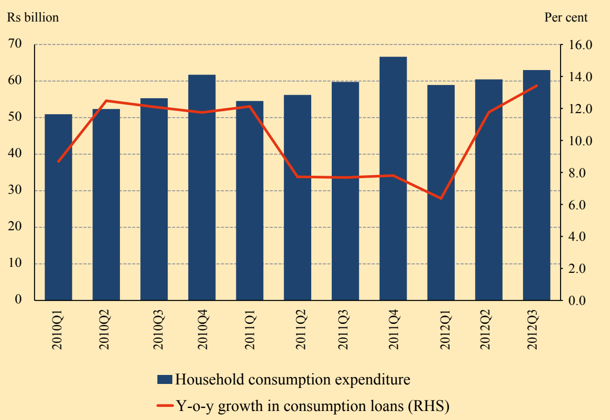
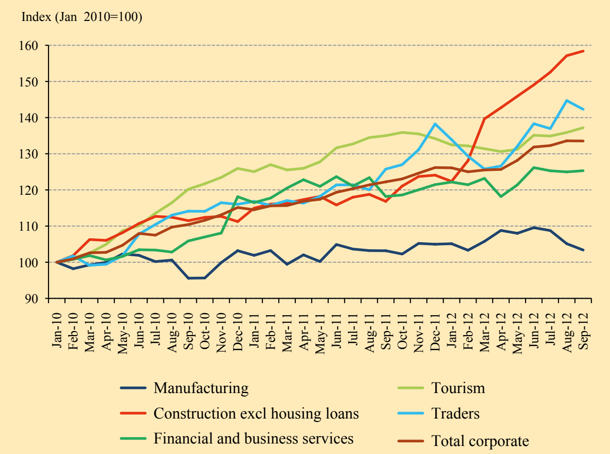


Chart 3.18: Evolution of Corporate Credit



are exposed to major foreign exchange risks. The Special Line of Credit in Foreign Currency put in place by the Bank in June 2012 has been utilised to the extent of US$18.9 million so far by export operators to mitigate foreign exchange risks.

Corporate credit quality reflected conditions in the real sector. NPLs rose quite noticeably in the *'construction'* sector and, to a lesser extent, in *'manufacturing'* where, as a percentage of credit extended, they were up by 7.8 per cent and 9.5 per cent, respectively, as at end-September 2012 compared to 4.5 per cent and 9.0 per cent a year earlier. The ratio of NPLs to credit in the *'tourism'* sector increased as well, but the rise was from a very low base of 1.2 per cent to 1.8 per cent (Charts 3.20 and 3.21). To address the risks arising from the significant increase in NPLs in the *'construction'* sector, the Bank expects to implement, in the near future, a macro prudential measure, namely the Loan-to-Value ratio which is the ratio of loan underwritten to the value of the asset being funded.

3.3.4 Concentration of Credit

Large exposures in the banking sector refer to all exposures above 15 per cent of the capital base to a customer or a group of closely-related customers. As at end-September 2012, the percentage of aggregate large exposures to the capital base, that is, the credit concentration ratio, stood at 229 per cent compared to 250 per cent a year earlier. This was well within the prudential limit of 800 per cent. As a percentage of total credit, large exposures were mostly unchanged from a year earlier, at around 29 per cent as at end-September 2012 (Table 3.2).

Chart 3.19: Y-o-y Growth of Credit to the Construction Sector

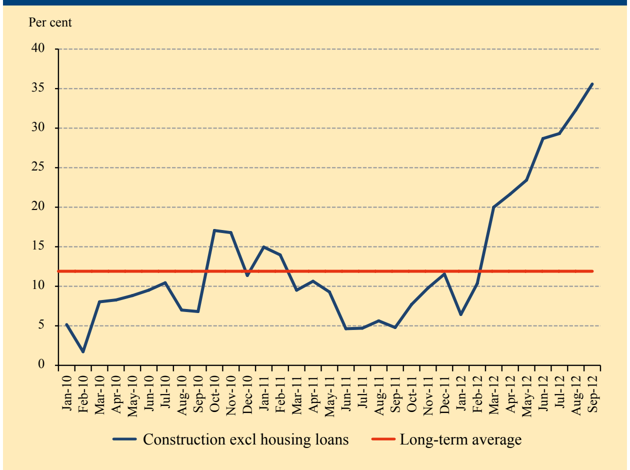


Chart 3.21: NPLs as a percentage of Sectoral Credit

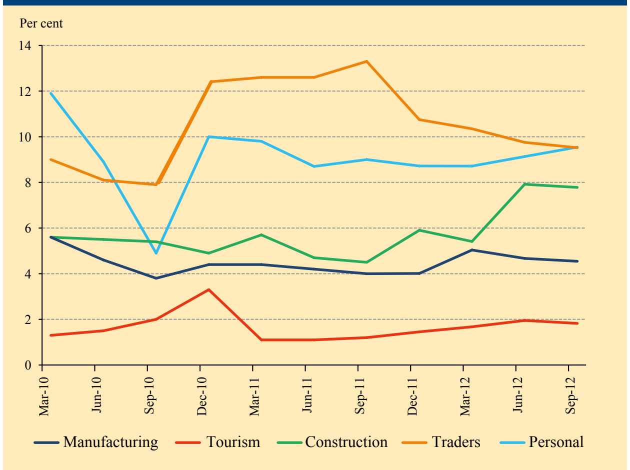


Chart 3.20: Sectoral NPLs to Total NPLs

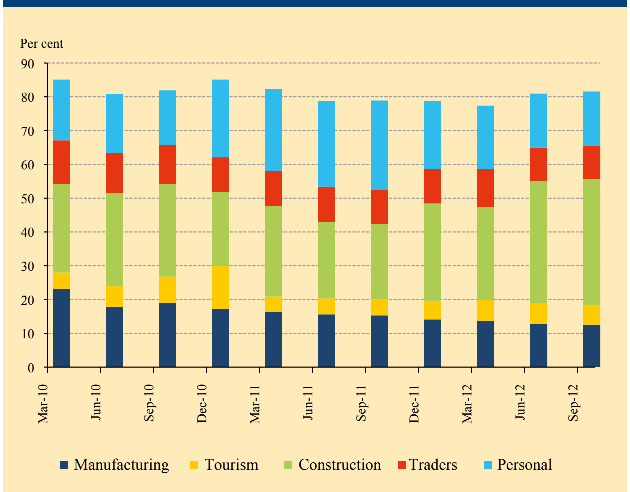


Table 3.2: Concentration Risk

	Percentage of Aggregate Large Exposures to Capital Base	Percentage of Aggregate Large Exposures to Total Credit Facilities
Sep-09	212	28
Sep-10	197	25
Sep-11	250	30
Dec-11	246	29
Mar-12	232	29
Jun-12	233	29
Sep-12	229	29

A granular analysis indicates that the exposure of banks to the ten largest borrowers in the system increased y-o-y by about 39.0 per cent as at end-September 2012. The ten largest borrowers accounted for 36.5 per cent of total large exposures and represented 92.0 per cent of banks' total capital base as at end-September 2012 (Table 3.3).

Although credit concentration does not seem to point to large financial stability risks, there is ground for the closer monitoring of credit to large conglomerates as the latter may be engaged in inter-related economic activities.

3.3.5 Cross-Border Activities of Banks

Most banks, in particular foreign-owned banks operating in Mauritius, have been able to mobilise cross-border funds (excluding foreign currency deposits from Global Business Licence holders) to finance their global business activities. These are constantly monitored as they may pose contagion risks to the domestic banking system. Cross-border funds are obtained mainly in the form of deposits and borrowings, which are typically extended as loans, placements and investments with customers and financial institutions abroad. As at end-September 2012, cross-border sources of funds grew by 15.8 per cent to make up around 27 per cent of total banking sector liabilities whereas cross-border uses of funds expanded by 5.0 per cent to represent some 56 per cent of total banking assets.

Sources of Funds

Of the two main components of cross-border sources of funds, borrowings from abroad grew by 15.9 per cent as at end-September 2012, as against a decline of 7.3 per cent as at end-September 2011, while cross-border deposits grew by 25.1 per cent, as against a drop of 7.3 per cent a year earlier.

Despite weak economic conditions, Europe has remained the major source of cross-border deposits and borrowings although banks are also increasingly tapping funds from Africa, Asia and America. While growth of foreign currency borrowings from Europe has been somewhat consistent, partly reflecting borrowings of foreign-owned banks from their head offices, foreign currency deposits mobilised from Europe went up by an equivalent of Rs4.3 billion to Rs36.1 billion as at end-September 2012 (Chart 3.22).

Uses of Funds

As at end-September 2012, cross-border funds were used mainly as loans (50.8 per cent), placements (33.1 per cent) and investments (14.1 per cent). In order to manage their foreign currency liquidity position, most banks operating in Mauritius have continued to place a large portion of their foreign currency deposits with banks abroad although a shift on the part of some foreign-owned banks operating in Mauritius towards more profitable/risky assets have contributed to a decline in cross-border deposits with banks abroad.

The proportion of deposits placed in Europe has somewhat fallen over time, probably as a result of domestic-owned banks reducing their exposure to European banks as part of a prudent risk management strategy. In contrast, placements in America, mainly Canada, have increased as banks reformulated their strategy towards safer jurisdictions. Most foreign-owned banks operating in Mauritius, however, have continued to place a large portion of their foreign currency deposits with their head-offices and related companies as part of their liquidity risk management policy.

Although there has been some attempt to diversify cross-border loans towards other countries, these are still concentrated in Asia, in particular India, because of the Double Taxation Avoidance Agreement with this country. Loans to the African region have

Table 3.3: Exposure of Banks to Ten Largest Borrowers

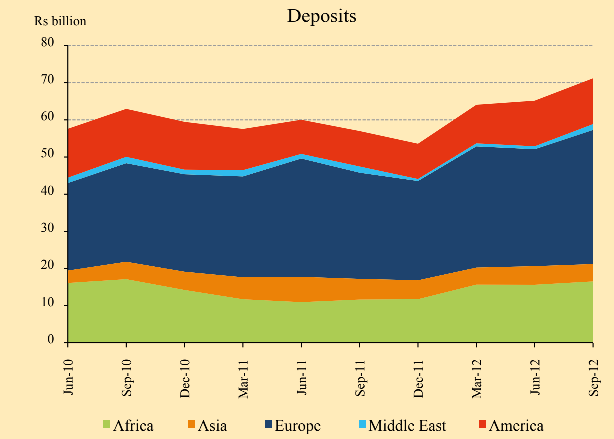
	Ten Largest Borrowers (Rs million)	Ten Largest Borrowers as a percentage to Total Large Exposures	Ten Largest Borrowers as a percentage to Total Capital Base
Sep-10	47,550	33.8	72.7
Sep-11	56,706	30.7	76.7
Sep-12	78,680	36.5	92.0

increased by two-fold since 2010 but the level remained modest. The share of loan exposure to the Middle East remained low although there is scope to redeploy funds there (Chart 3.23).

Impairment in Cross-Border Loans

Banks in Mauritius adopt a rather prudent approach of dealing mostly with creditworthy international customers who generally display low default probability. As at end-September 2012, the level of impairment across regions was relatively low, with the non-performing loans ratio at 0.6 per cent in Asia, 0.8 per cent in Europe and 2.0 per cent in Africa compared to 0.5 per cent, 1.0 per cent and 2.8 per cent, respectively, as at end-September 2011. On an overall basis, however, non-performing loans as a percentage of credit extended outside Mauritius stood at 1.4 per cent as at end-September 2012, up from 0.7 per cent as at end-September 2011.

Chart 3.22: Cross-Border Deposits and Borrowings



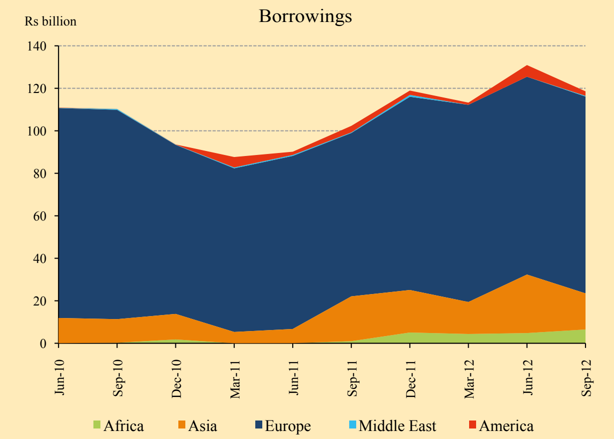
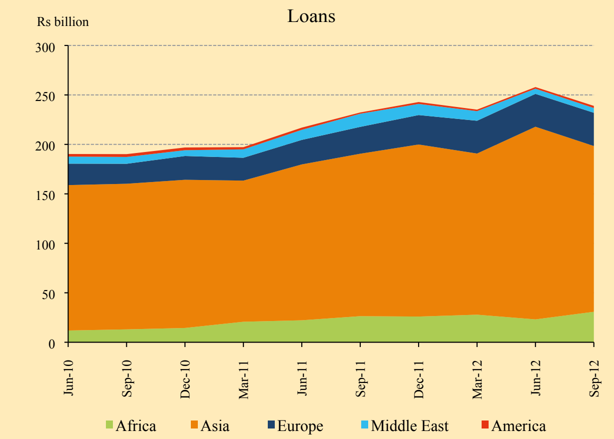
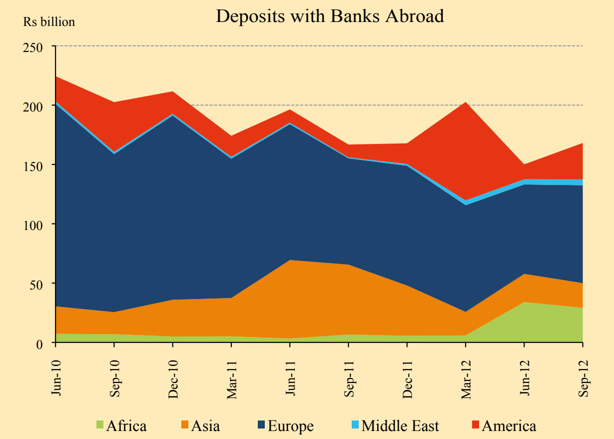


Chart 3.23: Cross-Border Loans and Deposits with Banks Abroad





3.4 Banking Sector

3.4.1 Balance Sheet Structure and Risk Profile

Banks in Mauritius have maintained a reasonable pace of activity against the subdued global economic backdrop. Total banking sector assets grew by 5.1 per cent as at end-September 2012 compared to 4.0 as at end-September 2011, largely driven by Segment B assets, which made up the majority of total banking sector assets (60.2 per cent) and expanded by 3.5 per cent compared to 1.1 per cent a year earlier. In contrast, the growth of Segment A assets decelerated from 8.8 per cent to 7.7 per cent over the year to end-September 2012.

As a percentage of GDP, total banking sector assets fell to 270.1 per cent as at end-September 2012, from 273.5 per cent a year earlier. This was led by the declining ratio of Segment B assets to GDP while the ratio of Segment A assets to GDP was relatively stable (Chart 3.24).

Over the past years, banks have gradually shifted out of cash and balances into advances as the main source of income. The share of cash and balances with banks declined to 22.6 per cent as at end-September 2012, from 24.4 per cent as at end-September 2011 while the share of advances in total assets rose to 64.7 per cent, from 62.5 per cent over the same period (Chart 3.25).

Asset Diversification

Banks have progressively increased the proportion of 100 per cent risk-weight assets, which accounted for 51.2 per cent of total assets as at end-September 2012 compared to 44.8 per cent as at end-September 2011. In contrast, assets bearing 20 per cent risk-weight accounted for 11.1 per cent of total assets as at end-September 2012 compared to 21.1 per cent a year earlier while the amount of risk-free assets has remained almost unchanged (Chart 3.26).

3.4.2 CAMEL Rating

The latest CAMEL rating of banks as at end-June 2012, published in December 2012, indicated that six banks registered a slight deterioration in their composite ratings compared to end-December 2011 although they remained in the same rating category. One bank was upgraded from the 'fair' category to the 'satisfactory' category while the remaining 13 banks maintained the same ratings (Table 3.4). Based on the CAMEL ratings, the banking sector is considered to have maintained its stability and soundness as at end-June 2012.

Chart 3.25: Components of Banks' Total Assets

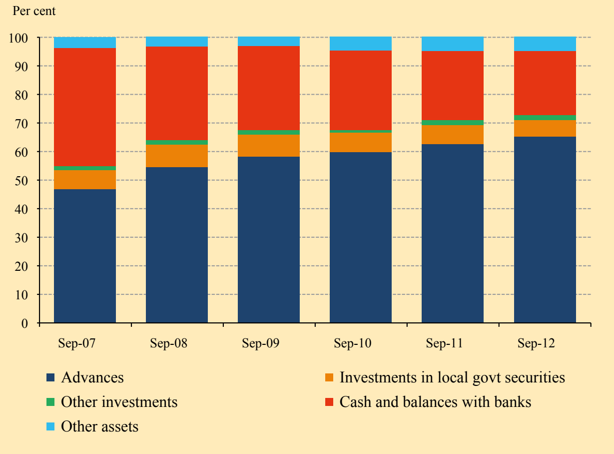


Chart 3.24: Banks' Total Assets as a percentage of GDP

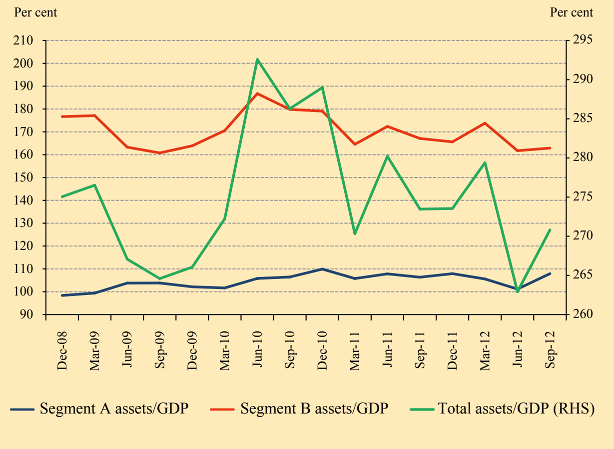
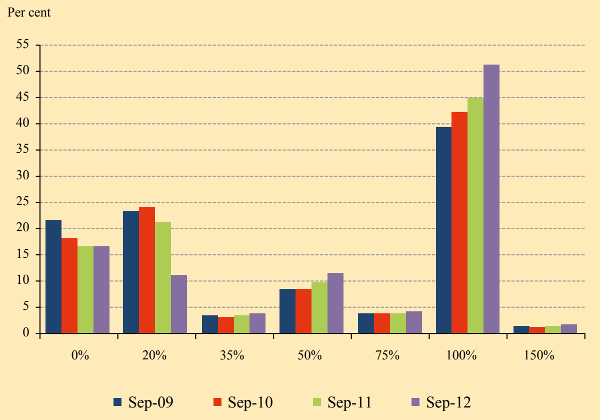


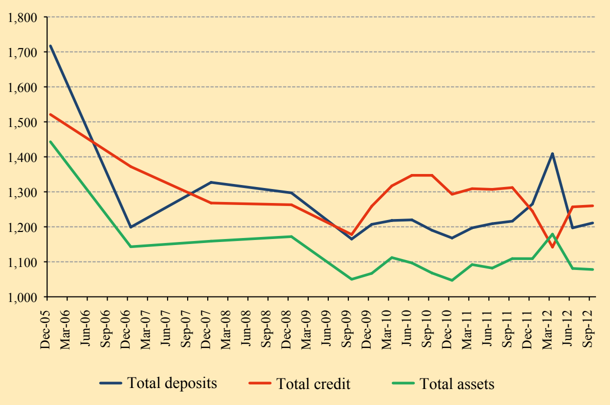
Chart 3.26: Risk Diversification



3.4.3 Market Concentration

Generally, there has been a significant improvement in market concentration in the banking sector over time, with the Herfindahl-Hirschman Index (HHI) for total assets falling from 1,443 in December 2005 to 1,078 in September 2012 (Chart 3.27).

Chart 3.27: Herfindahl-Hirschman Index



However, the overall improvement in the HHI masks the share of market power still held by the three largest banks in Mauritius. Excluding these three banks, the HHI for total assets falls to 454, that is, to the low concentration band. Even excluding the two largest banks from the computation of the HHI leads to a marked decrease in the HHI (Table 3.5). Thus, although concentration in the overall banking sector has diminished, the sector remains dominated by a few large banks with relatively high market power, implying that there is room for policies that promote competition and reduce market concentration.

3.4.4 Regulatory Capital

Banks have continued to be resilient, with robust balance sheets despite an exceptionally challenging international environment.

Table 3.4: CAMEL Rating

Bank	Dec-11	Jun-12	Change
ABC Banking Corporation Ltd	3+	3+	↔
AfrAsia Bank Limited	2+	2-	↓
Bank of Baroda	2+	2+	↔
Bank One Limited	2+	2-	↓
Banque des Mascareignes Ltée	3+	3-	↓
Barclays Bank PLC	2-	2-	↔
Bramer Banking Corporation Ltd	3+	3+	↔
Century Banking Corporation Ltd	3+	2-	↑
Deutsche Bank (Mauritius) Limited	2+	2+	↔
Habib Bank Limited	2-	2-	↔
HSBC Bank (Mauritius) Limited	2+	2+	↔
Investec Bank (Mauritius) Limited	2+	2+	↔
Mauritius Post and Cooperative Bank Ltd	3+	3+	↔
P.T Bank Internasional Indonesia	2-	2-	↔
SBI (Mauritius) Ltd	3+	3+	↔
Standard Bank (Mauritius) Limited	2+	2-	↓
Standard Chartered Bank (Mauritius) Limited	2+	2-	↓
State Bank of Mauritius Ltd	2+	2+	↔
The Hongkong and Shanghai Banking Corporation Limited	2+	2+	↔
The Mauritius Commercial Bank Limited	2+	2-	↓

The level of capitalisation maintained by banks in Mauritius were comfortably above the current regulatory minimum of 10 per cent, standing at 16.7 per cent of risk weighted assets as at end-September 2012 compared to 15.8 per cent a year earlier (Chart 3.28). The increase was due to higher growth in capital (2.3 per cent), counterweighed by the growth in risk-weighted assets (1.4 per cent). The underlying capital buffer provides a safety net for banks to absorb losses that would arise under adverse conditions and maintain the supply of credit in the economy. As of date, it is estimated that the capital adequacy ratio of the banking sector (excluding the branches of foreign-owned banks operating in Mauritius) could absorb losses of more than 15 per cent of the current balance sheet.

Tier 1 capital of most banks in Mauritius comprises mainly common equity, which is the component of capital having the highest loss-absorbing capacity. The aggregate Tier 1 capital ratio (excluding branches of foreign-owned banks operating in Mauritius) rose to 14.4 per cent as at end-September 2012, from 12.9 per cent at end-September 2011. Over this period, most banks have accumulated capital largely by retaining profits. Although one bank has issued capital to sustain new business, no bank has had recourse to capital injection from the public sector or has had to deleverage by shedding assets. The dispersion of total resources by Tier 1 capital shows that, in aggregate, 76.4 per cent of total assets were held by banks having Tier 1 capital ratios of more than 10.0 per cent as at end-September 2012 (Chart 3.29).

Even though the banking sector is well-capitalised, there is a need to consolidate and strengthen the soundness of the sector in the long term as well as keep up with changes in international standards. In this context, the Bank has issued, in 2012Q4, a Consultative Paper for the Implementation of Basel III. Amongst the measures envisaged, the introduction of countercyclical capital conservation buffer will aim at protecting the banking sector against the consequences of excessive credit growth. Taking into account the importance of domestically systemic important banks to financial stability, an extra capital buffer is being considered to strengthen the capacity of the large banks to manage shocks under more severe stress conditions in the long term relative to their size, complexity and interconnectedness.

Leverage

Leverage, a measure of resilience that does not use weights to determine risks, has not changed much

Chart 3.28: Y-o-y Contribution to the change in Capital Adequacy Ratio

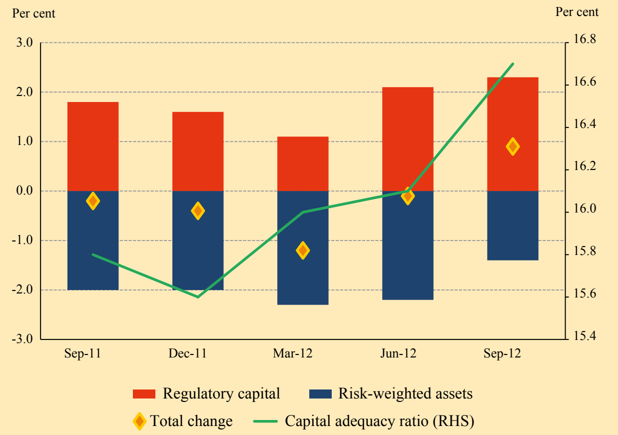


Chart 3.29: Dispersion of Total Assets by Tier 1 Capital

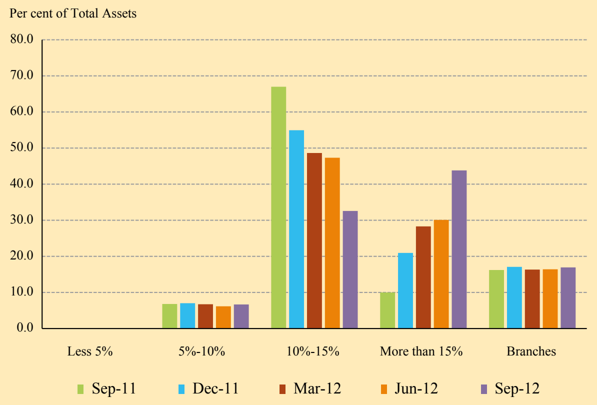


Table 3.5: HHI and Market Power in the Banking Sector

	Deposits	Loans	Total Assets
Banking Sector	1,211	1,260	1,078
Excluding two largest domestic banks	588	603	570
Excluding one foreign bank (branch)	1,077	1,210	962
Excluding two largest domestic banks and one foreign bank (branch)	454	553	454

over the past years as most banks have maintained an equitable balance between balance sheet growth and their equivalent in terms of total risk-weighted assets. The leverage ratio of the banking sector (excluding branches of foreign-owned banks operating in Mauritius) increased slightly by 50 basis points over the past twelve months to 5.4 per cent as at end-September 2012 due to the higher increase in Tier 1 capital relative to the increase in total assets (Chart 3.30).

3.4.5 Financial Performance

Higher earnings and low loan losses have led to higher profitability in the banking sector. The aggregate pre-tax profits of banks - measured as the sum of pre-tax profits for the four preceding quarters – increased by Rs0.1 billion to Rs17.6 billion as at end-September 2012.

Components of Revenue and Expense

On the revenue side, net interest income remained the dominant source of revenue for the banking sector, accounting for 64.9 per cent of total revenue as at end-September 2012 compared to 62.4 per cent a year earlier. As a percentage of total assets, net interest income rose from 2.1 per cent to 2.2 per cent during the same period. Income from fees and commission fell by Rs0.1 billion to Rs4.8 billion as at end-September 2012 and represented 0.5 per cent of total assets. Similarly, trading income decreased by Rs0.4 billion to Rs2.5 billion due to market conditions but, as a percentage of total assets, net trading income remained flat at 0.4 per cent over the period under review. The other components of income increased by Rs0.4 billion to Rs3.7 billion and represented 0.3 per cent of total assets as at end-September 2012 (Chart 3.31).

On the expense side, banks' non-interest expense increased by Rs1.3 billion to Rs13.7 billion as at end-September 2012. However, as a ratio to total assets, non-interest income has remained flat at 1.3 per cent. Overall, the sector's cost-to-income ratio expanded to 38.3 per cent as at end-September 2012, from 36.8 per cent as at end-September 2011.

Return on Equity and Return on Assets

The annualised return on equity (ROE) for the banking sector, as measured by the ratio of pre-tax profit to average equity, decreased to 19.6 per cent as at end-September 2012, from 22.1 per cent as at end-September 2011. Since the beginning of the crisis, the performance of domestic-owned banks, which derive

Chart 3.30: Leverage Ratio

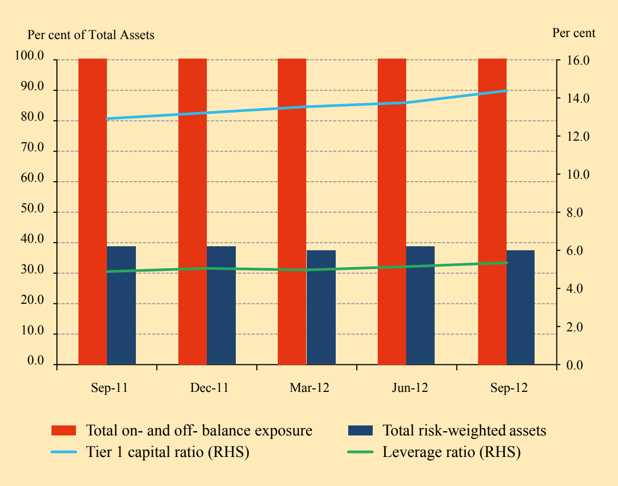


Chart 3.31: Components of Revenue and Expense

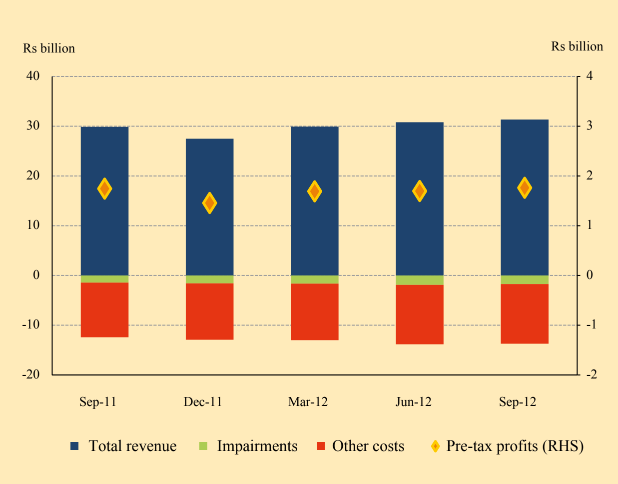
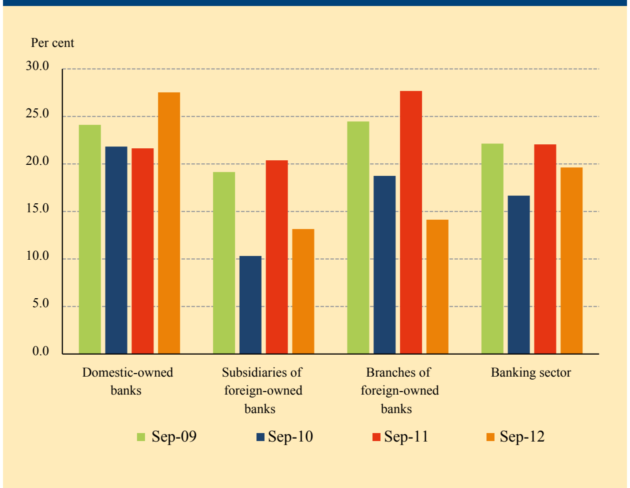


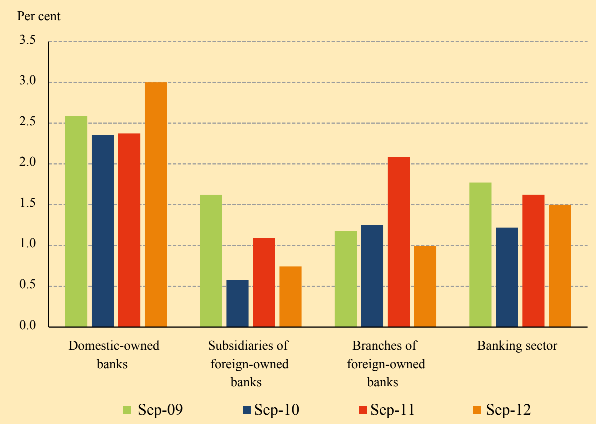
Chart 3.32: Return on Equity



a larger proportion of their revenue from activities in the domestic economy, has been relatively steady, even improving as at end-September 2012. Comparatively, foreign-owned banks operating in Mauritius have experienced a decline in the profitability of their global banking activities due to the prevailing low level of interest rates internationally (Chart 3.32).

The annualised return on assets (ROA) of the banking sector has broadly followed the same trend, with a decrease of one percentage point to 1.5 per cent as at end-September 2012 due to a higher increase in average assets relative to the increase in the level of pre-tax profits (Chart 3.33).

Chart 3.33: Return on Assets

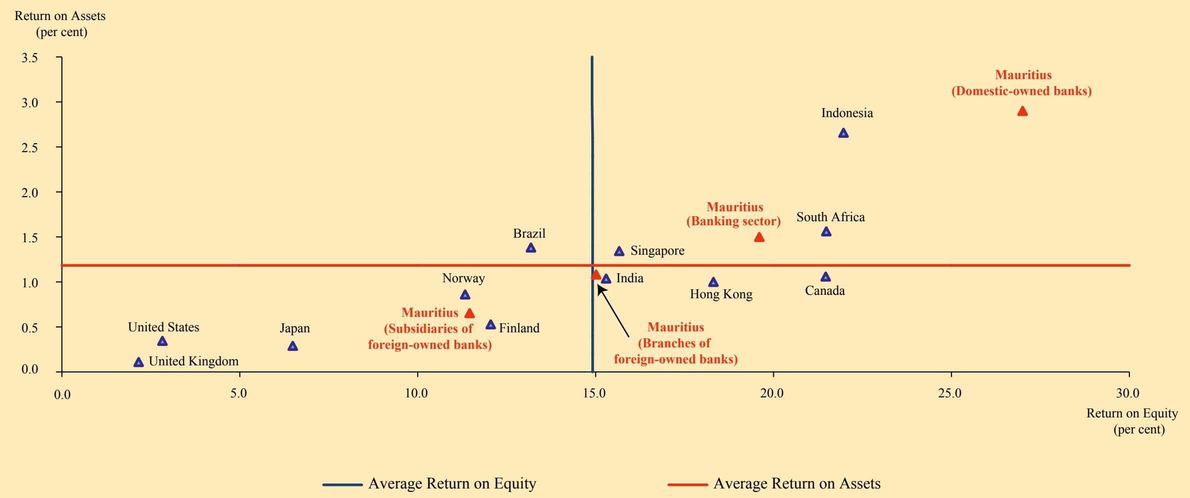


Box III: International Comparison of Profitability of Banks

In comparison to many of their international peers, the profitability of banks in Mauritius has remained robust over the past years, consistent with the economic and financial conditions in the domestic economy. The performance of domestic-owned banks, which accounted for 61.1 per cent of annualised total pre-tax profits of the sector, was underpinned by strong net interest income and net fees and commission income that represented, respectively, 56.7 per cent and 18.9 per cent of their total revenue as at end-June 2012.

Furthermore, the aggregate pre-tax return on average assets and pre-tax return on average equity (calculated according to the IMF's Guide on Financial Soundness Indicators) of domestic-owned banks stood at 2.9 per cent and 27.0 per cent, respectively, as at end-June 2012 compared to an average of 1.2 per cent and 14.9 per cent for a selected group of countries for the same period (Chart I).

Chart I: International Comparison of Return on Equity and Return on Assets of Banks



Note: Position as at end-June 2012.
Source: International Monetary Fund.

3.4.6 Funding and Liquidity Risks

Banks in Mauritius have continued to operate in a favourable funding environment for most of 2012H2. Funding risk has remained low since most banks do not rely on short-term wholesale funding to finance their core lending business but instead make greater use of customer deposits, which are a stable source of funding.

Deposits from customers, (including deposits from residents and non-residents but excluding deposits from banks) represented 67.8 per cent of total banking sector liabilities as at end-September 2012 compared to 69.2 per cent a year earlier (Chart 3.34). Deposits from banks and borrowings from banks, which are the main components of wholesale funding in Mauritius, made up 15.4 per cent of banks' total liabilities as at end-September 2012 compared to 15.1 per cent a year earlier.

Shareholders' fund, which is a permanent source of funding, accounted for 10.2 per cent of total banks' liabilities compared to 9.4 per cent a year earlier. The percentage of interbank loans to total liabilities remained rather marginal, at 0.6 per cent as at end-September 2012, as most domestic-owned banks could mobilise sufficient deposits to finance their core lending activities.

Domestic-owned banks source the largest share of their funding to finance their activities from deposits from residents. The latter represented 60.6 per cent of the total liabilities of domestic-owned banks as at end-September 2012 compared to 62.0 per cent as at end-September 2011 (Chart 3.34). Deposits from non-resident customers accounted for 16.6 per cent of domestic-owned banks' total liabilities while borrowings from banks, which represented only 3.2 per cent of the total liabilities of domestic-owned banks as at end-September 2012, comprised mainly cheaper funding raised abroad to finance lending in foreign currency to non-residents.

Notwithstanding the challenging international funding environment, foreign-owned banks operating in Mauritius have maintained satisfactory access to deposits from non-residents to fund their operations. As at end-September 2012, deposits from non-residents accounted for 47.5 per cent of foreign-owned banks' total liabilities compared to 51.5 per cent as at end-September 2011 (Chart 3.34). Without

Chart 3.34: Components of Total Liabilities

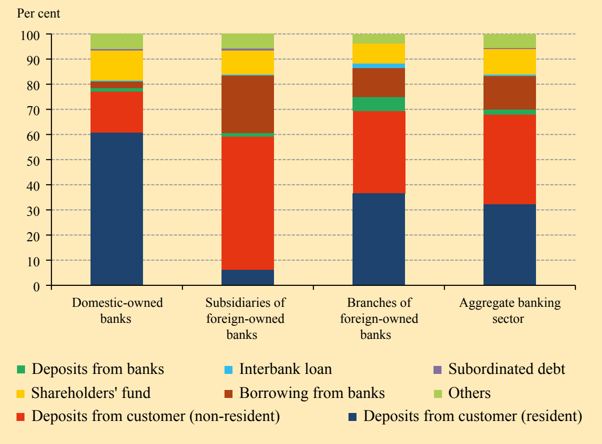
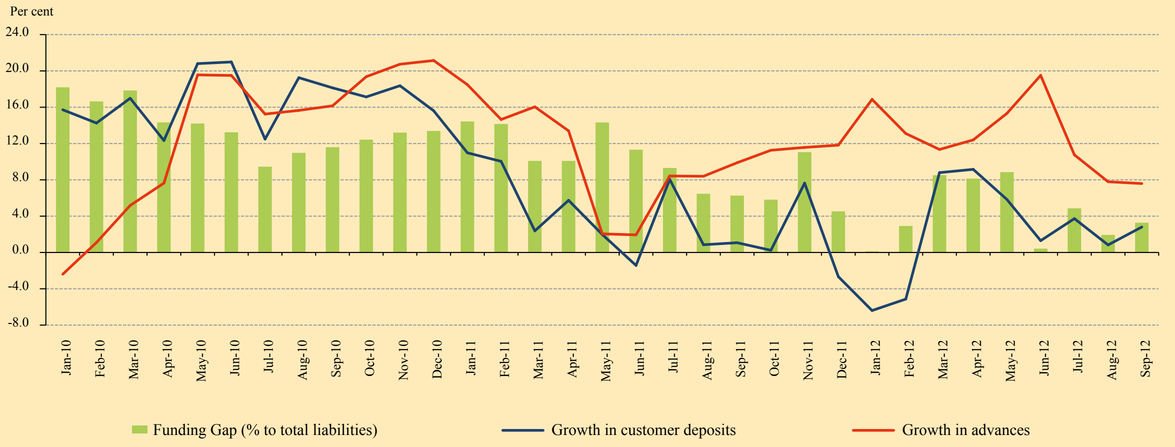


Chart 3.35: Y-o-y Growth in Advances and Deposits from Customers



affecting their liquidity position, there has been a retrenchment in the strategy of foreign-owned banks whereby a portion of their deposits is lent directly to customers. The remaining portion of their deposits continued to be placed with their head office. The aggregate borrowings from banks abroad, mainly from parent banks of subsidiaries and head office of branches of foreign-owned banks operating in Mauritius, accounted for 19.8 per cent of their total liabilities as at end-September 2012 compared to 19.1 per cent as at end-September 2011.

The growth of deposits from customers has slowed since the publication of the August 2012 Financial Stability Report. The difference between deposits from customers and advances - a measure of the funding gap that needs to be filled in from wholesale funding and other sources - shows that surplus funds in the banking sector have narrowed. As at end-September 2012, the banking sector operated with a funding surplus of 3.3 per cent of total liabilities compared to a surplus of 6.3 per cent as at end-September 2011. The reduction was largely due to the fact that the growth of 7.6 per cent in advances has outweighed the growth of 2.8 per cent in customer deposits for the same period (Chart 3.35).

The contraction in funding gap is mainly associated with domestic banking activities and may, to some extent, illustrate the slowdown in the gross domestic savings rate over the past years (Chart 3.36). Low savings which are a reflection of the persistently large current account deficit might potentially give rise to future vulnerabilities.

While banks have continued to expand their cross-border activities, a mild decrease in the share of foreign currency deposits to total deposits, from 62.1 per cent as at end-September 2011 to 60.3 per cent as at end-September 2012, was recorded. However, banks have been managing their funding and liquidity risks across currencies cautiously by matching, to a large extent, most of their liabilities with assets in the same foreign currency and maturity.

As at end-September 2012, demand and savings deposits accounted for 56.8 per cent of total deposits while time deposits, which represent a more stable long-term source of funding, accounted for the remaining 43.2 per cent of total deposits. The maturity pattern of time deposits has remained rather unchanged over the years, with customers having a broad preference for shorter maturities, typically six months or less (Chart 3.37).

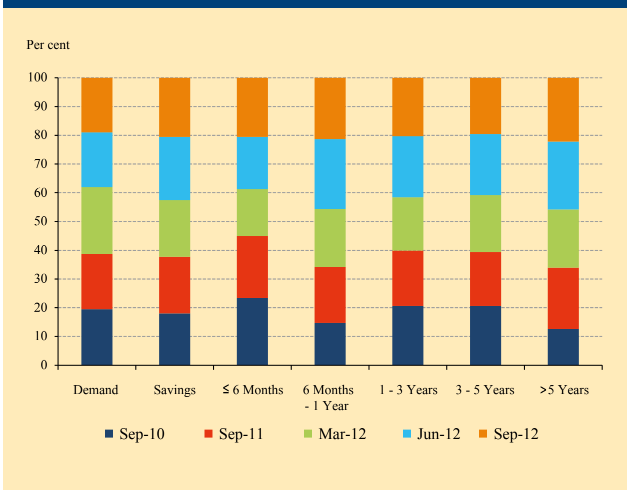
Since demand and savings deposits have no contractual maturity and customers can withdraw funds on request, there is a risk that a significant portion of such deposits may be withdrawn within a short period of time in reaction to any adverse developments affecting banks. Hence, in order to meet their obligations, banks in Mauritius hold a reasonable proportion of liquid assets to manage liquidity risk. As at end-September 2012, the ratio of liquid assets to total deposits stood at 40.3 per cent, down by 2.6 percentage points compared to end-September 2011.

The three main components of liquid assets as at end-September 2012 consisted of government securities

Chart 3.36: Gross Domestic Savings Rate

** Forecast*
Source: Statistics Mauritius.

Chart 3.37: Components of Total Deposits



(21.6 per cent), deposits with banks abroad (62.2 per cent) and balances with the Bank of Mauritius (9.5 per cent). A reverse stress test conducted on data as at end-September 2012 indicated that most banks would, on average, be able to sustain a drawdown in demand and savings deposits of more than 15 per cent without having recourse to liquidity-injecting operations by the Bank of Mauritius. Moreover, system-wide risk arising from interbank contagion would be limited by the relatively small amount of interbank loans. Overall, with adequate capital levels and a strong liquidity and funding position, the banking system would be able to cope with periods of market stress.

Stress Testing

As at end-September 2012, the distribution of credit exposure in key sectors was generally concentrated among banks with capital adequacy ratio (CAR) of above 12 per cent (Chart 3.38). A stress test was conducted to assess the ability of banks to absorb possible shocks on their credit portfolio in the event of a general weakening in economic activities causing 10 per cent of the loan portfolio in key sectors and 5 per cent of the loan portfolio in the remaining sectors to become impaired as at end-September 2012.

The size of the impact of the shock varied among banks, depending on the composition and quality of their portfolio and the amount of capital they have to withstand the shock. Results concluded that banks (excluding branches of foreign-owned banks) would generally be resilient to the adverse shock affecting key sectors, with banks' capital adequacy ratio dropping from 15.8 per cent to 12.7 per cent (Chart 3.39). Overall, the banking sector is assessed to withstand the impact of the specified shock.

Chart 3.38: Bankwise Distribution of Credit by Capital Adequacy Ratio

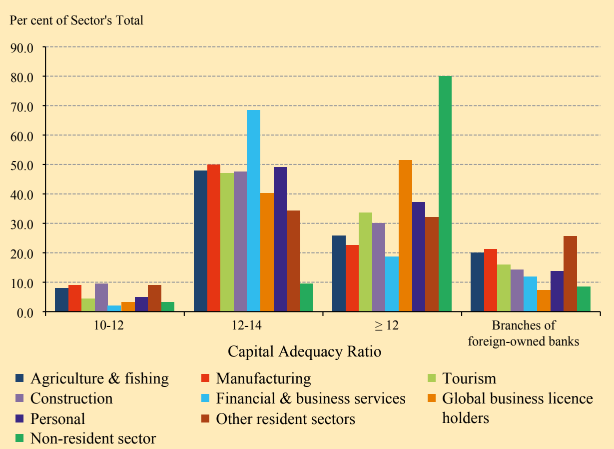
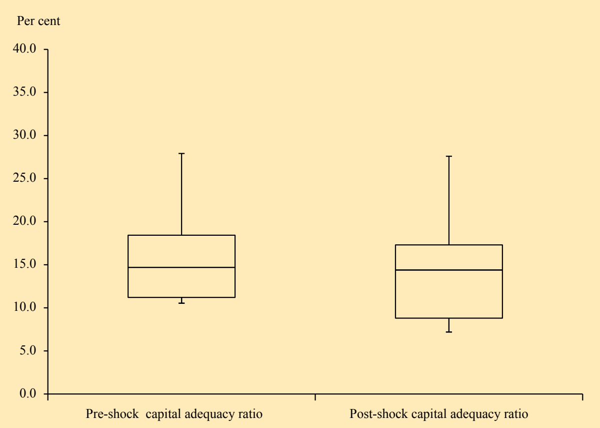


Chart 3.39: Bankwise Distribution of CAR



Box IV: Selected Financial Stability Indicators

Core Set of Financial Soundness Indicators	Sep-09	Sep-10	Sep-11	Sep-12
Capital-based				
Regulatory capital to risk-weighted assets	15.3%	15.9%	15.8%	17.2%
Regulatory Tier 1 capital to risk-weighted assets	13.2%	13.6%	13.8%	15.7%
Non-performing loans net of provisions to capital	11.1%	8.6%	9.6%	14.7%
Asset Quality				
Non-performing loans to total gross loans	2.6%	2.5%	2.6%	3.8%
Sectoral distribution of loans to total loans				
Interbank loans	*0.3%*	*0.3%*	*0.6%*	*0.2%*
Central bank	*0.0%*	*0.0%*	*0.0%*	*0.0%*
General Government	*0.0%*	*0.0%*	*0.0%*	*0.0%*
Other financial corporations	*1.3%*	*1.2%*	*1.2%*	*1.3%*
Non-financial corporations	*32.8%*	*33.9%*	*33.0%*	*32.8%*
Other domestic sectors	*14.4%*	*15.9%*	*14.7%*	*20.2%*
Non-residents	*51.2%*	*48.8%*	*50.6%*	*45.5%*
Earnings and Profitability				
Return on assets	1.7%	1.2%	1.6%	1.5%
Return on equity	22.1%	16.7%	22.1%	19.6%
Interest margin to gross income	69.0%	70.5%	62.4%	65.2%
Non-interest expenses to gross income	37.6%	43.0%	36.8%	38.6%
Liquidity				
Liquid assets to total assets	26.5%	23.6%	18.2%	16.4%
Liquid assets to short-term liabilities	31.8%	31.2%	26.7%	25.1%
Sensitivity to Market Risk				
Net open position in foreign exchange to capital	5.2%	4.3%	1.7%	3.0%
Encouraged Set of Financial Soundness Indicators				
Capital to assets	7.8%	7.0%	7.3%	8.0%
Value of large exposures to capital	217.7%	217.0%	250.2%	214.8%
Customer deposits to total (non-interbank) loans	138.7%	148.8%	131.4%	124.0%
Residential real estate loans to total loans	6.3%	6.9%	5.7%	7.8%
Commercial real estate loans to total loans	2.1%	3.2%	5.2%	7.5%
Trading income to total income	18.5%	11.4%	11.3%	9.6%
Personnel expenses to non-interest expenses	51.0%	50.9%	54.5%	50.2%

Box IV: Selected Financial Stability Indicators (Continued)

Macroeconomic Indicators	Sep-09	Sep-10	Sep-11	Sep-12
Headline inflation	4.4%	2.0%	6.2%	4.4%
Year-on-year inflation	0.9%	2.5%	6.3%	3.9%
Key Repo Rate (end of period)	5.75%	4.75%	5.50%	4.90%
Total Public Sector Debt/GDP (end of period)	57.2%	58.6%	55.5%	56.8%
Total External Public Sector Debt/GDP (end of period)	9.2%	10.0%	11.0%	12.4%
Import coverage of Gross International Reserves (No. of months)	4.9	4.7	4.5	5.1
Deposits/Broad Money Liabilities*	83.6%	84.5%	83.4%	83.9%
Household Debt/GDP (end of period)**	15.0%	16.5%	17.7%	19.4%
Corporate Debt/GDP (end of period)**	45.7%	49.0%	49.9%	51.3%
	2009Q3	2010Q3	2011Q3	2012Q3
Real GDP growth***	2.9%	5.7%	3.7%	3.9%
Unemployment rate	7.4%	7.6%	7.9%	7.9%
Current account deficit/GDP	8.1%	11.4%	16.7%	12.7%

** Banks deposits excluding GBL deposits, deposits from non-residents, banks outside Mauritius, government deposits and deposits from banks inside Mauritius.*
*** Debts contracted with banks only.*
**** Percentage change over corresponding period of previous year.*

1. FSIs are calculated on a domestic consolidation basis using the Financial Soundness Indicators Compilation Guide of the International Monetary Fund. Figures may be slightly differerent from other parts of this report.
2. As from June 2012, figures include Non-Bank Deposit Taking Institutions.
3. Total loans include advances to non-residents.
4. Figures may not add up due to rounding.

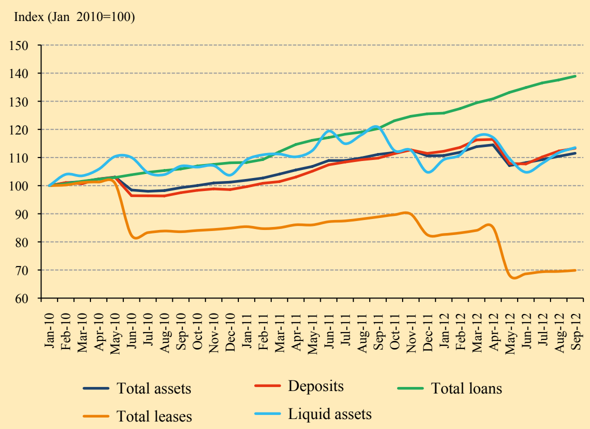
3.5 Non-Bank Deposit-Taking Sector

Non-Bank Deposit-Taking Institutions (NBDTIs) are mainly engaged in mobilising deposits and extending leasing and loan facilities to individuals and corporates. During 2012H2, the NBDT sector remained stable and sound. As at end-September 2012, assets of NBDTIs represented 5.5 per cent of total banking sector assets, compared to 5.7 per cent a year earlier, and accounted for 14.8 per cent of GDP.

Balance Sheet Structure

The merger of one NBDTI with a bank in May 2012 reflected the lower balance sheet growth of this sector. As at end-September 2012, the y-o-y growth of NBDTIs' assets slowed to 0.4 per cent, from 11.9 per cent in the corresponding period of 2011, driven by a contraction of 21.4 per cent in leasing facilities while loans grew by 15.5 per cent. Deposits, which accounted for 63.2 per cent of total liabilities, grew by 3.2 per cent as at end-September 2012, down from 12.6 per cent, a year earlier (Chart 3.40).

Chart 3.40: Balance Sheet of NBDT Sector



Liquidity

Liquidity has stayed relatively stable during the period under review with a liquidity ratio above the statutory minimum of 10 per cent. As at end-September 2012, the liquid assets to total assets ratio and the liquid assets to total deposits ratio stood at 13.9 per cent and 22.0 per cent, respectively (Chart 3.41).

Capital Adequacy

NBDTIs are well-capitalised and operate well above the minimum capital adequacy requirement, maintaining a capital adequacy ratio of 25.1 per cent as at end-September 2012 compared to 23.9 per cent as at end-September 2011. As at end-September 2012, NBDTIs invested some 77.6 per cent of their assets in the 35 per cent and 100 per cent risk-weight buckets compared to 40.0 per cent as at end-September 2011 (Chart 3.42).

Sectoral Credit

Credit extended by NBDTIs represented 14.7 per cent of total private sector credit as at end-September 2012 and was channelled mainly to the *'construction'* and *'personal'* sectors, which together accounted for 82.1 per cent of total NBDTIs credit. Comparatively, the *'manufacturing'*, *'wholesale and retail trade'* and *'financial and business services'* sectors collectively accounted for 7.5 per cent in total NBDTIs credit. Reflecting the structural change in the sector, NBDTIs credit, comprising loans and leases, grew by 4.8 per cent as at end-September 2012 compared to 11.4 per cent a year earlier. The growth of credit

Chart 3.42: Risk Diversification of NBDTIs

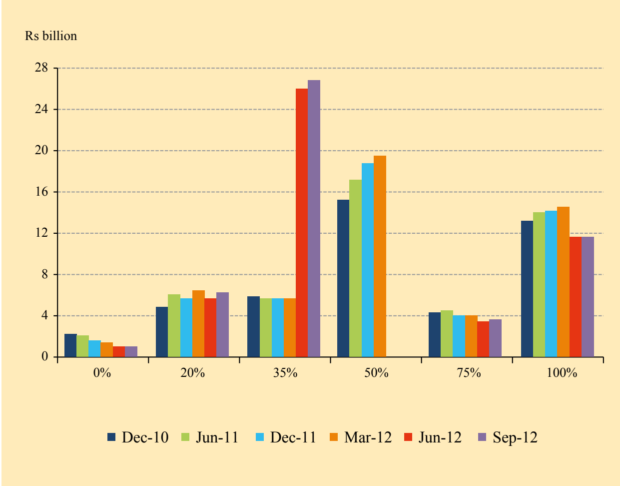


Chart 3.43: Sectoral Distribution of Credit by NBDTIs

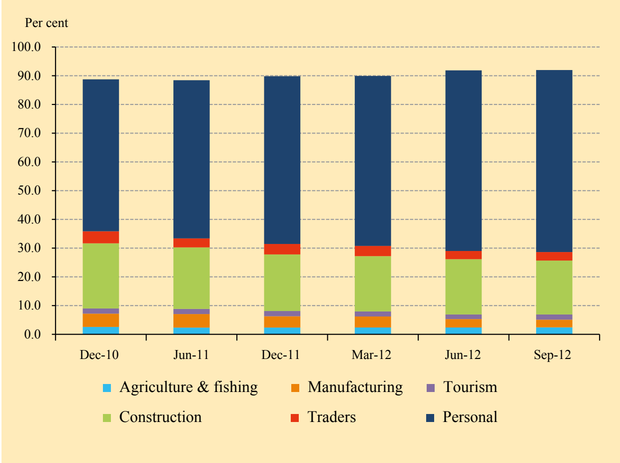


Chart 3.41: Liquidity Indicators of NBDTIs

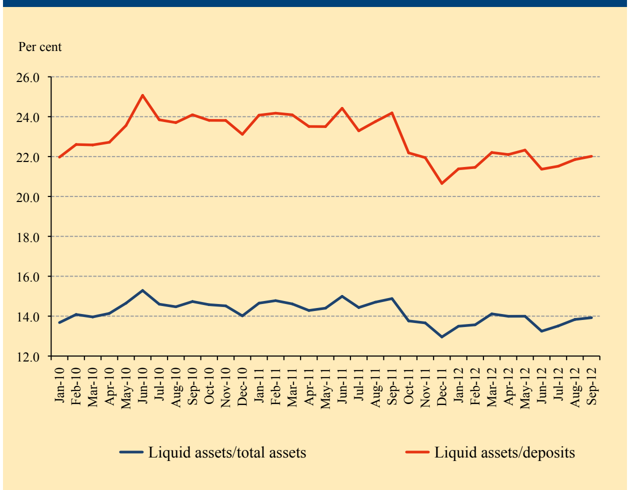
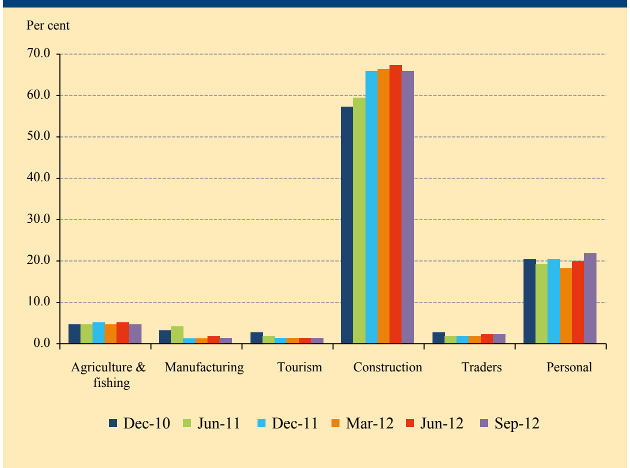


Chart 3.44: NPLs in Key Sectors as a ratio of Total NPLs



to the *'personal'* sector decelerated while credit extended to the *'construction'* and *'manufacturing'* sectors contracted during that period.

Asset quality of the NBDTIs, as measured by the NPL ratio, deteriorated to 7.1 per cent as at end-September 2012 compared to 6.6 per cent in the corresponding period of 2011. This partly reflected a rise in the NPL ratio of the *'personal'* sector to 21.8 per cent as at end-September 2012, from 18.0 per cent as at end-September 2011. On a sectoral basis, 65.4 per cent of NPLs were registered in the *'construction'* sector as at end-September 2012. The ability of NBDTIs to absorb losses arising from NPLs is considered as adequate, with the coverage ratio standing at 35.9 per cent as at end-September 2012 compared to 37.5 per cent a year earlier.

3.6 Insurance Sector

The insurance sector in Mauritius is a relatively small component of the financial sector. While the insurance sector is interconnected with the broader financial sector in a number of ways, its relatively small size suggests that the systemic risk to the financial sector is limited. In addition to supervision of individual insurers, the FSC monitors trends and developments at the industry level using financial soundness indicators in areas such as capital adequacy, profitability and liquidity.

Insurers generate income from premiums and investment returns. While 2012 financial figures for insurers are not yet available, investment returns for the insurance industry appear likely to have been affected by the relatively weak returns on Mauritian bond and equity portfolios, which may have been compensated, however, by investments in foreign equities in the US, Europe and Asia. The low-yield environment remained an important challenge for the insurance industry. Reinsurance is a significant expense for Mauritian general insurers. Industry reports indicate pricing was stable in 2012.

3.6.1 Reinsurance Activities

According to a recent report of the International Association of Insurance Supervisors (IAIS), traditional reinsurance is unlikely to cause, or amplify systemic risk. The IAIS, however, observed that the financial crisis experience suggests that reinsurance groups and conglomerates that are heavily engaged in non-insurance activities are likely to become both originators and amplifiers of systemic crises. The IAIS further recognised that the intrinsically global nature of the reinsurance model business in general, and the evolving nature of alternative risk transfer products as well as their affinity to the financial markets in particular, make it prudent to call for a continued monitoring of the reinsurance sector.

In Mauritius, general insurers extensively make use of reinsurance outside of the motor segment. Over the past four years, general insurers have reinsured around 40 per cent of their gross premiums (excluding Motor insurance) (Table 3.6).

Table 3.6: Proportion of Premiums Reinsured by General Insurers

	2008		2009		2010		2011	
Region	Gross Premium (Rs '000)	% of Gross Premium Reinsured	Gross Premium (Rs '000)	% of Gross Premium Reinsured	Gross Premium (Rs '000)	% of Gross Premium Reinsured	Gross Premium (Rs '000)	% of Gross Premium Reinsured
Accident and Health	775,781	46	943,166	43	1,072,272	41	1,300,639	41
Engineering	248,023	84	290,106	84	313,172	87	268,012	83
Guarantee	5,968	76	7,190	81	22,318	72	46,684	48
Liability	227,367	51	339,917	60	440,107	70	445,517	65
Miscellaneous	294,451	83	212,620	83	277,688	76	295,574	70
Motor	1,894,414	6	2,150,244	6	2,282,857	5	2,575,843	5
Property	871,674	80	906,573	78	855,320	77	959,314	74
Transportation	417,790	62	385,522	59	310,867	62	355,287	55

Source: FSC.

Given the extent to which reinsurance is used, the extent of dispersion of reinsurance in the industry was examined, with a focus on the property and liability segments that are both relatively large and use reinsurance extensively. It was found that the reinsurance programs of the Mauritian reinsurance industry are highly diversified when viewed on an aggregate basis. Only one reinsurer had a share greater than 15 per cent of one of the two segments. In both segments, the majority of reinsurers had less than 5 per cent market share. Should an event, such as a large natural disaster occur, the industry as a whole is not exposed to any single reinsurer (Table 3.7).

An analysis of credit ratings quality revealed that 79 per cent of property premiums were reinsured by a reinsurer rated B or higher, while 99 per cent of liability premiums were reinsured by a reinsurer rated A or above. General insurers reinsured over 95 per cent of gross premium with reinsurers rated by S&P, Fitch and A. M. Best for both segments (Table 3.8).

Table 3.7: Market Share of Reinsurers

	Number of Reinsurers	
Market Share	**Property**	**Liability**
0-5%	80	59
5-10%	2	3
10-15%	1	4
15-20%	1	0
TOTAL	**84**	**66**

Source: FSC.

Table 3.8: Reinsurance and Market Share of Property and Liability Segments

	Property		Liability	
Rating Range	**No. of Reinsurers**	**% of Market Share**	**No. of Reinsurers**	**% of Market Share**
Greater or equal to A	11	20	15	99
Smaller than A, Greater or equal to B	49	59	39	0
Smaller than B	6	8	4	0
Unrated	18	13	8	1
TOTAL	**84**	**100**	**66**	**100**

Source: FSC.

4. Financial System Infrastructure

During 2012H2, the payment systems operated within prescribed parameters with high degree of technical reliability, and did not register any technical or operational weaknesses that might have impacted on financial stability.

The Mauritius Automated Clearing and Settlement System (MACSS), the large value payment stream settling in real time, operated without any downtime. It settled 257,620 transactions, representing a 12.6 per cent increase compared to 2011H2. The value of transactions reached Rs1.1 trillion in 2012H2, that is, a decrease of 2.2 per cent compared to 2011H2 (Chart 4.1).

The low value payment stream, which comprises the Cheque Truncation System and Bulk Clearing System (BCS), proved to be a reliable support for the MACSS to vehicle low value transactions. During 2012H2, the BCS processed 2.6 million cheques and cleared 1.5 million electronic fund transfers, representing increases of 2.4 per cent and 32.0 per cent, respectively, compared to 2012H1. The value of these transactions grew by 8.4 per cent and 44.0 per cent, respectively, over the same period (Table 4.1).

Both the MACSS and BCS are operating well below their respective maximum capacity and do not currently require any system upgrade.

4.1 MACSS Business Continuity Procedures

MACSS is the mainstay of the Mauritian payment systems infrastructure, enabling the settlement legs of sub-systems like the Automated Clearing House, the Central Depository System and the Contribution Network Payment, a revenue collection system. Given its systemic importance, MACSS has been designed along the core principles of Systemically Important Payment Systems (SIPS). SIPS core principle VII states that *"The system should ensure a high degree of security and operational reliability and should have contingency arrangements for timely completion of daily processing"*. A tried and tested Business

Chart 4.1: Transactions on MACSS

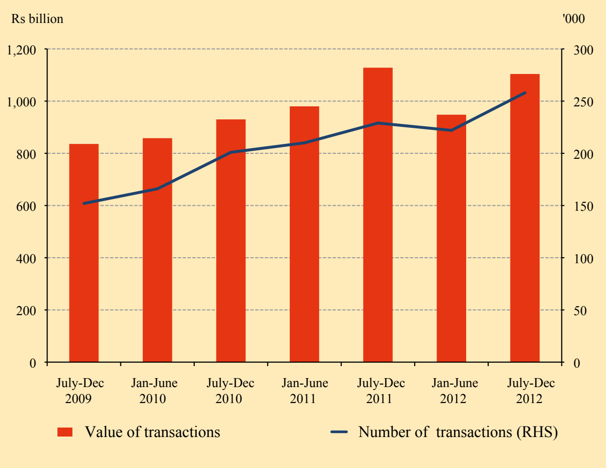


Table 4.1: Volume and Value of Transactions on BCS

	Cheque Clearance		Electronic Transfers	
	Number of Cheques	Amount (Rs' 000)	Number of ETs	Amount (Rs' 000)
January-June 2012	2,576,044	127,420,890	1,121,766	25,854,331
July-December 2012	2,637,772	138,172,525	1,481,798	37,221,362
July	*453,418*	*23,746,073*	*234,174*	*5,432,057*
August	*428,256*	*21,776,630*	*237,605*	*5,688,255*
September	*397,667*	*20,543,860*	*183,686*	*4,842,066*
October	*476,909*	*25,001,750*	*250,287*	*5,924,351*
November	*423,120*	*21,648,556*	*241,361*	*6,576,081*
December	*458,402*	*25,455,656*	*334,685*	*8,758,552*

Continuity Plan is one underlying requirement of this principle.

The MACSS rules and procedures describe the business continuity plan for the system, which is tested on the second Tuesday of every quarter. During testing, the MACSS application at the main site is turned off and participants are expected to operate from the fall-back site.

A MACSS fall-back connectivity test was carried out on 4 September 2012 with the objective of testing operational procedures as well as the system's capability to switch to and run from another environment. It was observed that all participants were able to operate from the fall-back site without any incident or assistance. The MACSS application was likewise operated smoothly without any noticeable slowness or disruptions. On the day following the fall-back test, operations resumed smoothly at the main site without any data loss.

MACSS Oversight

The Bank oversees MACSS as part of its statutory obligations to promote and maintain a sound and efficient payment system. Currently, MACSS oversight is carried out in the form of off-site surveillance of daily payments and self-assessment returns submitted by participants to the Bank on a yearly basis to allow the Bank assess their operational reliability.

According to the latest self-assessment survey, no participant experienced significant or recurring downtime. Only one case of MACSS-related fraud was reported but this was the result of an action taken on a phishing scam by one bank's customer. The incident was thus more related to that bank's internal security procedures and did not point towards any weakness in MACSS security.

4.2 Mauritius Credit Information Bureau

The Bank has been operating the Mauritius Credit Information Bureau (MCIB) since December 2005. Over time, the number of participants in the MCIB has broadened to include banks, NBDTIs, other types of credit providers and utility service providers. In September 2011, the Credit Reporting Standards Setting Task Force launched by the World Bank with the support of the Bank for International Settlements published a set of five General Principles on Credit Standards Reporting. Box V provides an assessment of the Bank's compliance with those standards.

Box V: Compliance of the MCIB with the World Bank's Credit Reporting Standards

General Principle 1: *Credit reporting systems should have relevant, accurate, timely and sufficient positive and negative data collected on a systematic basis from all reliable, appropriate and available sources and should retain this data for a sufficient amount of time.*

The MCIB currently hosts 40 participants comprising the central bank, banks, leasing companies, insurance companies, the Mauritius Housing Company, the Development Bank of Mauritius, the National Housing Development Co Ltd, the Mauritius Civil Service Mutual Aid Association Ltd, the Employees Welfare Fund, and two utility service providers, CEB and CWA. Participants have the obligation to furnish information on new credit facilities as soon as they are uploaded on their system and are ready for disbursement. Existing information should be updated as soon as there is a change in the credit facility. Information is updated by participants on a daily basis and MCIB data is subject to a set of validation checks at the entry point. The MCIB collects both positive and negative information which is retained online for a minimum period of two years, after which it is purged from the system and retained offline for a further period of seven years.

General Principle 2: *Credit reporting system should have rigorous standards of security and reliability, and be efficient.*

The MCIB application can be accessed through very secure network and it has rigorous embedded access control system to prevent unauthorised access. It also keeps an activity log which is regularly monitored. The Bank has set strict rules under which participants may access the database and a close monitoring is maintained to identify any system abuse. There has never been any adverse report on security and safety issues. The system is available on a 24/7 basis and may be accessed from the fall-back site in case of disruption of the main server. Daily backups of the system are made and stored safely.

General Principle 3: *The governance arrangements of credit reporting service providers and data providers should ensure accountability, transparency and effectiveness in managing risks associated with the business and fair access to the information by users.*

The Terms and Conditions governing the MCIB put the onus on participants to submit accurate and updated information to the MCIB. The Bank has the necessary legislative powers to deal with non-compliant participants who face the risk of penalties or licence revocation, depending on the persistence of non-compliance. The MCIB has well-defined procedures for internal reporting and escalation of problems. Being an in-house unit of the Bank, the MCIB is subject to the same level of internal and external audit as other units of the Bank.

General Principle 4: *The overall legal and regulatory framework for credit reporting should be clear, predictable, non-discriminatory and supportive of data subject and consumer rights. The legal and regulatory framework should include effective judicial or extra-judicial dispute resolution mechanisms.*

The setting up and operation of the MCIB rest on the Bank of Mauritius Act 2004 while the responsibilities of the operator and data providers are governed by the Terms and Conditions of the MCIB. All participants have an equal right to use the available information. They have access to the same reduced level of information for the protection of the public and there are strict conditions attached. The legal framework upholds the interest of data subjects by providing them the right to enquire on data registered in their names by participants in the MCIB database. The Terms and Conditions provide for extra-judicial dispute resolution mechanism. The use and confidentiality of information of subjects is also safeguarded under the Bank of Mauritius Act 2004.

General Principle 5: *Facilitation of cross-border credit data transfers.*

There is currently no arrangement with any institution for cross-border credit data transfers. However, existing laws make provision for sharing of information under specific conditions.

5. Risks to Financial Stability

While macroeconomic conditions have stabilised globally, growth is expected to remain uneven across regions. According to the IMF World Economic Outlook Update of January 2013, the US is projected to grow at around 2 per cent in 2013 while the euro area is expected to contract. Many advanced economies continue to face high unemployment rates and public debt levels. In the US, authorities are focusing their efforts on a credible medium-term plan to avoid excessive fiscal consolidation, which may act as a drag on growth while in the euro area, maintaining the momentum for fiscal and regulatory reforms is critical for the future of the monetary union. Against this backdrop, emerging market and developing economies are forecast to drive much of the recovery as their better underlying fundamentals and increasing shift towards internal demand should sustain their growth paths. Among these economies, sub-Saharan countries are expected to remain robust and register a rebound in output which will contribute to accelerate growth in 2013.

Confidence in global financial markets remains fragile and leaves markets considerably vulnerable to high volatility and risk aversion. Deleveraging by banks, especially in advanced economies, is on-going. While the outlook may have eased somewhat, international banks continue to be subject to funding pressures and have maintained generally tight credit conditions. Heightened regulation, which may weigh on earnings and profitability, and uncertainties with regards to the fiscal path underline the delicate situation of international banks. In Europe, fragmentation of credit flows persistently weighs on financial stability. However, regulatory reforms are set to make the financial system safer through financial institutions and markets that are more transparent, less complex and less leveraged. There has been concrete progress toward establishing a banking union, which should help to break the vicious link between sovereigns and domestic banks and help improve supervision of the banking system.

According to Statistics Mauritius, the domestic economy is projected to expand at a higher rate of 3.7 per cent in 2013 as the global economy stabilises. However, this outlook is conditional on the evolution of the situation in the euro area although the gradual shift of exports away from the euro area is expected to mitigate the downside risks on economic growth.

According to the IMF Article IV Mission in January 2013, prudent macroeconomic policies in 2012 resulted in good fiscal and inflation outcomes. However, as the external environment is still difficult, accelerating growth in 2013 will be challenging. The IMF expects that growth would be supported by higher activity in fishery, information & communications technology and financial services. In the medium term, fiscal consolidation should continue to reduce external imbalances and economic vulnerabilities.

The financial condition of banks is not projected to register any major changes in the foreseeable future given the well-capitalised and healthy banking system. Funding and liquidity are expected to remain adequate. However, risks may arise from increasingly significant cross-border activities, which raise the exposure of banks to developments abroad. Moreover, sustained credit growth in certain sectors of the economy could be early indicators of potential asset bubbles. Developments in the real estate, both in terms of price and rental growth and the associated impact on the banking sector, warrant close monitoring. System-wide risk arising from interbank contagion would be limited by the relatively small amount of interbank loans. The Bank continues to strengthen the regulatory and supervisory framework to adhere to international best practice. It has started to address the systemic risk posed by large complex institutions in the domestic banking sector and has also initiated work on the implemention of Basel III. Overall, the banking sector is viewed as robust and resilient.

Financial stability risks remain important at the global level, especially taking into account the uncertainty related to the euro area sovereign debt crisis. Domestically, the relatively strong financial positions and robust capital levels of banks as well as adequate liquidity and funding mitigate the risks posed by international factors. Looking ahead, the persistently large external current account deficit, which reflects low savings, could potentially give rise to future vulnerabilities.

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