3. Domestic Macroprudential Assessment

The domestic economy remained resilient to external headwinds. At this stage, external vulnerabilities in terms of capital flows, foreign exchange reserves and external debt are assessed to be manageable. In nominal effective terms, the rupee has remained rather stable. Recent trends in private sector credit in some sectors as well as rising NPL have raised some financial stability concerns. The Bank has, accordingly, introduced a set of macroprudential measures with a view to improving the resilience of the banking system. Banks in Mauritius are well capitalised and are assessed to be resilient to a range of shocks in their credit portfolios. Most banks have continued to report positive results and good profitability since the August 2013 FSR. The payment systems operated smoothly without any major disruption.

3.1 Domestic Economy

The domestic economy continued to perform relatively well in an environment characterised by weak economic conditions in some key trading-partner countries. Latest national accounts data show that real GDP growth rate eased from 3.4 per cent in 2012 to 3.2 per cent in 2013. With the exception of the '*construction*' sector, all major sectors recorded positive growth rates. Sectors that contributed the most to output growth were '*financial and insurance activities*', '*manufacturing*', '*wholesale and retail trade*', '*professional, scientific and technical*', and '*information and communication*'. As the global economic recovery becomes more entrenched, it is estimated that domestic growth momentum could pick up to a range of 3.7-4.0 per cent in 2014, close to the potential output. Looking ahead, a prolonged weakness in the euro area economy impacting on external demand is the main downside risk to the growth outlook.

3.1.1 External Vulnerabilities

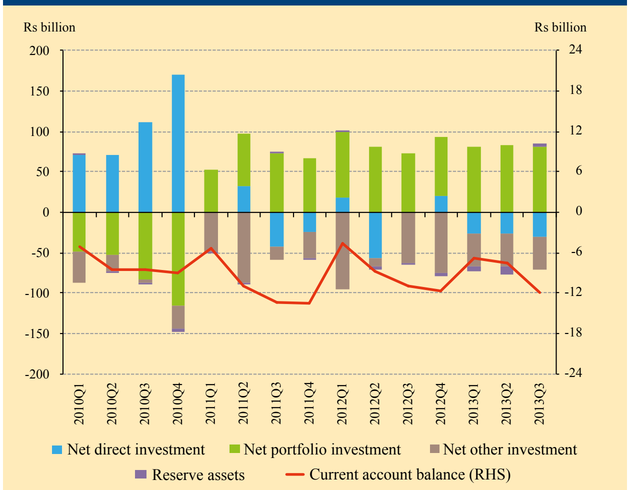
For a small open economy like Mauritius, external vulnerabilities are important considerations in assessing the potential impact of external shocks on the macroeconomy and financial stability. External indicators show that pressures emanating from external sources, mostly related to capital flows and foreign exchange reserves, are currently regarded as manageable. The impact of increasing recourse by Government to external financing of the budget deficit, however, is a source of concern (Box I).

Balance of Payments[2]

During the third quarter of 2013, the current account deficit worsened to Rs11.9 billion, largely attributable to falling net services surplus coupled with the deteriorating performance in the balance of trade. The trade deficit increased to Rs17.4 billion while the services account posted a significantly lower surplus of Rs1.9 billion, down from Rs4.5 billion a year earlier, reflecting mainly a sharp drop in tourism receipts.

The current account deficit continued to be financed by debt-creating flows (Chart 3.1). Net financial flows in the three months ended September 2013 stood at Rs15.2 billion compared to Rs8.8 billion in the same period of the previous year. In terms of composition of flows, 'Direct investment' and 'Other investment' recorded net outflows of Rs30.6 billion and Rs39.4 billion, respectively, while 'Portfolio investment' posted net inflows of Rs81.8 billion. Excluding cross-border transactions of GBC1s, non-residents' direct investment in Mauritius registered net inflows of Rs4.7 billion in the first semester of 2013, directed mainly toward the real estate sector. The overall balance of payments for the third quarter of 2013 recorded a deficit of Rs3.4 billion as against a surplus of Rs1.1 billion in the corresponding quarter of the preceding year.

Chart 3.1: Financing of the Current Account



[2] As from 2010, balance of payments includes cross-border transactions of GBC1s.

The continuous deterioration of the current account deficit, estimated at 13.1 per cent of GDP in the third quarter of 2013, which reflects a growing savings-investment gap, raises concerns over external sector vulnerabilities. The recent heightened financial market volatility in Indonesia, Turkey, India, South Africa and Argentina - with most of these countries having high current account deficit and susceptible to short-term foreign capital flows - underscores the importance of strengthening the economic fundamentals of a country. Containing the size of the current account deficit within sustainable levels, and putting in place an appropriate policy framework to attract more stable and long-term capital flows remain key challenges in managing the external sector.

Reserve Adequacy

The reserves-to-imports ratio provides an important measure of reserve adequacy, especially in cases where balance of payments instability emanates from rising current account deficit financed by short-term and volatile capital flows. As at end-December 2013, the gross official international reserves increased to a high of Rs105.0 billion, representing 5.6 months of import cover based on the value of imports of goods *f.o.b* and non-factor services for the year 2012. This compares with 4.9 months recorded as at end-December 2012 (Chart 3.2). Other indicators of reserve adequacy, namely the reserves to broad money liabilities and reserves to gross external debt ratios, estimated at 29.2 per cent and 180.8 per cent, respectively, as at end-September 2013, are assessed to be adequate.

3.2 Fiscal Sector

Total Public Sector Debt

With a view to enhancing debt sustainability, Government has continued its efforts towards fiscal consolidation. The budget deficit, which stood at 3.7 per cent of GDP in 2013, is forecast to decline to 3.2 per cent in 2014 and below 3.0 per cent in 2015/16, driven by an expected increase in tax revenue. The primary balance was in deficit in 2013, representing

Box I: External Indicators

		Sep-12	Sep-13
		Rs million	
Gross External Debt [1]	as at end	50,121	60,574
External Debt Service	year ended	6,761	7,110
Exports of Goods	year ended	78,210	86,275
Exports of Goods and Services	year ended	179,701	189,111
Imports of Goods and Services	year ended	223,490	235,238
Gross Official International Reserves [2]	as at end	89,379	102,446
GDP at market prices	year ended	337,285	359,784
Broad Money Liabilities	as at end	331,264	350,499
Indicators		*Per cent*	
I. Solvency			
Gross External Debt/GDP		14.9	16.8
Gross External Debt/Exports of Goods		64.1	70.2
Gross External Debt/Exports of Goods and Services		27.9	32.0
External Debt Service/Exports of Goods		8.6	8.2
External Debt Service/Exports of Goods and Services		3.8	3.8
II. Reserve Adequacy			
Reserves/Imports of Goods and Services		40.0	43.5
Reserves/ Broad Money Liabilities		27.0	29.2
Reserves/Gross External Debt		178.3	169.1
Gross External Debt/Exports of Goods and Services		27.9	32.0

[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 comprise gross foreign assets of the Bank of Mauritius, reserve position in the IMF and the foreign assets of Government.*

1.1 per cent of GDP and is expected to vary between -0.4 per cent and 0.2 per cent through 2015.

Public sector debt, including debt of central Government and public enterprises, stood at 59.6 per cent of GDP as at end-September 2013. It is expected to fall to 57.8 per cent and 56.3 per cent in 2014 and 2015, respectively.

As a result of the various measures taken to lengthen the maturity profile of Government debt and in order to reduce rollover risks and costs associated with debt management, long-term domestic debt (by original maturity) as a share of total domestic Government debt increased from 48.3 per cent as at end-September 2012 to 52.5 per cent in the corresponding period of 2013.

External Debt

The gross external debt of the country, comprising central Government, public corporations, monetary authorities and private sector debt, increased by 20.9 per cent, from Rs50.1 billion as at end-September 2012 to Rs60.6 billion as at end-September 2013. The rise was primarily attributable to higher central Government external debt, partly offset by a decline in public enterprise and private sector external debts. As a percentage of GDP, gross external debt stood at 16.8 per cent as at end-September 2013, up by 1.9 percentage points compared with a year ago.

The ratio of central Government external debt to GDP increased from 10.5 per cent as at end-September 2012 to 12.7 per cent as at end-September 2013. It is expected to rise further in the years ahead. This is in line with the Government's present strategy to shift towards more foreign financing and, at the same time, lengthen the maturity profile of its debt. As at end-September 2013, central Government debt was mostly denominated in US dollar (38.1 per cent) and euro (35.2 per cent) (Chart 3.3).

As at end-September 2013, 78.1 per cent of central Government external debt was based on floating interest rates whilst 18.4 per cent carried a fixed interest rate and 3.5 per cent was interest free. Government external debt might be subject to some interest rate risk in the medium term, as advanced economies achieve sustained recovery and raise their key interest rates.

The large increase in external debt of the Government could also pose some risks in relation to adverse movements in exchange rates though the risks could be mitigated by a rather balanced currency composition of external debt. The external debt-service ratio, which was below 4 per cent in 2013, is expected to hover in the range of 4.2 per cent to 4.7 per cent in the period 2014 to 2016.

At this juncture, risks to financial stability stemming from Government finances seem low in the light of the contained budget deficit and the declining trend in public sector debt to GDP ratio. The Government's strategy to shift towards more foreign financing and to lengthen the maturity profile of its debt mitigated debt servicing costs and rollover risks. However, the increase in external debt of the Government poses some interest rate risks in the medium term and has also contributed to persistent excess liquidity in the banking system.

Chart 3.2: Gross Official International Reserves and Import Cover

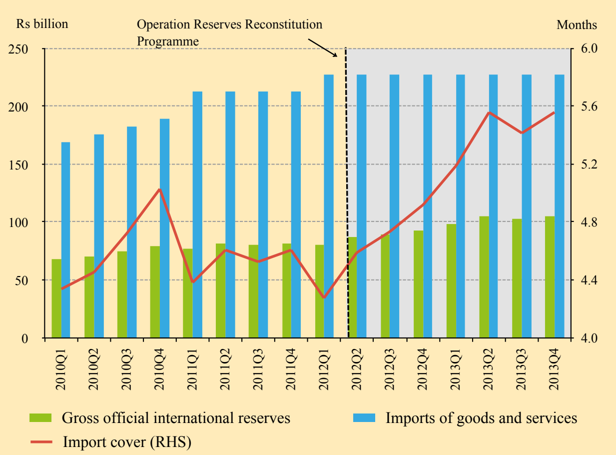
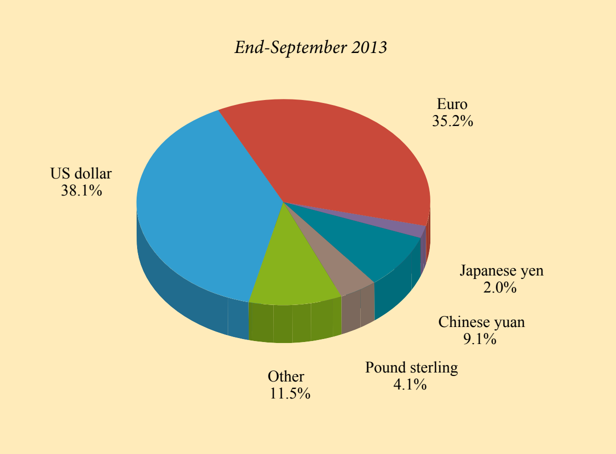


Chart 3.3: Currency Composition of Central Government External Debt



3.3 Financial Markets

3.3.1 Foreign Exchange Market

In the global currency market, demand for the US dollar firmed up at the start of the second half of 2013 by the US Fed's announcement of an upcoming scale back on its asset purchase programme with a view to phasing out quantitative easing altogether by mid-2014. The rally was short-lived as the US dollar tumbled across the board following assurance by the US Fed that the accommodative policy pursued by the central bank was likely to remain in place for the foreseeable future. The technical shutdown of US Government and the debacle over the debt ceiling negotiations in October 2013 also adversely affected the value of the safe haven currency.

The euro built up on its mid-year upward trend vis-à-vis the US dollar as the economic outlook in peripheral Eurozone countries appeared to stabilise and the single-currency bloc kept its forward momentum, albeit at a slow pace. The appreciation of the single currency was briefly constrained as unemployment in the euro zone reached an all-time high of 12.2 per cent in September 2013. It was further hit in November when the ECB slashed its key refinancing rate to a record low to head off deflationary pressures across the region. The Pound sterling saw a strong rally in the second half of the year, capitalising on sustained improvement in the UK economy. Meanwhile, the Japanese yen weakened further and touched the 105 mark against the US dollar as the Bank of Japan maintained its aggressive monetary easing.

Against this backdrop and reflecting domestic demand and supply conditions, the rupee appreciated against the US dollar but depreciated against the euro and the Pound sterling. Based on the average dealt selling rate on transactions equivalent to US$30,000 or above, an appreciation of 2.73 per cent was noted against the US dollar in the second semester of 2013 while depreciation of 4.65 per cent and 2.57 per cent was recorded against the Pound sterling and euro, respectively. In nominal effective terms, the trade-weighted value of the domestic currency inclusive of tourism receipts, as measured by MERI2, registered an appreciation of 0.55 per cent between July and December 2013 (Chart 3.4).

3.3.2 Stock Market

Global equity markets rebounded in the second half of 2013 as market sentiment and global risk appetite were boosted by the accommodative policy that is foreseen to be sustained in the US and other major advanced economies. Equity indices in emerging markets recovered somewhat during October 2013 but fell subsequently as expectations of tapering of the US asset purchase programme increased. The SEMDEX, which reached its highest level in two years in December 2013, tracked global equity indices and was supported by better-than-expected corporate financial results, partly driven by stronger euro, and a higher volume of transactions on the part of domestic investors (Chart 3.5). The SEMDEX rose by 9.5 per cent between end-June 2013 and end-December 2013, mainly due to increases in tourism and banking sector stocks. The SEM-7 gained 7.7 per cent over the same period. However, net foreign investment on the domestic stock market was negative, with net outflows of around Rs202 million.

Chart 3.4: Exchange Rate Movements

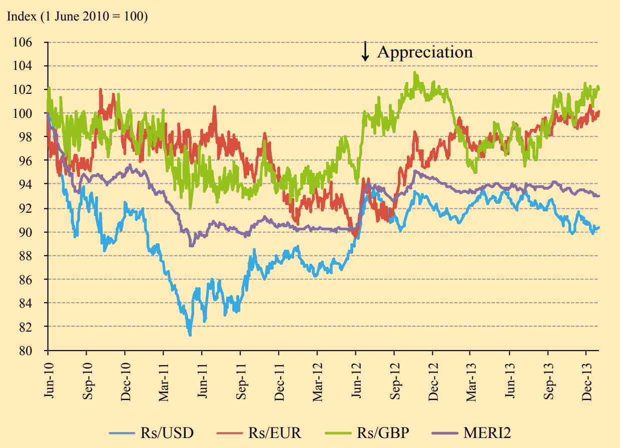
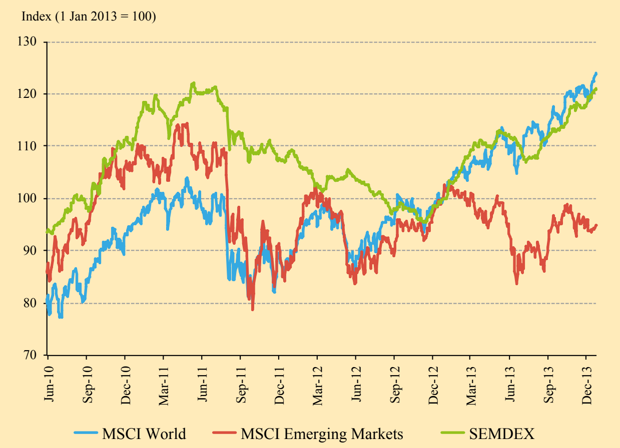


Chart 3.5: Evolution of Stock Markets



Sources: Thomson Reuters and Stock Exchange of Mauritius.

3.4 Credit Growth and Credit Risks

During the year ended September 2013, total credit granted by banks continued to expand albeit at a slower rate compared to the preceding period. Credit risk remained one of the main risks that banks face in Mauritius as advances constitute around 62 per cent of total banking assets.

The August 2013 FSR pointed to the fact that amid lacklustre construction activity, '*construction*' remained a vulnerable sector where the level of NPL called for close monitoring by the Bank. In addition, the banking sector is characterised by credit concentration in some sectors of the economy. Accordingly, in October 2013, the Bank has introduced a set of macroprudential policy measures to mitigate risks to financial stability and strengthen the soundness of banks. These prudential measures include, *inter alia*, additional portfolio provision and sectoral limits that will become applicable to three specific sectors, notably '*construction*', '*tourism*', and '*personal*' and will take effect in a phased manner starting 1 July 2014.

Box II provides additional information on the macroprudential policies.

Box II: Macroprudential Policies

Even if banks are assessed to be resilient at present, the rapid increase in credit to the '*construction*' sector as well as anecdotal evidence that property prices are rising significantly in Mauritius have raised some concerns for financial stability. As at end-September 2013, 8.4 per cent of credit extended to '*construction*' sector was classified as non-performing and the corresponding NPL ratio accordingly has stayed high for some time. In addition, there have been concerns regarding the level of sectoral concentration risk in the economy.

This prompted the Bank to issue five macroprudential policy measures in October 2013 to improve the resilience of the banking system. These measures are expected to address the build-up in systemic risk, driven by a potential overheating in the property market.

Loan-to-Value Ratio (LTV ratio)

The LTV ratio is being introduced to discourage speculation and prevent the build-up of excessive leverage associated with the rapid credit expansion to the '*construction*' sector. The LTV ratio imposes a cap on the size of a loan relative to the value of the property, and in the event of credit default or a decline in property prices, the LTV ratio is expected to contain any loss that might be incurred by the bank. These relative prudential limits target mostly credit facilities granted for the purchase or construction of a first property above Rs5 million and/or any subsequent residential unit. With a view to encouraging first-time buyers to acquire residential properties, the LTV ratio has been reviewed from 80 per cent to 90 per cent for housing loans below Rs5 million that qualify for a preferential risk weight. Individual borrowers entitled to housing loans under the national housing empowerment scheme are exempted from this prudential requirement. The LTV ratio has come into effect on 1 January 2014.

Debt-to-Income Ratio (DTI ratio)

Mortgage loans represent a large component of household indebtedness. A high level of indebtedness may dampen households' capacity to service mortgage loans, specifically when interest rates rise to adjust to economic fundamentals. At the same time, the relative size of mortgage loans in the balance sheets of banks also causes the latter to become vulnerable to adverse developments in the household sector. This measure came into effect on 1 January 2014, and should ensure that borrowers are not overleveraged whenever they have recourse to credit facilities from banks for the acquisition of a residential property. It is expected that the DTI ratio will raise prudential standards applied by banks to their '*construction*' credit portfolio. Individual borrowers entitled to housing loans under the national housing empowerment scheme are exempted from this prudential requirement.

Box II: Macroprudential Policies (Continued)

Risk-Weighted Assets

Following the increase in the risk weights on claims secured by residential property and commercial real estate for the purchase or construction of property in Mauritius, banks will be required to hold additional capital for such type of loans as from 1 July 2014. The risk weights for past due loans (net of specific provisions) on claims secured by residential property and commercial real estate for the acquisition of property in Mauritius have been raised to encourage banks to make full provision on NPL in this category. This measure should improve the resilience of banks by requiring them to hold extra capital for their exposure to the property market.

Additional Portfolio Provision

Banks are required to maintain a 1 per cent loan loss provision as cushion against potential future credit losses on loans that have not been individually assessed for impairment. The level of NPL has historically been higher in some key sectors of the economy on account of sectoral concentration of credit risk. To ensure early provisioning against potential future credit losses due to rising corporate indebtedness and NPL and effective 1 January 2014, banks have been required to make additional portfolio provision of 0.5 per cent over and above the existing portfolio provision of 1 per cent for the *housing* segment under the '*construction*' sector. The same condition is being made applicable to the *commercial, residential* and *land parcelling* segments under the '*construction*' sector, as well as to the '*tourism*' and '*personal*' sectors, and effective 1 January 2015, the additional portfolio provision for these three specific categories will be increased to 1.0 per cent.

Sectoral Limits

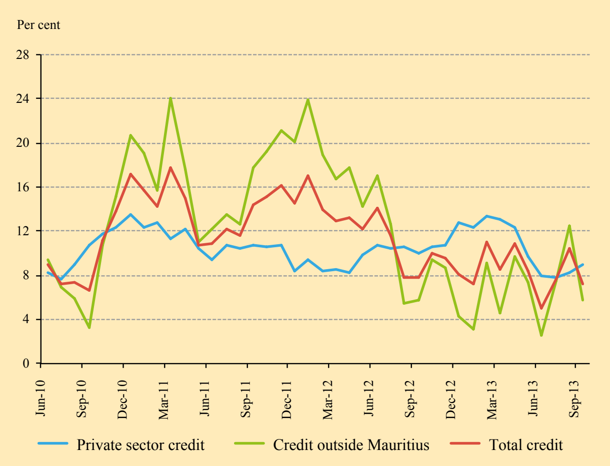
As a prudential measure to reduce sectoral concentration of credit risk in the economy, the Bank has introduced sectoral limits on the *commercial*, *residential* and *land parcelling* segments of the '*construction*' sector, as well as in the '*tourism*' and '*personal*' sectors in a phased manner starting 1 July 2014.

3.4.1 Total Credit

Growth in total credit decelerated to 7.2 per cent as at end-September 2013, from 7.7 per cent as at end-September 2012, as a result of a slowdown in both the level of private sector credit in Mauritius and credit granted outside Mauritius. Private sector credit, however, as a ratio of total credit, increased by 0.8 percentage point to 47.6 per cent and as a share of GDP at market prices, it increased by 1.6 percentage points to 74.3 per cent. Growth in credit to the private sector, which trended upward to 13.3 per cent as at end-February 2013, dropped to 9.0 per cent as at end-September 2013, driven by a deceleration in corporate credit. Growth in cross-border credit slowed to 5.7 per cent, from 5.8 per cent a year before (Chart 3.6).

The private sector credit to GDP gap moved into positive territory since 2010Q2 and maintained a broad upward trend (Chart 3.7). This constitutes a risk, the more so as the increase in credit does not appear to be channelled into investment. While both the private investment rate and private sector credit as a ratio of GDP trended upward until 2008, the private investment rate registered a sharp and continuous decline after 2008 (Chart 3.8). Subdued and uncertain external demand conditions, weak business sentiment as well as internal operational challenges might have weighed on firms' investment decisions.

Chart 3.6: Y-o-y Credit Growth



Non-Performing Loans

The ratio of NPL to total credit rose from 3.1 per cent as at end-September 2012 to 3.5 per cent as at end-September 2013 (Table 3.1). NPL as a percentage of private sector credit stood at 5.6 per cent as at end-September 2013. The NPL ratio of cross-border credit went up significantly, reaching a peak of 2.8 per cent as at end-June 2013, mainly on account of impaired credit pertaining to some corporates in India, but subsequently decelerated to 2.1 per cent as at end-September 2013.

Rising NPL are generally accompanied by higher level of specific provisions. In line with the increase in NPL on private sector credit, specific provisions rose by 42.8 per cent as at end-September 2013 compared with 14.4 per cent a year earlier. The coverage ratio, that is, the ratio of specific provisions to NPL, increased from 39.9 per cent to 43.3 per cent over the same period, providing an adequate buffer against bad debt (Chart 3.9).

3.4.2 Household Sector Credit

Household credit represented 27.4 per cent of total private sector credit as at end-September 2013. This was higher than the level of 25.9 per cent as at end-September 2012. Growth of credit to households trended downward

Chart 3.8: Private Investment and Private Sector Credit

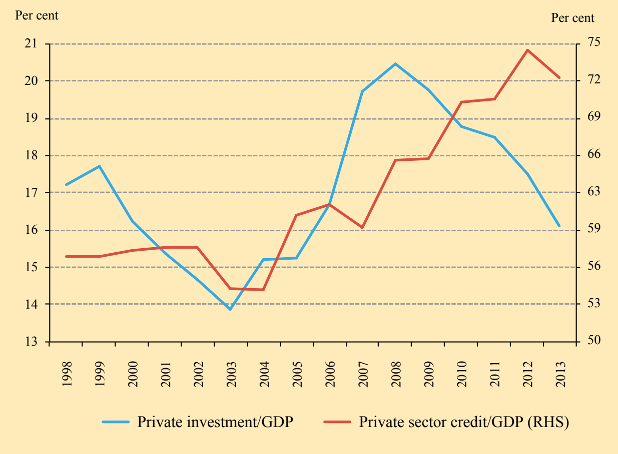


Chart 3.7: Private Sector Credit to GDP Gap

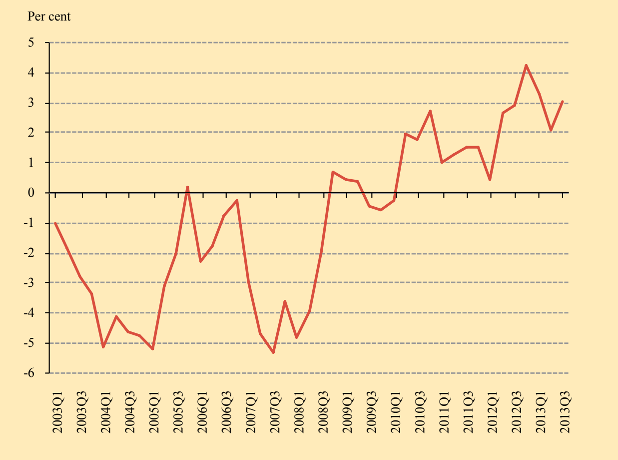


Chart 3.9: Non-Performing Loans and Coverage Ratio

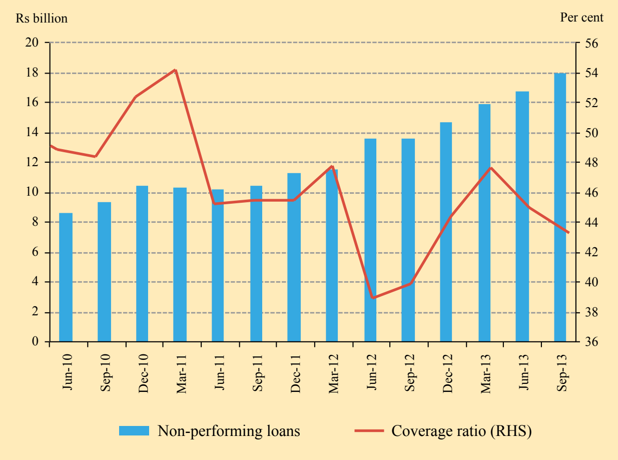


Table 3.1: Non-Performing Loans of Banks

	NPL as a percentage of private sector credit	NPL as a percentage of credit outside Mauritius*	Total NPL as a percentage of total credit
Sep-09	4.9	1.6	2.4
Sep-10	4.7	0.8	2.1
Sep-11	4.5	1.5	2.3
Sep-12	5.3	1.9	3.1
Jun-13	5.4	2.8	3.4
Sep-13	5.6	2.1	3.5

** Including GBLH.*

as from March 2013 but remained, on average, above 15 per cent. As a percentage of GDP, household credit stood at 20.3 per cent as at end-September 2013 (Chart 3.10).

Some 60 per cent of household credit is allocated for housing purposes and the remaining credit is channelled towards consumption. During the year ended September 2013, housing credit grew at a slower rate of 12.5 per cent compared with an increase of 18.7 per cent a year earlier. Growth in credit for consumption showed a rapid increase, reaching a peak of 22.9 per cent as at end-May 2013 before decelerating to 19.0 per cent as at end-September 2013 (Chart 3.11). The NPL resulting from credit extended to the '*personal*' sector has remained unchanged at 9.5 per cent as at end-September 2013 compared with the year before.

3.4.3 Corporate Sector Credit

Exposure of banks to the corporate sector continued to rise, reaching around 70 per cent of total private sector credit as at end-September 2013. The largest share of corporate credit was extended to the '*tourism*' sector, which constituted 25.6 per cent of total corporate credit. Credit granted to '*financial and business services*', '*construction (excluding housing loans)*' and '*traders*' accounted for 15.6 per cent, 15.5 per cent and 15.0 per cent, respectively, of total corporate credit (Chart 3.12). Credit granted to '*manufacturing*' and '*agriculture*' each represented 9.7 per cent of total corporate credit.

Credit extended to corporates increased by 7.3 per cent y-o-y as at end-September 2013, driven by credit to most major sectors of the economy. Credit to the '*tourism*' sector

Chart 3.11: Y-o -y Growth of Household Credit

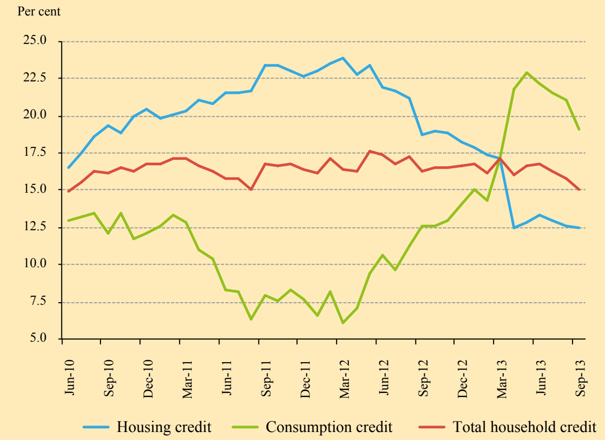


Chart 3.12: Sectorwise Distribution of Credit to Corporates

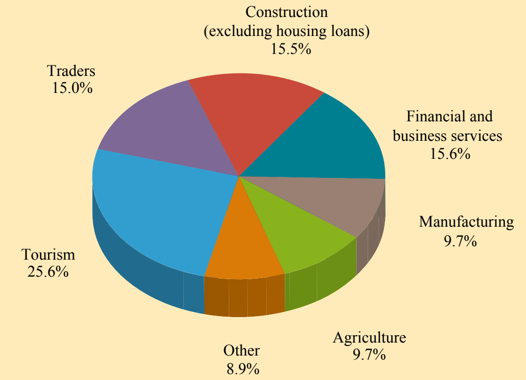


Chart 3.10: Household Credit as a percentage of GDP

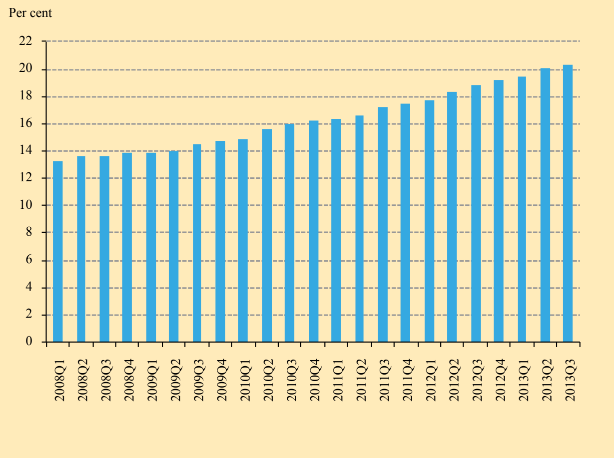
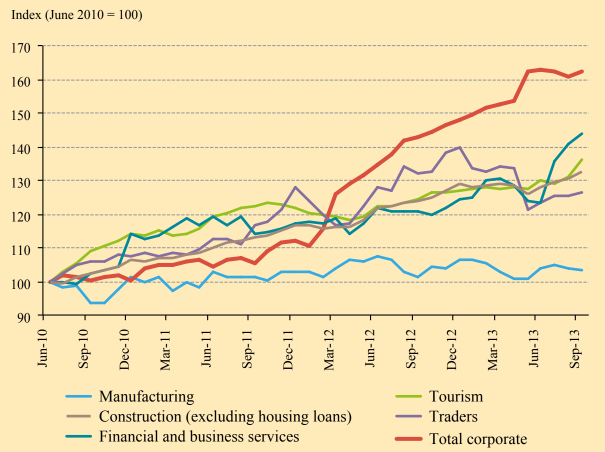


Chart 3.13: Evolution of Credit to Corporates



grew by 9.4 per cent as at end-September 2013 compared to 1.6 per cent in the corresponding period of 2012. Concurrently, credit expansion in the '*manufacturing*' and '*financial and business services*' sectors was higher over the year to end-September 2013. As regards '*traders*', credit contracted by 4.2 per cent as against robust growth of 13.1 per cent recorded a year earlier (Chart 3.13).

Banks' exposure to '*construction (excluding housing loans)*' has increased rather rapidly over the past years, notwithstanding lacklustre construction activity. As at end-September 2013, credit extended to '*construction (excluding housing loans)*' grew by 13.3 per cent, driven by respective increases of 27.6 per cent and 13.8 per cent in credit extended to residential and commercial property development. This growing level of credit presents a risk to banks amid possibly rising property prices that could potentially become a source of vulnerability for the financial system. The Bank has accordingly increased vigilance on credit granted to the '*construction*' sector. A detailed analysis of the sector is provided in Box III.

Box III: Credit to the Construction Sector

The banking sector has accumulated a large stock of credit to the '*construction*' sector inclusive of housing loans over the past five years. The take-off of the Integrated Resort Scheme and the Real Estate Scheme has triggered a boom in the property market from non-residents. The low interest rate environment, coupled with competitive home loan packages offered by banks to property buyers, have also bolstered credit to the '*construction*' sector, which increased by almost two-fold from Rs39.5 billion as at end-September 2009 to Rs73.4 billion as at end-September 2013 (Chart I). As a percentage to GDP, credit to the '*construction*' sector rose rapidly from 14.1 per cent to 20.4 per cent over the same period (Chart II).

Chart I: Credit to Construction Sector

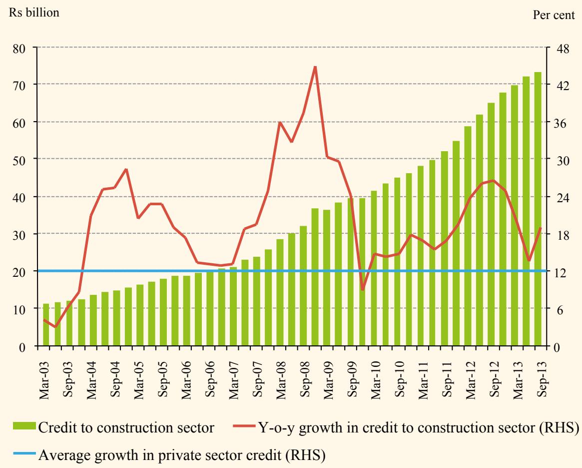
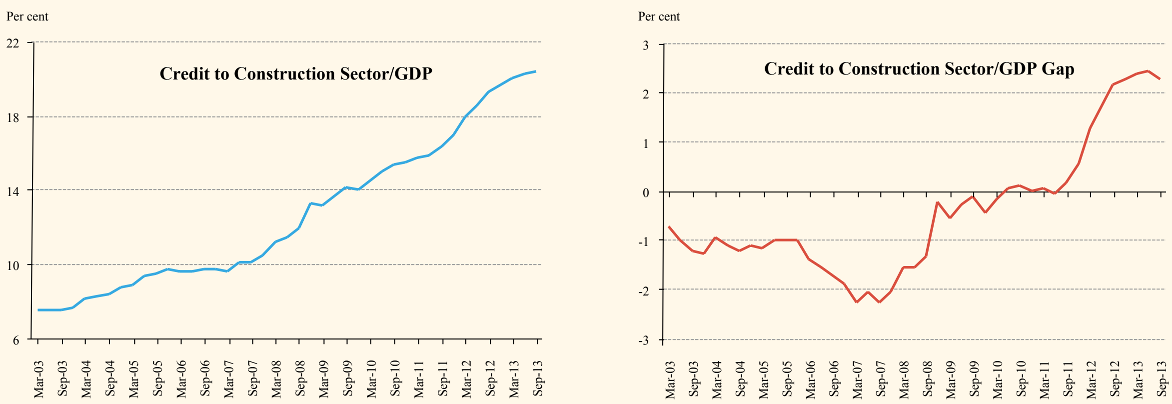


Chart II: Credit to Construction Sector/GDP



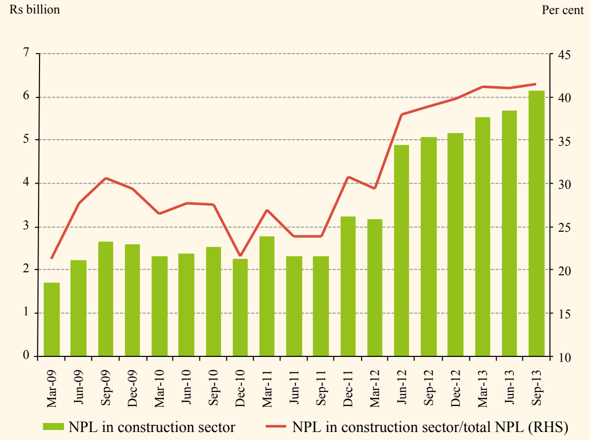
Box III: Credit to the Construction Sector (Continued)

Although growth in credit to '*construction*' has generally exceeded average growth in private sector credit over the past ten years, credit to construction/GDP gap - which measures the deviation of the credit to construction/ GDP ratio with its long-term trend - has remained below zero for most of this period. However, from June 2010 onwards, credit to construction/GDP gap has overshot its long-term trend and moved into positive territory in the subsequent quarters. This rapid increase in the gap has raised some concerns for financial stability.

Concurrently, a significant increase was recorded in the NPL of the '*construction*' sector, which went up from Rs2.7 billion as at end-September 2009 to Rs6.1 billion as at end-September 2013 (Chart III). During this period, the proportion of NPL in construction to total NPL increased from 30.5 per cent to 41.4 per cent. The Bank is concerned about this increase in NPL in the '*construction*' sector, and the resulting risk to banks.

The Bank remains vigilant to the evolution of the level of credit granted to '*construction*' as part of its current macroprudential surveillance of the financial system.

Chart III: Non-Performing Loans in the Construction Sector



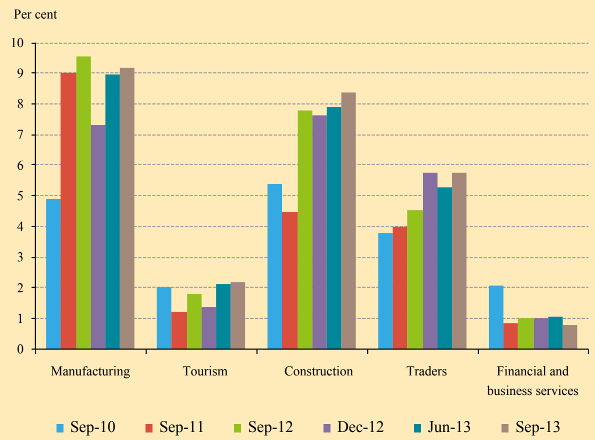
Non-Performing Loans

The highest levels of NPL in the past five years have been in the '*manufacturing*' sector, but after a steep rise from 2010 to 2011, they now seem to be contained at about 9 per cent (Chart 3.14). However, a rising trend in the level of NPL was registered in the '*construction*' and '*traders*' sectors over this period. NPL in '*construction*' sector has risen from under 5 per cent as at end-March 2009 to over 8 per cent by end-September 2013. In the '*traders*' sector, NPL has increased from less than 4 per cent as at end-September 2010 to nearly 6 per cent by end-September 2013. In '*tourism*' and '*finance and business*' sectors, NPL remained comparatively low at 2 per cent and under 1 per cent, respectively, as at end-September 2013. Nevertheless, the '*tourism*' sector may warrant closer monitoring, with the decline in tourism receipts despite higher tourist arrivals.

Credit in Foreign Currency

Private sector credit extended in foreign currency may have financial stability implications due to foreign exchange volatility that can affect the repayment capacity of borrowers. As at end-September 2013, foreign currency credit accounted for 15.7 per cent of total private sector credit, with the '*transport*' sector borrowing 41.6 per cent of its loans in foreign currency and '*tourism*', '*manufacturing*' and '*financial and business services*', 39.4 per cent, 24.5 per cent and 15.7 per cent, respectively. The risk to the banks is, however, eased to some extent as operators in these sectors also receive income in foreign currency. Going forward, the reversal of accommodative monetary policy in advanced economies might have implications on debt servicing costs and the rupee exchange rate.

Chart 3.14: NPL as a percentage of Sectoral Credit



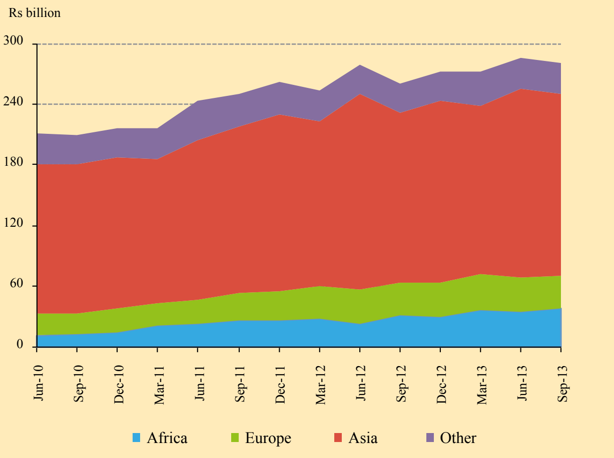
3.4.4 Cross-Border Credit

Total credit to borrowers outside Mauritius amounted to around Rs281 billion as at end-September 2013, representing a y-o-y increase of 7.7 per cent compared with 3.9 per cent a year earlier. The cross-border exposures of banks show a bias towards Asia, which accounted for 64.2 per cent of total cross-border credit as at end-September 2013 (Chart 3.15). Despite attempts to diversify cross-border activities towards other regions, credit is still concentrated in Asia, in particular India, mainly because of the DTAA with this jurisdiction. Total credit to India accounted for around 92 per cent of the total credit to the Asian continent. Uncertainty over the DTAA could have an adverse impact on cross-border credit to India. Credit to the African region has increased almost three-fold over the last three years, reflecting growing opportunities in this region.

Risks to financial stability arising from banks' cross-border exposures are moderate since the level of impairment across regions is relatively low. On an overall basis, NPL as a percentage of cross-border credit stood at 2.1 per cent as at end-September 2013, marginally up from 1.9 per cent as at the same time last year. Excluding GBLH, the ratio of impaired credit to total cross-border credit was 0.5 per cent in Asia, 0.8 per cent in Europe and 1.4 per cent in Africa as at end-September 2013.

In the context of growing cross-border banking activities in the region, the setting up of Supervisory Colleges is required for a more effective supervision of banking groups with cross-border operations (Box IV).

Chart 3.15: Cross-Border Credit



Box IV: Supervisory College

The Basel Committee on Banking Supervision now requires in its Core Principle on Home-Host Relationships that the home supervisor establishes bank-specific supervisory colleges for banking groups with cross-border operations to enhance effective oversight. Accordingly, the Bank organised Supervisory Colleges in November 2013 for two systemically important banking groups, namely The Mauritius Commercial Bank Limited (MCB) and State Bank of Mauritius Ltd (SBM). Each college constituted a multilateral working group of home and host supervisors of the MCB and the SBM for the African continent and Indian Ocean region. This forum provided a very good opportunity for all supervisors as well as the two Mauritian banks to share information that will help the Bank to conduct consolidated supervision. Interest has also been expressed for the organisation of supervisory colleges on a regular basis.

3.4.5 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. Over the year ended September 2013, the percentage of aggregate large exposures to capital base, that is known as the credit concentration ratio, dropped from 229.0 per cent to 219.6 per cent (Table 3.2). The credit concentration ratio was well below the prudential limits imposed on aggregate large credit exposures. As a percentage of total credit facilities, large exposures increased to 30.9 per cent as at end-September 2013, from 29.7 per cent in the corresponding period of 2012.

Credit exposure to the ten largest borrowers represented 34.0 per cent of large credit exposures as at end-September 2013 (Table 3.3). They also accounted for 74.7 per cent of banks' total capital base and 27.9 per cent of total private sector credit. Despite the decline in the credit concentration ratio, close monitoring of credit extended to large conglomerates is warranted as these may be engaged in inter-related economic activities. Balance sheet vulnerabilities of some large corporates in Mauritius is a matter of concern for the Bank.

The *Guideline on Credit Concentration Risk* was amended following the review of the aggregate large credit exposure limits applicable to banks and non-bank deposit-taking institutions. The guideline was also reviewed to incorporate certain macroprudential measures, namely sectoral concentration limits to be put in place by banks. Box V provides an analysis of credit concentration at the sectoral level.

Table 3.2: Concentration Risk

	Percentage of aggregate large exposures to capital base	Percentage of aggregate large exposures to total credit facilities
Sep-09	212.0	28.0
Sep-10	197.0	25.0
Sep-11	250.0	30.0
Sep-12	229.0	29.7
Jun-13	205.5	28.2
Sep-13	219.6	30.9

Table 3.3: Exposure of Banks to Ten Largest Borrowers

	Ten largest borrowers (Rs million)	Ten largest borrowers to total large exposures (Per cent)	Ten largest borrowers to total capital base (Per cent)
Mar-12	65,248	36.0	83.0
Sep-12	78,680	36.5	92.0
Dec-12	77,417	39.3	85.3
Mar-13	69,679	38.9	73.4
Jun-13	69,315	40.0	73.0
Sep-13	74,611	34.0	74.7

Box V: Credit Concentration

The credit portfolio of banks in Mauritius is rather concentrated, with 45 per cent of banks' private sector credit channelled to two main economic sectors, namely '*construction*' and '*tourism*' (Chart I). In parallel, concentration of credit is also high within certain sectors where most of the credit facilities are supplied by only a few banks. This Box examines credit concentration within four sectors: '*construction*', '*tourism*', '*personal*' and '*manufacturing*'.

Chart II displays Lorenz curves that plot the distribution of credit by banks within these four sectors as at end-September 2008 and end-September 2013. This shows that 10 per cent of the total number of banks operating in Mauritius, that is, two banks, continue to supply more than 50 per cent of credit to each of these sectors. There has been a slight improvement at the margin, particularly in '*construction*' and '*manufacturing*', as the number of banks providing the remaining credit has increased somewhat between the two time periods considered.

Chart I: Sectorwise Distribution of Private Sector Credit

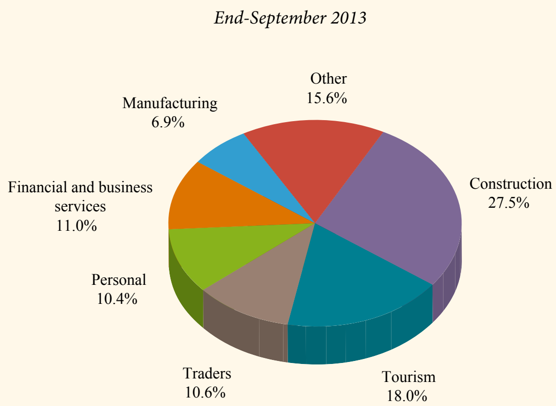
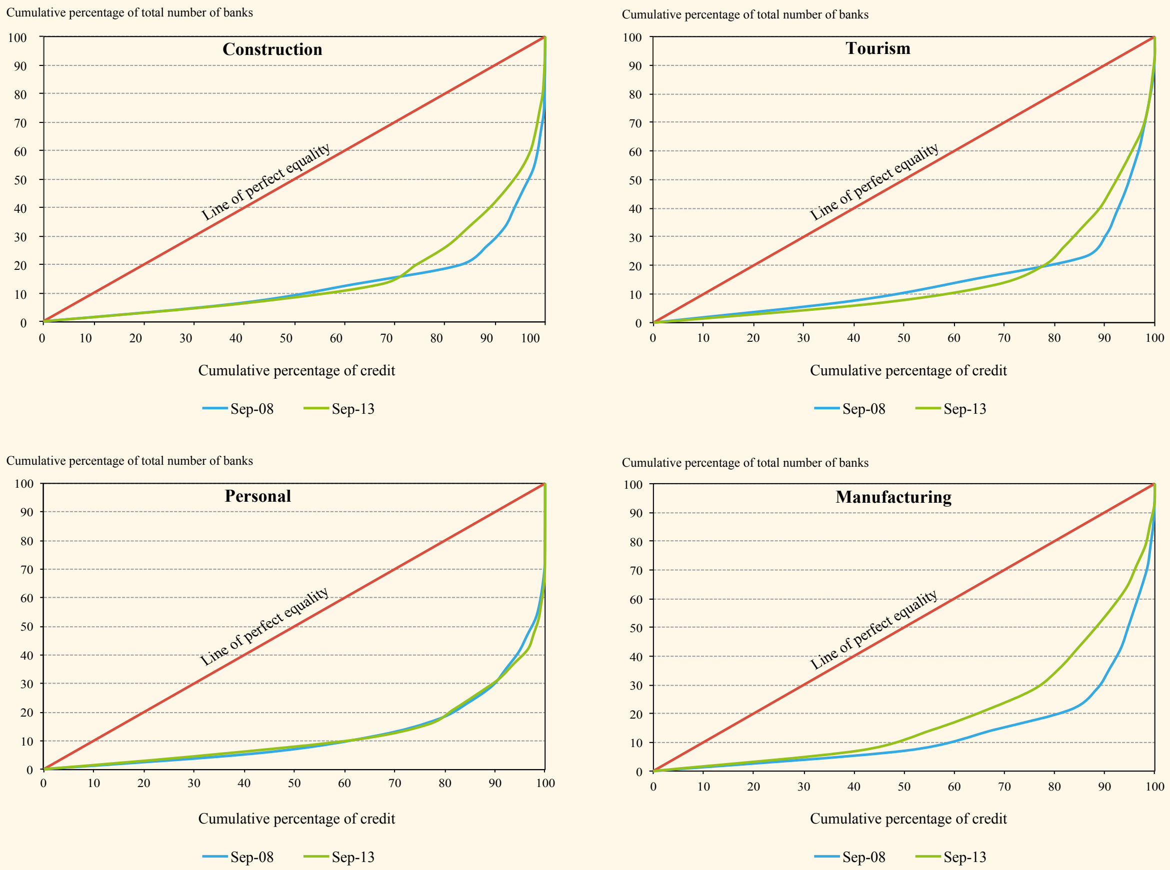


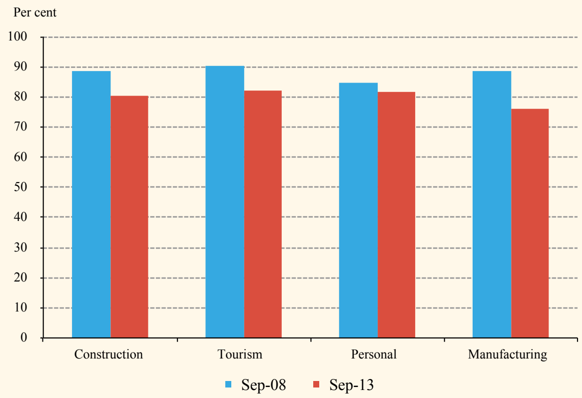
Chart II: Distribution of Credit by Banks



Box V: Credit Concentration (Continued)

Considering the four banks that extend the largest share of credit to the private sector, it is found that the share of their total credit to overall private sector credit has declined to around 77 per cent as at end-September 2013 compared with around 84 per cent as at end-September 2008. The fall was particularly noticeable in the '*manufacturing*', '*tourism*' and '*construction*' sectors where the share of the four banks providing the most credit dropped by 12.5 per cent, 8.3 per cent and 7.9 per cent, respectively (Chart III).

Chart III: Share of Private Sector Credit by Four Banks



From an ownership perspective, domestic-owned banks continued to provide the largest share of credit to the private sector. This proportion even increased between September 2008 and September 2013 in all sectors, except in '*manufacturing*'. Relative to 2008, branches of foreign-owned banks granted a lower share of credit to almost all four sectors while credit extended by subsidiaries of foreign-owned banks generally increased, partly as a result of the re-classification of one bank within this category.

With the aim of reducing the risks attached to the concentration of credit in particular sectors, the Bank has recently imposed regulatory limits on the total amount of credit that can be granted to the '*construction*', '*tourism*' and '*personal*' sectors. These limits will be implemented in a phased manner starting from 1 July 2014. It is expected that compliance with the regulatory limits will contribute towards a more diversified credit portfolio held by banks.

3.5 Banking Sector

3.5.1 Balance Sheet Structure and Risk Profile

On a consolidated basis, total assets of the banking sector breached the Rs1 trillion mark in May 2013 and stood at Rs1,015 billion as at end-September 2013. Banking sector assets increased by 10.9 per cent as at end-September 2013 compared with 5.1 per cent in the corresponding period of 2012, driven by higher growth in both Segment A and Segment B assets. Over the year to end-September 2013, Segment A and Segment B assets grew by 13.2 per cent and 9.5 per cent, respectively, and accounted for 40.7 per cent and 59.3 per cent of total assets.

The rising level of excess liquidity recorded in the banking system is clearly reflected in changes noted in the balance sheet structure of banks. The share of cash and balances with banks in total assets increased to 24.0 per cent as at end-September 2013 compared with 22.6 per cent a year ago. Contrary to the previous trend whereby banks have gradually shifted out of cash and balances with banks into advances, funds deployed as advances accounted for a lower ratio of 61.7 per cent of total assets as at end-September 2013 compared with 64.7 per cent as at end-September 2012 (Chart 3.16).

In terms of the ownership structure of the banking sector, total assets held by domestic-owned banks registered y-o-y growth of 16.1 per cent as at end-September 2013 (Chart 3.17). Comparatively, total assets of subsidiaries of foreign-owned banks and branches of foreign-owned banks grew at lower rates of 8.4 per cent and 1.7 per cent, with one branch of a foreign bank having transferred the whole of its undertaking to a locally-incorporated bank.

3.5.2 CAMEL Rating

The latest CAMEL rating of banks for 2013Q2 showed that 14 banks were assigned a 'satisfactory' rating compared to 15 banks for 2012Q4 (Chart 3.18 and Table 3.4). Six banks were in the 'fair' category in 2013Q2 compared to five in 2012Q4, and one bank was classified in the 'marginal' category. The CAMEL ratings indicated that the banking sector continued to maintain stability and soundness in the quarter ended June 2013 although close monitoring is warranted for banks that have been downgraded.

Box VI provides a new tool to discuss financial stability issues in Mauritius.

Chart 3.16: Components of Banks' Total Assets

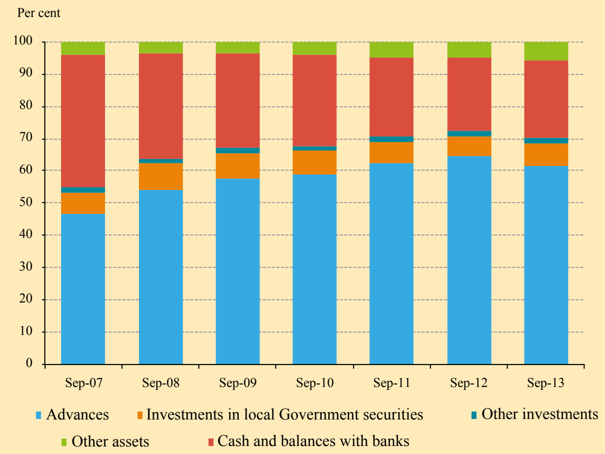


Chart 3.17: Banking Sector Assets

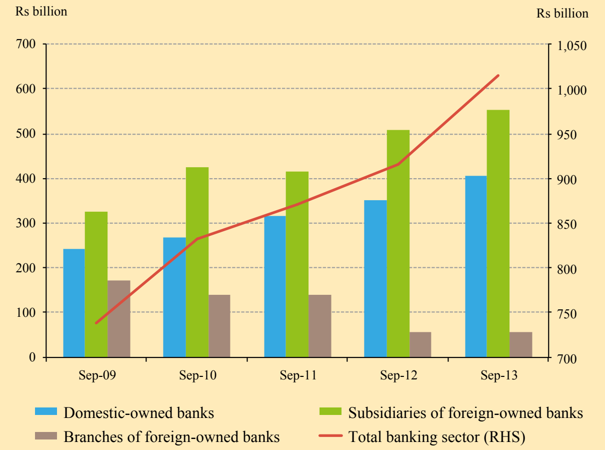


Chart 3.18: CAMEL Rating of Banks

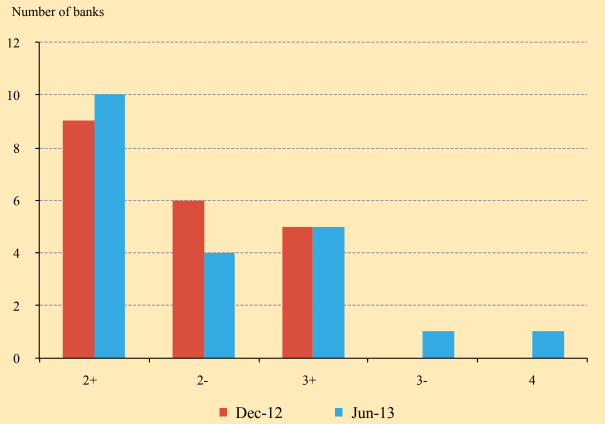


Table 3.4: CAMEL Rating of Banks*

Bank	Dec-12	Jun-13	Change
ABC Banking Corporation Ltd	3+	3+	↔
AfrAsia Bank Limited	2+	2+	↔
Bank of Baroda	2+	2+	↔
Bank One Limited	2-	3+	↓
Banque des Mascareignes Ltée	3+	3+	↔
BanyanTree Bank Limited **	-	3+	-
Barclays Bank Mauritius Limited ***	2-	2-	↔
Bramer Banking Corporation Ltd	3+	3-	↓
Century Banking Corporation Ltd	3+	4	↓
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	2-	2-	↔
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+	↑

* *1 : Strong   2+ and 2- : Satisfactory   3+ and 3- : Fair   4 : Marginal   5 : Unsatisfactory*

** *Started operations on 18 February 2013.*

*** *Barclays Bank PLC until May 2013.*

Box VI: A Cobweb Model for Assessing Financial Stability in Mauritius

This Box develops a cobweb model to assess financial stability in Mauritius. It considers three time periods: pre-crisis in 2008Q2; crisis in 2009Q2; and 2013Q2.

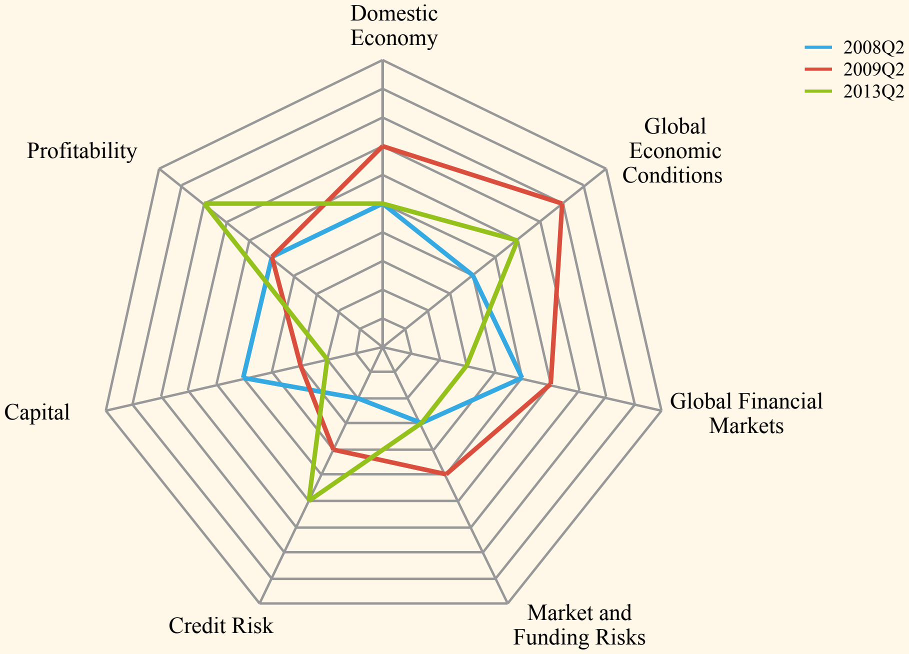
In building the cobweb, a seven-pronged approach is used whereby financial stability is assessed under seven dimensions: *domestic economy*, *global economic conditions*, *global financial markets*, *market and funding risks*, *credit risk*, *capital*, and *profitability*. Under each dimension, there are a number of sub-indicators that, in our view, best reflect financial stability conditions and are used to quantify risks that may arise. The analysis is based on 52 sub-indicators.

In designing the cobweb, the sub-indicators are diagnosed for normality, skewness and kurtosis, and are subject to various transformations. As a first step, the data are standardised into z-scores, described as:

$$z = \frac{x - \mu}{\sigma}$$

Box VI: A Cobweb Model for Assessing Financial Stability in Mauritius (Continued)

Chart I: Performance of the Cobweb Model



Note: Lower vulnerability closer to the center

where x is the data point, μ is the series average, and σ is the standard deviation of the series. The range of the z-scores of each sub-indicator is divided into 11 equally sized data subsets (percentiles) corresponding to a rank between 0 and 10. This scale is then used to rank the actual z-scores obtained for each sub-indicator at every data point. The final rank of a particular dimension at one point in time is the average of the ranks of all sub-indicators that fall under that dimension. The rank of each dimension is mapped into a cobweb-style diagram whereby a lower rank indicates lower risk and vice versa.

A zero rank corresponds to the dot in the middle of the cobweb, that is, relatively low risk. The rank increases as we move away from the centre, indicating higher risk. It is important to note that the concept of risk remains relative. The mean and median of each dimension, which equal 5, do not correspond to 'normal risk' or to any vulnerability level.

The final ranks obtained for the different dimensions are shown in the cobweb. It is generally found that the scores increased in 2009Q2, but were lower in 2013Q2 except for the *credit* and *profitability* dimensions (Chart I).

With regard to the *domestic economy* dimension, it is assessed that risks to financial stability increased in 2009Q2 as a result of the global financial and economic crises. Thereafter, the risks from this dimension subsided until 2011, when the intensification of the euro area sovereign debt crisis started to impact on the domestic economy. In 2013Q2, the risks from this dimension were estimated to be lower.

Risks to financial stability in Mauritius from *global economic conditions* were assessed to be higher when the economic and financial crises intensified and lower during the recovery period. Over the year to 2013Q2, risks originating from the global front were unchanged but remained higher than in the pre-crisis period (2008Q2).

Box VI: A Cobweb Model for Assessing Financial Stability in Mauritius (Continued)

Risks from *global financial markets* went up after the collapse of Lehman Brothers in September 2008 but subsided thereafter. Compared to 2009Q2, risks from *global financial markets* were lower in 2013Q2, as market volatility fell, liquidity conditions improved and equity markets recovered.

Market and funding risks in Mauritius were also higher in 2009Q2 amid tumultuous international markets but they fell subsequently. In 2013Q2, *market and funding risks* declined as domestic financial markets were less volatile compared to a year earlier. Funding indicators were also at comfortable levels and did not raise any financial stability concern.

Credit risk increased considerably between 2008Q2 and 2013Q2, principally explained by rising NPL ratios and higher indebtedness of households and corporates. Movements in the rank of the *capital* dimension indicate that banks have consolidated their capital positions since the outbreak of the crisis in 2008. However, reflecting lower profitability ratios, risks from the *profitability* perspective increased between 2008 and 2013.

The cobweb model is likely to evolve as new data are fed in, and new sub-indicators for each dimension are added to further improve the model. Although the cobweb model is a useful tool, which is used by several central banks as well as the IMF, it is important to bear in mind that it is only one way of analysing the many indicators that may be used to assess financial stability.

3.5.3 Regulatory Capital

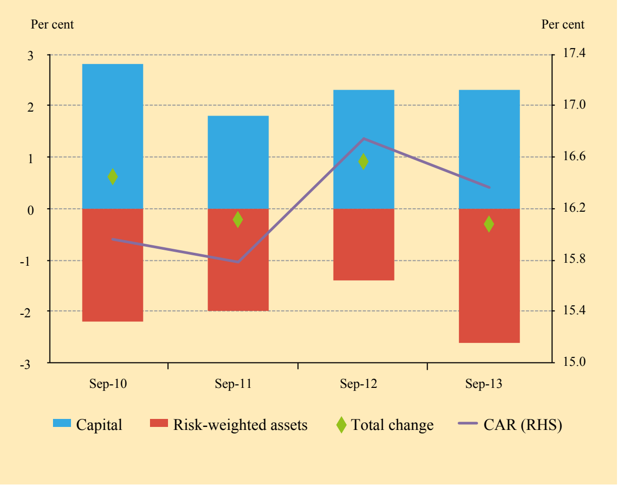
The level of capitalisation maintained by banks in Mauritius was comfortably above the current regulatory minimum of 10 per cent. The aggregate CAR of banks dropped marginally to 16.4 per cent as at end-September 2013, from 16.7 per cent as at end-September 2012, as the increase in risk-weighted assets (2.6 per cent) generated from balance sheet expansion was somewhat stronger than that of regulatory capital (2.3 per cent) (Chart 3.19).

At the current level of regulatory capital, the majority of banks maintain reasonable capital buffer against potential losses that might arise under adverse conditions. Based on estimates, the aggregate CAR could absorb losses of more than 15 per cent of the current balance sheets of banks.

Tier 1 capital comprises mainly common equity and is seen as the component of capital having the highest loss-absorbing capacity. Between end-September 2009 and end-September 2012, the evolution of Tier 1 capital ratio of the banking sector indicated an upward trend and was mainly driven through retention of earnings and new capital injections by a few banks. Subsequently, the aggregate Tier 1 capital ratio dropped from 15.3 per cent as at end-September 2012 to 14.3 per cent as at end-September 2013. This can be explained by the increase of 11.4 per cent recorded in core capital that was largely offset by growth of 19.2 per cent in risk-weighted assets held by banks over this period.

From the ownership perspective, branches of foreign-owned banks maintained the highest level of core capital over the five-year period ended September 2013, with a y-o-y average of 31.2 per cent, followed by subsidiaries of foreign-owned banks (16.1 per cent) and domestic-owned banks (11.4 per cent) (Chart 3.20).

Chart 3.19: Y-o-y Contribution to the Change in CAR



The leverage ratio of the banking sector, computed as the ratio of Tier 1 capital to total on- and off- balance sheet exposures, remained range-bound over the past five years ended September 2013 and indicated that banks have kept a reasonable balance between the size of their balance sheets and their equivalent in terms of risk-weighted assets. Branches of foreign-owned banks maintained the highest leverage ratio with an average of 8.9 per cent, followed by domestic-owned banks (6.4 per cent) and subsidiaries of foreign-owned banks (4.3 per cent) (Chart 3.21).

3.5.4 Financial Performance

The profitability of banks is still well above the pre-crisis level despite the decline in pre-tax profit - measured as the sum of pre-tax profit for the preceding four quarters - from Rs17,591 million as at end-September 2012 to Rs13,518 million as at end-September 2013 (Chart 3.22). The drop in pre-tax profit can be explained on the income side, by the rolling-out of exceptional gains earned by one bank in 2012Q2 and on the expense side, by the rise in non-interest expenses and impairment charges. With the exception of a few banks which posted losses, the remaining banks have continued to report positive results and good profitability.

Components of Revenue and Expense

During the year to end-September 2013, net interest income, which remains the major source of banks' income, rose by 3.9 per cent to Rs21,128 million. The increase in net interest income was driven by higher interest earnings generated from domestic banking activities in comparison to cross-border activities of banks.

Net fees and commission income has increased steadily over the past years. Compared with the previous year, net fees and commission income rose by 16.8 per cent to Rs5,620 million as at end-September 2013 and were mostly earned from local banking activities. Net trading income performed less well during the year, declining to Rs1,476 million. The fall in the fair value of some assets that were marked-to-market, contributed towards most of the decline in net trading income. Other income decreased to Rs1,181 million due to the exclusion of dividend income earned by one bank from its investments in some corporates that were transferred to its non-banking subsidiaries. Overall, non-interest income fell by 24.8 per cent to Rs8,279 million during the year to end-September 2013.

Chart 3.20: Tier 1 Capital Ratio

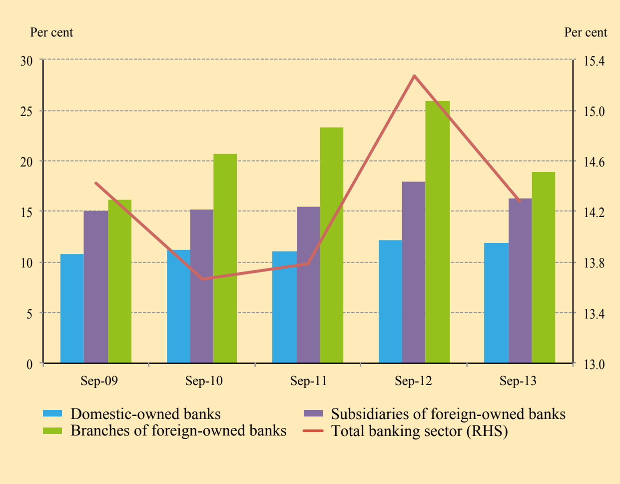


Chart 3.21: Leverage Ratio

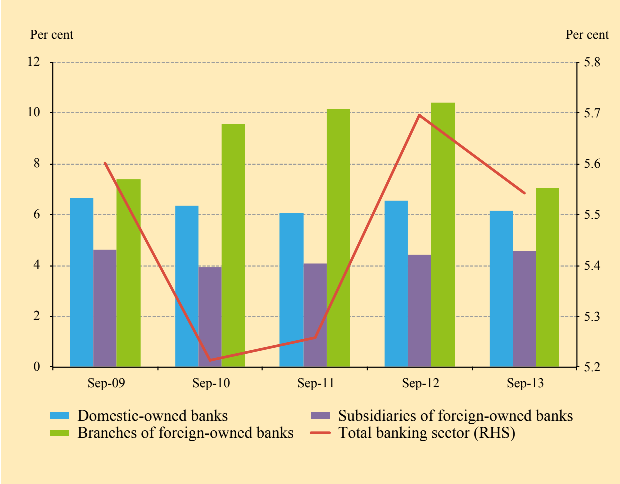
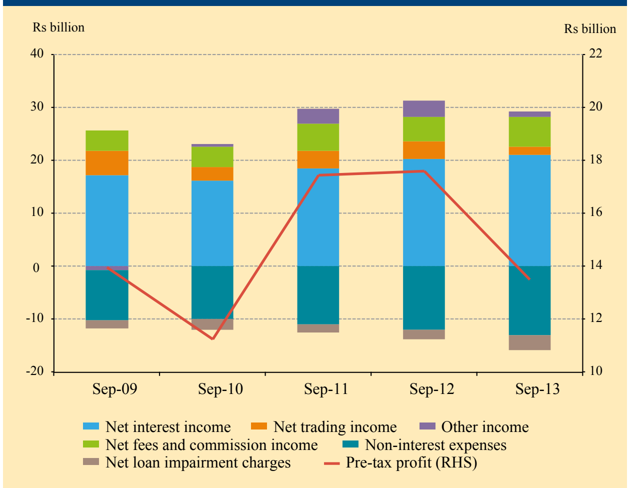


Chart 3.22: Components of Pre-Tax Profit



On the expense side, non-interest expenses of banks rose by 7.7 per cent to Rs12,908 million as at end-September 2013 on account of higher personal expenses. Although net impairment charges rose to Rs2,980 million as at end-September 2013, loan losses are considered to be relatively low.

Return on Assets

The annualised pre-tax ROA for the banking sector, as measured by the ratio of pre-tax profit to average assets, decreased to 1.0 per cent as at end-September 2013, from 1.5 per cent as at end-September 2012 (Chart 3.23). Movements in profit were uneven across the banking sector. Higher interest income together with the rise in fees and commission income have contributed to bolster the earnings of some domestic-owned banks whereas a few subsidiaries of foreign-owned banks, which operate mainly in the global business sector, saw their ROA edge down.

Return on Equity

The decline in profitability has also contributed to the fall in the ROE. Measured by the ratio of pre-tax profit to average equity, the ROE fell from 19.6 per cent as at end-September 2012 to 13.0 per cent as at end-September 2013. The reduction in the ROE was not generalised across the banking sector. During the year to end-September 2013, domestic-owned banks, generally, continued to earn higher ROE than their foreign-owned counterparts (Chart 3.24).

Despite the fall in profitability, the level of pre-tax profit is still considered robust. It has enabled most banks to strengthen their core capital by retaining profits. As at end-September 2013, 46.6 per cent of the total assets of the banking sector (excluding branches of foreign-owned banks) have contributed to generate an ROE of more than 20 per cent as compared with 46.3 per cent a year earlier (Chart 3.25). The reduction in the ROE of branches of foreign-owned banks was due to the conversion of activities of one of them into a subsidiary.

3.5.5 Funding

Banks in Mauritius continue to operate in a favourable funding environment, both locally and internationally. Funding and liquidity risks remain moderate as banks rely mostly on deposits from customers rather than short-term wholesale funding to finance their core lending business. Deposits from customers (including deposits from residents and non-residents) remain the most important component of banks'

Chart 3.23: Return on Assets

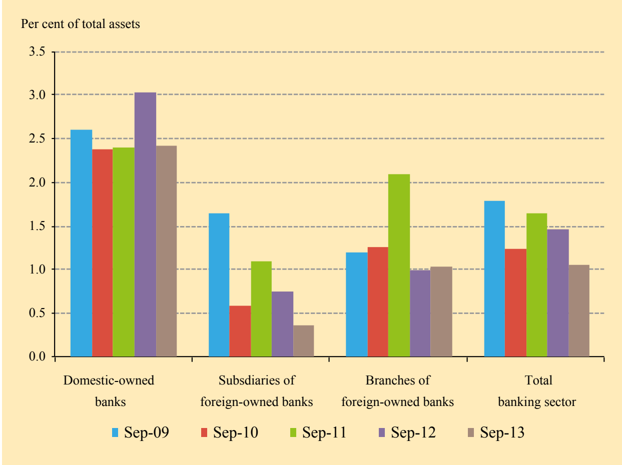


Chart 3.24: Return on Equity

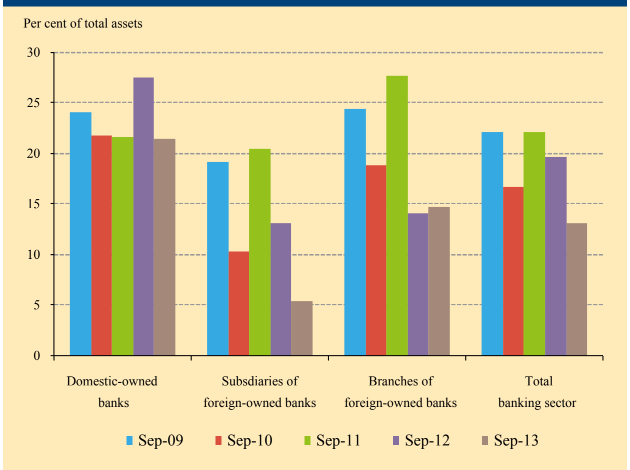
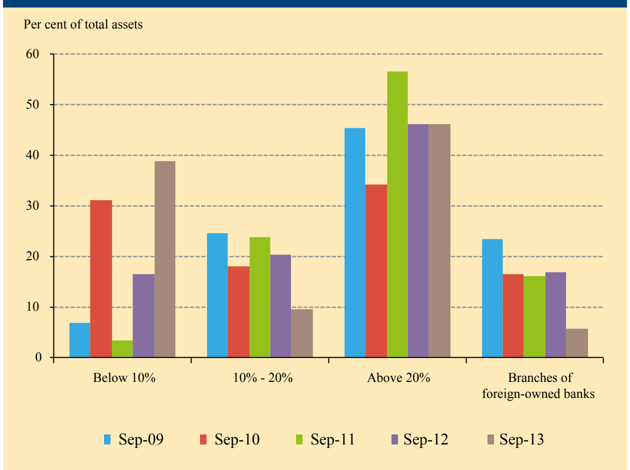


Chart 3.25: Dispersion of ROE



funding, representing 63.9 per cent of total liabilities of banks as at end-September 2013 compared with 67.2 per cent a year earlier (Chart 3.26).

As at end-September 2013, demand and savings deposits accounted for 62.1 per cent of total deposits of banks whilst time deposits, which represent a more stable long-term source of funding, accounted for the remaining 37.9 per cent of total deposits. The maturity pattern of time deposits has remained rather unchanged over the years even though customers have a broad preference for shorter maturities, typically six months or less (Chart 3.27).

An increasing portion of deposits from customers is mobilised from cross-border activities mostly by foreign-owned banks to fund their operations. Over the year to end-September 2013, cross-border deposits of banks (excluding deposits mobilised from GBLH) as a percentage of total liabilities of banks rose from 7.8 per cent to 11.1 per cent (Chart 3.28). Most of the cross-border deposits originated from Europe although the shares of cross-border deposits from Africa and America are rising. Foreign currency deposits are invested mainly in assets denominated in the same currency.

Wholesale funding, notably borrowings from banks, represented 14.5 per cent of banks' total liabilities as at end-September 2013 as compared with 13.4 per cent a year earlier. Most of the borrowings from banks were sourced by foreign-owned banks from overseas parent banks and related entities as part of their treasury operations. However, this method of financing has also been used by domestic-owned banks to take advantage of low interest rates in major international markets. Over the year to end-September 2013, cross-border borrowings from banks in Europe, as a percentage of total liabilities, declined to 6.5 per cent, from 10.1 per cent a year ago while the share of cross-border borrowings from Asia increased from 1.9 per cent to 5.5 per cent (Chart 3.29).

Since demand and savings deposits have no contractual maturity and customers may withdraw funds on request, there is a risk that a significant portion of such deposits be withdrawn within a short period of time in reaction to any adverse development affecting banks.

A reverse stress test conducted on relevant data as at end-September 2013 indicated that most banks would, on average, be able to sustain a drawdown in demand and savings deposits on an average of 15 per cent without having recourse to liquidity-injecting operations by the Bank of Mauritius. Moreover, system-wide risk arising

Chart 3.26: Components of Total Liabilities

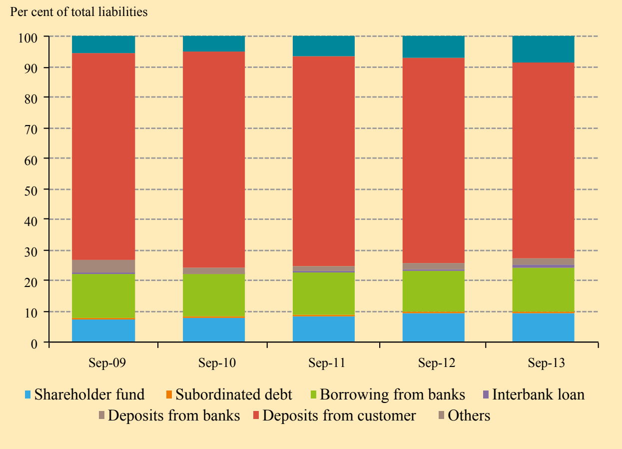


Chart 3.27: Components of Total Deposits

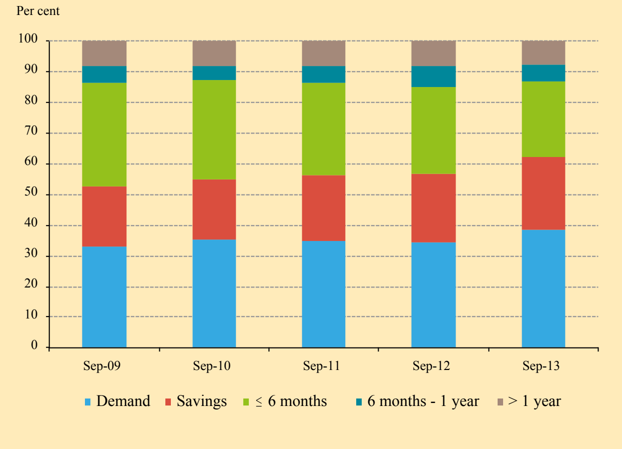
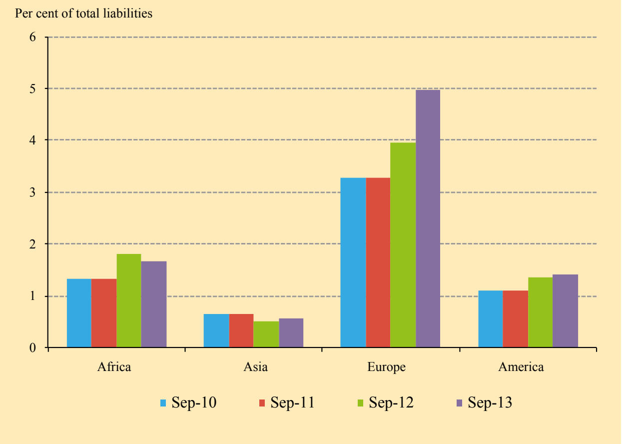


Chart 3.28: Cross-Border Deposits



from interbank contagion would be limited given the low volume of transactions conducted on the interbank money market.

3.5.6 Liquidity

In view of managing liquidity risk, banks operating in Mauritius hold a reasonable proportion of liquid assets. The ratio of liquid assets to total deposits has improved to 45.3 per cent as at end-September 2013, from 40.3 per cent the year before. The three main components of liquid assets consisted of Government securities (23.0 per cent), placements with banks abroad (65.5 per cent) and balances with the Bank of Mauritius (8.1 per cent).

The level of banks' excess reserves stood at an estimated Rs9.7 billion as at end-December 2013. The persistence of the surplus liquidity is mainly due to increased recourse by Government to foreign financing of its deficit, net intervention by the Bank on the domestic foreign exchange market to build up foreign exchange reserves under the Operation Reserves Reconstitution programme and additional deposits of Government funds with banks.

With a view to bringing down the excess liquidity in the system, the Bank has raised the fortnightly average CRR on rupee deposits from 7.0 per cent to 8.0 per cent. The Bank has also raised the daily minimum CRR for rupee deposits from 5.0 per cent to 5.5 per cent, effective from the fortnight beginning 4 October 2013. At the same time, in order to encourage banks to raise deposits in foreign currency, the Bank lowered the fortnightly average and the daily minimum CRR on foreign currency deposits from 7.0 per cent and 5.0 per cent to 6.0 per cent and 4.5 per cent, respectively. The combined effect of these measures has temporarily drained some Rs2 billion from the banking system. However, it is projected that the volume of excess liquidity will remain significantly high throughout 2014, which entails potential risks to monetary and financial stability in terms of higher inflation, deterioration in lending standards and financial disintermediation. In addition, the mopping up of such volumes of excess liquidity from the system would weigh heavily on the balance sheet of the Bank.

3.5.7 Stress Testing

As at end-September 2013, the distribution of credit exposure in the key sectors of the economy was generally concentrated among banks with CAR of above 12 per cent (Chart 3.30). A stress testing exercise was conducted to assess the ability of banks (excluding branches of foreign-owned banks) in absorbing potential

Chart 3.29: Cross-Border Borrowings

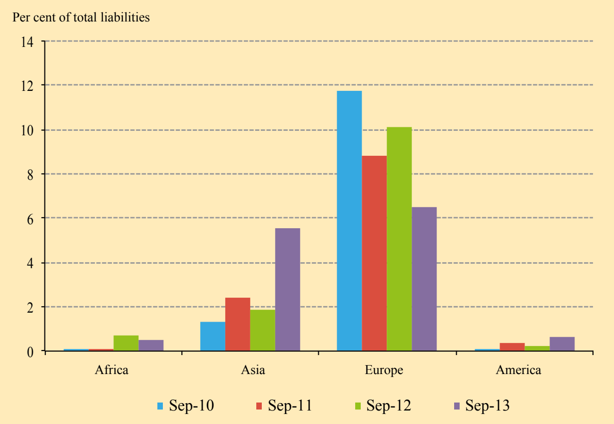


Chart 3.30: Sectorwise Distribution of Credit by Banks' CAR

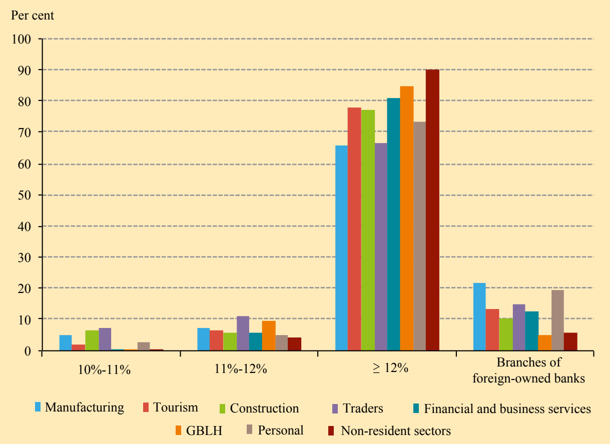
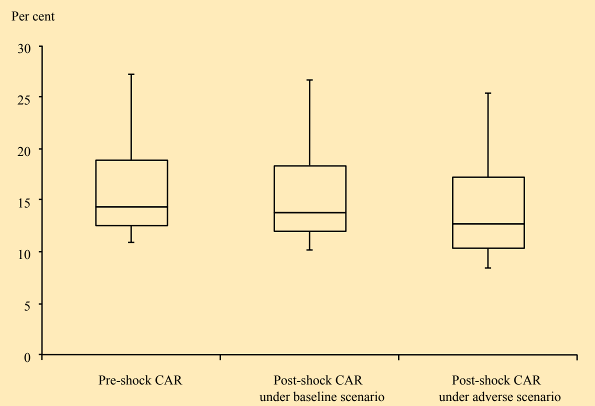


Chart 3.31: Pre and Post-Shock CAR



shocks on their credit portfolio in the event of a general weakening in economic activity under a baseline and an adverse scenario. The impact of the stress test varied among banks, depending on the composition and the quality of their credit portfolio and the amount of capital they hold to withstand the shock.

Under the baseline scenario, a mild deterioration in economic environment and financial conditions of banks is assumed whereby loan losses in the credit portfolios of banks would range between 2 per cent and 5 per cent, depending on the vulnerability in specific sectors. As at end-September 2013, the Bank has estimated that no bank would require any capital injection under the baseline scenario and that the aggregate CAR would drop from 16.2 per cent to 15.5 per cent (Chart 3.31).

Under the adverse scenario, the results showed that economic environment and financial conditions of banks would weaken sharply. Deterioration in credit quality of the loan portfolio of banks would lead to loan losses ranging between 5 per cent and 10 per cent in key sectors of the economy, owing to significant write-off and credit defaults. Since most banks operate well above the minimum capital requirement, the Bank has estimated, as at end-September 2013, that banks' CAR would drop from 16.2 per cent to 14.0 per cent and the majority of banks would be able to withstand the shock.

Overall, the banking sector is assessed to be resilient to both the baseline and adverse scenarios.

3.6 Non-Bank Deposit-Taking Sector

The non-bank deposit-taking sector comprises institutions licensed by the Bank to raise deposits from the public and to extend leasing and loan facilities to individuals and corporates. Since the August 2013 FSR, the performance of NBDTIs remained stable and sound. Assets of NBDTIs were equivalent to 5.6 per cent of the total assets of the banking sector as at end-September 2013 compared with 5.5 per cent in the corresponding period in 2012, and accounted for 15.8 per cent of GDP.

Balance Sheet Structure

As at end-September 2013, assets of NBDTIs grew by 13.5 per cent, from 0.4 per cent in the corresponding period of 2012, driven by 17.3 per cent and 9.2 per cent growth in loan and leasing facilities, respectively. Loan and leasing facilities accounted for the major share of NBDTIs' total assets which, as at end-September 2013, stood at 73.6 per cent. Deposits, which accounted for 62.4 per cent of total liabilities, registered higher growth of 12.0 per cent as at end-September 2013 compared with an increase of 3.2 per cent a year earlier (Chart 3.32).

Liquidity

Despite a decline in liquidity ratios, NBDTIs have remained relatively liquid, with a liquidity ratio above the statutory minimum of 10 per cent. As at end-September 2013, the liquid assets to total assets ratio and the liquid assets to total deposits ratio stood at 12.9 per cent and 20.7 per cent, respectively, down from 13.9 per cent and 22.0 per cent in the corresponding period in 2012 (Chart 3.33).

Capital Adequacy

Assets of NBDTIs remained concentrated in the 50 per cent and 100 per cent risk-weight buckets,

Chart 3.32: Y-o-y Growth of Total Assets and Deposits

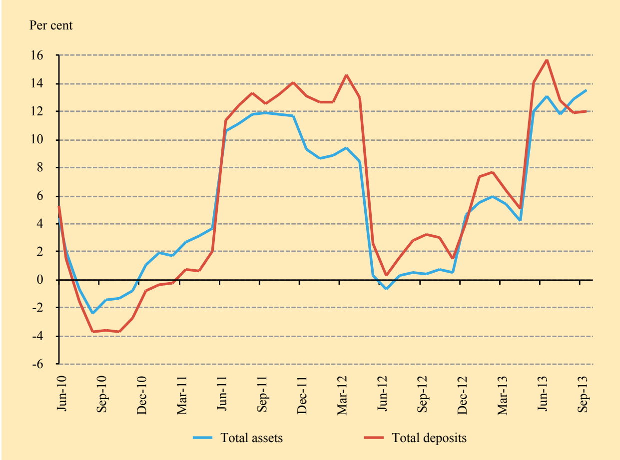
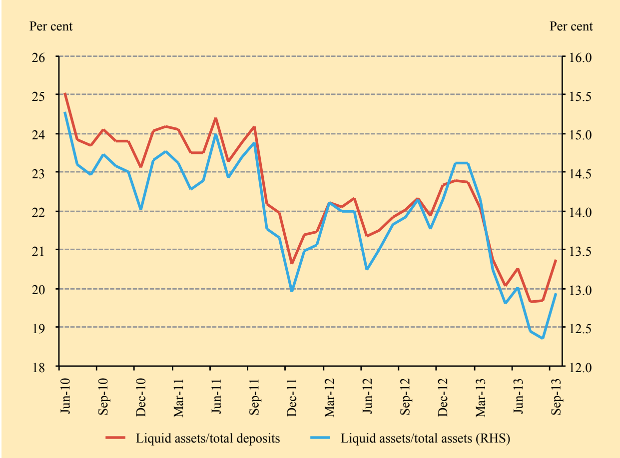


Chart 3.33: Liquidity Indicators of NBDTIs



which as at end-September 2013, accounted for 46.2 per cent and 22.7 per cent, respectively, of total NBDTIs' assets. The sector is assessed as sound as NBDTIs are well-capitalised, with a CAR of 25.7 per cent as at end-September 2013 compared with 25.1 per cent as at end-September 2012 (Chart 3.34).

Sectoral Credit and NPL

Credit extended by NBDTIs to the private sector represented 13.5 per cent of the combined private sector credit extended by banks and NBDTIs. NBDTIs' credit was channelled mainly to the '*personal*' and '*construction*' sectors, which accounted for 66.9 per cent and 17.0 per cent, respectively, of total NBDTIs' credit. Credit to the '*manufacturing*', '*tourism*' and '*traders*' sectors collectively accounted for around 7 per cent of total credit.

Credit extended by NBDTIs grew by 15.7 per cent as at end-September 2013, from 4.8 per cent in the corresponding period of 2012. Credit extended to the '*personal*', '*construction*', '*tourism*' and '*financial and business services*' sectors increased over the year to end-September 2013 while credit extended to '*manufacturing*' contracted over the same period.

In contrast to the banking sector, asset quality of NBDTIs improved, with the overall ratio of NPL to total credit falling to 5.1 per cent as at end-September 2013, from 7.1 per cent in the corresponding period of 2012. The '*personal*' sector, to which the largest share of NBDTIs' credit is channelled, recorded NPL ratio of 0.6 per cent (Chart 3.35). Despite a slight decline over the year to end-September 2013, '*construction*' recorded the highest NPL ratio of 22.8 per cent. The ability of NBDTIs to absorb losses arising from NPL is considered as adequate, with a higher coverage ratio of 44.5 per cent as at end-September 2013 compared with 35.9 per cent as at end-September 2012.

3.7 Insurance Sector

Property Insurance

While the insurance industry safeguards itself from catastrophic losses with the use of extensive reinsurance, the take-up for residential property insurance is low. Home or property insurance provides coverage in the case of loss or damage to property and/or the contents of a house as well as liability for injuries and damage caused to third parties arising from home ownership or personal liability. Take-up for residential property insurance in Mauritius is low as the current rate of insured property in Mauritius is roughly 10 per cent in 2011.

Reinsurance Activities

In Mauritius, general insurers widely make use of reinsurance outside of the Motor segment. Over 2008-2012, general insurers have reinsured around 39 per cent of their gross premiums (excluding Motor insurance).

Gross premium for property insurance amounted to around Rs924 million in 2012, of which 74 per cent was reinsured (Table 3.5).

Looking at the market share of the property and liability segments of reinsurance, it is observed that the reinsurance industry in Mauritius is highly diversified. In the property segment, 108 reinsurers hold less than 5 per cent of the market share. Two reinsurers hold a market share in the range 15-20 per cent. In the liability segment, 63 reinsurers

Chart 3.34: Risk Diversification Matrix of NBDTIs

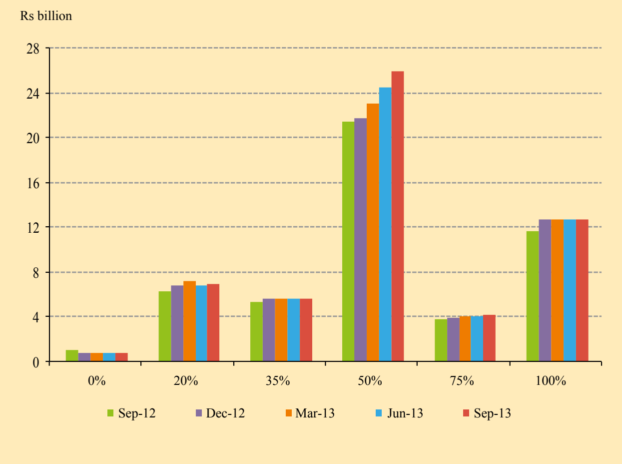


Chart 3.35: NPL as a ratio of Sectoral Credit

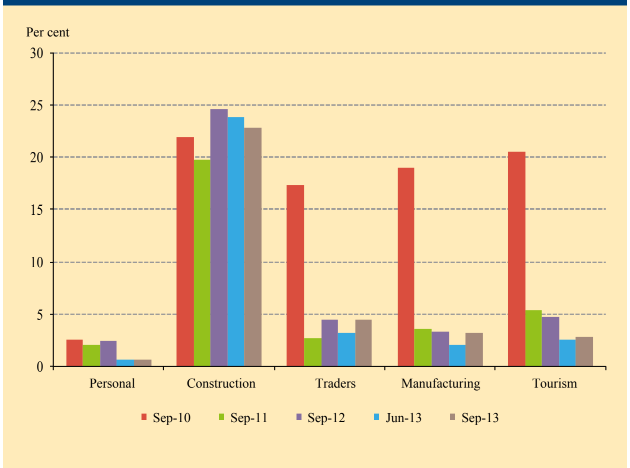


Table 3.5: Proportion of Premium Reinsured by General Insurers

	2010		2011		2012	
	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	1,072,272	41	1,300,639	41	1,320,698	39
Engineering	313,172	87	268,012	83	235,521	81
Guarantee	22,318	72	46,684	48	61,424	55
Liability	440,107	70	445,517	65	353,151	58
Miscellaneous	277,688	76	295,574	70	260,077	67
Motor	2,282,857	5	2,575,843	5	2,698,398	7
Property	855,320	77	959,314	74	923,766	74
Transportation	310,867	62	355,287	55	330,223	57

Source: FSC.

had less than 5 per cent market share, and one reinsurer has more than 20 per cent market share (Table 3.6). In case of a major natural disaster, the industry as a whole is not exposed to any single reinsurer.

Table 3.6: Market Share of Reinsurers

	Number of Reinsurers	
Market Share	Property	Liability
0-5%	108	63
5-10%	1	3
10-15%	0	1
15-20%	2	0
> 20%	0	1
Total	111	68

Source: FSC.

3.8 Other Non-Bank Institutions

On the basis of information available in the MCIB database, credit extended by institutions other than those regulated by the Bank of Mauritius stood at Rs14.4 billion as at end-December 2013. The largest share of credit was allocated to the '*construction*' sector (45.5 per cent), followed by '*traders*' (17.8 per cent) and '*educational*' sectors (10.9 per cent). It is noted that arrears amounted to Rs2.5 billion.

These figures are exclusive of hire-purchase companies and efforts are being made by the Bank to expand coverage of exposures to other non-bank institutions.