

# 1. Executive Summary

Global economic and financial conditions have generally improved since the August 2013 Financial Stability Report. Market sentiment remained positive and global risk appetite increased as monetary accommodation continued to drive financial markets, reducing fears of any disruption in the fragile economic recovery. Market volatility was generally low despite an increase in October 2013 due to the US Government shutdown and debt ceiling negotiations.

However, a divergence was noted between emerging market economies and advanced economies. Shifting expectations on the timing of when the US Federal Reserve would scale back its asset-purchase programme exerted pressure on financial markets in some emerging market economies. The sharp depreciation of the currencies of several emerging market economies during early 2014 amid fears of contagion from a slowdown in China and an expected increase in US tapering this year call for vigilance against risks of heightened market volatility. In its January 2014 World Economic Outlook Update, the International Monetary Fund has revised global growth to 3.0 per cent in 2013 and forecast growth to accelerate to 3.7 per cent and 3.9 per cent in 2014 and 2015, respectively.

In general, the global economic environment is expected to improve and it is estimated that domestic growth could pick up to a range of 3.7-4.0 per cent in 2014. The main downside risk to the growth outlook remains a prolonged weakness in the euro area impacting on external demand.

Against the backdrop of contained budget deficit and declining trend in public sector debt, risks to financial stability stemming from Government finances seem presently low. Nonetheless, increasing recourse by Government to external financing of its deficit has contributed to raising excess liquidity on the domestic money market, entailing risks to monetary and financial stability. Gross official international reserves increased to Rs105.0 billion and represented 5.6 months of import cover as at end-December 2013. The deteriorating current account deficit, estimated at 13.1 per cent of GDP in 2013Q3, is a major concern, the more so since it is primarily financed by debt-creating flows.

The Mauritian banking sector remained well-capitalised and generally profitable during the year ended September 2013. Total credit continued to grow albeit at a slower pace, but the quality of assets held by banks deteriorated slightly, with the ratio of non-performing loans to total credit rising by 40 basis points to 3.5 per cent as at end-September 2013. Against the backdrop of the persistently high and growing excess liquidity, banks should maintain prudent lending standards with respect to credit risk management policies.

The Bank has been concerned about the potential impact on financial stability of the rapid increase in credit to the '*construction*' sector and anecdotal evidence that property prices are rising significantly in Mauritius. Credit concentration has also been a concern. 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, effective July 2014, for three specific sectors, notably '*construction*', '*tourism*', and '*personal*'.

An assessment of the performance of non-bank deposit-taking institutions indicates that the sector remained sound and stable, with growth in assets and an improvement in both asset quality and the overall capital adequacy ratio. During the second semester of 2013, the financial sector was supported by an efficient and secure payment system, with both the Mauritius Automated Clearing and Settlement System and the Port Louis Automated Clearing House operating smoothly without any major disruption.

As confirmed by the IMF Article IV Consultation Mission, when they visited Mauritius in January 2014, the banking sector appears to be robust and resilient to external shocks. With the implementation of additional policy measures and on-going reform of our regulatory framework, the Bank remains vigilant to vulnerabilities associated with credit risk, and will continue to monitor sectoral developments as well as the evolution of corporate indebtedness. Looking ahead, the build-up in excess liquidity needs to be urgently addressed in order to maintain orderly conditions on the money market. The IMF has, among other measures, proposed to issue Government securities to reduce excess liquidity in the banking system.