8. Concluding Remarks

This Financial Stability Report has sought to identify systemic risks to the domestic financial system. Systemic risks are those that hold the potential to significantly impact real economic activity. Moreover, the interconnectedness between economic units (borrowers and lenders of financial resources) within and outside the local economy warrants the surveillance of all components of the financial system, as indicated in this Report. In the light of assessments made on the outlook for financial stability of the domestic financial sector, key challenges remain in the areas as identified below:

A. Global and Domestic Macroeconomic Environment

- Mauritius' relatively large external trade and current account deficits (as a share of GDP) highlight the importance of net capital inflows to finance those imbalances, with GBC net inflows playing a leading role in covering the funding gap. In this context, strong policy coordination is warranted between the Bank (in its capacity of guarding the payment systems and regulator of domestic banks) and the FSC (as regulator of GBC financial vehicles). The ongoing implementation of the existing Memorandum of Understanding between the Bank and the FSC, thus, provides comfort in this regard.

- The declining trend in gross domestic capital formation (as a share of GDP) reduces actual and potential economic growth. As such, efforts to stimulate private and public investment should be pursued, as should efforts to diversify the economy away from traditional sources of foreign exchange earnings, within a competitive framework.

B. Private Debt: Households and Corporates

- Household indebtedness and household debt service (both as a share of disposable income) are relatively low by international standards, but warrant monitoring nonetheless. Macroprudential measures and credit limits are currently in place to halt any excessive expansion in bank financing of residential and commercial real estate properties. Yet, case-by-case analysis and monitoring of NPL is still needed to secure a proper implementation of the policy measures.

- Corporate indebtedness, as a share of GDP, is also relatively low by international standards in Mauritius. However, the high leverage ratio of some leading corporations in the economy remain a concern and may pose a risk to the soundness of banks. Deleveraging - accompanied by equity infusion and/or higher revenue growth - in an orderly manner is, thus, warranted so as to support future investment and growth of the corporates and economic sectors affected.

C. Performance of the Banking Sector

- To address credit and possible foreign exchange risk resulting from local banks' exposures to frontier emerging markets (India, South Africa, Nigeria, Tanzania), the Bank encourages banking institutions to buttress their internal credit rating procedures, as needed, while strictly abiding to existing guidelines and regulation on foreign exchange exposures. Banking institutions are also encouraged to conduct regular stress testing and have formal and well-developed contingency funding plans to manage credit, exchange and liquidity risks.

- The deceleration in banks' domestic credit growth is likely to be interwoven with the high leverage ratios confronting leading corporates in the economy. Recurrent corporate debt rescheduling may be initially tackled with hikes in bank capital. Yet, over the long run, there may be a need to develop restructuring frameworks that would allow companies to service their debt, while investing and growing, as needed. The Bank therefore urges banking institutions to develop such restructuring frameworks as soon as possible.

- Credit concentration warrants proactive action by the regulator. In the short-term, one option is to increase bank's capital allocations, so as to lower concentration ratios across the board. Over the medium-term, there is a need to toughen the restrictions of banks' exposures to large borrowers and large business groups in line with the recommendations of the April 2014 Supervisory Framework for Measuring and Controlling Large Credit Exposures issued by BCBS. The framework includes a general limit applied to all of a bank's exposures to a single counterparty, which is set at 25 per cent of a bank's Tier 1 capital. This limit also applies to a bank's exposure to identified groups of connected counterparties (i.e., counterparties that are interdependent and likely to fail simultaneously). A tighter limit will apply to exposures between banks that have been designated as Domestic-Systemically Important Banks. This limit has been set at 15 per cent of Tier 1 capital.

D. Payment Systems Infrastructure

- A number of policy initiatives are currently in place to develop efficient and cost-effective payment systems along internationally accepted principles and good practices.