Monetary Policy Committee

Assessing Risks to Financial Stability

30 September 2013

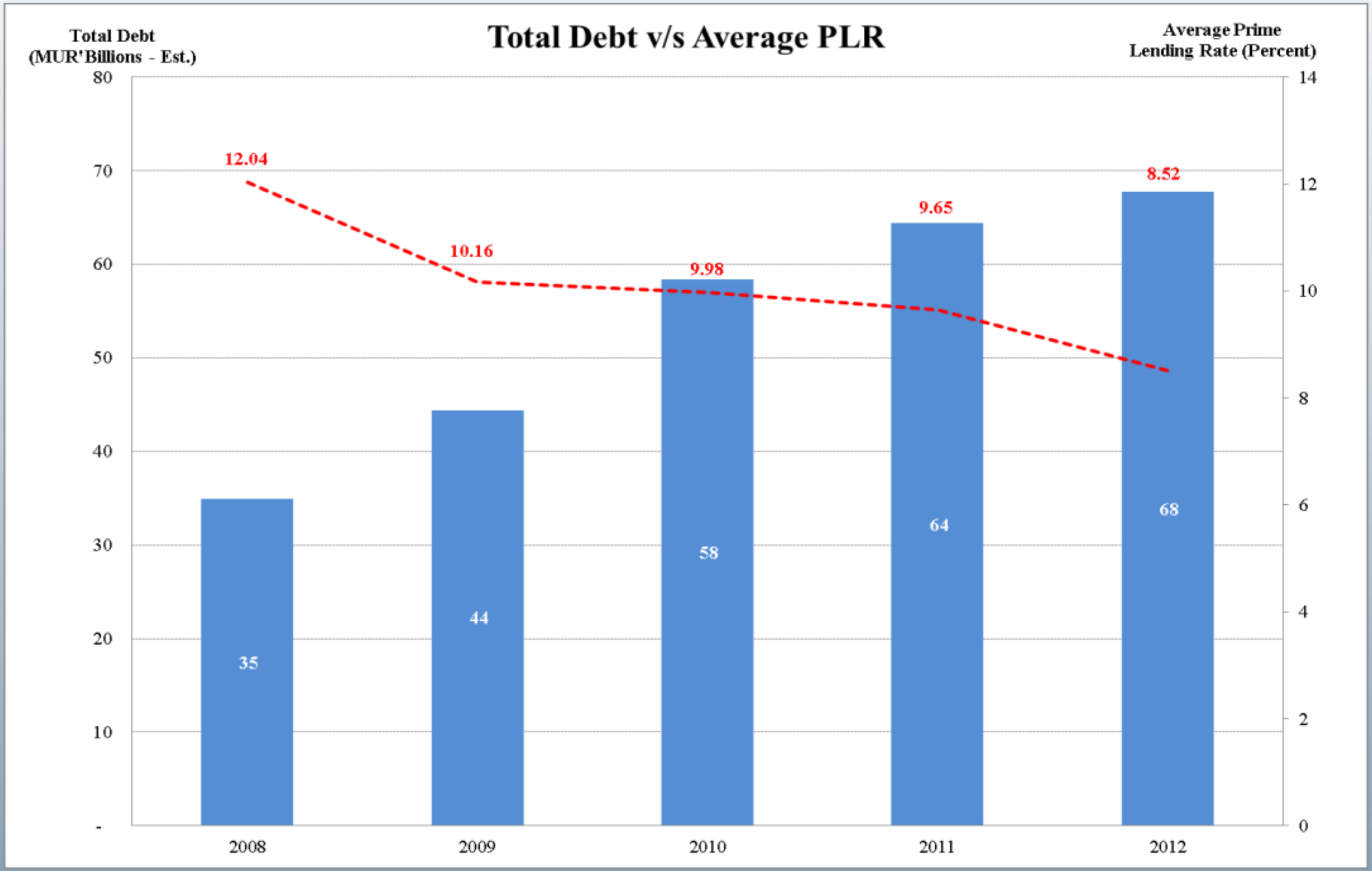
Inflation Forecasting at the Bank of Mauritius

Econometric Models for Inflation Forecasting include:

1. ARMA Model
2. VaR Model

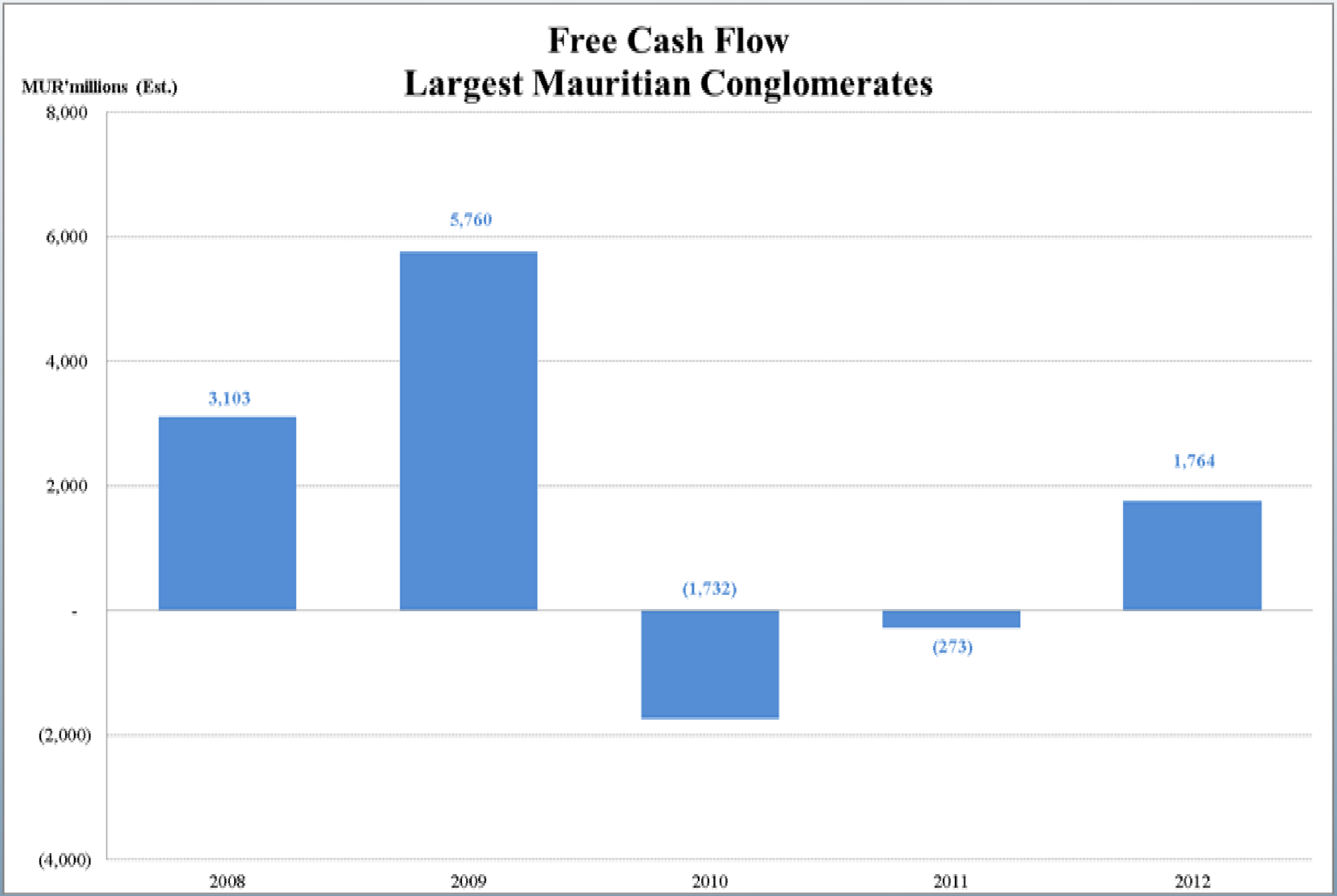
- The BoM also continues to use and refine its GAPS model which provides forecasts for various variables such as growth and inflation.
- The Bank also relies heavily on expert judgement when forecasting inflation in the medium term.
- Judgement plays a key role when it comes to inflation forecasting vs. Over-reliance on models.

The Largest Private Groups in Mauritius have used lower interest rates to take on even more debt…



Source: BOM Staff Estimates based on annual reports of the largest corporates.

… while free cash flows have been decreasing, leading to a deterioration in corporate balance sheets



The Debt Situation…

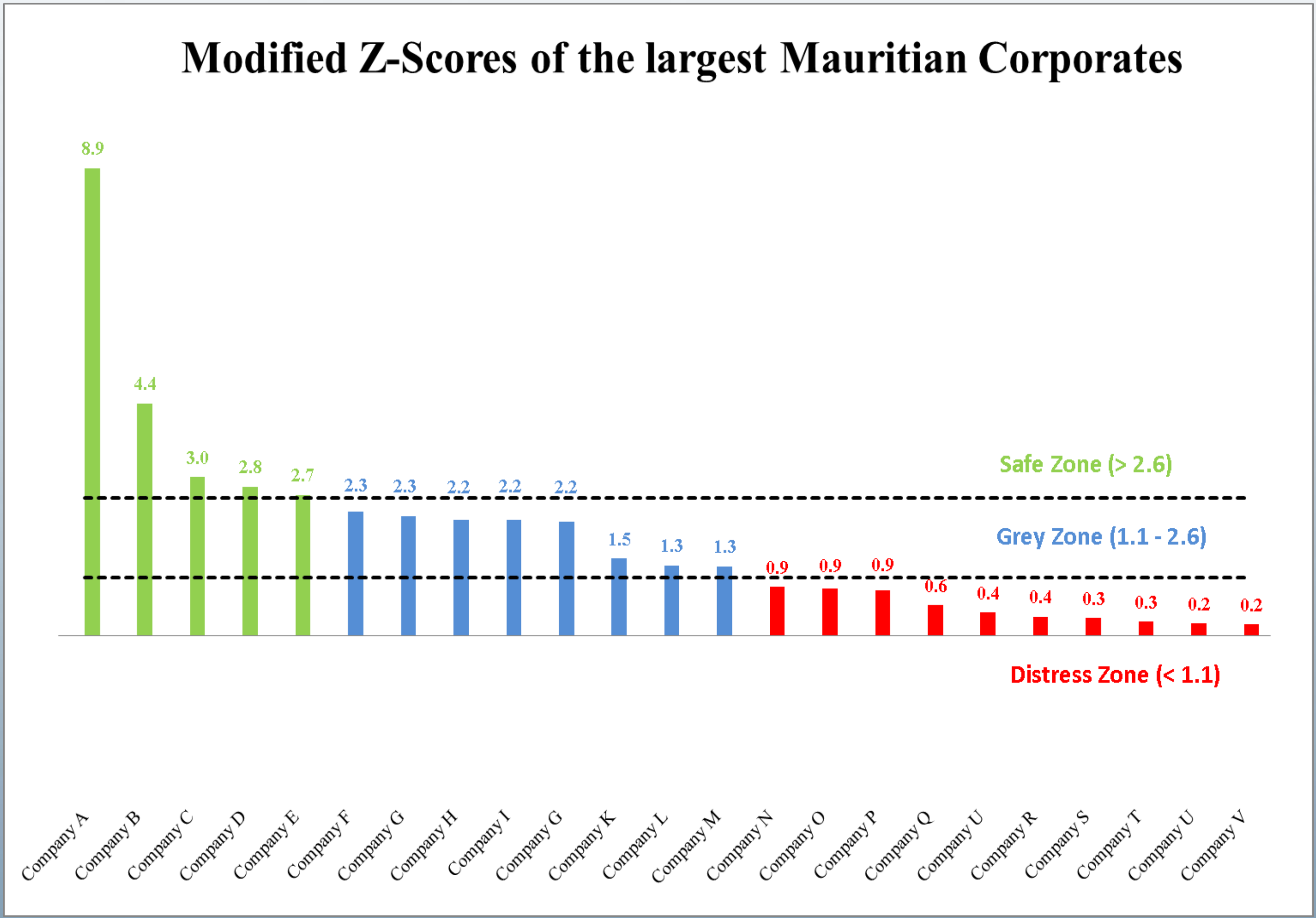
- Working Capital Pressures on the Balance Sheet continue to eat away at Free Cash Flow and lead to a high reliance on short term debt to finance operations. These are structural problems.

- Many large groups generate negative carry with return on capital lower than their cost of debt. Structural problem and management inefficiency. Free Cash Flow to Debt Ratios have worsened.

- Demand expectations which led to heightened CAPEX have not materialised, ex: tourism.

- Rental Yields in many Commercial Real Estate Projects remain below the cost of financing yielding to negative arbitrage and cash flow pressures. Oversupply in commercial real estate space kept pressure on rental yields.

Risks to Financial Stability posed by certain large groups remain a concern for the BoM



Source: BOM Staff Estimates based on annual reports of the largest corporates.

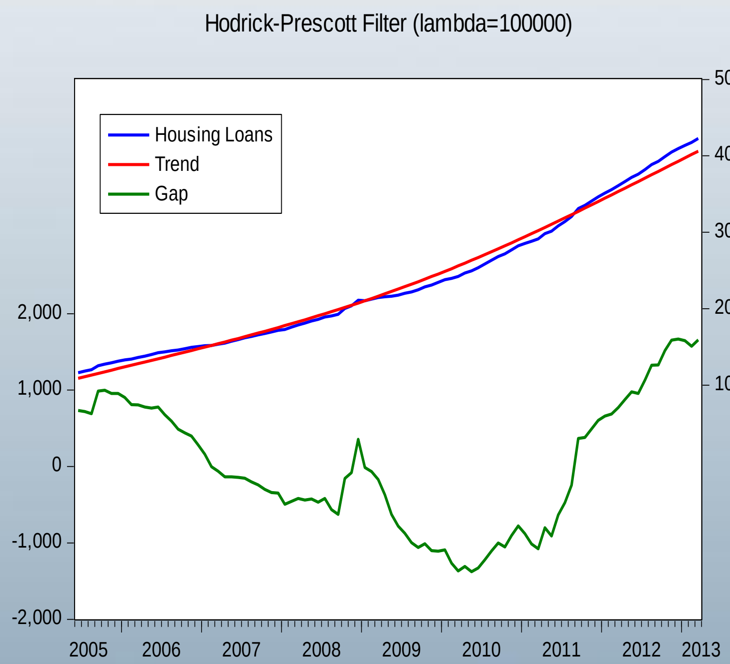
Debt levels of distressed zone companies are not sustainable and require structural solutions

Distress Zone Companies					
Year	2008	2009	2010	2011	2012
Sum of Total debt (MUR'000)	29,945,960	32,817,965	44,426,152	52,846,090	55,602,635
Sum of FCF (MUR'000)	299,598	2,140,885	(3,589,622)	(744,595)	(683,120)
Grey Zone Companies					
Year	2008	2009	2010	2011	2012
Sum of Total debt (MUR'000)	9,235,275	9,276,273	11,001,778	11,626,330	12,263,713
Sum of FCF (MUR'000)	359,111	2,150,939	992,534	236,448	941,831
Safe Zone Companies					
Year	2008	2009	2010	2011	2012
Sum of Total debt (MUR'000)	3,088,197	2,987,934	2,991,989	2,749,522	2,654,739
Sum of FCF (MUR'000)	2,253,871	1,468,608	864,640	235,018	1,505,356

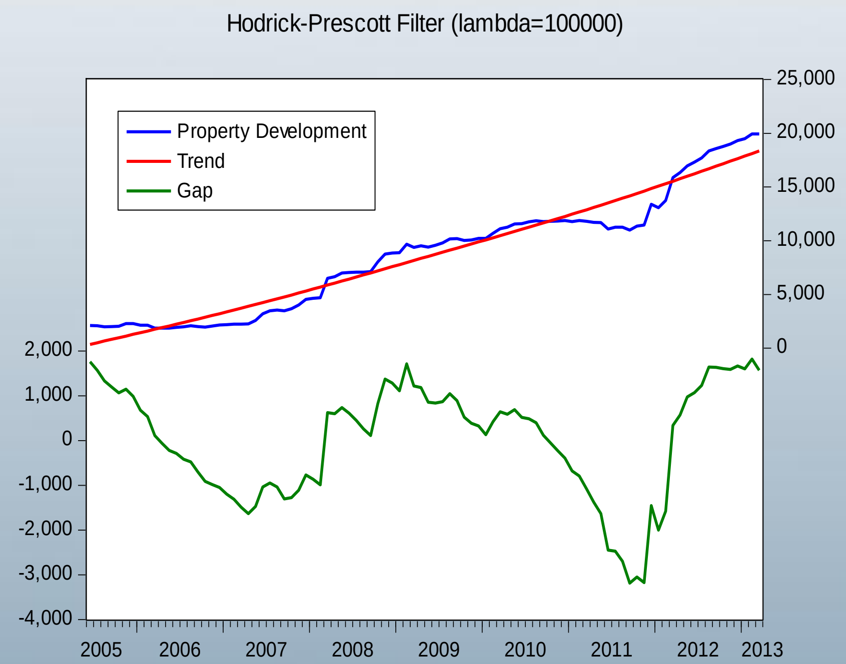
Source: Largest Mauritian conglomerates annual reports – BOM staff estimates

Sustained Deviations from Trend in Credit Growth to certain sectors point to signs of overheating

Housing Credit

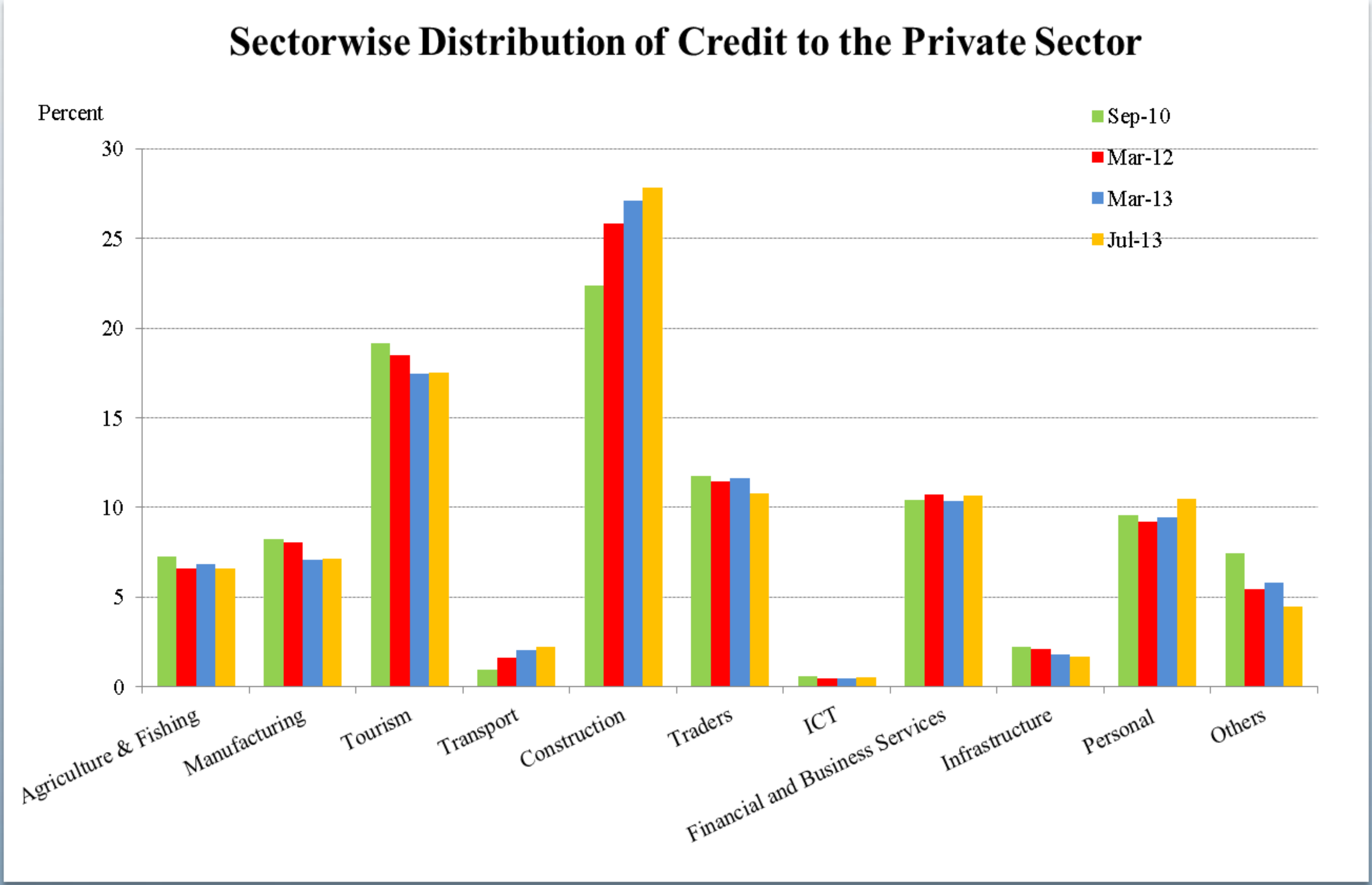


Property Development Credit



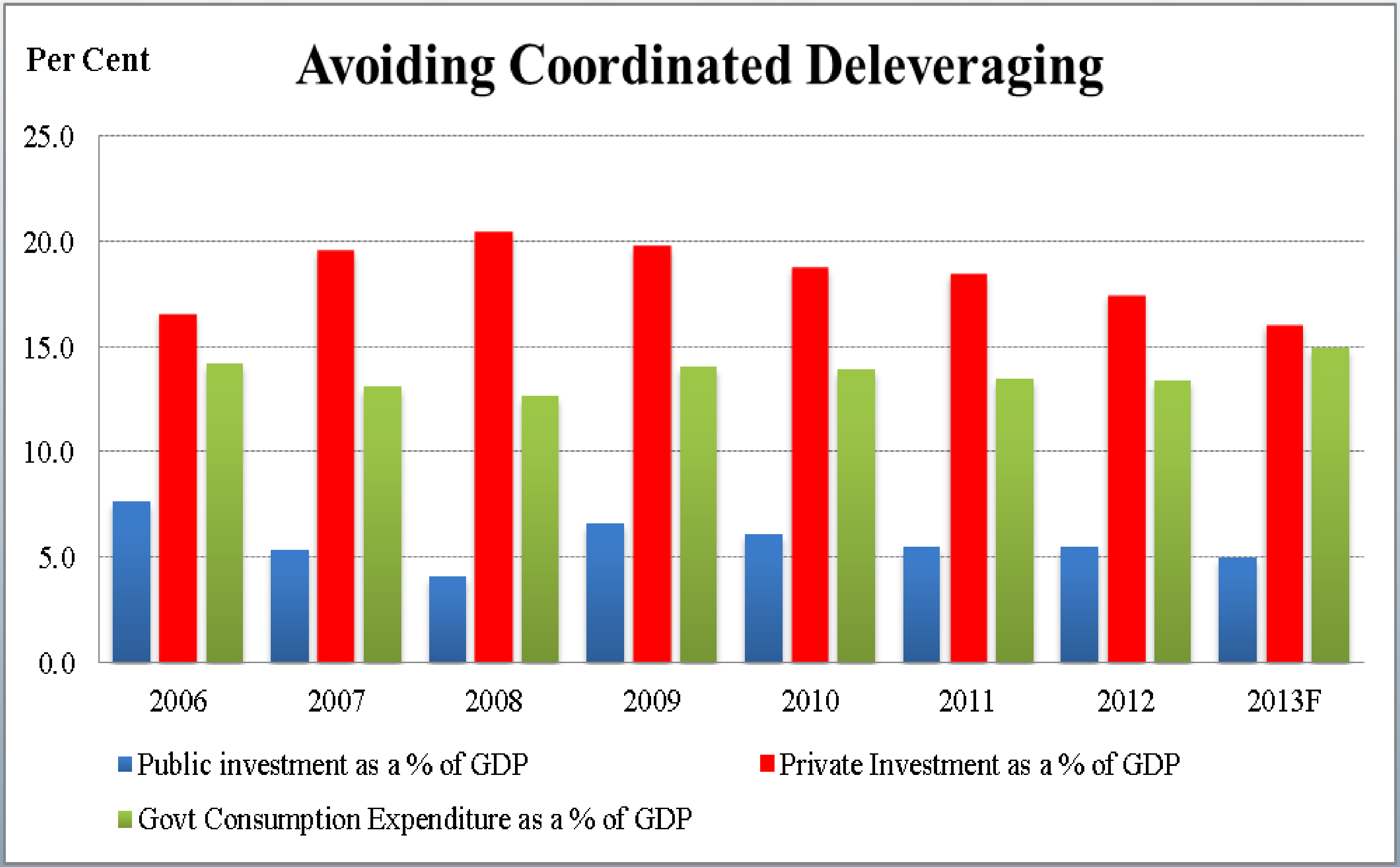
Source: BOM Staff Estimates.

Exposure of Banks to the Construction Sector continues to grow despite rising NPLs from this sector



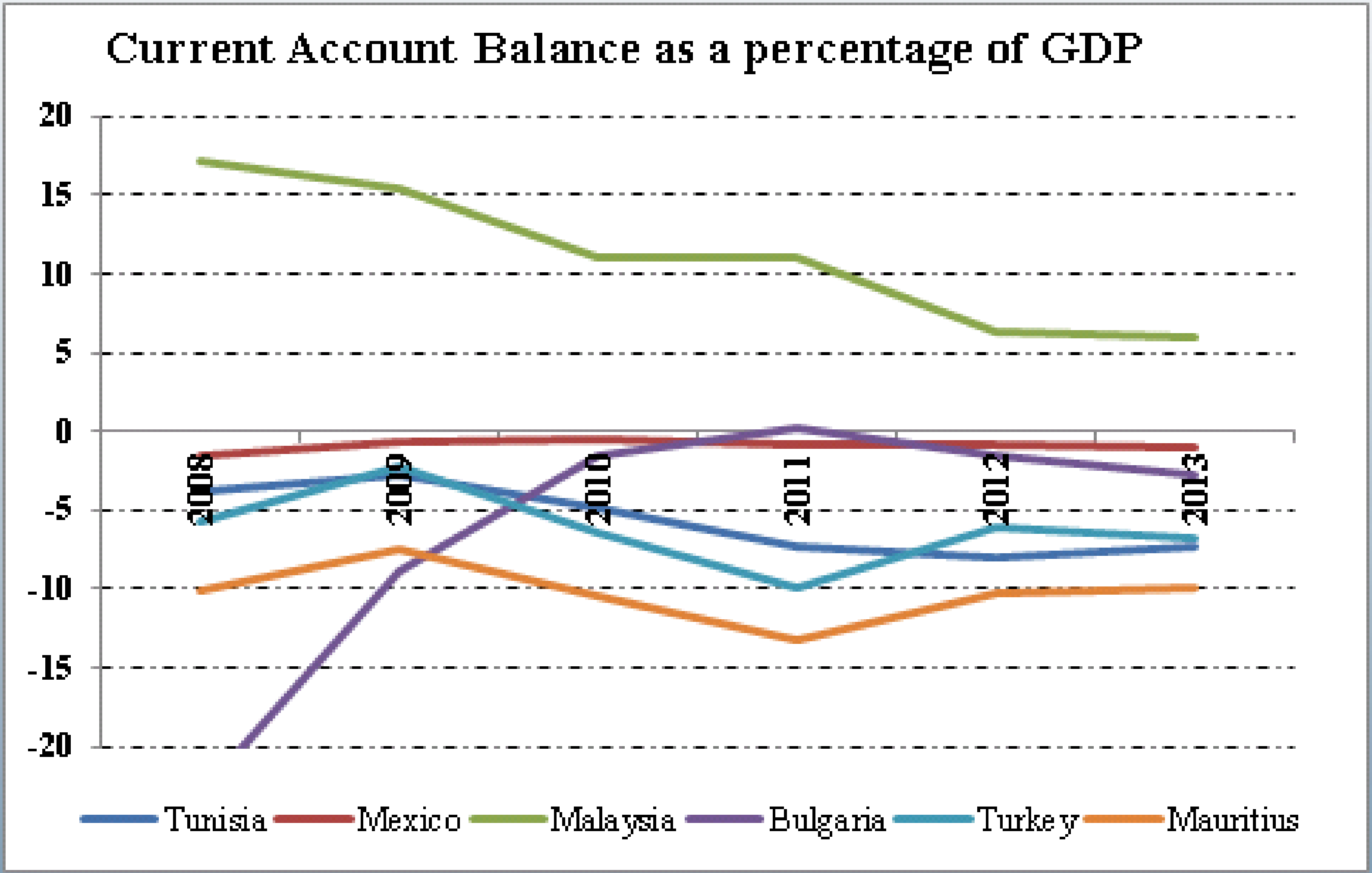
Source: Bank of Mauritius.

With the investment capacity of the private sector constrained, Government must do more to avoid coordinated deleveraging



Source: Statistics Mauritius.

Mauritius as a country is simply not competitive enough. Our over-reliance on consumption contributing to a high CAD not sustainable



Source: BOM Staff Estimates.

What the Bank of Mauritius is doing beyond the MPC

- Assessment of the exposure of banks to the debt of large groups with weak Balance Sheets in order to gauge concentration risk. Stress tests to provide gauge of cushion requirements on top of minimum Basel requirements.

- Bank of Mauritius consulting with banks on the implementation of macro-prudential measures, especially in the real estate sector. Trying to limit speculation on properties in excess of Rs5M.

- Bank is concerned by the speed of asset rotation from deposits to real estate as inflationary expectations remain above savings rate. Herd mentality and speculation a concern.

- Negative real interest rates lead to mis-allocation of capital as seen in the high levels of indebtedness in the private sector with weak free cash flows.

- Economy over-reliant on real estate/construction. Not sustainable with a need for further diversification.

Monetary Policy has its limits

- Monetary Policy cannot resolve long term structural problems in the private sector. In fact, more debt has been taken as rates have been cut creating even more risk to financial stability.

- Structural problems require structural solutions. More can be done with Government, banks and the BoM. Example: BoM has provided more than 40M EUR via banks to the tourism and export sectors for better asset liability matching and to lower the cost of debt of firms. Firms need to restructure their businesses and clenze balance sheets.

- Endless interest rate and exchange rate subsidies discourages the private sector from focusing on efficiency. Need to look at other tools beyond the repo rate especially with fast falling savings rate as a % of GDP. Same old measures have not worked.

- Government must sustain CAPEX investments and focus on structural reforms in order to sustain long term growth above 4%.

- Over-reliance on real estate/construction be it locally or from foreign investments not sustainable drivers of growth. Call on more economic reforms that are structural in nature.

Thank you