

Statement From The Governor

“ Time for us to move on and sharpen our focus on our next destination - a high-income economy... ”

Looking back over the global landscape in recent years, characterised as it has been, by painful adjustments in financial and economic affairs, it is hard to avoid the conclusion that we have been lurching from crisis to crisis. We have continually seen elusive signs of recovery, buffeting both business confidence and consumer sentiment, and nurturing continued apprehensions about the adverse impact on world markets and on the vulnerable emerging economies in particular. Can we now, at long last, expect the global economy to secure itself on a firmer footing? What about the risks still looming on the horizon? I am a strong optimist - had it not been so, I can hardly imagine how I could have stayed on this job. Whenever I am asked how we, in Mauritius, an isolated, vulnerable, and small open economy turned in such a creditable performance in such an unpromising environment, I reply “*We never allowed ourselves to lose our nerve, or our focus*”.

Despite global uncertainty, the Mauritian economy stood its ground and logged a growth rate of 3.2 per cent in 2013. This growth was driven by all sectors, except construction. Unemployment remained stuck around 8 per cent. We succeeded in anchoring inflation expectations. Indeed, since 2009, the annual average rate of inflation has been close to 4 per cent, and its volatility much reduced compared to previous years. We did everything within our statutory powers to achieve a low-inflation environment, hand-in-hand with a stable exchange rate, to ensure a solid basis for sustainable, equitable, and broad-



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based growth. Headline inflation and year-on-year inflation stood at 3.3 per cent and 4.0 per cent, respectively, in June 2014. Domestic and external imbalances remained contained. We continued with our reforms domestically to secure a sound financial sector through a series of initiatives detailed in the report.

We expect our economy to grow by about 3.5 per cent in 2014, and inflation to remain below 4.0 percent in 2014. On current trends, we do not expect the international economic environment to improve significantly. It is time for us to move on and sharpen our focus on our next destination - a high-income economy. We should be under no illusion that we can get there without accelerating the pace of reforms and, preferably, embracing the commitment to reform as our national credo.

Banking Sector Developments

Our banking sector remained robust. Total assets, which had crossed the Rs1 trillion-mark in May 2013, grew by 7.5 per cent during the period under review. Total deposits and total loans increased by 6.0 per cent and 2.7 per cent, respectively. Banks were well-capitalised, with a capital adequacy ratio of 16.7 per cent and low non-performing loan ratios. In April 2014, we welcomed two new banks in our jurisdiction, the first to be granted a licence for stand-alone private banking business.

Macroeconomic and Financial Stability

The relative stability in our nominal effective exchange rate, contrasting sharply with the turbulence registered in leading emerging markets, benefited both domestic consumers and producers, while also enhancing our attraction as an investment destination and as an IFC-in-the-making.

Cross-border banking has been growing rapidly. We have supported its development by bilateral agreements with several international regulatory bodies to secure a better exchange of information between home and host supervisory authorities. In November 2013, we organised our first-ever Supervisory Colleges for our two largest banking groups to enable their host regulators in other jurisdictions, and ourselves, to get a holistic view of the risks posed by these institutions, within and beyond our borders. We are also actively engaged in several initiatives to harmonize regulatory and supervisory practices to promote financial stability within the region.

The persistence of low interest rates led to excessive credit growth in some sectors which, if left unchecked, could have resulted in higher non-performing loans. In October 2013, after much soul-searching, we rolled out a suite of macroprudential measures to contain these risks. These measures which include "Loan-to-Value ratios", "Debt-to-Income ratios", "Risk-Weighted Assets", "Additional Portfolio Provision" and "Sectoral Limits", became effective this year. We issued our guideline for dealing with domestic systemically important banks (DSIB's) in July 2014. It provides a framework for assessing the systemic importance of a bank based on key indicators such as size, interconnectedness, structure and complexity, amongst others. The banks, which would be identified as DSIB's, will be subject to a capital surcharge as from March 2016.

We followed up on the recommendations of the Reserve Bank of India Team which came over to assist the Bank in the in-depth investigation of the Ponzi Schemes which we unearthed early last year. There was a clear need for a stronger framework to gather intelligence on financial transactions and analyse information on actual and/or looming financial breaches. In December 2013, we set up a dedicated Market Intelligence Cell to meet this need. In January 2014, we mainstreamed this cell with our work on compliance and enforcement. This will assist the Bank in fulfilling one of its new mandates, namely to carry out investigations and take measures to suppress illegal, dishonourable and improper practices, market abuse, and any potential breach of the banking laws.

We made considerable progress with our plan to implement Basel III to enhance the resilience of the banking sector. The opening shot was the release in October 2012 of a consultation paper on the likely implications of Basel III implementation. In June 2014, we issued guidelines on the scope of application of Basel III and eligible capital.

Monetary Policy

Throughout 2013-14, the Key Repo Rate (KRR) was kept unchanged at 4.65 per cent. One important development was the publication of the technical presentations made by various parties at the MPC meetings, once again highlighting our commitment to a fully-transparent decision-making process. The divergence of opinion regarding the monetary policy stance persisted. On the one hand, the internal MPC members called for a gradual and smooth exit from the current accommodative monetary policy stance. This view was motivated by the improving external environment, rapid credit growth, the rise in non-performing loans, and the need to halt the decline in domestic savings while also anchoring inflation expectations. On the other hand, the external MPC members were more concerned with stimulating domestic growth, which they perceived as being still fragile, and supported an accommodative monetary policy.

In April 2014, the Bank started to use Taylor Rule estimates as a guide to monetary policy-making. Estimates of the neutral interest rate suggested that monetary policy was falling behind the curve. Internal members were of the view that it was high time to start the normalisation process. However, the majority of MPC members voted to keep the KRR unchanged. The Monetary Policy Transmission Mechanism, already weakened by the excess liquidity that had been plaguing the system for the past few years, broke down when some banks adjusted their savings rates downwards although the MPC had decided to leave the KRR on hold. At the July 2014 meeting, the MPC decided, by consensus, to keep the KRR unchanged at 4.65 per cent, with a majority of members agreeing that it was time to normalise interest rates, and giving forward guidance on the direction of the change in the KRR in the first quarter of 2015.


We renewed our efforts to restore the monetary transmission mechanism. We made some progress in our efforts to persuade the Treasury to share sterilisation costs. We prevailed on the Treasury to introduce three savings products targeting individual savers, two varieties of Five-Year and one Three-Year Government of Mauritius Savings Bonds to mop up some of the excess liquidity. A Memorandum of Understanding between the Treasury and the Bank is at an advanced stage of negotiation: it will provide the burden-sharing modalities, and may necessitate some enabling changes in the Public Debt Management Act 2008.

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Improving Customer Experience

In June 2014, we released the Report of the Task Force on Unfair Terms in banking contracts, *Banking Your Future: Towards a Fair & Inclusive Banking Sector*. It makes 100 recommendations, including the abolition of 19 fees and the review of 13 others, and a free basic bank account for all Mauritian citizens above 16 years old. These recommendations aim to improve the bank-customer relationship and help both banks and customers to achieve a fairer deal. The report is open for public consultation up to 31 October 2014. After the consultation period, the Bank will analyse the report, along with the feedback and decide on an action plan.

It is the first time in the history of the Bank that a Task Force has been set up to look holistically into banking practices prevailing in the country, and the first time in the history of banking in Mauritius that these practices have been examined so closely with inputs from all categories of stakeholders. It seems that the customer around whom banks should centre their business has been gradually left on the side over the years. The Report seeks to provide a framework to bring the customer back at the heart of banking business. All stakeholders and the general public were invited to participate in this banking reform initiative by commenting on the proposed recommendations, making suggestions and proposals, so that together we can pave the way to a modern, efficient, and customer-centric banking sector.



Paving the way to a modern, efficient, and customer-centric banking sector.”

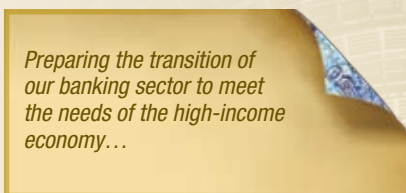
Regional and International Involvement

We pursued our involvement in regional fora. In October 2013, the Bank hosted the fourth meeting of the Financial Stability Board Regional Consultative Group for Sub-Saharan Africa, which I co-chair. In January 2014, the Bank hosted a meeting of the Committee of African Banking Supervisors of the AACB, which is chaired by a senior colleague from the Directorate of Supervision. In May 2014, the Bank hosted the IFSB Summit. Our work with SADC and COMESA continued apace, making further progress in the area of macroeconomic convergence, financial stability, and development of the regional payments system. We also welcomed a delegation of the African Union's *High Level Panel on Illicit Financial Flows from Africa*, headed by His Excellency Thabo Mbeki, former President of South Africa. The visit offered an opportunity to share our experience on such matters as our due diligence process and the application of international best practices and standards in the field.

The Banking Sector of the Future

I intend to spend the rest of my third mandate to prepare the transition of our banking sector to meet the needs of the high-income economy that is within our sights. We recognise that a lot still remains to be done, especially if we want to hasten progress in this direction - which is a perfectly legitimate objective in view of our past trajectory. We have continuously strengthened our regulatory and supervisory framework to reinforce the resilience of our banking sector. We have stepped up our efforts to modernise our payments system infrastructure, and floated international tenders for the National Payment Switch. This will revolutionise the payment space, reduce transaction costs, and level the playing field for smaller banks and other potential payment processors who cannot currently compete away the high margins prevalent in the industry because of the prohibitive cost of installing

alternative platforms for the provision of new technology-driven products. We have amended legislation to allow differentiated banking licences in such areas as Islamic banking, private banking and investment banking. We have set out a framework to provide for agent banking for more efficient delivery of banking services and to promote financial inclusion.



Preparing the transition of our banking sector to meet the needs of the high-income economy...

In parallel, the Bank has been vested with new powers, giving us explicit responsibility for promoting public understanding and awareness of financial products, and for conducting investigations. Credit unions with assets of more than Rs20 million have also come under our purview. We recognise the pioneering role that credit unions have played in improving financial access to previously unbanked segments of society and we shall apply proportionality in our approach to supervising and regulating the sector. We have launched the eXtensible Business Reporting Language (XBRL) project that will simplify data collection and reporting by banks and other regulated institutions while also facilitating in-depth and timely analysis at the Bank.

We have continued with process re-engineering and organisational restructuring to deliver on our extended mandate, to meet new challenges, and to incorporate new technology. In addition to the Intelligence, Compliance, and Enforcement Section mentioned earlier, we also set up a specialised unit for reserve management to serve as the nucleus for a Middle Office and Risk Management Division which we created just after the period covered by this report. We re-jigged the Economic Research Division and tasked it with developing our forecasting and modeling capacity to support our expected move to an explicit Inflation Targeting regime.

None of these moves would have been possible without recruiting new staff, with the requisite experience, at an appropriate level in the Bank's hierarchy. Already a technology-intensive industry, banking will become a battlefield for still more disruptive technologies in future. An ageing staff, with dated skills and outmoded work habits, will be hard-pressed to cope with the emerging challenges facing the regulator. We placed considerable emphasis on upgrading our in-house skills and recruiting new blood. We opened our doors to regular graduate interns two years ago. We followed it up this year by launching a Graduate Trainee Programme which will allow the Bank to spot potential new recruits, enhance its professional competence, and rejuvenate its workforce.

The Rupee goes polymer

Last August, the Honourable Prime Minister launched our very first polymer bank notes, which have been in circulation since then. I am happy to say that two of the three polymer bank notes have received international recognition. The Rs25 polymer bank note and the Rs500 polymer bank note were shortlisted for their state-of-the-art security features at the International Association of Currency Affairs 2014 Technical Excellence in Currency Awards. Our Rs25 bank note came out 2nd in this contest. I am pleased to say that our efforts to adhere to the highest standards in all business areas have paid dividends.

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Words of Appreciation

I have always been guided by my *sens du devoir* in discharging the immense responsibility entrusted to me by the Prime Minister to lead the central bank of the country in the midst of challenging times for our economy and our people. It has not been an easy ride. My task would have been still more difficult, had I not received the support of the staff of the Bank, in particular my close collaborators in the Governor's Office, the Policy Unit, and elsewhere, and my Deputy Governors and their key staff. Supporters and well-wishers beyond the Bank have played a crucial role, especially when my resolve appeared to flag. I wish to express my deepest gratitude to all of them. Our economy has reached a tipping point. If we unite our efforts and pull in the same direction, we will be able to carry through the much-needed reforms to take us forward to new levels of development. The tantalising prospect of a high-income economy beckons...

Looking Ahead

For our vision of a modern, fair, and inclusive banking sector to come to life, it is today that we must make a start on shaping it!

Inclusiveness and sustainability of growth and development are the two areas where the Bank can make its biggest contribution to this transformation. This can best be achieved in the context of a dynamic and competitive financial sector, effectively serving the interests of both savers and investors. For our vision of a modern, fair, and inclusive banking sector to come to life, it is today that we must make a start on shaping it!



Rundheersing Bheenick
13 October 2014