BANK OF MAURITIUS
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COMMUNIQUÉ

The crisis in the euro zone has intensified recently. The Eurozone sovereign debt crisis currently poses the single biggest downside risk to the global growth outlook. A small open economy like Mauritius, with its high level of dependence on the Eurozone, is necessarily exposed to heightened risk. There is a need for close monitoring and strong vigilance to anticipate events and take proactive measures, whenever required. With this in mind, the Bank has decided to embark on a programme to build up its foreign exchange reserves, ***Operation Reserves Reconstitution*** (**ORR**).

The level of reserves currently stands at 4.5 months of imports of goods and services and is broadly adequate by international metrics. However, the Bank considers that, in these exceptional times, more insurance is required against possible shocks. The basic objective of ORR is to increase the level of the Bank's foreign reserves to 6 months' import cover eventually.

Reserves-building implies quasi-fiscal costs given the important interest rate spread between reserve assets denominated in foreign currencies and the costs of sterilization instruments issued in domestic currency. It may also compromise the price and financial stability objectives of the Bank. The Bank's balance sheet cannot sustain sterilization costs associated with the ORR. The Bank has accordingly entered into an arrangement with the Ministry of Finance and Economic Development (MOFED) to meet the sterilization costs. A joint BoM/MOFED committee is being set up to oversee the implementation of the ORR.

The Bank is concerned with the increasing misalignment of the rupee exchange rate with underlying fundamentals. In its report for the 2012 Article IV Consultation (March 2012), the IMF observed:

> *The exchange rate is only one mechanism for reducing external imbalances, and not necessarily the most obvious one in the case of a floating exchange rate regime. The mission recommended that the authorities monitor real exchange rate developments in relation with its fundamentals. Any further real appreciation not warranted by fundamentals might be resisted through sterilized interventions, but such policies should also be supported by fiscal adjustment and productivity increasing reforms to facilitate external adjustment.*

An IMF mission revisited this subject in the light of the worsening global economic crisis and proposed policy options for Mauritius to cope with its effects. The mission, which delivered its preliminary report earlier this week, noted:

> *In the current situation, sterilized intervention could be considered to reduce exchange rate misalignment relative to equilibrium. Sterilization costs should be borne by the fiscal authorities through recapitalization in the form of interest bearing government paper, by reimbursing the Bank for incurred sterilization costs, or by issuing government paper in excess of fiscal financing needs*.

The persistence of the crisis, worsening external market conditions facing Mauritian exporters, and the continued depreciation of certain currencies, are triggering alert signals for our export enterprises. The Bank of Mauritius is concerned that economic operators may be affected by the mismatch between the currencies in which their earnings are denominated and their outstanding debt in rupees, which may lead to debt servicing difficulties with adverse effects on the balance sheet of operators and their creditors, namely domestic banks. The Bank of Mauritius stands ready to minimise any such exchange risks by offering a Special Foreign Currency Line of Credit (in Euro or US dollar at the option of the borrowers) to the affected sectors, through their respective banks.

The Bank will closely monitor domestic and global economic developments and will step in with additional measures should they be required.

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