Rundheersing Bheenick: Positive response to the crisis and major financial developments in Mauritius

Statement by Mr Rundheersing Bheenick, Governor of the Bank of Mauritius, Port Louis, 14 October 2009.

* * *

What a period of exceptional turbulence it has been for the finance and banking sector and for globalised economies like that of Mauritius! The year (FY 08/09) began ordinarily enough, with our focus resolutely on the achievement of price stability especially as inflation threatened to enter double-digit territory. Within a matter of weeks, Lehman Brothers became a household name for all the wrong reasons, engulfing companies, countries and continents far removed from the original epicentre of the crisis in the US subprime market.

The downside of globalisation, until then a subject of little mainstream interest, manifested itself in the speed at which the contagion spread. Never since the Great Depression has the world economy come so close to the brink of collapse. For a small open economy which depends critically on open trade flows for both its imports of essential items, like food and fuel, and for the necessary exports to be able to pay its way in the world, the situation was fraught indeed!

As fear gripped major markets, it became increasingly difficult for economic operators and regulators alike not to give in to panic and ensure a level-headed response to a situation which was not only rapidly deteriorating but also clouded with growing uncertainty. The rupee started depreciating as foreigners disinvested from both stocks on the local exchange and dumped Government paper. It did not matter one iota that domestic banks had no exposure to toxic assets and had reduced non-performing loans to a historically low level. And, for that matter, it did not help that an international rating agency chose this year to threaten the two largest domestic banks with a possible downgrade.

How did we react to these various external shocks and threats? We put the banking sector on high alert, with daily monitoring of all major movements, to enable us to take pre-emptive and timely action at the slightest sign of any adverse development. Thus, no sooner had reports begun to reach us that trade credit lines, traditionally extended to domestic banks by large foreign banking institutions, were being withdrawn that the Bank decided to set up a Special Line of Credit in foreign currency to meet the shortfall, thus becoming one of the first Central Banks in emerging countries to provide trade financing which is the very life blood of a trading nation. And that was several months before the G-20 at its London meeting in April 2009 emphasised the importance of trade credit in supporting global economic recovery.

The crisis also brought the Ministry of Finance and Economic Empowerment (MOFEE) and the Central Bank on a convergent path as fiscal and monetary policy entered a phase of maximum coordination where Government came up with a Fiscal Stimulus Package, approximating 3.8% of GDP, while the Central Bank embarked on a series of cuts in the Key Repo Rate (KRR) and a reduction in the minimum Cash Reserve Ratio (CRR).

In parallel, both MOFEE and the Bank actively joined the international debate to search for a lasting solution out of the financial and economic crisis. We paid particular attention to de-stigmatising access to IMF resources. The Flexible Credit Line that was rapidly put in place by the G-20 was tailor-made to meet the requirements of the Mauritian situation in the face of an expected worsening of our external accounts. Without any *ex-ante* conditionality, this line provided a way of staunching any unexpected massive forex outflow and financing the growing balance of trade deficit that, under this scenario, could no longer be funded by the combination of net foreign investment inflows and the rise in earnings on the services account on which the economy depended to balance its books.

Luckily for us, the situation never got out of hand and there was no need to have recourse to this facility after all. There was even an unexpected bonus for Mauritius as far as relations with the Fund were concerned: effective February 2009, our exchange rate arrangement was reclassified from “managed floating” to “free floating” as from 1 November 2008 – which is nothing short of remarkable given that this period witnessed interventions by many major Central Banks in support of their currencies.

Let me now briefly highlight some major developments during the year.

- The banking sector continued its growth during the period March 2008 to March 2009 – with an 11% rise in deposits from Rs503 billion to Rs557 billion, a 20% rise in advances from Rs342 billion to Rs409 billion, and a 22% rise in bank profits from Rs11 billion to over Rs13 billion.
- The supervisory and regulatory framework was enhanced and modernised – with a seamless transition from Basel I to Basel II for capital adequacy after a frictionless year of parallel run, and the revision of some guidelines especially those relating to credit concentration and related party transactions.
- The Bank initiated the publication of regular bi-annual Financial Stability and Inflation Reports starting with the first issues in July 2008 and November 2008 respectively, thus fulfilling one of the requirements of its enabling legislation.
- The foreign exchange market saw growing competition with the issue of 14 new licences to money changers and one to a foreign exchange dealer: nine of these had commenced operations before 30 June 2009.
- We enhanced our Islamic finance credentials by hosting a Seminar on Islamic Capital Markets jointly with the Financial Services Commission and the Islamic Financial Services Board, which the Bank joined as an Associate Member in 2007. We authorised the local branch of a major international bank to provide Islamic financial services through a window operation.
- We achieved greater transparency regarding fees and commissions charged by banks by enforcing a standard template for reporting fees and commissions by all banks in Mauritius because we believe that a better-informed consumer can lead to more competitive outcomes and cheaper services.
- We pursued our efforts to graduate to the IMF’s more demanding Special Data Dissemination Standards, thereby demonstrating our commitment to the provision of data of quality and frequency to rank with the best anywhere.
- Faced with the deteriorating external environment and its knock-on effects on the domestic economy, the Monetary Policy Committee met six times during the year – including a special meeting in July 2008, when the relentless upward pressure on inflation with serious risks of high inflation expectations becoming entrenched, made it more appropriate to raise the policy interest rate by 25 basis points to 8.25% per annum. The Bank raised the minimum CRR effective 15 August 2008, which led to a rise in short-term interest rates, thereby further tightening monetary conditions.
- Subsequently, the monetary policy stance was loosened, with the KRR being reduced by a cumulative total of 250 basis points in the period of six months to March 2009. This monetary easing was done in conjunction with the expansionary fiscal policy designed to shore up the domestic economy, which I referred to earlier.
- The Bank took over the Debt Management function from MOFEE, including the responsibility for the drafting of the Government Debt Management Strategy.
- Total Government debt stood at Rs134 billion as at end-June 2009 as against Rs122 billion at end-June 2008 – at less than 60% of GDP, a far cry from the rising debt levels in the major economies, some of which exceed 100% of GDP. The Bank

has smoothed out the weekly issues of Treasury Bills and provided an advance monthly issuance calendar to the market. The Bank also introduced online auctioning of Treasury Bills on a pilot basis, thus paving the way for the issue of single-maturity instruments on different days and for greater efficiency in the money markets.

- We revisited our portfolio management approach – which was designed for a context where our reserves were a fraction of their current level – in search of higher yield without sacrificing quality and without taking unnecessary risks. As I mentioned in my Statement introducing the Annual Report of last year, we had separate Peer Reviews carried out by both the Bank for International Settlements (BIS) and the Reserves Advisory and Management Program of the World Bank's Sovereign Investments Partnership. Both reports have now been received.
- Any change in our portfolio management strategy is tied up with changes in our accounting approach and the profit allocation framework as well as with the risk appetite that is now warranted in the circumstances. We envisaged changing our accounting approach to allow for dynamic provisioning of expected losses from "negative carry" resulting from forex sterilisation operations. Our first attempt to do this was unfortunately aborted with the Bank thus missing an opportunity to rank among the pioneers of this approach which has gained wide recognition after the crisis. The disallowed provision had to be remitted by way of a second transfer of profit during the year.
- The Bank hosted the 7th meeting of Governors of the Association of African Central Banks in July 2008 and, in that same month, co-hosted with the Centre for Central Banking Studies of the Bank of England, a seminar on "Inflation Targeting, Modelling and Forecasting". Later on during the year, the Bank co-hosted with the African Export and Import Bank an event to publicise the latter's products to the Mauritian business community.
- The Bank has been appointed as the Settlement Bank for the COMESA Regional Payment and Settlement System (REPSS). The REPSS project is now under implementation.
- Since the IMF announced that it was increasing the number of African Regional Technical Assistance Centers (AFRITACs), the Bank joined MOFEE in lobbying for Mauritius to be the venue for AFRITAC (South). We expect to report on this in more detail in the next report.
- The Bank has extended the coverage of the Mauritius Credit Information Bureau to allow collection of credit information from all institutions, including leasing, insurance, hire purchase and utility companies, which will lead to further improvement in credit quality.
- The Bank entered into a Memorandum of Understanding with the Central Statistics Office (CSO), to provide for a more structured collaboration between the two institutions. This was preceded by a weekend brainstorming session between the Bank, MOFEE, and the CSO.
- We give in this Report for the first time some metrics which will allow the informed observer to gauge our efficiency in meeting our mandate at least cost. It will be seen that an entire working month (23 meetings against a statutory minimum of 12) was taken up with Board meetings and the dividing line between governance and management became increasingly blurred – which would no doubt make an interesting case-study for institutions like the BIS, the central bank of central banks, concerned with central bank governance issues.

- The Bank launched a commemorative gold coin to mark the 40th Anniversary of the Independence of Mauritius. The coin has been the fastest-selling coin in the history of the Bank, with the issue being sold out in less than five days. This feat has inspired us to come up with a “Father of the Nation” Platinum Series, made up of three different coins to be launched over the next three years, beginning in October 2009.

In the previous year, we had already reached record levels in terms of training fellowships extended to our staff to widen the Bank’s knowledge base. This year, we continued with this tradition with a total of 85 training opportunities provided to staff, or about the same level as the previous year. We intend to pursue in this direction to enhance our skill levels to enable us to meet new challenges.

On behalf of the Bank, I wish to extend my appreciation to our staff who have put in tremendous effort and hard work to allow the Bank to fulfil its mandate. The close working relations with the industry were continued through different fora such as the Banking Committee, involving the Mauritius Bankers Association (MBA) and all Chief Executive Officers of banks, the Bureau Meeting involving the MBA and the Management of the Bank of Mauritius, and various regular meetings at other levels such as those with Treasurers and Compliance Officers. Without this close collaboration, the transition to Basel II would not have proceeded as smoothly as it did. A special word of thanks therefore goes to the Chairman, the Chief Executive and members of the MBA for facilitating the task of the regulator.

To conclude, let me thank the Prime Minister for his presence at the launch of the commemorative coin and his continued support during these trying times. I take this opportunity to also thank the Vice Prime Minister and Minister of Finance and Economic Empowerment for the close collaboration and support, which has helped enormously to maintain confidence in the economy and give it a much-needed sense of direction and cohesion in these troubled times.