Rundheersing Bheenick: Main developments in 2011 and Mauritius's economic outlook for 2012

Letter by Mr Rundheersing Bheenick, Governor of the Bank of Mauritius, to stakeholders, Bank of Mauritius, Port Louis, 14 February 2012.

The original speech, which contains various links to the documents mentioned, can be found on the Bank of Mauritius' website (http://bom.intnet.mu).

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With the crisis in its fifth year since "sub-prime" became part of the international jargon, one could have been excused for thinking along the lines of Murphy that everything that could conceivably have gone wrong had already gone wrong and that 2011 was, at worst, going to be more of the same as we'd seen it all before or, quite possibly, turn out to be somewhat better since all manner of weaponry had already been deployed to take on the hydra-headed beast as it successively morphed from a US sub-prime crisis to a US banking crisis to a full-blown global financial crisis before emerging in its latest and most pernicious and destructive avatar as the worst global economic crisis in eight decades and, surely, this impressive arsenal – much of it never tried before on this scale – would at last begin to get the better of the beast. But, it was not to be.

2011 turned out to be the stuff of nightmares. A Hollywood mogul contemplating an economic disaster movie would have fired any script-writer who would have dared to come up with such improbable plots and sub-plots as these, in no particular order, as part of the global economic crisis storyline: a nuclear disaster in the third largest economy; a tsunami engulfing South-East Asia; large universal banks tumbling like the proverbial house of cards, scrambling for capital, losing their CEO's and their prime rating; an acute sovereign debt crisis in the European periphery,, threatening contagion to the rest of the eurozone; a credit crunch in the midst of unprecedented Quantitative Easing; *de facto* nationalisation of banks in hard-core capitalist economies; a sex-scandal forcing the exit of the head of the International Monetary Fund (IMF); democratically-elected leaders being replaced by appointed technocrats in Greece and Italy, under the pressure of markets; the US caught in fiscal gridlock and losing its triple-A rating; an uprising in the Arab world,, toppling long-established dictators with a key role in the politics of oil; the death of a tinpot dictator in North Korea; the spectre of an unpredictable Iran joining the nuclear club; currency and capital markets in the doldrums but with nervous twitches as they see-saw between risk-on and risk-off modes; gold bugs having a field day – Goldfinger's dream of world domination at last coming true? – as even the respected World Bank President re-discovers the merit of a gold-exchange standard to combat exhorbitant currency volatility; the euro doing very poorly with the prospect of its implosion leading to an explosion of summitry, but with sophistry more in evidence than solutions – all this, and more, against a back-drop, at the global level, of the world trade system still pursuing the elusive closure of the Doha round and, at the local level in many countries, an amorphous "occupy" movement gathering momentum to vent its frustration against all manner of crisis-related ills, real or imagined. Fact was indeed stranger than fiction.

Our unfortunate script-writer would, in all likelihood, have been black-listed forever for bringing Hollywood and the guild of screenwriters in disrepute if he had also had the temerity to include in his screenplay of global financial and economic mayhem affecting the major countries and their systemically-important institutions a tableau with a starkly contrasting narrative: a tiny ultra-peripheral economy with a population of just 1.3 million; a fruit-salad of a nation with a rich diversity of languages, religions and ethnicities, and democratic to a fault; a success story *sans pareil* of: structural adjustment, demographic transition, diversification away from mono-crop dependence on sugar, export-driven industrialisation, off-shoring from banking and finance to business processes, and of economic transformation generally as it weaned itself away from trade-preferences to the post-WTO world; an economy that has kept growing *throughout* the crisis when bigger economies contracted; an unemployment rate that has stayed below 8 per cent; an inflation rate that has tumbled from 10.9 per cent in April 2007 – the date of the establishment of the Monetary Policy Committee – to a historical low of 0.1 per cent in October 2009, to reach 4.8 per cent in December 2011; a total public debt of less than 60 per cent of GDP, much of it owed domestically with the balance held by multinational or national financial institutions, not commercial banks; a rising level of net international reserves from Rs85.8 bn in 2007 to Rs109.6 bn in 2011; a fiscal deficit of 3.2 per cent in 2011; gross FDI inflows of Rs10 bn in 2011, not far below the record level of 2010; a record profitability posted by the largest bank in the country, a domestic one that has been in business since 1838; and a free floating currency that has adjusted flexibly without the benefit of any controls to *appreciate* during the crisis with the exchange rate index, MERI 1, standing at 91.6 in December 2011 from its base of 100 in calendar year 2007.

Such a tableau, *invraisemblable* as it seems, is not the fruit of the imagination of our hypothetical script-writer. The country depicted does exist. And the experience highlighted is the result of the patient and combined efforts of policy-makers, real sector operators and its people generally, as they strived to adapt and re-adapt to the continuously-changing external environment confronting them. The picture that is painted is that of Mauritius: vibrant, resilient, and resolutely moving forward. And the Bank of Mauritius, that I have had the privilege of leading, has contributed to the rich palette that comprises the policy landscape, especially the financial and monetary aspects, adding our own touches and flourishes as we proceeded.

In keeping with past practice, I next highlight the main developments of the past year before concluding with my perspective on the current year. Links are provided at the end of the relevant paragraphs for those readers who may be interested in delving in greater detail into some of the issues discussed.

Economy The Mauritian economy continued to display a creditable degree of resilience despite difficult external conditions. Growth momentum was maintained in 2011 at 4.1 per cent, not far below trend, and projected to be slightly below 4 per cent in 2012. The unemployment rate was fairly stable at 7.9 per cent, a far cry from the rising joblessness in our main export markets. The fallout from the euro crisis will continue to affect our euro-centric economy. The call that we launched two years ago to diversify production and find alternative markets, which then fell on deaf ears, is increasingly finding a favourable echo among real-sector operators and decision-makers. ***(More on this issue)***

Monetary Policy Our monetary policy, continuously decried by business lobbies and regularly denounced by the press with an eye, no doubt, on their advertisers, confounded its critics by measuring up to its primary task of bridling inflation. At the beginning of the year, we had anticipated that higher commodity prices would drive up headline inflation but it would decline by end-2011. The Monetary Policy Committee (MPC) raised the Key Repo Rate (KRR) at two successive quarterly meetings in March and June by 50 and 25 basis points, respectively. These hikes contributed to contain inflationary pressures. At the September meeting, although inflation expectations were still high, the MPC maintained its stance as the global economy recovery was showing signs of losing momentum. In December, as the euro sovereign debt crisis had intensified causing the domestic economic outlook to be clouded by still greater uncertainty, the MPC proceeded to a very small cut of 10 basis points, the first time that the KRR was moved by less than 25 basis points, to 5.40 per cent per annum to manifest its concern about the low level of business and consumer confidence while avoiding undue risks on the inflation front. Headline inflation rose from 3.3 per cent in January to 6.6 per cent in November before declining to 6.5 per cent in December. Barring unforeseen shocks, we expect both year-on-year and headline inflation to moderate this year and gradually move within a narrowing range around our comfort level of 4–6 per cent. ***(More on this issue)***

Review of the MPC I had explained on several occasions the rationale for a thorough review of the functioning of the MPC in the light of its operating experience of four years. This was entrusted to Sir Alan Budd, a former Member of the Bank of England MPC. He made a number of recommendations in his Report which, I am glad to note, supported my own line of thinking. We have taken some decisive steps to enhance the independence and transparency of the MPC: beginning with the 4Q 2011 MPC meeting, the minutes of MPC meetings and the pattern of individual votes are being published; and there were legislative changes in December 2011 to sever the remaining formal links with the Board of Directors of the Bank. ***(More on this issue)***

Financial and Money Market Developments We addressed the issue of excess liquidity which could have fuelled inflationary pressures by a judicious combination of two measures. First, we raised the Cash Reserve Ratio from 6.0 to 7.0 per cent in February 2011 and increased the minimum daily cash ratio from 4.5 per cent to 5.0 per cent. Second, we stepped up the issuance of BoM paper to nearly Rs10 billion. To cope with persistent problems of liquidity overhang in different parts of the maturity spectrum, we extended the tenor of our paper well beyond the usual maturity of Central Bank paper of up to one year, and continued with the practice of issuing BoM Notes with maturities of 2, 3 and 4 years, which we started in August 2010. The operation was successful and was favourably commented by the January 2012 Article IV Consultation Mission of the IMF. ***(More on this issue)***

Another interesting development in the money market that occurred during the year is the daily publication of the Port Louis Interbank Offered Rate (PLIBOR) as from 26 August 2011 on the Reuters page at 12 00 hours. The PLIBOR, which is an average interbank rate, is computed and published for four tenors, namely Overnight, One Week, One Month and Three Months. These rates will be also available on the Bank's website in early 2012. ***(More on this issue)***

Domestic Foreign Exchange Market The tumultuous conditions prevailing in international currency markets prompted us to take steps to prevent contagion from seeping into our small, but completely open, domestic foreign exchange market. The Bank intervened actively to smooth out excessive rupee volatility – while taking extra care to remain broadly neutral and avoid any unnecessary and dangerous balance-sheet risks – with total foreign currency purchases equivalent to US$533 million nearly matched by foreign currency sales equivalent to US$512 million. We continued to provide the State Trading Corporation, at their request, with their foreign exchange requirements to pay for food and fuel imports. We maintained the foreign currency swap facility, introduced at the beginning of the crisis in December 2009. We, however, decided to withdraw the Special Foreign Currency Line of Credit that had been made available to banks for trade financing since December 2008. I am pleased to note that, as a result of our vigilance, liquidity conditions on the foreign exchange market stayed comfortable throughout 2011, with a roughly similar total turnover of foreign exchange transactions as the previous year, and the rupee behaved fairly well during the year, contributing enormously to maintain price stability and real incomes in our import-dependent island. ***(More on this issue)***

Reserves Management Given "negative carry," we did not seek to accumulate reserves. We managed to keep them at a comfortable level throughout the year. In December 2011, the gross external reserves of the Bank exceeded Rs80 billion while net international reserves amounted to almost Rs110 billion, representing around 37 weeks of imports. Our gold holdings amounted to around Rs5.7 billion as at end-December 2011, or around 7 per cent of gross external reserves. Our reserves are at a comfortable level when measured against the two traditional metrics of import cover and short-term debt cover.

We actively pursued our diversification strategy into higher-yielding instruments and comparatively stable currencies. We thus invested in currencies such as the Norwegian Krone and the Swedish Krone. We intend to increase the share of our investment in fixed-income securities. Amendments have been brought to the Bank of Mauritius Act to support these moves. The Bank has negotiated with the Reserve Bank of India to invest in Indian government bonds and is currently negotiating with the People's Bank of China to invest in Chinese government bonds. The diversification strategy adopted by the Bank, together with enhanced operational efficiency, were behind the improved financial performance of the Bank which realized a net profit of Rs258 million for the FY2010/11, compared to Rs72 million for the corresponding period last year, in spite of the continuation of the low-yield environment for currency placements.

We have made some progress with the idea of setting up the Sovereign Wealth Fund which I had discussed quite lengthily in my previous Letter to Stakeholders. I have had follow-up discussions with the IMF and other central banks which have gone down this road. Together with my Head of Financial Markets Operations, I participated in the first Africa Sovereign Funds Roundtable in Morocco, which brought together central banks, pension/social security funds, sovereign wealth funds and finance ministries across the African continent. The Roundtable provided participants with guidance on ways to address strategic, governance and investment management challenges.

Debt Management We scored some success in our attempt to improve the domestic debt profile of central government which we lengthened. In October 2011, we introduced 273-day Treasury Bills to widen the maturity spectrum of available instruments and smoothe the yield curve – I will take up the issue of the yield curve in the next paragraph. We built benchmark bonds by re-opening the issues of longer-term Government instruments several times during the year to stimulate the secondary market and establish a reference yield. In November 2011, we revamped the auctioning process by conducting single-maturity auctions of Treasury Bills and holding more frequent auctions during the week. This was facilitated by the implementation of a web-based on-line auctioning system now in its final stage. We are planning to extend the system, which now handles only Treasury Bills, to other Government debt instruments. ***(More on this issue)***

Yield Curve The year also brought a major development in the capital market with the correction of the yield curve. This curve – which shows the yields of Government securities of different tenors – had been relatively distorted at its shorter end since 2007 and was stressed downwards by factors such as the excess liquidity plaguing the banking system and the decrease in the KRR. I have detailed earlier the measures which we took to bring liquidity to reasonable levels. These helped to reduce the pressure on yields which started to move upwards, thereby removing the distortions at the shorter end of the curve. By the end of 2011, we had achieved a smooth upward-sloping yield curve. This smooth yield curve is expected, among other things, to benefit the development of a corporate bond market by enabling market participants to price their financial products.

Development of a Secondary Market One of the obstacles to the proper development of a secondary market is the tendency for banks to hold their portfolio of Government securities to maturity. The marked preference of banks for official paper, even at the cost of driving down yields in the preferred part of the spectrum, and a growing risk-aversion which impeded the growth of credit prompted us to introduce a new tool in the form of a cap on banks' holdings of Treasury Bills in their banking books. This cap was initially set at 20 per cent of daily average rupee deposits and tightened further to 18 per cent as from July 2011. There is no limit on banks' holdings of Treasury Bills in their trading book. This is expected to encourage banks to direct loanable funds towards extending more credit and also promote the long-awaited development of the secondary market. ***(More on this issue)***

Banking Sector Performance Our banking sector continued to show remarkable resilience – in some cases, insolently so – in the midst of the global financial meltdown. As at 30 September 2011, unaudited figures show that banks realised profit after tax of Rs15.9 billion against Rs10.1 billion a year earlier. The banking sector continued to expand driven by the Segment A, i.e. domestic, business, while Segment B business contracted slightly. The ratio of non-performing loans to total loans hovered around 2 per cent. ***(More on this issue)***

Fee income is now a non-negligible component of banks' total income and there have been complaints from various quarters that bank charges are on the high side. We decided to set up a Working Group on fees, charges and commissions to study the reasonableness of bank charges relative to the services offered. The Working Group's main task will be to analyse banks' pricing for their services, particularly with regard to basic banking services offered to the public. I reminded bankers at the last Banking Committee meeting of the year that the Bank is fully empowered to regulate fees and charges in the banking sector. Moves in this direction can be envisaged to ensure that customers get a fair deal.

Regulation and Supervision We amended several of our guidelines and issued new ones in response to the changing financial environment. We adopted the risk-based approach to supervision by an optimum allocation of our supervisory resources to institutions that we believe pose greater risks to the financial and economic system. We fine-tuned the implementation of the Basel II framework by requiring banks to submit their Internal Capital Adequacy Assessment Process and prepared ourselves to move to the Basel III framework. ***(More on this issue)***

We firmly believe that transparency builds confidence in the integrity of the banking system. In April this year, after preliminary work spanning over two years, we took the bold step of publishing our CAMEL ratings of banks. At first, this initiative did not appeal to our bankers, but it favourably impressed the IMF Article IV Consultation Mission of January 2012, which did not hesitate to qualify it as a *première* in Africa. Today, the half-yearly publication of the CAMEL ratings seems to have been widely accepted in the country and forms an integral part of our framework for the public disclosure of information on the banking sector.

We pursued our efforts to enhance supervisory cooperation and information-sharing with other countries. The Bank entered into Memoranda of Understanding (MoUs) with the Central Bank of Kenya and the Maldives Monetary Authority, which brings the number of MoUs signed with foreign regulatory bodies and agencies to ten. The Bank and the Central Bank of Kenya are setting up a protocol for joint co-ordination and conduct of on-site examination of financial institutions – which will come in handy as Mauritian and Kenyan entities have interests in the banking sector in one another's country. We have established a framework for regular exchange of information at mutually agreed intervals with foreign "home" regulators for an effective supervisory oversight of international banking groups operating in Mauritius, and participated in the work of the related supervisory colleges.

Islamic Finance March 31, 2011, marked another milestone in the development of our banking sector with our very first full-fledged Islamic bank, Century Banking Corporation, launching its operations.

We are actively pursuing discussions with the International Islamic Liquidity Management Corporation, of which we are a founder-member, for the issuance of Islamic liquidity instruments that would mark our entry in Islamic capital markets, facilitate liquidity management by domestic banks conducting Islamic banking business, and enhance our attractiveness for Islamic finance. A Joint Committee of the Bank of Mauritius and the Ministry of Finance and Economic Development has been set up to study all issues relating to Islamic capital markets and, in particular, assess prospects for the issuance of Sovereign *Sukuks*.

Small and Medium Enterprises Financing Scheme Less than a month after the Minister of Finance announced the creation of a Small and Medium Enterprises (SMEs) Development Fund in the Budget presented in November 2011, we acted promptly to set up the "Small and Medium Enterprises Financing Scheme" to facilitate access of SMEs to finance. Under the Scheme, the 14 participant banks – i.e. all the banks involved in Segment A activity – will provide credit facilities to SMEs at 3 percentage points above the prevailing KRR in an amount of up to Rs3 billion over the next three years. Over the period December 2011 to

November 2012, funds of Rs1 billion will be disbursed to SMEs. Loans under the scheme are free of the processing costs and charges normally applied to such lending. They also carry a partial guarantee extended by a participating state-owned enterprise. The Bank is closely monitoring all funding provided under the scheme to ensure its smooth operation. ***(More on this issue)***

Deposit Insurance Scheme We made some progress on the Deposit Insurance Scheme in consultation with selected member banks of the Mauritius Bankers Association. We have approached the Swiss-based International Association of Deposit Insurers, of which Mauritius is an Associate-member, for their expert views and comments on the proposed Scheme. It is our fervent hope that we will be able to plug in an additional safety-net in our banking regulatory/supervisory infrastructure and minimise the risks now being implicitly underwritten by the monetary and fiscal authorities.

Single Financial Regulator The twin-peaks regulation model has been listed among the possible suspects responsible for the financial and banking crisis in some jurisdictions. An important policy development was the announcement in the November 2010 Budget Speech of the possible move to a single regulator for all financial services in our jurisdiction. This will most certainly impact on the way the Bank currently functions. A team of experts of international repute has been identified to undertake a study on the way forward.

Mauritius Credit Information Bureau Since its launch in 2005, the Mauritius Credit Information Bureau (MCIB) has rapidly emerged as an essential decision-making tool for system participants to assess any prospective borrower's credit profile. The credit information system also provides reputational collateral to borrowers such as SMEs and small borrowers who often face difficulties in accessing finance due to lack of tangible collateral. An important amendment was brought to the Bank of Mauritius Act in uly 2011 empowering the Bank to impose sanctions on credit providers who refuse to join the MCIB. Another amendment enabled the Bank to become a participant of the system which the Bank formally joined in January 2012. Lenders are encouraged to share the benefits derived from the MCIB with borrowers by reducing processing fees, charges and lending rates. ***(More on this issue)***

Cheque Truncation System In my last letter, I had regretted my inability to deliver on the Cheque Truncation System (CTS) which had got entangled in procedural difficulties. This year, we took bold steps to steer this long-delayed project in the right direction. Amidst unfounded criticisms and baseless allegations of fraud and malpractice, the new system was set up in collaboration with commercial banks. On 6 September 2011, Dr the Honourable Navinchandra Ramgoolam, GCSK, FRCP, Prime Minister, Minister of Defence, Home Affairs and External Communications, came to the Bank to launch the CTS in the presence, amongst others, of the Honourable CG Xavier-Luc Duval GCSK, Vice Prime Minister and Minister of Finance and Economic Development, and the CEO's of all banks operating in Mauritius. We chose to mark the occasion by donating a cheque of Rs1 million to the Prime Minister's Relief Fund, with this Bank of Mauritius cheque being the first to be cleared by the CTS.

The deployment of this new system which provides for the Bulk Clearing System for low-value electronic transactions marks the beginning of a new era for the payment and settlement system of the country. Cheque clearing is now faster and more secure. During the course of 2012, we will interface the system with the national switch, which we are now working on, to cater for the effective clearing of card-based transactions from ATMs and points-of-sales.

With the CTS having been the object of so much unwarranted attack, I feel it my duty to provide assurance to all stakeholders that the Bank has acted in all fairness and legality as well as in the best interests of the entire community of cheque-users, and bank customers generally, in this matter. Technology never stands still and it is in the nature of competitive bids that many of them fail to win the contract.

Dialogue with Stakeholders I have made regular dialogue with our stakeholders an integral feature of my governorship. It is my strong belief that there cannot be effective policymaking in central banks without effective communication and outreach. During the year, I continued with my open-door policy of meeting people from different walks of life and different areas of activity, from academia to private sector operators, and consumer associations. This allowed me to feel the pulse of the economy and fill gaps in the Bank's staff reports, while also being sensitive to all shades of opinion, including those that rarely make the headlines in the local press.

In addition to our regular schedule of quarterly meetings with the banking sector through the Banking Committee, I also held meetings with the MBA Bureau, an offshoot of the Banking Committee, to address the most pressing issues. We held a grand total of 49 trilateral meetings with CEO's and Board Directors of banks and other deposit-taking institutions as well as with their external auditors to review their financial performance and to discuss regulatory issues. I personally chaired the meetings with the larger, systemically-important, institutions. My First Deputy Governor handled the rest but briefed me on the issues to be addressed prior to the meetings, and on the outcomes and any concerns thereafter.

The Bank's traditional Annual Dinner in honour of Economic Operators was marked this year by the presence of HE Mallam Sanusi Lamido Sanusi, Governor of the Central Bank of Nigeria, as our Guest of Honour. This annual event gave me the opportunity to express my appreciation to our stakeholders for the cordial working relations that we have had during the year. It allowed me to comment on the past year and to highlight future areas of concern for the regulator. The function, which was the first black-tie event ever organised by the Bank, turned out to be a runaway success.

As part of our open and transparent communication strategy, I accepted invitations to speak from various institutions, at home and abroad. I began the year with a keynote address at the Future of Financial Markets Forum in Mumbai in January. I continued with an address at the SAID Business School at the University of Oxford in February. I delivered a dozen addresses to share my views on a wide range of topics, from economic analysis and supervisory matters to payment system infrastructure and corporate governance, on Mauritius and on Africa. There were two common threads in my addresses: overseas, the main thrust was to present Mauritius as an *avant-garde* banking and financial centre at the cutting edge of monetary policy-making and banking/financial regulation; locally, I highlighted the need to deliver on our core mandate. I did not elude the burning issue of exchange rate management when invited to speak at a Round Table on the exchange rate organised by the Mauritius Exports Association. It was the opportunity for me to underline the essential fact that our much-maligned monetary policy/exchange rate strategy has delivered the goods for the nation as a whole and done it in a more sustainable manner than the previous infernal spiral which banked on continued depreciation…which fuelled inflation…which sparked wage demands…which stoked up inflationary pressure…which necessitated further depreciation etc. ***(More on this issue)***

Corporate Social Responsibility Since I joined the Bank, I have integrated Corporate Social Responsibility as a key element of the Bank's outreach to the wider Mauritian community to project a less technocratic and austere image. The Bank of Mauritius Inter-Club Youth Championships – now a regular feature in the Bank's calendar of activities – were held for the fifth consecutive year on 24–25 September 2011. This fifth edition was co-sponsored by 14 commercial banks − namely ABC Banking Corporation, Bank of Baroda, Bank One, Bank International Indonesia, Barclays Bank, Bramer Banking Corporation, Deutsche Bank, Hong Kong and Shanghai Banking Corporation, Investec Bank, Mauritius Post and Cooperative Bank, SBI (Mauritius), Standard Bank, Standard Chartered Bank and State Bank of Mauritius. Around 725 athletes from 25 clubs participated, including the 15 best athletes selected from 400 Rodriguans who participated in the Inter-Club/School Youth Championships held in Rodrigues. A record number of national records – 14 of them – were established this year.

We were proud to note that two athletes who first came to national attention at the Inter-Club Youth Championships won bronze medals in the "*Indian Ocean Island Games 2011*" held in Seychelles. The Bank rewarded the record-setters as well as the two bronze medallists at a prize-giving ceremony held at the Bank in December 2011, in the presence of their parents/families, trainers, and national sport officials.

Financial Literacy Programme The Bank continues to play its role in the promotion of financial literacy. This year, the Bank launched a Financial Literacy–Essay Competition on the theme 'The Importance of Saving for Youngsters', which was open to students of Forms IV and V. We also organised the fifth edition of the "Monetary Policy Challenge" in June 2011. At the prize-giving ceremony held at the Bank in December 2011, the winners of both competitions were rewarded, in the presence of parents, teachers and college rectors of the winners. ***(More on this issue)***

Internship Programme As part of our outreach initiatives, we planned an internship programme but it took us some time to deliver on it. We first had to address very real concerns about data confidentiality and secrecy before we tentatively introduced an internship programme, limited to students of the University of Mauritius and the University of Technology. Five interns were selected after an interview and posted in different divisions of the Bank to acquire practical experience in Central Banking. The internship programme covered the period July to September 2011. In 2012, we intend to broaden the programme to accommodate interns from anywhere throughout the year.

Training We continued to provide up-to-date training to staff to better equip them for the challenges ahead. IMF technical assistance in the areas of macroeconomic modelling and supervision was on-going. Training in these areas is expected to enhance skills and the analytical capacity of Bank staff.

Capital of the Bank With the approval of the Minister of Finance, we doubled the Bank's capital from Rs1 billion to Rs2 billion in November 2011. This injection of capital was rendered necessary on account of the significant increase in the volume of the Bank of Mauritius Instruments which we had to issue to cope with excess liquidity to maintain orderly conditions in the banking and financial sector.

Issue of New Notes In October 2011, we issued banknotes of Rs200, Rs500 and Rs1,000 denominations with enhanced security features to extend the life of our ageing family of banknotes. These features have the advantage of facilitating authenticity verification by consumers and cash-handlers, thus enhancing protection against counterfeiting. The upgraded banknotes are legal tender concurrently with other notes of existing family of banknotes. ***(More on this issue)***

Launching of Third Platinum Coin During this year we launched the third platinum coin of the "Father of the Nation" Series, thus completing the collection, designed to pay homage to Sir Seewoosagur Ramgoolam who left his indelible imprint on the destiny of our country. The obverse of the third coin displays Le Morne Brabant, a rocky outcrop on the south-west coast of the island which served as a shelter for marooned slaves during the slavery period and which is inscribed on the World Heritage list of UNESCO since July 2008. We expect to issue a special collectors' edition of all three coins in 2012.

Central Bank Statistics A regular and timely flow of quality data is an essential characteristic of a modern economy. The Bank shoulders part of this obligation on behalf of the nation, and has specific responsibility for data relating to money, finance, and the balance of payments. The Bank is strongly committed to improve the quality of its data and to ensure that they meet international standards. A recent IMF Technical Assistance mission to the Bank validated the quality of our surveys of Global Business Corporations with a Category 1 licence and confirmed that we now qualified to join the top league of nations that subscribe to the Special Data Dissemination Standards – a project that I espoused since my early days at the Bank as I was alarmed by the rising Errors & Omissions component of our balance of payments. We were among the few central banks worldwide to participate in the very first Coordinated Direct Investment Survey initiative launched by the IMF in 2010. We have also initiated the process of compiling Balance of Payments (BoP) statistics in accordance with the sixth edition of the IMF's BoP Manual – an exercise that we expect to complete by 2014. ***(More on this issue)***

Financial Stability Developments The year witnessed growing international recognition of the stellar role played by the Bank in our very small jurisdiction in addressing financial system vulnerabilities and financial stability issues against a background of strong regulation and supervision. We started the year by being invited – the second in sub-Saharan Africa after South Africa – to join the Financial Soundness Indicators Reference Group (FSIRG), set up under the auspices of the IMF. The FSIRG will assess the experience of countries in compiling and disseminating Financial Soundness Indicators and improve their usefulness for financial stability analysis. In November, in a public statement released on its website, the Financial Stability Board (FSB) listed Mauritius as a jusrisdiction taking actions recommended by the FSB after conducting an evaluation of our jurisdiction. The FSB, which is hosted by the BIS in Basel, was launched by the G-20 in April 2009 to build and expand on the work of the Financial Stability Forum, itself initiated in 1997 by G-7 Ministers of Finance and Central Bank Governors. It has a broad mandate relating to all aspects of the financial system from standard-setting to contingency planning for cross-border crisis management. We ended the year on an even stronger note by being invited by the FSB to join its Regional Consultative Group (RCG) for sub-Saharan Africa. The RCG for sub-Saharan Africa forms part of a network of six RCG's established in 2011 following FSB's decision in November 2010. The Bank is privileged to form part of such a group, together with eight other African countries, and contribute to the debate on global financial stability. ***(More on this issue)***

A major lesson learnt from the current global banking crisis is the need to reduce the complexity of banking and financial structures. Simpler structures facilitate risk assessment, effective supervision, and efficient resolution if financial institutions run into difficulties. We have studied the structure of our domestic systemically-important financial institutions − D-SIFI's – and concluded that some simplification is called for. A prime candidate for reform is the bank-subsidiary model where a bank is the parent of subsidiaries in the group. We shall separate banking from non-banking activities to ensure that depositors' money is not at risk. This will strengthen our financial system and reduce vulnerabilities, thus contributing to financial stability.

Regional Cooperation We played an active part in regional cooperation initiatives within our area of responsibility. My Deputy Governors and I attended several meetings during the course of the year. The charters of both COMESA and SADC, the two major African regional economic organisations to which Mauritius belongs, provide in their governance mechanism, for a joint meeting of Central Bank Governors and Ministers of Finance co-chaired by a Minister and a Governor. Both bodies met for the first time since their creation in 2011. I was privileged, on behalf of fellow-Governors, to co-chair both inaugural meetings − the COMESA meeting in Lusaka in July, and the SADC forum in October in Mauritius. We hosted the Macroeconomic Sub-Committee of the SADC Committee of Central Bank Governors. We also had the privilege of welcoming the Ministers of Finance and Central Bank Governors of SADC for the inaugural meeting of the Peer Review Panel in October 2011, held back-to-back with the joint forum mentioned earlier. (***More on this issue)***

The Bank continued its prominent role in the area of Payment and Settlement System in COMESA and is now hosting the software for the Regional Payment and Settlement System (REPSS) and the SWIFT Bank Identification Code for the COMESA Clearing House (CCH). In September 2011, we hosted a Workshop on the Live Operations of REPSS, attended by delegates from 15 countries and the CCH. Major technical issues were cleared and the REPSS software was ready to be rolled out with the first group of central banks which had signed the relevant agreements and prefunded their account at the Bank of Mauritius.

The way we conduct our business at the Bank seems to be of increasing interest to our peers from the region and beyond. We welcomed a delegation of the Central Bank of Seychelles headed by my fellow-Governor in April 2011. The Personal Assistant to the Governor of the Central Bank of Rwanda came for a short attachment in the Governor's office to see how we ran the office. We also welcomed delegations from central banks from beyond the region, e.g Papua New Guinea, for training attachments at the Bank.

AFRITAC South In my letter of last year, I had briefly mentioned the impending establishment of one of the African Technical Assistance Centres (AFRITAC) of the IMF in Mauritius. AFRITAC South – as the centre set up in Mauritius is called – was officially launched in October 2011 by the Vice Prime Minister and Minister of Finance and Economic Development at the Bank where it is presently housed. We welcomed, for the occasion, an important delegation of the IMF which comprised, among others, Dr Min Zhu, Deputy Managing Director, and Ms Antoinette Sayeh, Director of the African Department. Dr Zhu delivered the 7th lecture in the Bank of Mauritius Lecture Series on *Global Challenges and Policies in Sub-Saharan Africa.* ***(More on this issue)***

Overseas Engagements of the Governor, the First Deputy Governor and the Second Deputy Governor in 2011 My two Deputy Governors and myself had a very busy schedule of meetings in 2011, as part of our commitment to various regional and international organisations and bodies. Given the critical importance for us central bankers to keep abreast with international developments, these meetings provided a platform for exchanging views and establishing and maintaining contacts with our peers. ***(More on this issue)***

Forthcoming events As I look ahead, I note with satisfaction that our efforts to heighten the Bank's visibility on the regional and international front are beginning to bear fruit. In the course of the year, we will have the privilege to host several regional and international meetings, which I give below in chronological order:

- In April, we will host the meeting of the Committee of Central Bank Governors (CCBG). CCBG meetings are normally held twice every year – hosted by a SADC-member central bank in April on a rotation basis, and by the South African Reserve Bank every September.
- In May, we will host, for the first time in Mauritius, the 19th Summit of the Central Bank Governors of the Francophone countries. We expect the participation of over 34 Francophone countries.
- In August, the Reserves Advisory and Management Program (RAMP), an arm of the Treasury Department of the World Bank, will hold a workshop in Mauritius. RAMP manages a part of our reserves.
- In September, we will host a seminar of the Islamic Financial Services Board on the role of Islamic Finance in the development of Africa.
- In November, as Chair of the SADC Group of Banking Supervisors, we will be organising a regional seminar for banking supervisors jointly with the Financial Stability Institute. This will be open to other countries in the region and will help to promote cooperation among regional banking supervisors.
- Again in November, we will host the second meeting of the Official Monetary and Financial Institutions Forum to be held in Africa, after Cape Town last year.
- We have only just been approached by The Banker magazine, an offshoot of the prestigious Financial Times, and FT Global Conferences to hold their inaugural Global International Financial Centres Congress in Mauritius, possibly in November. We are yet to finalise the matter.

These events will be the high points of the year as we celebrate the Bank's 45th Anniversary.

Closing Remarks Each year that goes by brings its share of good things that we would like to remember and celebrate, and less good ones that we wish never happened and that we would like to forget. 2011 has been no exception. The work of a Central Banker only gets more and more complicated as the environment in which central banks operate continues to be clouded with uncertainty and becomes increasingly challenging and demanding.

On the global front, knowledgeable observers seem to converge on the view that the crisis will be even more prolonged than is now expected. Some believe that prospects in the eurozone are quite bleak as hard-core Europe will be unable to do what it takes to save the euro from the repercussions of fiscal profligacy in its periphery. The “decoupling” theory has been exploded as a myth and the prospect of a hard landing in China dashes any hope of global salvation from the East. Small open economies like Mauritius will be buffeted by the raging turbulence. I cannot help reflecting that the smallness of our economy can actually prove to be an asset rather than a liability, the more common view, because small size gives us an added adaptive advantage: a quick response capacity and the flexibility to continually adjust to the volatile external environment – to trim our sails to the prevailing wind, like a small craft, rather than blithely sailing on with the inertia of an ultra-large crude carrier. Such flexibility in some of our policies and strategies has so far played in our favour. We have been able to achieve a growth rate of 4 per cent on average in the last two years. We continue to remain cautiously optimistic for this year. Pessimism is unwarranted, and unhelpful in any case. There is now a greater need for policy-makers to align and coordinate their policies to maintain the growth momentum and shore up confidence and business sentiment in the country.

The Mauritian economy was buffeted by an unceasing succession of challenges throughout the year as the world continued its fruitless struggle to engineer a sustainable recovery, with the oft-sighted “green shoots” turning out to be a mirage. Major economies were shaken to their very foundation and drew generously on the medicine chest to try expansionary remedies, for some, or a dose of austerity for others, as they coped with mounting unemployment, social instability, political turbulence, fiscal gridlock, currency volatility, nervous markets and the spectre of recession hanging over vast swathes of the global economic landscape. We at the Bank rose to the challenge and continued our successful record of delivering on our core mandate of price stability and orderly and balanced economic development. We had recourse to unusual tools to achieve our objective. In December, we even had a welcome relief from our usual regimen of being regularly pelted with brickbats by the local commentariat when *The Banker*, a professional magazine of the British Financial Times Group, awarded yours truly the title of *Central Banker of the Year 2012, Africa* – a trophy to add to the *tableau vivant* of the hypothetical scenario with which I began this missive.

This recognition gives me and my team considerable satisfaction as it is the first time in the Bank’s history of nearly 45 years that we are garnering such an award. It rewards the determination and the consistency with which we have been conducting our policies in an extremely difficult and very uncertain global environment, without giving in to the strident siren calls for quick monetary fixes to give a temporary, but ultimately self-defeating, boost to our exports. Real gains for all Mauritians can only come from productivity increases.

And the future? The IMF Managing Director has recently opined that the world economy is entering a new extremely dangerous phase. We must be on our guard. We need to coordinate our efforts, align our policies, and take concerted measures with other policy-makers to navigate the treacherous waters ahead. Above all, we must look in the same direction. And we must be always ready to deploy new policy tools, if we are to steer a safe and steady course while awaiting calmer weather. Let me end by quoting Micheal Mussa, a former Chief Economist of the IMF, on the merits of economic policy tools:

> “My favourite economic policy tool is prayer. It is not demonstrably less effective than the others and it carries none of the bad side effects.”

Prayers, anybody?

As I sign off this letter, five years to the day since I first donned the hat of Governor, I invoke Mussa's twist on the Pascal wager and fervently hope and pray that 2012 will surprise us on the upside, with a much better outturn than current prognoses for the global economy and for our key partner-countries, and that – however pummelled, hammered and buffeted we may be – we shall be able to keep our economy on course to deliver respectable growth, more jobs and greater prosperity for all our stakeholders.