# Rundheersing Bheenick: Comprehensive reflections on economic and financial activities in Mauritius during 2008

Letter by Mr Rundheersing Bheenick, Governor of the Bank of Mauritius, to stakeholders, Bank of Mauritius, Port Louis, December 2008.

*The original speech, which contains various links to the documents mentioned, can be found on the Bank of Mauritius' website.*

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**Dear Stakeholders**

As we begin 2009, every central bank Governor around the world must be asking himself whether the worst is over yet. Except for a few *über*bears and habitual doomsayers, no one anticipated the troubles of 2008. Now that we are caught up in a global slowdown, with most of the major economies actually in recession, we have new concerns. What are the prospects for 2009? Will the bail-out work? Why has Mauritius so far escaped the wreckage of financial systems and banking around the world? Shall we see the end of the crisis this year and if so, when?

The lessons are becoming clear and I believe it is possible to reshape the global financial system to make it do its job again in promoting development, growth in jobs and the relief of poverty. I am hopeful that the global economy will emerge fitter from this crisis. But there are no quick fixes. The ability of Mauritius and other small states to elude the immediate impact of the crisis can be put down to two broad factors; first: avoiding the worst aspects of global credit delinquency through appropriate banking regulation and supervision; second: stability and probity in accounting and banking methods, recognising risks for what they are, and reducing exposure to potential losses, rather than grabbing gold-plated opportunities for making a fast buck.

In 2007, we launched a new strategy for communication which culminated in the *End-of-Year Letter to Stakeholders*. The essential idea here is to share with you the experiences of the Bank of Mauritius, the highs and lows of the year, and also to bring to you the outlines of our future policy. This year, we continue with this tradition.[1] We present a review of developments in the banking sector in 2008, discuss some of the initiatives taken by the Bank and adumbrate a foggy outlook for the year ahead.

The year 2008 has been unprecedented in global banking history and this has deeply affected the pattern of our work at the Bank. It began with massive inflows of foreign exchange powered by portfolio flows, investments in IRS projects and gilts, causing our currency to appreciate significantly. The second part of the year saw global currency movements and the scaling down of investments by foreigners. We closed the year with a reverse situation. Between these two extremes, the Bank navigated sometimes in rough seas but despite the storms, the Bank and its many partners have consolidated the financial sector by keeping a steady course and taking some exceptional measures to protect our economy from the effects of the global turmoil.

At the Bank, we have stepped up our vigilance and taken prompt action to sustain investor confidence and long-term financial stability by tasking a special multi-divisional cell, comprising senior officers from various disciplines, to monitor closely the evolution of the crisis.

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[1] We are presenting this letter in a new computer-friendly format. Sections are segmented into principal points and detail. You can either navigate to the detail by clicking on the access points or skip the detail and read on. We hope that this will help in finding the points of special interest to you.

In the midst of all these uncertainties, I must admit we have also been lucky. Our banking system has been steady and stable throughout the year, maintaining strong capital buffers and high solvency ratios, all of which have ensured its resilience. The judicious lending and investment practices of our banks have protected them from exposure to the toxic assets and complex derivative products fatally linked to the US sub-prime credits and the over-valuation of real estate. A key element in the soundness of our banking practices has been our greater reliance on deposit funding rather than on money market or external funding. These classic and simple safety measures have kept us relatively unaffected by the global financial crisis.

If banking has remained safe and secure in Mauritius, what can we say of the wider aspects of the domestic economy? Or, in U.S parlance, what about Main Street?

Mauritius has not of course entirely escaped the spillover effects of the global crisis on the real economy. Indeed, the impact is becoming increasingly visible. We are witnessing a slowdown in levels of production and investment in Mauritius. This will have knock-on effects on banking activities and there will be need for a revaluation of assets that are pledged as security. Yet, the strong performance of our banks during the past year, their solid deposit base, their low level of non-performing loans, and the continuous monitoring of all banking matters under the watchful eye of your Central Bank, comfort us in the view that we are well-placed to confront the anticipated levels of external shocks that our wider economy will face.

**(Click here for further details on Performance of the Banking Sector)**

In the second half of 2008, the Bank has been working closely with the Treasury to respond to the unfolding global crisis and further buffer the domestic economy. The Additional Stimulus Package announced by Government in December was prepared in consultation with the Bank as part of the closer policy dialogue between the Bank and the Ministry of Finance. Furthermore, in response to tight liquidity conditions in global credit which might have exerted an adverse impact on the cost and availability of short-term trade finance, the Bank took pre-emptive action by making available a Special Foreign Currency Line of Credit of US$ 125 million. This allowed local banks to maintain the flow of credit for international trade, which is a vital lifeline for an open economy like ours.

### *Regulation and supervision*

The flaws in the national regulatory systems of the major economies have been cruelly exposed by the global crisis and its attendant financial scandals. Effective and timely regulation, built on prudent, transparent and sound supervisory practices, must be at the heart of a stable financial system. In the course of last year, the Bank reviewed its supervisory structures and revisited most of its regulatory guidelines to ensure that the supervision of the banking sector remains ahead of the game and meets a high standard when gauged by international norms.

**(Click here for further details on Supervisory issues)**

The Bank has been actively engaged in both on-site and off-site supervision of banks. The objective is to strengthen our system-wide approach to supervision and to prevent any spillover into the system of any specific risk from individual banks. The exercise includes cross-border banks, that is, subsidiaries as well as branches of banks outside Mauritius. This is done through a mechanism of cooperation and information-sharing with home and host supervisors.

**(Click here for further details on Memoranda of Understanding)**

### *Financial stability*

Enhancing financial stability became a core task in 2008, and in this area, the Bank took two important steps during the year. First, the Bank ensured closer coordination with the

Financial Services Commission through the new Joint Coordination Committee (JCC). The enhanced collaboration helps to avoid regulatory gaps and the JCC will improve cooperation on supervision, by establishing a lead regulator for each financial institution. The second initiative in the pursuit of financial stability is the publication of the Bank's very first Financial Stability Report (FSR) in line with an explicit requirement of our enabling Act. As I mentioned in the Foreword of the FSR, "*The Financial Stability Report provides a useful communication tool about existing and potential future risks to financial stability and can serve as a means of focusing efforts to mitigate the key risks*." The FSR identified certain areas of vulnerabilities and proposed specific measures. It also unveiled the Mauritius Exchange Rate Index to track the average value of our currency against currencies of our trading partners. The FSR will be published twice a year.

**(Click here for details on the Mauritius Exchange Rate Index)**

### *Basel II*

Notwithstanding some weaknesses in Basel II which have been brought to the fore by the global crisis, the Bank endorses the stand of the Basel Committee on Banking Supervision for a prompt implementation of the Basel II framework with its increased sensitive measurement of risks and enhanced market transparency. The Bank issued various guidelines required for the implementation of the standardised approaches of the Basel II framework. The way was thus cleared for the Basel II framework to become operational as from the quarter ending 31 March 2009.

**(Click here for the January 2009 Communiqué on Basel II)**

### *Islamic banking and Islamic money market*

In 2008, we made significant progress in the introduction of Islamic banking in the country. We issued guidelines on Islamic banking after a process of intensive consultation through a multi-disciplinary sub-committee which the Bank spearheaded.

The *Guideline for Institutions Conducting Islamic Banking Business* became effective at end-June 2008, and amendments were brought to the Income Tax Act and other relevant Acts to take into account the specificities of Islamic banking. The Bank approved two Islamic Banking applications and we expect these institutions to start operation soon. One of these entities is headquartered in the Gulf region.

The Bank has recently embarked on another major project, the development of an Islamic money market and liquidity management framework. This will allow Islamic banking institutions to conduct interbank transactions for the management of short-term liquidity and have access to Sharia-compliant money market products. The Bank is working closely with the Islamic Development Bank in this respect. In May this year, we shall be hosting an international seminar on Islamic Capital Markets in collaboration with the Islamic Financial Services Board.

### *AML/CFT measures*

The maintenance of our reputation as a clean financial centre continues to be one of our priorities. The Report of the Joint World Bank–IMF Financial Sector Assessment Programme (FSAP) mission of 2007 commended the Bank on its Anti-Money Laundering and Combating the Financing of Terrorism regime.

**(Click here for excerpts of the FSAP Report on Money Laundering)**

### *Reinforced regional presence*

I have always been a firm proponent of regional economic cooperation as I believe that building ties with other countries in the region is vital for a small country like Mauritius. In 2008, we have seen much progress on this front.

Following a decision of the COMESA Committee of Governors of Central Banks (Tripoli, Libya, November 2007), the Bank was appointed to act as the settlement bank for the Regional Payment and Settlement System (REPSS) of the COMESA Clearing House to allow cross-border payments between COMESA member-states. In April 2008, the Bank organised a workshop for all COMESA central banks on the functioning of the REPSS.

During the year, the Bank also hosted the Eastern Africa Sub-Regional meeting of Governors of the Association of African Central Banks and facilitated the Board Meeting of the African Export-Import Bank, which was held in Mauritius.

The global financial crisis also brought African Central Bank Governors together to explore the way forward.

- I attended the meeting of African Ministers of Finance and Governors of Central Banks (Tunis, November 2008), which was convened jointly by the African Development Bank, the African Union, and the United Nations Economic Commission for Africa, to assess and exchange notes on the evolving situation and to identify measures that could effectively be taken. At the end of the meeting, I was privileged to join a handful of Ministers/Governors in a teleconference with the US Treasury on the eve of the first G-20 Summit in Washington on the global crisis.
- In December I attended the meeting of francophone Governors which the Banque Centrale de L'Afrique de L'Ouest hosted in Abidjan to examine the impact of the crisis on the countries of the African Francophone Group at the IMF and the World Bank.

The comparative performance of our country in the region was very creditable, as illustrated for example, by the World Bank's 2008 "**Banking the Poor Report"**. Mauritius is the league champion in terms of financial access with over 2000 accounts per thousand adults. We came third, behind Malaysia and Singapore, in this global survey. This publication, which explores associations between banking policies and practices with the level of financial access in the selected countries, had its world-wide launch at the Bank of Mauritius Headquarters in November 2008.

### *Monetary policy*

The exceptional capital inflows at the beginning of 2008, to which I alluded earlier, put significant pressure on monetary matters for our small economy. They cause the rupee to appreciate and fuelled the rising rate of price inflation, already affected by the unprecedented spike in oil prices and the steady increase in prices of food and commodities. The Bank was therefore confronted with the combined challenge of combating inflation and preserving the competitiveness of the export-oriented sectors. The Monetary Policy Committee (MPC), normally set to meet on a quarterly basis, met eight times in 2008 with interim meetings having to be called to deal with rapidly-changing conditions.

**(Click here for further details on the work of the Monetary Policy Committee)**

With rising inflation, the Bank continued with its tight monetary policy in the first quarter of 2008. Unpredictable developments on the international scene in the second quarter, coupled with our own projected inflation, compelled the Bank to ease its stance a little in the second quarter. An expansionary budget, handed down in June 2008, coupled with a generous wage-award for the civil service which raised the spectre of wage push inflation, further complicated the situation in the third quarter before currency volatility, stock market nervousness, financial turmoil and the global economic slowdown threw things in complete disarray in the last quarter. Policy actions were coordinated with Government. During 2008, the Key Repo Rate was cut by a total of 250 basis points to stand at 6.75 per cent at the end of the year.

**(Click here for evolution of the Key Repo Rate in 2008)**

The decisions of the MPC, which are taken by simple majority, became mired in controversy. This, in turn, provided fertile ground for lobbyists and other pressure groups to seek to influence outcomes in their favour.

In addition to the interest rate decisions of the MPC, the Bank had recourse to other tools to respond to abnormal monetary and credit conditions. Owing to structural excess liquidity in the system, the overnight rate had remained persistently outside its set limits (the corridor) since the framework was introduced in December 2006. The Bank increased the Cash Reserve Ratio (CRR) from 4 per cent to 6 per cent in August. This resulted in the rate falling rapidly back within the limits of the corridor. However, in view of the rapidly-changing global environment, the Bank subsequently reduced the CRR first to 5 per cent and then to 4.5 per cent in December, to ensure that the system had sufficient liquidity. Another measure that I considered necessary in the circumstances was the widening of the corridor from the symmetric band of 50 basis points to a band of 125 basis points around the Key Repo Rate.

**(Click here for further details on other measures aimed at strengthening the Monetary Policy Framework)**

When we compare with many other emerging economies, which are as dependent on imports as Mauritius, we have little reason to be too unhappy as we have managed to keep inflation at reasonable levels. And this year, we have the extra burden of having to counter the knock-on effects of the global economic slowdown on Mauritius, especially on our export-dependent sectors such as tourism and manufacturing.

To deliver on our mandate to fight inflation, the Bank invested resources in capacity-building. In July 2008, the Bank hosted a regional seminar on Inflation Targeting, Modelling and Forecasting, in collaboration with the Centre for Central Banking Studies of the Bank of England (CCBS). Held at the Bank's Headquarters, and attended by central banks in the region, the seminar set a new attendance record in the entire history of the CCBS.

We also published our first Inflation Report in November, to fall in line with a requirement of the Bank of Mauritius Act 2004. This report retraced the historical pattern of inflation in Mauritius, and offered valuable insights into the critical factors affecting fluctuations in prices, which may serve as a guide for the future. We intend to publish Inflation Reports twice per year.

### *Domestic debt management*

An important development in 2008 was the take-over of debt management functions, both Domestic and External, from the Debt Management Unit of the Ministry of Finance and Economic Empowerment. The new arrangement, which took effect from 1 July 2008, under an agreement reached by the Bank with the Ministry of Finance and Economic Empowerment, also requires the Bank to advise on the debt management strategy. Jointly with the Commonwealth Secretariat, the Bank organized, at the end of 2008, a two-week Workshop on Debt Recording and Management for staff members of the Bank, and officers from both the Ministry of Finance and Economic Empowerment and the National Audit Office.

### *Domestic foreign exchange market*

During 2008 there were erratic movements in the foreign exchange market. This reflected rapid and substantial global fluctuations. The Bank intervened regularly on the market and by the end of the year, we succeeded in significantly dampening volatility.

**(Click here for further details on Intervention on the Foreign Exchange Market)**

There have been different views, some quite vociferous, on how "weak" or how "strong" the rupee should be, depending from which side of the market one is operating. Any orchestration of demand for a central-bank-led depreciation of the Mauritian Rupee fails to appreciate the serious ill effects of a highly devalued currency for a small import-dependent open economy like ours. Its consequences could be disastrous if a self-accentuating expectation is fuelled with instant pass-through into domestic inflation.

The Bank believes that both sellers and buyers should get a fair price. One way of achieving this is by reducing the cost of intermediation. The Bank has been addressing this in two ways. First, the Bank has agreed to buy and sell foreign currency directly in a structured manner from/to those in the market that have, or require them, in large quantities. Second, with a view to spurring greater competition, the Bank issued licences to 14 new Money Changers and one Foreign Exchange Dealer on a revised set of conditions.

Whilst the Bank does not target any specific exchange rate against any particular currency and is not itself in a market-maker, we do have a key role in market management. This is a matter of continual review by the IMF which commented favourably on the functioning of our interbank foreign exchange market in its 2007 FSAP Report. We can say that the foreign exchange market has functioned well in 2008.

**(Click here for excerpts on Exchange Rate from the IMF)**

### *Changes in our financial landscape*

The year 2008 witnessed some significant reshaping of the banking scene in Mauritius. Two banks had new shareholders and two others merged into one, leading to three new names being added to the list of operating banks, while four were de-listed. Whereas the current trend worldwide is to effectively nationalise banks as part of the response to the credit crunch, in Mauritius we have the reverse situation – the public sector selling its majority interest in one of the banks to private sector operators.

### *Strengthening of interaction with the banking industry*

At the apex level, collaboration between commercial banks and the Bank occurs through the quarterly Banking Committee meetings in which Chief Executives of all banks and the Mauritius Bankers Association (MBA) participate. The Banking Committee is not confined to supervision and regulation alone but covers the entire gamut of issues relating to banks. I have increased interaction with the banking industry since June 2008 when I initiated meetings with the Bureau of the MBA, comprising the Chairman, the two Vice-Chairmen and the Chief Executive, in-between the regular Banking Committees.

The Banking Committee operates a number of sub-committees to examine certain areas in detail – compliance, treasury and payments system.

### *Information technology*

Banking technology has been evolving rapidly and has become a key driver of financial sector efficiency. On the technological front, the Bank has embarked on various projects which are at different stages of implementation:

- The Cheque Truncation Project

- The Mauritius Automated Clearing and Settlement System
- The Regional Payment and Settlement System
- The Mauritius Credit Information Bureau

**(Click here for further details on Information Technology projects)**

### *Towards a more modern and efficient Bank*

In 2008, we have moved to a new building, the Bank of Mauritius Tower. This has been a key element in the transformation of the work of the Bank now that it is properly housed and equipped with advanced information and communication technology.

**(Click here for further details on the New Headquarters Building and the Regional Office in Rodrigues)**

### *The restructuring*

A modern and efficient institution requires a workforce that has the requisite skills and knowledge. In 2008, we rejuvenated and strengthened the workforce by recruiting additional staff and promoting others in some critical functions of the Bank. To meet the need to constantly upgrade and develop skills, more than 50 officers, out of a total professional staff complement of around 125, were sent on training courses abroad. These covered a wide range of topics, such as Monetary Policy, Payment and Settlement Issues, Supervision, and Accounting and Auditing for central banks. The programme of continuing education and training will make further progress in 2009 with a special focus on International Financial Reporting Standards.

In 2009, we are organising a calendar of in-house training sessions for all levels to make the Bank an organisation in which staff are multi-skilled, flexible, adaptable, innovative and able to think laterally. Some of the courses include customer care, executive programmes for effective management and leadership, efficient communication and a better understanding of applicable law, including the Bank of Mauritius Act itself.

This year we are also targeting our Rodrigues Office for special attention. The staff will have the chance to come to the head office at regular intervals on induction courses to involve them more in the development of the Bank's operations and functions.

### *Bank charges – shop window for customers*

Many people have complained to us about the variations in charges between banks and the difficulties in finding out what they are. This is where a central bank can help to make banking easier for the customers we all serve. We have addressed this issue during the year. Since, November 2008, information on the fees and charges relating to normal services are available, on a standard comparable template, to all customers online at http://bom.intnet.mu.

### *Launching of commemorative gold coin*

To mark the 40th anniversary of the independence of Mauritius, the Bank launched a limited edition of a Commemorative Gold Coin to pay tribute to the Father of the Nation, Sir Seewoosagur Ramgoolam. The Prime Minister attended the launch event. This gold coin proved to be the fastest-seller in the Bank's history. The whole edition was sold within a week. In 2009, we plan to launch a "Father of the Nation" platinum series.

## Future projects

### *The Bank's financial markets function*

In keeping with our modernization plan of the financial system, I will continue to encourage the development of a vibrant futures and forward market. By mid-February 2009, the Bank intends to move away from paper-based auctions of Government securities and Bank of Mauritius instruments to online auctions.

Since I joined the central bank, it has been my aim to improve the returns on our foreign exchange reserves. When I attended the International Monetary Fund/World Bank Annual Meeting in 2007 and the BIS annual meeting of Governors last year in 2008, I engaged in consultations with those bodies for a peer review of our reserves management function.

In June 2008, a team from the World Bank Treasury's Sovereign Investment Partnership (SIP) conducted an on-site peer review of our reserve management operations. In September 2008, the BIS, which manages a part of our foreign reserves, conducted a similar review as well as an evaluation of our investment and risk-control processes. The recommendations of the BIS and SIP are under study and appropriate changes will be made to our Financial Markets operations. We will, at the appropriate time, revisit our accounting, provisioning and profit allocation policies, in consultation with our shareholder, the Government of Mauritius.

We envisage to recruit an expert with international experience in financial markets to give effect to the changes that we shall be introducing.

### *Special Data Dissemination Standard*

In 2009, we shall graduate from the current General Data Dissemination System of the IMF, in which Mauritius has been participating since September 2000, to the Special Data Dissemination Standard. This will enable us to meet the needs of global financial markets in the provision of timely and quality macroeconomic data. We are committed to develop the quality of data in the areas where the Bank has responsibility within our national statistical system.

We are improving the coverage of the balance of payments and the international investment position through the conduct of surveys of the Global Business Licence Holders. The Bank has enlisted the collaboration of the Financial Services Commission, our sister regulator, in this exercise***.***

**(Click here for further details on General Data Dissemination System and Special Data Dissemination Standard)**

### *Ombudsperson for banks*

I am confident that in 2009, the Bank will proceed with the appointment of an Ombudsperson for banks. As I have said on many occasions, for a small country of our size and the expected workload, a single Ombudsperson for the entire financial services sector would have been more appropriate so that the customer does not face jurisdictional issues.

### *Financial Literacy and Outreach Programme*

We started a Financial Literacy and Outreach Programme when the Bank commemorated its 40 years in 2007. In 2008, talks were delivered by eminent financial sector personalities, including Central Bank Governors. Dr Guy Quaden, the Governor of the National Bank of Belgium, spoke on "The First Ten Years of the Euro. Achievements. Challenges. Lessons for Other Parts of the World". We also recently had a lecture on "Applicability of International

Financial Reporting Standards to Central Banks" by Mr Ian Ingram, Director of Internal Finance from the European Central Bank.

The Bank also organised programmes in local languages on the local radio/television. The Bank intends to make such programmes a regular feature.

I thought I should mention here that the Bank does not have a specialised unit to take care of communications, events and functions. All events hosted by the Bank are co-ordinated by the Governor's office and organised by Staff who volunteer for the assignment.

### *Meetings attended by the management*

The Governor and the Bank's two Deputy Governors, the Chief Economist and the Head of Corporate Services attended a wide range of international meetings and seminars in 2008, as part of the remit of the Bank for furthering international contact and for keeping abreast of international developments with a view to improving the effectiveness and efficiency of our services.

**(Click here for further details on Participation in International Meetings and Seminars)**

Very sadly, 2008 witnessed the tragic loss of one of Mauritius' most reputed bankers, Mr Anil Guness, who died in the terrorist attacks in the Taj Hotel in Mumbai in November 2008 in the same week in which he last came to the Bank to attend our Banking Committee meeting. We shall miss his wise counsel and the sound judgments he brought to the work of the State Bank and within the banking sector in Mauritius and beyond.

Finally, I must emphasise that both the Management and the Board are strong in their resolve to take the Bank of Mauritius to greater heights in the days to come.

If we are to achieve our objectives, we need sufficient autonomy to do so, built on a close working relationship with the Government to ensure our polices and actions are complementary in our joint pursuit of economic and social development in this country.

2008 has been a year that will go down as a turning point in the history of global banking and finance.

Even, as the Bank wishes a very happy and prosperous year to all our stakeholders, we must all be conscious of the trials and travails that lie ahead in 2009, a year that could prove still more turbulent as the global crisis may very well intensify further. In 2009, the Bank needs to continue to be alert to the global financial and banking volatility and must be especially vigilant in protecting our interests and judiciously managing our reserves. No country has been immune to the crisis, but as light craft can in safe hands weather a storm, so this small, vulnerable and highly open economy of Mauritius may be buffeted but will maintain course and shall not be sunk.

The Bank of Mauritius will do all that is possible to ensure a safe passage through these difficult times in matters of banking and financial policy and practice.

Best wishes for 2009.