Rundheersing Bheenick: "Steaming on … in uncharted waters in storm-tossed seas" – five years of steering a central bank in a small, open island state and keeping the economy on an even keel

Letter by Mr Rundheersing Bheenick, Governor of the Bank of Mauritius, to stakeholders, Bank of Mauritius, Port Louis, 4 February 2013.

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On 28 December 2007, from my vantage point as newly-installed Governor, I issued my first Letter to Stakeholders to plug what I felt was a gap in our communication. I saw it as a vehicle to review developments in the economic and financial landscape and to give interested stakeholders a flavour of the Bank's actions during the past year. It was the year of the Bank's 40th Anniversary celebrations. Less auspiciously, it was also the year when the first tremors of an impending global financial crisis began to be felt in specialized corners of the financial market dealing with esoteric sub-prime mortgages originating in the US.

2. Five years on, the Letter to Stakeholders is well-embedded in the calendar of publications of the Bank, with its release much-awaited, not least by the local financial press. Five additional years in the life of the institution, five years at its helm as Governor, and five years of unending crisis, to boot — surely all this requires us to pause awhile, look back over those tumultuous, challenging yet ultimately rewarding, years and take stock of the progress achieved. But, first, a brief assessment of 2012 and the perspective for 2013 may provide some context.

3. ***The Global Economy*** 2012 has proved far more turbulent, uncertain and painful than most economists had predicted. The European Union, hailed until recently as the *nec plus ultra* of regional cooperation, came on the brink of implosion, with the rest of the world holding its breath in anticipation of the expected global crash likely to follow in the wake of the widely-predicted "Grexit" which would bring the eurozone to an ignominious end. Across the Atlantic, the US economy was hardly in better shape, barely managing in the nick of time to surmount its "fiscal cliff" before the predicted financial catastrophe. Fortunately, emerging market economies, though wounded, managed to pull the world economy round. In such exceptional circumstances, central banking in advanced economies had to be reshaped to accommodate unconventional policy measures, which would have been clearly beyond the pale for central bankers a decade earlier.

4. So here we are, at the start of 2013, facing the same questions as in preceding years: when shall we finally see an end to the global economic crisis and a sustained rebound in growth and job creation? As we start the New Year, there are tentative signs that the global economy is finally picking up, with growth momentum building modestly and financial conditions becoming more supportive. But the transition is likely to be slow and fragile. Even as we see some global growth, the legacy of subpar performance over the recent years is expected to play a major role in influencing investment and macroeconomic performance in general in 2013 and beyond. Doubts persist over the sustainability of the timid recovery once the flood of central bank money, propping up economic activity in the advanced countries, begins to be withdrawn — as it clearly must if we are not to see an unprecedented debasement of major reserve currencies, hand in hand with runaway inflation.

5. ***The Mauritian Economy*** For Mauritius, the odds of surviving intact in the face of the global turmoil over the past five years were very thin at best. We have a small open economy, heavily dependent on exports to the European Union, and we have been unable to rely significantly on regional or domestic demand to pick up the slack from depressed conditions in our traditional markets. Nevertheless, we avoided recession and have come out rather well. Key factors here were the support from the fiscal stimulus at the beginning of the crisis and an appropriately accommodative, but much-maligned, monetary and exchange rate policy that have together allowed the domestic economy to continue recording positive

growth rates even as some major trading partner economies were contracting. The added adaptive advantage arising from our smallness proved to be a real asset in these troubled times. In addition, our closely-regulated banking system was not drawn into the seemingly very lucrative, but high-risk, operations that proved fatal to banks in many advanced economies and we have had no banking failures or bailouts.

6. It is evident, however, that our economy is still operating below its potential. The crisis has shown up the shortcomings of the inertia in much of our trade for both goods and services, where we have seemed locked into previously successful, but fragile, strategies that have left us at the mercy of external market and policy failure. While the lesson has been learnt, many sectors have been caught wrong-footed and are now scrambling to diversify products and markets.

7. ***My own personal experience at the Bank*** The uncertainty and instability prevailing in the global economic and financial environment have kept me on my toes. It was a path full of challenges that confronted me, a path strewn with obstacles where I sometimes stumbled and where I found myself, like many fellow-governors elsewhere, regularly attacked, sometimes ridiculed, and even scorned. But I always emerged, often bruised, but more determined than ever, motivated by the unchanging desire to rise to the constantly-changing challenge, raise the profile of the Bank, and transform it into a modern and innovative institution that fulfils its mission confidently and efficiently for the sustainable development of the Mauritian economy. We had our share of achievements, small victories and successes obtained with great satisfaction.

8. The decisions and actions that I took at the Bank over the last five years have been directed towards maintaining financial and macroeconomic stability – this, as the global financial crisis revealed, is the most important function of a central bank. This overriding consideration has guided all my decisions and actions. However, given the highly uncertain and unstable global environment, flexibility and promptness in action turned out to be key elements in our decision-making. I saw the need to bring some key reforms to the organisational structure of the Bank. For operational efficiency, the Bank was restructured into a more flexible institution. New divisions were created to monitor areas that I had foreseen would be critical in the years to come, among which the Financial Stability Unit to monitor and assess the risks to financial stability and associated macro-prudential policy. Our strategies have borne fruit and the Bank's contribution to financial and macroeconomic stability has been recognised locally and internationally.

9. Let me sketch the broad outlines of the Bank's policies and actions during the past five years, which flow from this overriding consideration.

10. ***Monetary Policy*** At the very start of my tenure as Governor, I set out to remedy what was, to my mind, a major flaw in our approach to monetary policy decision-making. Although it had been three years since the new Bank of Mauritius Act had been enacted, with explicit provision for the creation of a Monetary Policy Committee (MPC), the interest-rate decision process had remained unchanged. One of my first moves as Governor was to establish this Committee, which was officially launched in April 2007. Soon after the first meeting, I proposed that amendments be brought to the law to enhance the independence of the MPC.

11. It was also a decisive stride towards improving governance at the Bank. I wanted more transparency and accountability at the level of the MPC and instigated a major review after it had been in operation for four years. The review resulted in two major changes, firstly in the composition of the MPC and, secondly, in the publication of the minutes of the meeting, including the voting patterns of individual members.

12. The establishment of the MPC with its enhanced transparency and accountability made monetary policy gain increasing credibility in the eyes of the public. We complemented our action by developing clear lines of communication with economic agents and adopted an open-door policy to respond to the concerns of the various economic stakeholders including real sector operators, academia, opinion leaders, and consumer associations. I held regular

public consultations through press conferences and public addresses. Today, inflation expectations are well-anchored and it has become much easier to interpret and understand monetary policy decisions. The Bank has been successful in disinflating the economy and has brought down the inflation rate to less than 4 per cent in 2012 from 10.9 per cent in April 2007.

13. ***Exchange Rate Policy*** Many of you will recall that the value of the rupee was in free fall in the years preceding my nomination as Governor of the Bank of Mauritius in 2007, paving the way for a one-way bet against the currency and fuelling unsustainable over-borrowing in rupees. It was clear to me that this would plague the economy with speculative transactions and constrain our move to the next stage of development. Exchange rate stability was the necessary condition that we had to satisfy if we were to stand any chance to succeed in realising the vision of our political leadership to build Mauritius into a vibrant international financial centre of repute.

14. My stance was to favour a stable currency, given our euro-biased exports and dollar-biased imports and the high exchange-rate volatility witnessed in the international forex market during the global financial crisis. A stable currency would remove foreign exchange risk, thus providing some element of certainty in doing business for both importers and exporters. To pursue this stable exchange rate policy, the Bank continued with its methods of adjustment and fine-tuning but never shied away from doing what we assessed was right under the varying circumstances faced by the economy. More recently, the Bank has attuned its policy to mitigate further appreciation pressures on the exchange rate value of the rupee to avert the adverse potential impact of the worsening euro debt crisis on key sectors of the economy. I firmly believe that the real test of our management of exchange rate policy has emerged in the medium-term perspective over the five years for a short-run view can be very misleading, even if it makes good headlines in the media.

15. ***Modernisation of the Financial Market infrastructure*** When I took over as Governor in 2007, I discovered that the growing financial sector, in particular the offshore segment, and increasing cross-border transactions posed new and complex challenges to the existing payment system infrastructure. I realised that the financial market infrastructure needed a major overhaul to meet these demands. So the first decision that I took in this area was to replace the existing real-time gross settlement system – the Mauritius Automated Clearing and Settlement System (MACSS) – with another application that was built on a more resilient architecture and supported multi-currency transactions. The extended capability of the system has no doubt been a major contributing factor behind the appointment by COMESA member-states of the Bank of Mauritius as the settlement bank for its Regional Payment and Settlement System, whose operations we now host. We pursued our modernisation process with the implementation of the Cheque Truncation System, which provides for the bulk clearing of low-value electronic transactions. I set out, during my tenure, to extend the coverage of the Mauritius Credit Information Bureau (MCIB) to all types of credit institutions operating in the economy. The MCIB has over the years emerged as an essential risk management tool for banks in their lending activities.

16. Over the past years, the card-based payment method has assumed growing importance in the economy and it is expected to make further inroads on cash and cheque-based settlement. The systemic importance of card transactions may pose a threat to the stability of the financial system if left unattended. In line with our mandate to ensure the stability and soundness of the financial system, I saw the need to revisit our erstwhile hands-off approach to this sector and move to regulate it properly. The Bank will thus set up and operate a National Payment Switch (NPS) by the end of the year. The NPS is a national, multifaceted switching platform for various payment channels and it will settle the net positions of banks on the MACSS while reducing the cost of transactions and routing costs via the reduction of interconnection charges and merchant fees, in particular on domestic transactions. The NPS will therefore address the inefficiencies of the current setup and provide a level playing field to all banks and operators.

17. I also devoted a lot of attention to deepening financial markets, the other leg of the modernisation of the financial market infrastructure. Small size and lack of depth have always hampered the development of the domestic money and foreign-exchange markets. I have introduced a number of measures to bring down the surplus of liquidity and enhance both the price-discovery process and the transmission mechanism in the money market. I am particularly pleased to note the progress achieved on this front by end-2012. It is even more encouraging to note that private initiatives have been coming forward to build on the current momentum. The current context in which Mauritius is viewed positively by international credit rating agencies, the low interest rate and inflation environment, and the prudent fiscal path and public debt levels provide increased traction to speed up the country's transformation into the long-awaited sophisticated international financial centre that would generate income and jobs for generations to come.

18. ***Reserves Management*** Reserves are strategic for a country to survive trade shocks and economic crises as they act as the first line of defence. It was clear to me that a more efficient management of these reserves would provide rich dividends to the country. Over the five years since 2008 I have found managing foreign exchange reserves an increasingly challenging task. Monetary policy worldwide turned significantly accommodative and a number of major central banks implemented quantitative easing, resulting in progressively lower yields on our reserves. I instigated a review of the Bank's investment strategy given the low profitability of operations. In an attempt to increase returns while containing risks, we reduced our exposure with foreign commercial banks (which were being de-rated), reviewed the investment horizon, invested in cash and near-cash instruments, and increased our holdings in high-yielding currencies even as we moved to include new currencies in our portfolio. In November 2009, the Bank purchased two metric tons of gold from the IMF, to diversify our portfolio further and mitigate the impact of currency volatility. Subsequently, I also increased our share of investment in fixed-income instruments. I am happy to report that the diversification strategy, coupled with enhanced operational efficiency, translated into higher net profits for the Bank: Rs395 million in FY 2011/12, from Rs258 million in FY 2010/2011, and just Rs72.4 million in FY 2009/2010. And we managed to do this at a time when many central banks and fund managers were actually making losses. In June 2012, we launched the Operation Reserves Reconstitution to maintain a more comfortable import cover and to combat unwarranted appreciation of the rupee. The Bank's gross external reserves at end-December 2012 amounted to USD3.0 billion (Rs93.0 billion), having risen from USD1.3 billion (Rs44.7 billion) at end-December 2006.

19. ***Regulation and Supervision*** At the time of my appointment as Governor, the Prime Minister, as the nominating authority, shared with me his vision of a sophisticated financial system that would contribute to make Mauritius a recognised international financial centre. This vision included a banking sector that could aspire to become a regional leader in the field. I proceeded to flesh out this vision. I imagined a vibrant, competitive, transparent, robust and profitable banking sector further extending its footprints in the region and beyond, but always well-regulated and enhancing the reputation of its home jurisdiction.

20. My assessment of the regulatory and supervisory framework in place at the time revealed that the framework was adequate although there were some areas that required strengthening to enhance the performance of the banking sector and the financial system. Some of these areas were highlighted in the report of the IMF/World Bank Financial Sector Assessment Programme team that was concluding its field visit to the country just as I was stepping into the shoes of Governor. New rules had in the meantime also been released by international standard-setting bodies e.g. those of the Basel Committee on Banking Supervision and the International Accounting Standards Board. Armed with these, we took measures to build confidence in the integrity of the banking system and encourage banks to improve their performance. We instilled more competition in the sector by opening up to new players as part of our efforts to reduce intermediation margins and provide a fairer deal to bank customers. And we continued to strengthen our regulatory and supervisory framework

to align it with emerging international best practice resulting from the global regulatory reforms triggered by the crisis.

21. It may appropriate here to comment *en passant* on the largest fraud to have ever been unearthed in the domestic banking sector, the MCB/NPF case, a financial scandal of the bank-within-a-bank type that came to light in 2003. It has been an eye-opener for the Bank, prodding us to step up the surveillance and supervision of financial institutions under our purview. This case still awaits resolution ten years later and the perpetrators are yet to be held accountable as the various associated cases laboriously wend their way through the legal process in domestic and British courts. This stands out in sharp contrast to the rapidity with which prosecutors and regulators in major money centres have reached settlement with several universal banks for a range of crisis-related misdemeanors and malpractices, with record fines. The glaring absence of an efficient banking resolution mechanism may be a brake on our attempt to transform our jurisdiction into an international money centre.

22. Another source of concern is the dominating presence of a couple of large complex financial institutions in our banking sector and their systemic importance – the so-called Domestic Systemically Important Banks. To mitigate the systemic risks that such institutions could pose to the system, I have urged those banks to reduce the complexity of their structures by separating their banking from non-banking activities. This will enable us to clarify the regulatory perimeter and assist in efficient resolution, should the need arise, without having recourse to taxpayers' money. In the same vein, we have encouraged branches of foreign banks operating in Mauritius to convert into locally-incorporated subsidiaries that would give us more effective control and greater ability to act independently in conditions of stress. We have met with some success on this front, and the process of conversion of the branch of a major foreign bank into a local subsidiary is at an advanced stage.

23. We raised some hackles when we moved to adopt what many considered an overly intrusive approach regarding governance at the level of bank boards. A major lesson learnt from the global financial crisis was the failure of board oversight. What happens in bank boardrooms is of vital importance for the smooth functioning of, not just of the bank concerned, but also the economy as a whole. We have brought major changes to our Guideline on Corporate Governance to prescribe rotation at board level and limit the tenure of board members to six years. Domestic realities and capacity constraints dictated a flexible approach to smooth the transition to the new regime.

24. Today, our banking sector is very vibrant, well-regulated, robust, profitable and increasingly transparent. There are new financial product offerings including Islamic banking and forex futures. It attracts growing interest from investors – three new banks have set up shop in six years. Some of our banks have set up subsidiaries in the region, with more now figuring in the Top 100 African banks. Mauritius is one of the rare countries in Africa to be Basel-II-compliant and we are now ready to move towards Basel III. There are however a few signs that are less comforting and that need to be addressed. The sustained increase in credit growth in some specific sectors could be an early indicator of incipient asset bubbles. Also, the rise in non-performing loans noted during the year does not augur well.

25. ***Developmental role of the Bank*** In the aftermath of the global financial downturn, central banks assumed, in truth, a more central role as they stepped in swiftly to shore up their economies and restore confidence in the financial system. The Bank of Mauritius did not shirk its responsibility and jumped into the fray with a number of unconventional measures to support the economic and social development of the island as the effects of the crisis began to reach our shores. These included (i) the provision in December 2008 of a Special Foreign Currency Line of Credit of USD125 million for trade financing (ii) the extension of a preferential line of credit to small sugar-cane planters faced with a sharp reduction in their revenue, and (iii) our full support to the Small and Medium Enterprises Financing Scheme – a limited form of directed lending which was initiated by the Ministry of Finance to ensure that

SME's had adequate access to bank credit. More importantly, the Bank introduced a Special Facility in Foreign Currency for an amount of €600 million to help highly-indebted economic operators, in the export-manufacturing and tourism sectors, suffering from the compression of margins in depressed market conditions, the weakness of export currencies, and the mismatch between their earnings in foreign currency and their debt in rupees. The Bank made a pre-emptive move to forestall any knock-on effects on the balance sheets of lending banks, which could have posed very serious risks to financial stability in view of some inherent characteristics of the local credit landscape relating to the interconnected nature of much lending — across borrowers, sectors, and banks — which presented clear contagion risks.

26. ***Financial inclusion*** Good supervision cannot be dissociated from the need to ensure that the best interests of consumers of financial services are protected. As far back as 2007, two flagrant areas where the consumer was not getting a fair deal came to my attention: the high interest rates on loans and opaque fees and commissions. One of my first actions was to request all banks to publish their principal interest rates, fees, charges and commissions, using a standard template to enable customers to better compare the cost of services provided. This took effect in November 2008. In the same spirit, the indicative exchange rates of individual banks are now published daily on the Bank's website for public information since September 2009. In 2012, I initiated work to impose a cap on fees and charges for services provided by financial institutions and actually imposed the maximum allowable margin for same-day trading of forex. I also established a Complaints Desk at the Bank and made it mandatory for each domestic bank to set up its own complaints desk. Furthermore, I instituted a *Task Force on Unfair Terms and Conditions in Banking and Related Financial Contracts* — this work is ongoing.

27. ***A new communication culture*** When I joined the Bank in 2007, I was struck by the very conservative manner in which the Bank communicated, mostly to a very limited and specialized audience. No wonder that few of our countrymen could grasp the essential functions that a central bank performs in an economy. This lack of understanding made the work of the Bank less effective because the public could not relate to it or understand that it was in fact their own interests that the Bank was meant to promote. So I decided to embark the Bank on a new communication drive — not without some misgiving from some quarters which saw this central bank activism as a transgression. In the past five years, I have made 80 local addresses, held more than 35 press conferences, and given innumerable press interviews and statements in both the local and international press.

28. The process of increasing our dialogue with a wider range of stakeholders of the economy brought many critical issues to light which enabled us to take several initiatives to respond to the identified needs. In the course of this transformation, the Bank was able to take more-informed decisions, and its visibility increased — as did the public's understanding of our various actions. Our web site has been upgraded and all information pertaining to the activities of the Bank are posted in real-time. In parallel, we launched financial literacy programmes to increase the awareness of our citizens to enable them to make better use of available financial products and of redress mechanisms available to them.

29. Let me here highlight the significant improvement in the quality, frequency, and timeliness of central bank statistics which since February 2012 have met the stringent requirements of the IMF's Special Data Dissemination Standards (SDDS). We are now engaged in the process to move to the even higher SDDS+ standard.

30. ***Regional cooperation and International visibility*** I have long held the view that tiny Mauritius cannot unlock its full development potential without accelerating its integration in the sub-Saharan Africa region. I have pursued this line during my mandate at the Bank which saw our increasing participation in various fora under the auspices of SADC, COMESA and the AACB to advance the regional and continental integration agenda. In 2011, I had the honour to co-chair, on behalf of fellow-Governors, the two separate inaugural Joint Meetings

between Central Bank Governors and Ministers of Finance for both COMESA and SADC. I also co-chaired the first meeting of the SADC Peer Review Panel in Mauritius in October 2011. In August 2012, I acceded to the Vice-Chairmanship of the AACB and the Bank will be hosting the 37th Assembly of Governors in August 2013. In February 2012, the Bank was invited to become a member of the newly-established Sub-Saharan Africa Regional Consultative Group of the Financial Stability Board. In October 2012, we successfully launched the Regional Payment and Settlement System of COMESA, which is hosted at the Bank.

31. ***Way Forward*** Over the past years, I have been constantly griping at the slow and long-drawn-out pace at which we are embracing change in much of the economy and in many of our institutions on which we depend to accelerate growth and development. It is widely recognised that we need to be quicker on our feet, more open to the process of innovation, more agile in exploiting alternative markets and new products and services, and much more willing to change our policies and procedures. Global economic poles are irremediably shifting to new centres in the East and to the South. Nearer to us, Africa is on the move. We must be quick to engage in the competition for the opportunities offered by the resource-rich, growing and more stable African continent. A higher growth path requires us to pay greater attention to international competitiveness. We must become more productive, shedding unnecessary layers of bureaucracy and ensuring greater probity in procurement, in both the public and private sector. Economic history, as embodied in the relatively recent Asian success stories, leaves no doubt about the importance of more efficient production and ease of doing business.

32. Our monetary policy strategy will continue to be guided by our primary objective of price stability and the promotion of orderly and balanced economic development. Central bankers worldwide continue to accumulate evidence that low and stable inflation allows all economic agents to make better decisions on savings and investment — the key conditions for sustained growth.

33. Going forward, we shall continue to ensure that monetary and exchange rate policy is formulated taking into consideration the interests of all stakeholders of the economy. While the fundamentals of the economy seem fairly strong for now, I am particularly concerned about the persistently high current account deficit, which mirrors a worryingly low savings rate. As our main export markets in Europe grapple with fairly bleak economic prospects in the foreseeable future, it is vitally important that we do not reduce our structural reform efforts to raise the productive potential of the economy and prepare for the heightened competition which we are likely to encounter on foreign markets as the recovery takes hold.

34. The Bank remains ever vigilant to potential risks to financial stability that could hamper our progress to another plane of development. On the regulatory front, we are moving forward with the implementation of Basel III. We shall introduce more stringent conditions, including higher capital requirements, as we step up our endeavours to address the risks posed by Domestic-Systemically Important Banks, whose failure might entail widespread consequences for the economy. Increasing access to financial services is a key priority for the regulator and I will take all necessary measures to ensure that consumers get a fair deal. The Bank is determined to keep a tight rein on bank charges and commissions, in the light of the report of the *Task Force on Unfair Terms and Conditions in Banking and Related Financial Contracts*, which I mentioned earlier. We concluded a lengthy process of consultation with both domestic banks and international regulatory bodies before finalising draft legislation on the Deposit Insurance Scheme which we submitted to the Ministry of Finance at the end of last year. We will pursue our efforts to deepen our financial markets.

35. ***Concluding Remarks*** As I look back upon my years helming the Bank, I am acutely aware of the weight of responsibility that comes with being called on to ensure financial and macroeconomic stability amid the extraordinary events of the past five years. I wish to thank the Prime Minister, Dr the Honourable Navinchandra Ramgoolam, GCSK, FRCP, for having

given me this opportunity to serve the nation in this capacity. My thanks also go to the various Ministers of Finance with whom I always maintained cordial personal — although occasionally tense professional — relations, my Deputy Governors, the Head of Governor's Office, and other key staff-members on whom I relied to deliver on my mandate.

36. The past five years have been tumultuous, but as I mentioned in my acceptance speech when I received the "Central Banker of the Year 2012, Africa" award, I have always maintained an unwavering focus on the statutory mandate of the Bank. My aim has also been to rejuvenate the Bank by bringing in vital improvements in line with international best practice. After 45 years, I believe the Central Bank has reached a level of maturity where it can confidently play a key role, not only in maintaining confidence in the economy, but also in accompanying the country's progress to ever-higher levels of growth, development and welfare.