Rundheersing Bheenick: Review of the year gone by and reflections on the present and future outlook

Statement by Mr Rundheersing Bheenick, Governor of the Bank of Mauritius, Port Louis, 14 November 2013.

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The financial year 2012–13 has been challenging for the Bank as I had anticipated in my last Statement, and we have continued to be tested by international and domestic pressures. The long-running financial crisis has now entered its sixth consecutive year. The global economy has remained under stress – the US witnessed timid growth, the euro area temporarily slipped into recession, the UK avoided “triple-dip” recession, and growth in emerging economies moderated. Occasional bouts of volatility in financial markets complicated the lingering global uncertainty. With monetary policy loose and fiscal space limited, particularly in the advanced economies, capital flows worldwide have been relatively more volatile as investors responded to uncertainty in major advanced economies. This impacted adversely on some emerging economies with rising inflation, capital outflows, and sudden depreciation of their currencies. Policymakers around the world introduced several non-conventional measures to calm financial markets and provide confidence to investors.

The Mauritian economy grew at a relatively healthy rate of 3.4 per cent in 2012 despite the negative sentiment that prevailed during much of that year. Headline inflation came down from 4.9 per cent in July 2012 to 3.6 per cent in June 2013 while year-on-year inflation stabilized, decreasing marginally from 3.7 per cent to 3.6 per cent. The increasingly diversified nature of our economy in terms of markets and products, and prudent and appropriate fiscal and monetary policies implemented during the year, maintained macroeconomic and financial stability in the country. We benefited from a steady flow of foreign direct investment, not far from previous highs, during the period. Unemployment hovered around 8.1 per cent in 2012, a level that I do not consider alarming in the current context, especially if account is taken of chronic over-reporting, continued skills mismatch, and labour market inflexibility which induces employers to have recourse to foreign labour.

During the year, the Bank was called upon to respond rapidly to the changing dynamics at the international level as well as on the domestic front.

Operation Reserves Reconstitution

In June 2012, the Bank launched the Operation Reserves Reconstitution (ORR) – an unconventional measure for the Bank of Mauritius which had pursued a free-floating foreign exchange regime until as recently as November 2011. The currency appreciation was getting quite alarming at the time and required urgent policy responses on our part. The ORR allowed us to address not only the growing appreciation of the rupee but to build up our reserves which crossed the Rs100-billion threshold in May 2013. We are today well on our way to achieve the target of six months’ import cover.

The ORR resulted, however, in excess rupee liquidity in the domestic money market and the Bank had to conduct open market operations to mop up the surplus. We had to complement the issue of Government securities with our own paper which reached a record level of almost Rs19 billion. This came with a cost and weighed heavily on the Bank’s balance sheet. The continuation of open market operations at the same level as in recent months will rapidly become unsustainable for us. A few years ago, I had flagged this issue. Today, I am renewing my call to the authorities to share the burden as it is certainly not in the interest of the nation to have a central bank with weak finances.

Ponzi Schemes

At the beginning of 2013, we were hit by a spate of financial scams. Scammers, using the loopholes in the regulatory framework, lured the public into investing in schemes that promised extravagant returns – which in fact turned out to be Ponzi Schemes. This was a wake-up call for regulatory and other authorities to review their operations as they relate to detecting and combating financial crime. When the Ponzi Schemes were uncovered, the Bank stepped in to manage the crisis and reassure victims by setting up a help desk to attend to the grievances of the public. The number of known victims of the six companies involved in the financial scams, who lodged complaints at the Bank reached 2,290 and the total defrauded amount stood at Rs835 million by 28 June 2013. The figure is rapidly nearing the Rs1 billion mark.

We undertook a series of actions to deal with the problem; most notably we sought the assistance of the Reserve Bank of India (RBI), which has first-hand knowledge of the matter. The RBI team's recommendations range from the reinforcement of Know Your Customer procedures and due diligence in banks, the setting up of dedicated cells to gather market intelligence, to enhanced coordination among regulators. These recommendations are in line with the restructuring and redefining of our mandate. They reinforced our commitment towards financial literacy, consumer education, and fair treatment of consumers, on all of which we had initiated work in early 2012. The Task Force on Unfair Terms and Conditions in Banking and related Financial Contracts was set up in July 2012 to investigate into the terms and conditions of contracts, including fees, commission and charges. The public was invited to make representations. We hope to be able to share the work of the Task Force with the public in the course of the coming year and, hopefully, pave the way for a better deal for users of banking and financial services.

Modernisation of the banking sector

We pursued our efforts to modernise the banking sector and enhance the soundness of our banks. We granted our 21st bank licence to a new bank which started operations in February 2013. We were concerned with the need to protect the cross-border branches of foreign banks operating in our jurisdiction from potential problems of their parents in their home country. We encouraged foreign bank branches to convert into subsidiaries. The proposal of Barclays Bank PLC Mauritius Branch, to convert itself into a wholly-owned subsidiary provided us with the opportunity to expand our legal arsenal with new provisions to aid such restructuring.

Our concern for ensuring financial stability further motivated us to consider the case of large and complex local banking institutions – an ever-present danger in a country where 65 per cent of bank assets are controlled by two banks. We are in the process of putting up a framework for Domestic Systemically Important Banks, wherein stricter requirements including the imposition of capital surcharge will be applicable. We issued a consultation paper outlining our proposal to the industry for comments.

We also brought important changes in the board room of banks, requiring diversity of board members, competence and periodic term renewal. I once reflected that a crisis is too good to be wasted – the global regulatory reforms were mirrored in our own efforts to strengthen the resilience of our banking sector. In May 2013, we issued a draft guideline on Basel III after we had circulated a consultation paper to the industry in October 2012. We continued our work on the setting up of Supervisory Colleges in Mauritius for our banks with cross-border operations. We expect to hold the first Supervisory Colleges later in the year.

Our banking sector assets grew at the rate of 10.2 per cent. The month of May 2013 also saw banking assets exceeding the Rs1.0 trillion mark for the first time. Profit after tax maintained its upward trend and the capital adequacy ratio of banks remained well above the regulatory requirement of 10 per cent. Nonetheless, the growing non-performing loans and the concentration of risks in our banking sector continued to raise financial stability concerns.

We started work during the year on the introduction of a wide range of macroprudential measures to contain banking sector risks.

At the heart of a modern economy is a robust and efficient payments system. The Cheque Truncation System, introduced the year before, saw the end of physical exchange of cheques on the Bank's premises on 31 January 2013.

International regional role

We continued to participate actively in regional fora organized by SADC, COMESA and AACB and brought our contribution to discussions relating to regional issues. The COMESA REPSS went live in October 2012. We were privileged to host in November 2012 the second meeting in Africa of OMFIF, which regroups diverse players from the public and private sector, central banks of developed and developing economies, sovereign wealth funds, and academia. Nearly 100 delegates from Europe, Africa, Asia and Latin America participated in the meeting.

On 30 August 2012, at the conclusion of the 36th Assembly of Governors of the AACB in Algeria, I assumed the Vice-Chair of the AACB, with Governor Mohammed Laksaci of the Bank of Algeria in the Chair. In August 2013, the Bank hosted the 37th Assembly of Governors of the AACB – the first time in its 45-year history that the AACB has held its meeting away from Continental Africa – and I took over the Chair for a one-year term. Almost simultaneously, I was appointed by the FSB RCG for Sub-Saharan Africa as its non-FSB member co-chair for a two-year term starting 1 July 2013.

Over and above the Governors who participated in OMFIF and AACB meetings in Mauritius during the year, I welcomed Ms Christine Lagarde, Managing Director of the IMF, Dr Duvvuri Subbarao, Governor of the Reserve Bank of India, and Mr Martin Redrado, former Governor of the Central Bank of Argentina.

Monetary Policy Committee

Since its inception in April 2007, the Monetary Policy Committee (MPC) witnessed several changes. 30 meetings have been held of which 29 were interest-rate-setting meetings. The MPC was reconstituted, for the second time, in December 2012 and the total number of members was reduced from nine to eight, comprising namely, the Governor, the two Deputy Governors, two members appointed by the Prime Minister, and three members appointed by the Minister of Finance and Economic Development. It was also explicitly laid down in the Bank of Mauritius Act that the MPC has to take into consideration the views of the Bank, the Ministry, and any other appropriate institution. Furthermore, the MPC adopted a Code of Conduct for its members.

During 2012–13, the MPC met on four occasions. At the first three meetings, the Key Repo Rate (KRR) was left unchanged at 4.9 per cent. In June 2013, the MPC, at its second meeting in its third reincarnation, took the decision to cut the KRR by 25 basis points to 4.65 per cent by majority vote – outvoting my two Deputy Governors and myself who preferred to adopt a more prudent stance in the face of growing vulnerabilities in the financial system. Monetary-policy-making is a forward-looking exercise, requiring objectivity and independence of mind, and should, in my view, be ideally operationally-independent of Government. The mandates of fiscal and monetary authorities are not necessarily incompatible – the overriding objective remaining the well-being of the nation. Indeed, fiscal and monetary coordination is a two-way traffic requiring mutual adjustment. At the June 2013 MPC meeting, the representation of the Ministry weighed on the final assessment of MPC members and resulted in an interest rate decision that the Bank did not consider fitting in then economic circumstances.

Transforming the Bank of Mauritius into a modern central bank

We carried on the process of modernising our statistical operations. We pursued our efforts to meet the highest standards applicable to balance of payments and monetary and financial statistics in terms of quality and frequency – SDDS+.

We launched our first polymer bank notes, a major innovation in bank note technology, in August 2013. We seriously considered this alternative as far back as 2008 but our earlier attempts to introduce polymer notes ran into legal hurdles and we first had to change the applicable law before we could proceed – thus missing our chance to be the first in Africa. As I write this Statement, polymer bank notes in three denominations of Rs25, Rs50 and Rs500 are circulating in parallel with paper bank notes.

In the wake of the global financial crisis, banking has become a 24-hr operation. Banks are evolving in an extremely dynamic and competitive environment. Financial institutions are more and more stretching regulations to outwit regulators; and we regulators, need to continuously strive to keep ahead of them. The demands on the Bank are becoming more and more exacting by the day. The restructuring of the Bank, which I initiated in 2007, is on-going. Our headcounts are among the highest, on a per capita basis, amidst our peers and a more flexible approach is needed to attract new talents. Fresh skills have been recruited to complement our pool of talents in new areas of business, for example, reserve management. A review of the salary and conditions of service at the Bank was conducted to align them with market trends, attract new talents as well as retain existing ones. The salary review includes a Performance Management System which will be introduced this year, paving the way for a mechanism that relates work performance and remuneration. These developments should translate into efficiency gains and allow the Bank to keep up to the mark when it comes to expected outcomes even if they exert pressure on our overhead expenses.

Words of Appreciation

In May 2013, our Prime Minister, Dr The Honourable Navinchandra Ramgoolam, GCSK, FRCP, appointed me for a third term of office. I am deeply touched by this mark of continued confidence in my abilities to lead the Central Bank. I will endeavor to uphold the trust placed in me and I am sincerely indebted to him for the unflinching support he extended to me since the beginning of my tenure of office.

I have worked closely with the Honourable Charles Gaëtan Xavier-Luc Duval, GCSK, Vice-Prime Minister and Minister of Finance and Economic Development, and his team during the year. We have often had diverging views on our assessment of the economic situation. Indeed it is common for Treasuries and Central Banks to have occasional differences when it comes to economic, financial and monetary policies – which our lively local media, and some interested lobbies, magnified. Here, we have different mandates but we both have the economic welfare of the Mauritian population at heart. I thank the Honourable Minister and his team for the cordial working relations between ourselves and between our respective staff, in particular at the level of different regular joint working committees.

I have a special word of appreciation for the strong bond of partnership that now exists between the Central Bank and the banking community. Our regular dialogue and frequent consultations have strengthened our collaboration. I therefore thank all stakeholders, in particular, Chief Executives of banks and the Chairman and the Chief Executive of the Mauritius Bankers Association, for joining our efforts for the advancement of the banking sector.

Finally, I need to express my sincerest appreciation to my two Deputy Governors, the Head of my Governor’s Office, my Heads of Division, and the Staff of the Bank for their support and commitment throughout the past year.

Looking ahead

There are increasing signs that we are nearing the end of the crisis with visible signs of what looks like a sustainable recovery. I never tire of saying that the best contribution that the Central Bank can make to the nation is to maintain price and financial stability – this is our *raison d'être*. Our heightened profile at the international level puts us in a position where we can make a significant contribution to issues of relevance to central banks well beyond our own frontier.

Over the years, we have transformed our economy to make it more diversified and resilient. Had we not engaged in, at times, painful reforms, we would have been hit harder by the crisis. We need to pursue these reforms and develop new drivers of growth that can take our economy out of the middle-income trap to a higher-income-level economy. Development, like life itself, is a journey and not a destination. The reforms must continue if we are to maintain our preeminent position in Sub-Saharan Africa.