Bank of Mauritius

Financial Stability Report

June 2024

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The Bank of Mauritius (hereafter referred to as the “Bank”) is issuing the first edition of its Financial Stability Report for 2024, covering the second half of 2023, unless otherwise stated.

This Report is published pursuant to section 33(2)(b) of the Bank of Mauritius Act which stipulates that the Bank shall publish at least twice a year a report on financial stability. The Report includes a review of financial stability and an assessment of policies of the Bank in relation thereto.

In line with its mandate to ensure the stability and soundness of the financial system of Mauritius in terms of section 4(2)(b) of the Bank of Mauritius Act, the Bank monitors developments in the banking and financial system to identify any vulnerabilities and risks to financial stability. The Bank makes an overall assessment in this report of the risks that can threaten the stability of the financial system and the measures taken to mitigate these risks. It evaluates the resilience of the financial system to the risks, as a stable and sound financial system is a prerequisite for financial intermediation and for creating conducive conditions for economic and financial development.

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Executive summary

Global developments

The global economic and financial environment improved in the second semester of 2023. Prospects for a soft landing of the global economy took shape with resilient global economic activity and faster disinflation. Economic growth was supported by both positive demand and supply-side developments. Fiscal expansion also supported aggregate demand in many countries and higher labour force participation helped to ease supply-side bottlenecks.

Central banks maintained the tight monetary policy stance. High interest rates led global disinflation into its final phase. Receding inflation and the outlook of a soft landing of the global economy amplified market expectations of a decline in interest rates during 2024 and propelled a rise in equity markets and renewed investors' appetite.

Risk to global financial stability eased in the second half of 2023, after bank failures triggered stresses in the first semester of 2023. Strains emerged, however, from the Commercial Real Estate (CRE) market as tighter financial conditions along with structural changes to working practices led to a rise in credit risk from the CRE market. Some banks with large loan concentration to the CRE segments, especially in the United States (US) and Europe, suffered considerable credit losses. These events, however, did not result in systemic risk across the global financial system.

Financial stability risk from the household sector continued to be influenced by high debt servicing costs and real estate price dynamics. Residential home prices kept on declining in many countries due to the high borrowing costs to finance the acquisition of properties. House prices, however, stayed above pre-pandemic levels, lessening concerns of a sharp downward adjustment. The metrics on household debt hovered around sustainable levels, keeping credit risk in the residential property market relatively low.

The global financial market showed mixed performances. Global equities rose as market confidence grew with expectations of potential cuts in US interest rates in 2024. Meanwhile, geopolitical tensions intensified following the start of the Israeli-Palestinian war in October 2023, which dampened risk appetite.

In general, global economic activity has continued to grow steadily as central banks win their fight against inflation. There was less downside risks to the global economy, as affirmed by the growth-at-risk framework of the International Monetary Fund (IMF) in its Global Financial Stability Report of April 2024. Still, near-term vulnerabilities from the real estate market persisted and could amplify risks to global financial stability and the economy.

Domestic developments

Economic activity in Mauritius was buoyant in the second half of 2023, propelled by strong performance of key sectors of the economy. In real terms, output grew at an annual rate of 5.1 per cent and 7.6 per cent during the third and fourth quarters of 2023 respectively. Demand-side dynamics, notably strong consumption and investment expenditure, also supported economic expansion.

Economic growth was stimulated by the traditional sectors of the economy, in particular the tourism, construction, financial services and manufacturing sectors. Conditions in the tourism sector continued to improve. The number of tourists surged to 698,944 in the second half of 2023, representing a growth of 12.6 per cent over the corresponding period of 2022. The construction sector maintained its robust growth momentum in the second half of 2023, whilst the financial services and manufacturing sectors expanded as well, albeit at a slower pace. Going forward, the economy is expected to grow steadily in 2024 with a projected expansion of 6.5 per cent in real terms.

Conditions in the labour market progressed, supported by buoyant economic activity. The unemployment rate declined to 6.1 per cent in December 2023, its lowest point over the past two decades. The Wage Rate Index (WRI), which captures changes in average wages paid to employees, rose further in the second half of 2023. These developments supported the financial soundness of households and contributed to safeguard macrofinancial stability.

Inflation maintained a downward trajectory, reflective of the domestic monetary policy stance and the global disinflation trend. Inflation dynamics suggested headline inflation would converge towards the Bank's inflation target range of 2 to 5 per cent in 2024. The Monetary Policy Committee (MPC) left its policy stance unchanged at its two meetings held in the second half of 2023. The MPC viewed that the policy rate hikes aggregating 265 basis points in 2022 have played a crucial role in anchoring inflation expectations. Market interest rates, both savings and lending rates, were stable in the second half of 2023.

The flow of bank credit to the economy upheld economic activity and concurrently cyclical risk factors eased to a large extent. Household credit expanded at an annual rate of 11.1 per cent in December 2023, after the pace of growth assumed a decelerating path. High borrowing costs combined with elevated construction costs have curbed the appetite of households for the acquisition and construction of residential properties, easing the procyclical vulnerabilities. Corporate credit increased steadily to reach 3.8 per cent in December 2023 and corporate leverage grew modestly.

Debt sustainability risks from the household sector maintained a declining trend in the second semester of 2023. Household sector indebtedness, comprising credit facilities extended by banks, Non-Bank Deposit Taking Institutions (NBDTIs), insurance companies, leasing companies, and pension funds as well as credit finance companies, were measured relative to Gross Domestic Product (GDP) and income, and confirmed a sustained decline. The ratios indicated that the leverage capacity of households remained sound and debt sustainability risks were well contained.

The debt servicing burden of the household sector moderated as interest rates were unchanged and household financials were reinforced by the rise in nominal income along with fiscal support. Debt serviceably metrics continued to improve, confirming the capacity of the household sector to service debt obligations. Credit risk from the household sector fell further as evidenced by a lower non-performing loans ratio, also reflecting lesser risk of debt servicing stress.

Corporate sector vulnerabilities continued to subside as earnings were healthy and corporate leverage grew modestly. Bank credit to the sector expanded at a slower rate than economic growth, suggesting lower cyclical risk. The robust performance of some key sectors of the economy bolstered business earnings. The asset quality of the corporate sector deteriorated slightly, mainly due to idiosyncratic factors associated with one bank which was placed under conservatorship by the Bank in February 2024. Credit risk from highly leveraged sectors, such as *Accommodation and food service activities*, *Traders* and *Real estate activities*, dropped in the second semester of 2023.

Activity on the domestic stock market gathered pace in the second half of 2023. Stock market indices rose consistently until October 2023 but retreated thereafter. Foreign investors' appetite for domestic equities remained upbeat, supported by the favourable economic outlook, and their net purchases stayed in positive territory.

The domestic foreign exchange (FX) was supported by economic dynamism. Conditions on the FX market and exchange rate movements evolved in line with both domestic market forces as well as global developments. The Bank intensified its FX interventions as from September 2023 to contain excessive exchange rate volatility. It intervened and sold US$310 million to the market, relative to US$50 million in the first half of 2023. The Rupee appreciated by 3.3 per cent against the US dollar from July to December 2023, partly as the US dollar lost some momentum towards the end of 2023 given the interest rate outlook in the US.

The FX reserves of the country continued to provide strong cushion against adverse external events. The Gross Official International Reserves (GOIR) rose to US$7.3 billion in December 2023. The level of the GOIR largely met the conventional measures of reserves adequacy, with an import cover of 10.9 months and satisfying the minimum reserves-to-broad money ratio. These measures implied that the level of international reserves was at a comfortable level.

The strategic business model common in the banking sector has led to accumulation of FX deposits from cross-border customers, which impacted the stringent reserve adequacy measures. In particular, the reserves-to-short-term debt ratio and the IMF Assessing Reserve Adequacy methodology were applied to assess the adequacy of the reserves. These measures do not consider all country-specific circumstances. As a general rule, they specifically disregard the large stock of foreign assets maintained by banks, which aggregated a net value of Rs603.7 billion in December 2023. Taking into account these foreign assets, the level of external vulnerability was still considered to be relatively low.

The resilience of the banking sector to adverse developments continued to support the stability of the financial system. High profitability levels enabled banks to consolidate their capital position and promote balance sheet growth. The Capital Adequacy Ratio (CAR) rose to 21.0 per cent in December 2023. The liquidity position of banks was sound as liquidity buffers were in excess of regulatory requirements, at 232.0 per cent. Growing cross-border banking activities, representing 57.7 per cent of banking sector assets, were prudently managed by banks and no signs of stress from these exposures were noted.

The stress tests showed the banking sector was resilient to a series of hypothetical and plausible shocks. The stress test framework was upgraded to enhance the measurement of the capacity of the banking sector to resist shocks and continue fulfilling its intermediation function under strained economic and financial conditions. The results demonstrated the adequacy of capital buffers to a series of macroeconomic shocks, ranging from diverse economic growth rates to hikes and cuts in interest rates as well as exchange rate depreciation. Forward-looking stress tests confirmed the strength of the banking sector to any materialisation of credit risk in coming quarters. The banking sector also exhibited commendable resilience to cross-border stresses. Liquidity stress tests similarly substantiated the resilience of the banking sector against a range of hypothetical withdrawals of funds by depositors, including by domestic and cross-border customers.

The Systemic Risk Indicator (SRI), a barometer of systemic risk in Mauritius, signalled a sustained decline in systemic risk during the second semester of 2023. This improvement occurred across most of the sources of systemic risk. In particular, favourable macroeconomic conditions, lower external vulnerability, financial markets activities, a healthier banking system, and positive dynamism in the household and corporate sectors led to further moderation of risks. Overall, upbeat economic activity is expected to contribute to the stabilisation of the level of systemic risk around moderate to low level during 2024.

Risks to financial stability from the Global Business (GB) sector moderated as conditions in the sector improved. The positive outlook for global investment flows coupled with banks' liquidity and capital buffers curtailed risks from the GB sector. The number of newly-licensed Global

Business Corporations (GBCs) continued to grow, complemented by persisting downward trend in the number of GBC exits. Aggregate GBC deposits held in the banking system rose at an annual rate of 5.2 per cent to US$12.4 billion in December 2023. GBCs prevailed as the primary source of FX deposits for the banking system, but this reliance has declined over the years in favour of non-resident sources. To assess risks from the GB sector to the banking system, the Bank also conducted stress tests on the adequacy of banking sector buffers to shocks to the GBC credit portfolio and deposits. The findings confirmed that the capital and liquidity buffers of most banks would be adequate to sustain the idiosyncratic shocks.

The performance of the Non-bank Financial Institutions (NBFIs) was altogether robust during the second semester of 2023. The favourable domestic macrofinancial environment offset the challenges from the global financial market environment for the NBFI sector. The NBDTIs recorded sound financial performance and balance sheet growth, which supported the consolidation of buffers. The insurance sector recorded higher penetration level, with both life and general insurers combined continuing to display healthy assets growth. The pension schemes were similarly resilient with on-going expansion of their assets. They on-boarded more risk through additional investments in equity, given the propitious macrofinancial landscape and outlook and moderation of risk to financial stability.

The micro-prudential regulatory framework fosters the soundness of individual financial institutions and contributes to the stability of the financial system. The Bank regularly upgrades its regulatory and supervisory framework for the banking sector to ensure that the prudential standards are aligned with international norms. The regulatory ecosystem was enhanced in the second semester of 2023 via revisions to a few existing guidelines and the introduction of new prudential standards. Among others, the Bank announced the introduction of the Guideline on Net Stable Funding Ratio which came into effect on 30 June 2024 to ensure that balance sheet growth of banks is driven by sustainable funding structure.

As part of its cyber risk and resilience strategy for the financial sector, the Bank established the Mauritius Financial Sector Cyber Committee (MFSCC) in October 2023. The aim of the MFSCC is to enhance the cyber and operational resilience of the financial sector, thereby contributing to safeguard its stability. It will *inter alia* create a national threat intelligence platform to collect and share threat information among banks, financial institutions as well as Government and law enforcement agencies to allow the identification of threats and develop coordinated defences and responses.

In general, favourable developments in global financial conditions combined with an upbeat domestic macrofinancial environment have lowered risks in the financial system. The perception of the banking sector, gathered in October 2023, pointed towards sustained moderation of risks to financial stability over the coming year. In 2024, it is expected that positive advancements in both domestic and global economic and financial landscape will further ease systemic risks. The Bank will continue to monitor the sources of risks and initiate any pre-emptive measures as and when required

1. Macrofinancial environment

Risks to the global economy eased in the second half of 2023 as economic activity grew steadily and inflation receded from its mid-2022 peak. The monetary policy stance of most countries stayed restrictive to fight inflation. Risks to global financial stability declined slightly, though strains in the CRE market emerged in the US and Europe raising concerns towards the end of 2023. The household sector continued to face the burden of high debt servicing costs.

Domestic economic conditions were buoyant in the second semester of 2023. Robust economic expansion improved labour market conditions, in turn maintaining the financial soundness of households. Activity on the FX market strengthened further and the FX reserve stayed at a comfortable level. The monetary policy stance remained unchanged as inflation maintained its downward trajectory. The SRI signalled a consistent drop in systemic risk, underpinned by strong economic growth, increased resilience to external shocks, a healthier banking sector and slower household credit growth.

Soft landing of the global economy

Global economic and financial conditions improved in the second half of 2023. Inflation declined faster than expected and economic growth was steady. Government and private sector expenditures contributed to sustain economic activity in several major emerging market and developing economies. Labour market conditions broadly improved, with increased participation rates, helping to alleviate supply-side strains. Against this backdrop, the IMF, in its April 2024 World Economic Outlook, revised upwards its global economic growth projections to 3.2 per cent in 2023 and 2024.

The monetary policy stance of central banks stayed restrictive in the second half of 2023. Receding inflationary pressures fuelled expectations that monetary policy could ease in 2024. Real interest rates declined towards the end of 2023, reflecting market expectations of the future interest rate trajectory. Expectations of lower interest rates induced a general shift in investor appetite towards risky assets.

Labour market pressures eased with a fall in job vacancies as well as a rise in labour supply. The risk of wage-price spiral remained largely contained. Long-term inflation expectations have stayed well anchored to central banks' target. The IMF has estimated global headline inflation at an average of 6.8 per cent in 2023, declining to 5.9 per cent in 2024.

Fiscal deficits as well as government debts hovered above levels observed prior to the pandemic. The rise in interest rates to combat inflation led to an increase in debt servicing costs of governments. As a result, the fiscal space in many countries remained tight with reduced room for budgetary manoeuvres. The fiscal stance has, however, diverged among advanced, emerging and developing economies. Fiscal authorities in advanced economies eased fiscal policy in 2023, while the stance in emerging and developing economies has been neutral.

Risks to global financial stability eased

Risks to global financial stability eased slightly in the second semester of 2023, following stresses triggered by bank failures in the first semester of 2023. However, the combination of higher borrowing costs and lower demand for CRE has led to a fall in CRE prices, causing some concerns in the global banking system. The adoption of remote working practices since the pandemic has contributed to dampen demand for office real estate and heightened vacancy rates in the US. Rental earnings in the CRE market were impacted, propelling a rise in credit risk from the sector.

Though concerns of a turbulence in the CRE market gained momentum at the beginning of 2024, systemic risk stemming from the market has so far been largely contained. The New York Community Bank (NYCB), one of the largest CRE lenders in the US, reported considerable losses in the last quarter of 2023. These losses were driven by higher provisions on its CRE portfolio. Similarly, the Deutsche Pfandbriefbank AG (PBB), a German bank specialised in real estate lending, announced a substantial increase in credit loss provisions due to persistent weaknesses in real estate markets. Moreover, banks with high concentrations to the CRE market were mostly small in size with no systemic importance.

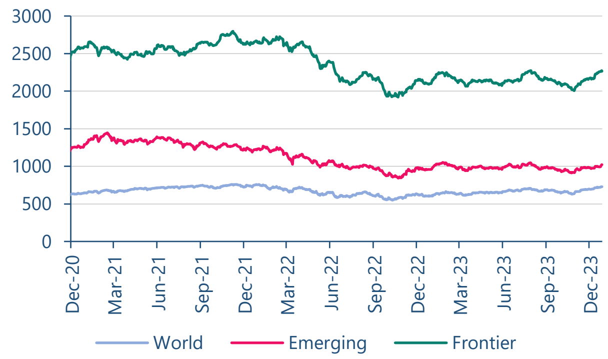
Risks to global financial stability from the household sector remained moderately skewed to the downside. Risk from a sharp correction in residential real estate prices subsided, as prices fell marginally in general. Debt servicing costs stayed elevated as central banks maintained a restrictive monetary policy stance, though debt sustainability ratios were at acceptable level. Housing affordability was, nonetheless, stretched given high residential real estate prices and borrowing costs.

Global financial markets adjust to interest rate outlook

Market sentiment in the second half of 2023 was largely driven by future path of inflation and interest rates, amid geopolitical tension rising further to the outbreak of the Israeli-Palestinian war in 2023. A "higher-for-longer" monetary policy theme initially emerged in the US, in the wake of persistent inflation alongside receding fears of a recession. The US economy displayed ongoing resilience with declining inflation as from the last quarter of 2023. Market confidence improved markedly, particularly in the last two months of 2023, as potential cuts in US interest rates in 2024 were priced in.

Global equities rose during last two months of 2023, amidst strong risk appetite, offsetting losses recorded in the previous months. The Morgan Stanley Capital International (MSCI) World Index, the MSCI Emerging Market Index and the MSCI Frontier Index rose by 6.8 per cent, 3.5 per cent and 5.7 per cent, respectively from June to December 2023 (Chart 1.1).

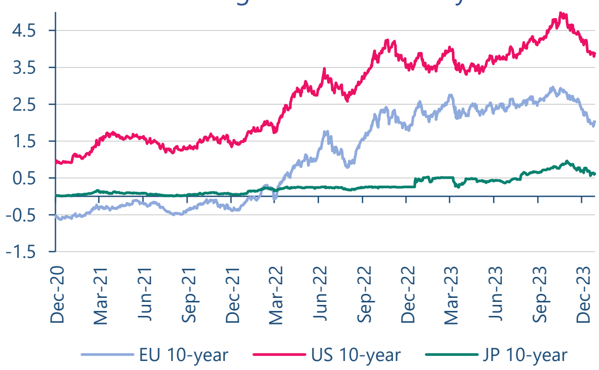
Chart 1.1: MSCI Indices



Source: Bloomberg

The performance of major sovereign bond yields was mixed. The 10-year US Treasury yield edged up by 4 basis points to 3.88 per cent in December 2023. Similarly, the JP 10-year yield rose by 21 basis points to 0.61 per cent. In contrast, the EU 10-year yield declined by 37 basis points to 2.02 per cent on weak economic data (Chart 1.2).

Chart 1.2: Selected government bond yields



Source: Bloomberg

The US Dollar Index (DXY) tumbled to 101.3 as at end-December 2023, from 102.9 as at end-June 2023 (Chart 1.3). The US dollar initially benefited from the positive interest rate differential against major currencies. Thereafter, with market expectations gradually shifting from 'less aggressive' to 'no further' interest rate hike, the US Dollar weakened rapidly, particularly in the last two months of 2023 when the DXY declined sharply by 5.1 per cent.

Chart 1.3: US dollar index

Source: Bloomberg

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Domestic macro conditions remained buoyant

The domestic economy continued to grow strongly during the second semester of 2023, owing to dynamism in the construction, financial services, tourism and manufacturing sectors. The economy expanded at an annual real rate of 5.1 per cent and 7.6 per cent during the last two quarters of 2023. Robust consumption and investment were key growth drivers on the expenditure front.

The unemployment rate fell to 6.1 per cent in December 2023, from 6.4 per cent in June 2023. Labour demand was well supported, as reflected in the upward trend maintained by the WRI throughout 2023. As a result, nominal household income went up, alleviating inflation-induced cost of living pressures as well as debt servicing burden.

The tourism sector maintained its expansionary momentum in the second half of 2023. Tourist arrivals reached 698,944, representing a 12.6 per cent leap compared to the corresponding semester in 2022. Arrivals by sea recorded a substantial boost with the launch of the new cruise terminal. The robust growth momentum in the tourism sector was expected to improve the financial position of operators in the industry, with positive spill-over effects on the other sectors of the economy going forward.

Chart 1.4: Monthly tourist arrivals and earnings

Source: Statistics Mauritius and Bank of Mauritius

Inflation slowed considerably in the second half of 2023, following the rise in interest rate during 2022. The impact of inflation on households were partly offset by the rise in nominal income and recovering economic activity. In addition, the Government deployed a series of support measures to mitigate the impact on vulnerable households. The fiscal support package included, *inter alia,* the adjustment of the personal income tax brackets and the extension of the Social Contribution Income Allowance.

The domestic macroeconomic landscape was expected to improve further in 2024, on account of positive and economic sentiment. Inflation was projected to decline within the 2 to 5 per cent target range during 2024. The dynamism observed in key economic sectors – such as tourism, manufacturing, financial services and construction – would support growth prospects. Strong public sector investment would also support growth. These favourable trends were anticipated to contain macrofinancial risks over the medium-term, despite a challenging

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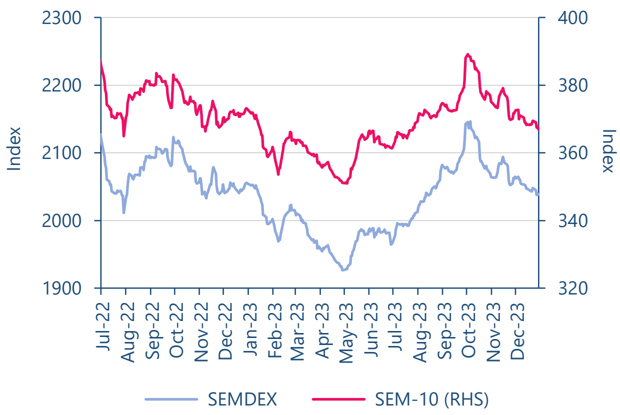
external environment. The economic outlook remained favourable, with real growth projected by the Bank at around 6.5 per cent in 2024.

Stock market activities recovered

The stock market recovered in the second half of 2023, as investors sentiment continued to improve. Both the SEMDEX and SEM-10 indices attained their highest levels for the year 2023 at the beginning of October but declined thereafter. The last quarter of 2023 marked a period of high volatility as stock prices assumed a downward trend till the end of December 2023. Overall, the SEMDEX closed at 2,038 points as at end-December 2023, higher by 3.6 per cent recorded from end-June. Similarly, the SEM-10 progressed by 1.5 per cent from end-June to close at 367 points as at end-December 2023 (Chart 1.5).

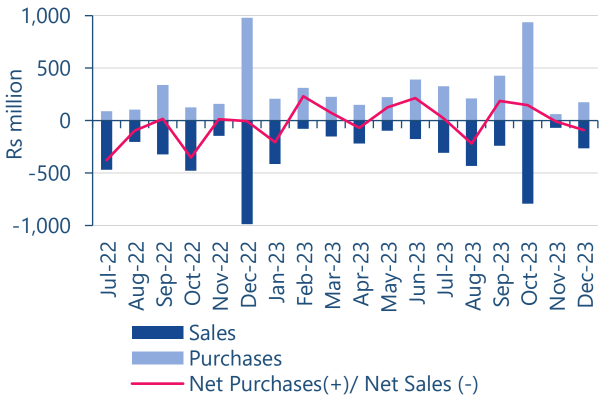
Chart 1.5: Trend of stock market indices



Source: Stock Exchange of Mauritius

Investment by non-residents on the SEM was quite volatile in the second half of 2023. Overall, favourable financial performance of listed companies and economic outlook supported foreign investors' appetite. Companies operating in the tourism and financial sectors displayed commendable performance, contributing to preserving investors' confidence. Net purchases by foreign investors stayed in positive territory, aggregating Rs38.8 million during the second semester of 2023 (Chart 1.6).

Chart 1.6: Investment by non-residents on the SEM and DEM



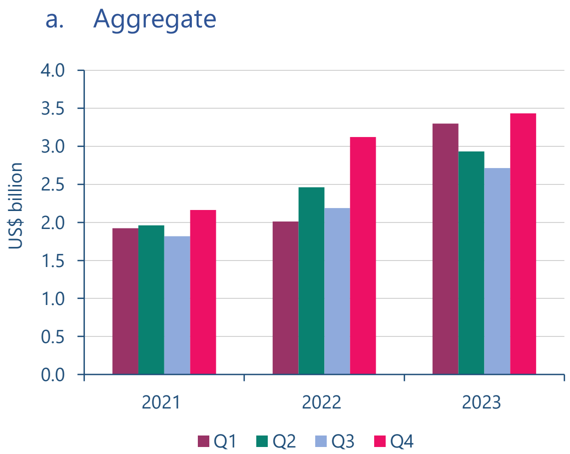
Source: Stock Exchange of Mauritius

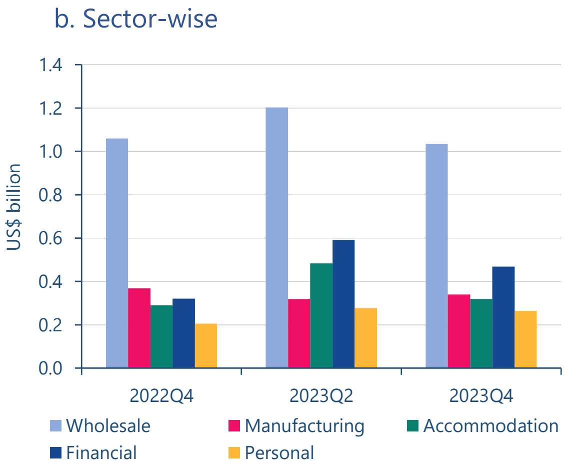
Continued improvement on the foreign exchange market

The FX market was well supported by economic dynamism in the second half of 2023. Total FX turnover of banks and FX dealers amounted to US$6.1 billion, a slight drop of 1.4 per cent compared to the turnover recorded in the first semester of 2023, but an increase of 15.7 per cent compared to the second half of 2022.

Banks and FX dealers purchased a total amount of US$2.9 billion in the second half of 2023, compared to US$3.1 billion in the preceding semester. These dynamics were mainly driven by lower FX transactions by the *'Accommodation and food service activities'* and *'Financial and insurance activities'* sectors. Banks and FX dealers sold a total amount of US$3.3 billion in the second half of 2023, slightly higher that the amount of US$3.2 billion registered in the preceding semester. Importers remained the largest buyers of FX, to the tune of US$991.0 million in 2023H2. Households purchased a total amount of US$99.0 million during the second semester of 2023, reflecting an increase of 4.9 per cent from the preceding semester.

Chart 1.7: Foreign exchange turnover



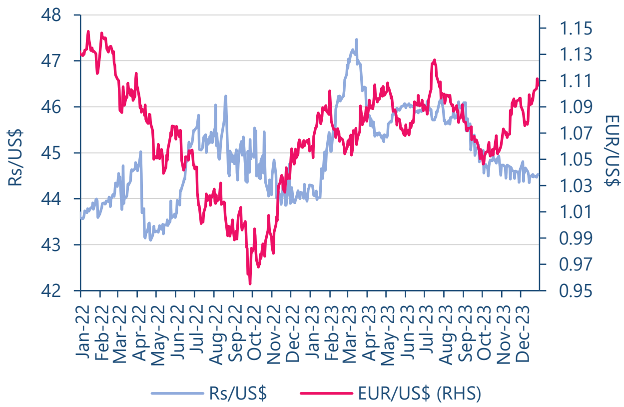


Source: Bank of Mauritius

The Bank increased the frequency of its FX interventions as from September 2023 to address temporary demand pressures, emanating mainly from importers ahead of the end-of-year festive period. The Bank sold a total amount of US$310 million through FX interventions in the second half of 2023, compared to US$50 million sold in the first semester.

The evolution of the exchange rate of the Rupee continued to reflect international factors as well as domestic demand and supply conditions. The Rupee appreciated by 3.3 per cent against the US dollar from July to December 2023 (Chart 1.8). This appreciation was partially due to the US dollar losing momentum towards the end of 2023. The interest rate outlook shaped the market's perception of a pause in monetary policy tightening by the US Federal Reserve in 2024, which largely influenced the performance of the US dollar against the Euro. As a result, the US dollar depreciated by 1.3 per cent against the Euro in the second semester of 2023.

Chart 1.8: Evolution of RS/US$ selling dealt rate and EUR/US$



Source: Bank of Mauritius

The balance sheet of the banking sector is exposed to volatility in the exchange rate of various currencies, which can give rise to vulnerabilities and systemic threat to financial stability in case of significant mismatches between FX assets and liabilities. The Bank gauges the degree of vulnerability of the banking sector to exchange rate movements by measuring the mismatch of FX asset and liability positions relative to banks' Tier 1 capital, also referred to as the net open position. The aggregate net open position of the sector increased to 1.5 per cent in December 2023 – well under the regulatory limit of 15 per cent – which shows that banks have robust capital buffers to absorb potential losses related to FX mismatches.

Tighter monetary conditions as inflation declines

The MPC maintained the Key Rate (KR) unchanged at 4.50 per cent at its two meetings held in the second semester of 2023. The MPC assessed that tight monetary conditions since 2022 played a crucial role in anchoring inflationary expectations and the interest rate increases were still working through the economy.

Conditions in the money market were broadly supportive of the monetary policy stance. The Bank pursued open market operations in line with the new monetary policy framework in the second half of 2023 to remove excess liquidity from the system. Some operational changes were brought to the conduct of the main operations. The 7-Day Bank of Mauritius Bills, issued on full-allotment basis in the first half of 2023, were auctioned at pre-determined tender amounts at a fixed rate equal to the KR. The interest rate corridor for monetary operations was concurrently widened to 300 basis points, up from 200 basis points. Consequently, banks could avail of the Overnight Deposits facility at 3.00 per cent and the Overnight Lending Facility at 6.00 per cent – i.e., at the KR ±150 basis points.

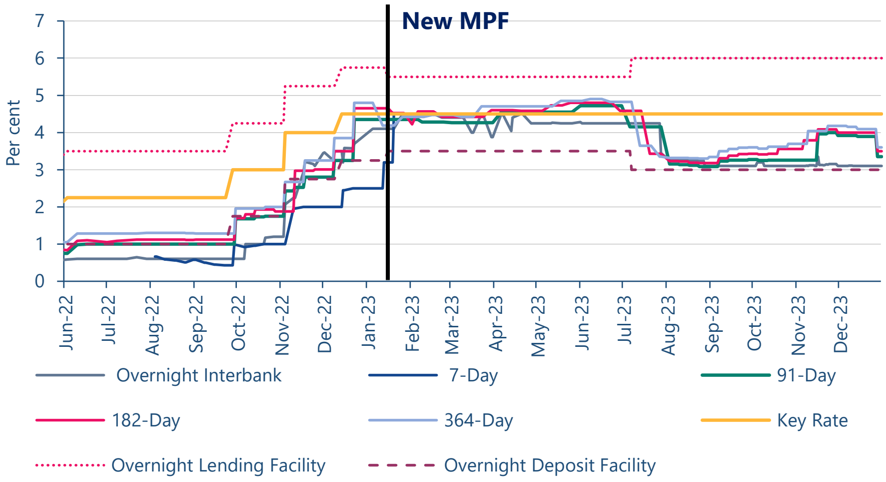
The amount of 7-Day Bills issued fell in the second half of 2023, with the adjustment to the operational framework. In particular, the weekly average amount of 7-Day Bills issued stood around Rs2.8 billion, compared to Rs64.7 billion in the first half of 2023. The surplus funds at the end of the day were channelled by banks to the Overnight Deposits Facility offered by the central bank. Banks availed of the Overnight Deposit Facility for a daily average amount of Rs45.1 billion in the second half of 2023, compared to Rs6.4 billion in the preceding semester.

The Bank conducted longer-term operations as part of its monetary policy operations to remove structural excess liquidity from the banking system. Bank of Mauritius Bills for an aggregate amount of Rs58.0 billion were issued in the 91-Day, 182-Day and 364-Day tenors. Two-Year Bank of Mauritius Notes to the tune of Rs25.2 billion were also issued. An additional amount of Rs15.1 billion was mopped up through the sale of FX on the market.

The lower scale of open market operations in the second half of 2023 led to a decline in the amount of outstanding Bank of Mauritius instruments to Rs121.3 billion as at end-December 2023, from Rs138.5 billion as at end-June 2023. Still, the average Rupee excess liquidity in the banking system fell to Rs2.6 billion in the second semester of 2023, compared to Rs4.6 billion in the preceding semester. Over the same period, the Government issued securities for an aggregate amount of Rs64.9 billion in various tenors, inclusive of Treasury Certificates issued to tap non-financial public sector entities against maturing securities of Rs47.5 billion, thus representing a net issuance of Rs17.4 billion.

The overnight interbank rate, the new operational target, evolved within the interest rate corridor between 3.10 per cent and 4.25 per cent, though closer to the lower bound. The changes to the operational framework led to some adjustments in money market rates. The weighted average yield in the 91-Day, 182-Day and 364-Day tenors stood at an average of 3.46 per cent, 3.83 per cent and 4.02 per cent, respectively, in December 2023 (Chart 1.9).

Chart 1.9: Evolution of market interest rates



Source: Bank of Mauritius

International reserves remained adequate

International FX reserves play a crucial role in mitigating a country's external vulnerability. They provide a buffer to meet external obligations during times of economic stress. Sufficient reserves can also help boost investor confidence and support the currency, which are key elements to the stability of the financial system.

The FX reserves of the country remained sound, providing a cushion against external shocks. The GOIR went up to US$7.3 billion as at end-December 2023, from USD$6.7 billion as at end-June 2023. The import cover of 10.9 months alongside a reserves-to-broad money ratio of 37.2 per cent – above the IMF's recommended range of 5-20 per cent – imply that the level of international reserves was at a comfortable level by satisfying two key traditional measures of reserve adequacy.

A more rigorous benchmarking exercise was undertaken based on the reserves-to-short-term debt ratio (Greenspan-Guidotti rule) and the IMF Assessing Reserve Adequacy (ARA) methodology.[1,2] These assessments are applied across emerging market economies and do not consider all country specificities. A sizeable flux of short-term deposits by non-residents would be such an example for Mauritius, given its status as an International Financial Centre. Moreover, the banking sector model is increasingly geared towards doing business with cross-

[1] *The reserves-to-short term external debt ratio measures the potential short-term demand for foreign assets from domestic sources.*

[2] *The ARA takes account of several economic variables, namely exports of goods and services, short-term external debt, broad money liabilities, non-GBC portfolio and other investment liabilities position, as well as GBC deposits of non-DSIBs (https://www.imf.org/en/Publications/CR/Issues/2024/05/28/Mauritius-2024-Article-IV-Consultation-Press-Release-Staff-Report-and-Statement-by-the-549629).*

border counterparts. Non-resident short-term deposits amounted to Rs406 billion in December 2023, accounting for 97.3 per cent of short-term external debt. Consequently, the reserves-to-short-term external debt ratio was 76.9 per cent in December 2023 while the GOIR-to-ARA metric ratio stood at 96.0 per cent.

The above stringent assessments ignore the substantial stock of FX buffers of banks, with their net foreign assets standing at Rs603.7 billion in December 2023. A drawdown of only 2.3 per cent of these foreign funds would satisfy the minimum 100 per cent threshold for the GOIR-to-ARA metric ratio, considering that the short-term external debt is a key component in the equation. Accordingly, it is reasonable to view external vulnerability as being low.

The IMF, in its Article IV Consultation Report of May 2024, recognised the country's robust liquidity risk management framework in place for the banking sector. The framework has been upgraded regularly and aligned with international norms, as reflected in the Bank's guidelines on liquidity risk management and FX exposures.[3] The fact that banks kept a much lower net open FX position than the prescribed upper limit of 15 per cent of their Tier 1 capital also clearly demonstrated their cautious approach to FX liquidity risk management.[4] Historically, deposit outflows by non-residents and GBCs have not impacted the domestic FX market. Subsidiaries of international banks operating in Mauritius can even seek credit lines from their parent banks, should they require liquidity support. With strong safeguards in place, it is unlikely that the reserves of the central bank would be required to meet potential withdrawal of deposits from the banking system. Nonetheless, the Bank would continue to purchase FX whenever the opportunity arises to shore up the level of international reserves to sustain external headwinds.

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[3] *The Guideline on Liquidity Risk Management, fully aligned with the liquidity standards of Basel III, includes a set of minimum standards that banks must adhere to when managing liquidity risk. The Guideline has been consistently upgraded with improvements brought in 2009, 2010, 2017, 2019, 2020, 2021 and 2023 since its introduction in January 2000. It was overhauled in 2017 to introduce the Liquidity Coverage Ratio standard for the banking sector.*

[4] *Banks' overall net open FX position of banks should not exceed 15 per cent of their Tier 1 capital. The Net Open Position in foreign currency measures the mismatch (i.e., the open position or gap) of foreign currency asset and liability positions of banks in order to assess the potential vulnerability to exchange rate movements. This mismatch is generally assessed against banks' capital. In technical terms, the computation of the Net Open Position in foreign currency is the sum of the net position for each foreign currency converted into a single unit of account.*

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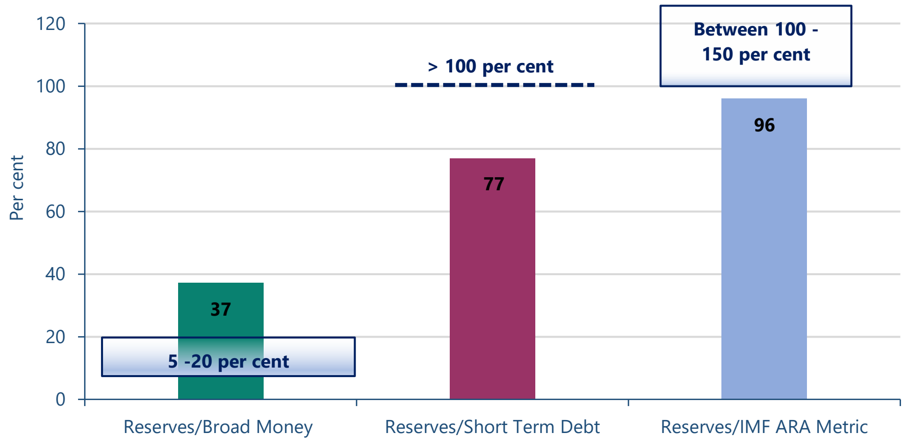
Chart 1.10: Selected reserve adequacy metrics



Source: Bank of Mauritius

Systemic risk fell steadily as macrofinancial conditions improve

The SRI signalled a sustained decline in systemic risk during the second semester of 2023.[5] This improvement is evident across most of the sources of systemic risk that were assessed, underpinned by favourable macroeconomic conditions, improved resilience to external shocks, growing financial market activities, a robust banking system and lower sectoral risks.

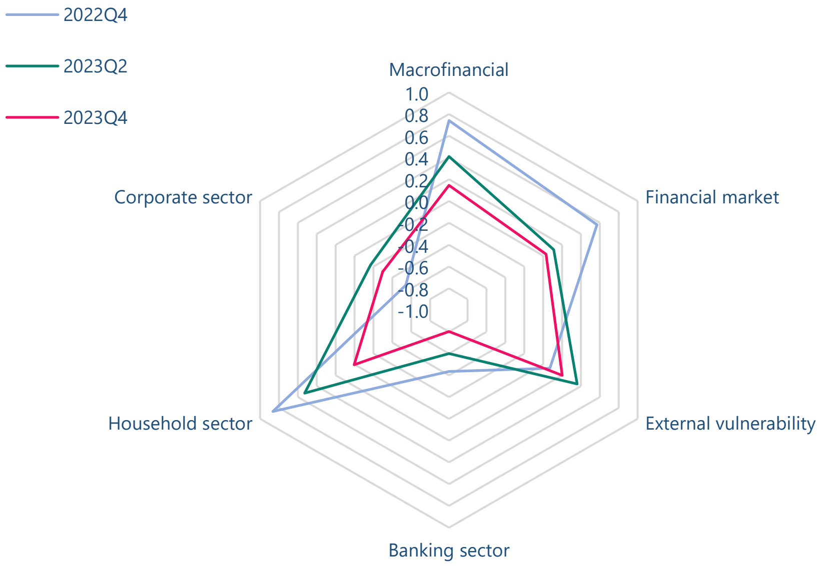
The decline in inflation along with slower pace of credit growth relative to economic expansion, contributed to mitigate macrofinancial risks. The fall in stock market activities towards the end of 2023 resulted in lower financial market risks. On the external front, the rise in FX reserves helped to consolidate the resilience of the country against external shocks. Risks from the banking sector shrunk considerably, with strong capital and liquidity buffers. From a sectoral perspective, financial stability risk from the household sector subsided. In particular, cyclical systemic risk receded significantly following a slowdown in demand for credit for residential purposes. The debt servicing capacity of households also improved with favourable macroeconomic conditions. Similarly, risks from the corporate sector fell owing to low corporate indebtedness to the banking sector and subdued exposure of banks to the CRE market.

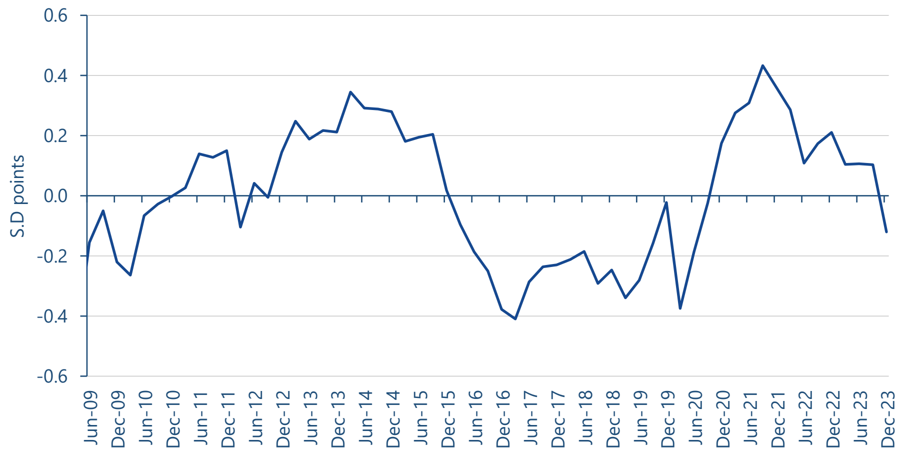
Looking forward, the degree of systemic risk is expected to recede further before stabilising at a relatively low level over the next few quarters, assuming no exogenous disruptive shocks.

[5] *The SRI gives an indication of the overall degree of systemic risk in the financial system. The SRI model was reviewed in July 2023 to improve its effectiveness in signalling the build-up of systemic vulnerabilities. As the SRI moves further upwards, the level of risk increases and vice versa.*

The sources of systemic risk may exhibit some uneven movements, but risks were anticipated to remain well contained.

Chart 1.11: Systemic Risk Indicator





Source: Bank of Mauritius

2. Financial soundness of households and corporates

Persistent dynamism in the household and corporate sectors in the second half of 2023 led to moderation of risks to financial stability. Sustained expansion of the economy, coupled with improving labour market conditions and nominal income, bolstered their financial soundness. The steady slowdown in household and housing credit growth lessened cyclical vulnerabilities. Residential property prices maintained an upward trajectory, but macroprudential tools in place are expected to curb vulnerabilities. The business environment and corporate earnings improved in tandem with the growing economy, thus reducing corporate sector vulnerabilities. Risks to financial stability from the household and corporate sectors are expected to continue retreating with favourable macroeconomic prospects.

Sustained positive dynamism in the household and corporate sectors in the second half of 2023 led to further moderation of risks to financial stability. Favourable progress in the macrofinancial environment as well as in the labour market and the corporate sector, including the rise in nominal income of households and corporate profitability, have supported the decline in risks. Economic activity was well supported by strong momentum in key sectors, which was expected to contribute to stabilise the level of risk around the moderate-to-low level during 2024.

The growth of household credit eased further in the second half of 2023, including credit for housing purposes, and alleviated cyclical risk factors. In addition, the WRI maintained an upward trend in the second semester of 2023 to reach its highest point in December 2023.[6] The Household Budget Survey of 2023 also elaborated on several developments in the household sector. For instance, the average household size fell from 3.4 in 2017 to 3.2 in 2023, while the average monthly household disposable income went up to Rs55,600 in 2023 or by 51.1 per cent since 2017. Adjusting for inflation and the smaller size of a typical household, the average real disposable income of households expanded by 22.4 per cent over that period. Moreover, the asset quality of households continued to improve in the second half of 2023. These developments reflected financial soundness of and lower risk from the household sector.

The corporate sector also indicated lower risk to financial stability in the second semester of 2023, despite a slight deterioration in its asset quality. The sustained expansion in aggregate demand supported a rise in corporate earnings. Corporate credit continued to grow at a lower rate than economic growth, which suggested better debt sustainability from the corporate

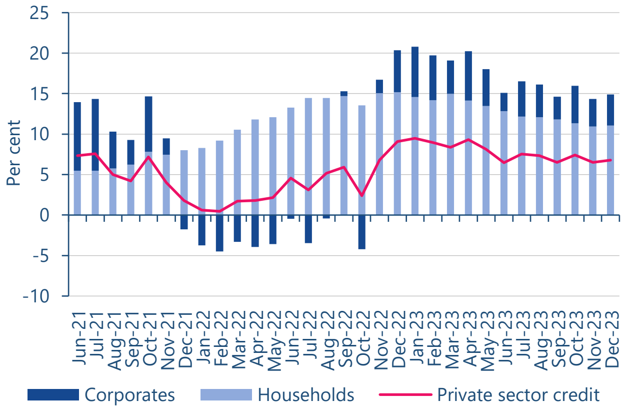
[6] *The WRI, published by Statistics Mauritius, shows changes in average wages paid to employees.*

sector. The decline in inflation stabilised operating costs and helped corporates to build their financial buffers. The NPL ratio of the corporate sector went up, but this rise was mainly attributed to the conservatorship of one bank and was not indicative of a broader increase in credit risk in the corporate sector.

Bank lending to the private sector was sustained

The flow of bank credit to the private sector kept its momentum in the second semester of 2023, supported by credit to households. Demand for credit facilities from the private sector stabilised, causing the pace of credit expansion to slow down marginally relative to the preceding semester to reach an annual growth rate of 6.8 per cent in December 2023 (Chart 2.1). Corporate credit grew consistently, with an annual growth rate of 3.8 per cent in December 2023. Household credit expanded at an annual growth rate of 11.1 per cent in December 2023.

Chart 2.1: Annual growth of private sector credit



Source: Bank of Mauritius

Household credit growth slowed further

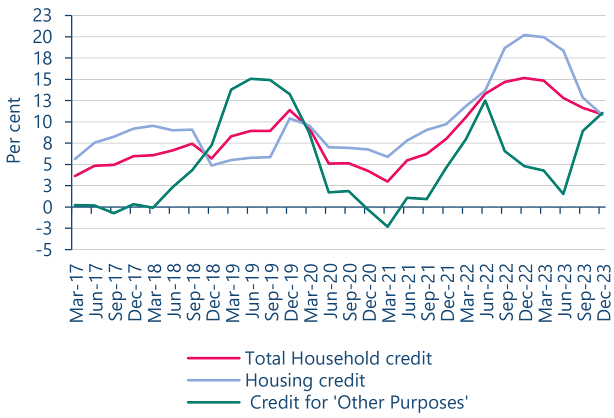
The pace of household credit growth slowed in the second half of 2023 owing primarily to softer demand for housing credit, which made up around 70.1 per cent of total household credit from the banking sector. High mortgage interest rates coupled with a rise in construction costs curtailed the appetite of households for the acquisition and construction of residential real estate.[7] Housing credit rose annually by 10.8 per cent in December 2023, after peaking at 20.4 per cent in February 2023. Though this slowdown did not impact residential property prices, it alleviated the build-up of cyclical vulnerabilities stemming from the residential real estate market. It is noteworthy that the weight of mortgage interest payment for housing purposes in the average monthly household consumption expenditure has remained roughly the same at around 3.0 per cent in 2023 relative to 2017.[8]

[7] *The Construction Price Index, as published and compiled by Statistics Mauritius, reached its highest point in December 2023.*

[8] *As per Household Budget Survey published by Statistics Mauritius, April 2024.*

Credit for *'other purposes'*, which represented around one-third of total household credit, was on an upward trend in the second semester of 2023, led by a surge in credit facilities for the purchase of land and motor vehicles.[9] This component grew at an annual rate of 11.1 per cent in December 2023, compared to 1.6 per cent in June 2023 (Chart 2.2). The sustained rise in wages reinforced the sound financials of the household sector and supported consumption expenditure.

Chart 2.2: Annual growth of credit to households

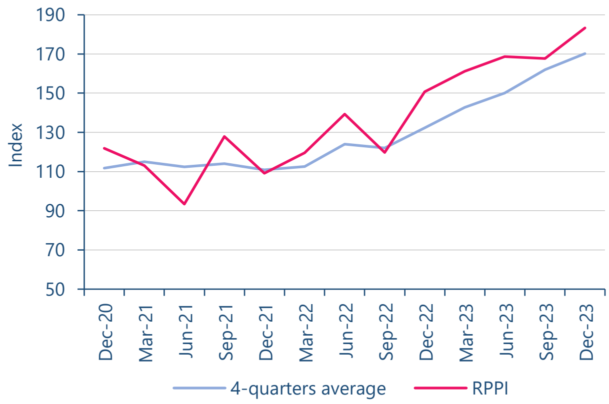


Source: Bank of Mauritius

Residential property prices continued to rise

The higher interest rate environment and the slowdown in housing credit growth have not, so far, led to a correction in residential property prices as prices remained well above pre-pandemic levels. This reflects the trend in global residential home prices, which have generally stayed above pre-pandemic levels. The Residential Property Price Index (RPPI), the indicator of movements in residential property prices in Mauritius, rose to a new high in the second semester of 2023, suggesting that demand for residential property remained strong even if housing credit growth has slowed (Chart 2.3).

Chart 2.3: Residential Property Price Index



Source: Statistics Mauritius and Bank of Mauritius calculations

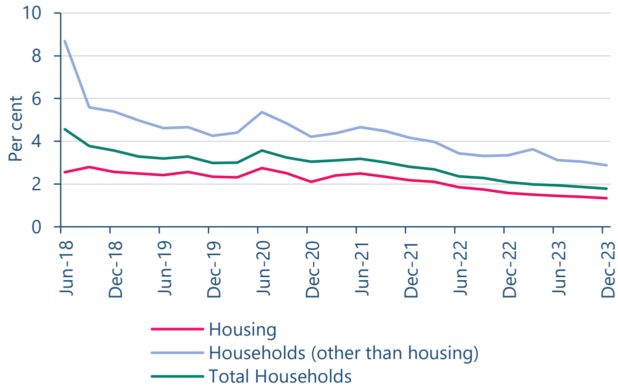
Around 90 per cent of housing credit extended by banks were collateralised by residential real estate assets in December 2023. Around 64 per cent of banks applied a loan-to-value (LTV) ratio of 90 per cent or below and a debt service-to-income ratio of 40 per cent or below, which together provided a buffer in case of a downward correction in residential property prices. The close monitoring of residential property prices and the application of macroprudential tools by banks remained one of the building-blocks of sectoral assessment of systemic risk.

[9] *Credit extended to households for 'other purposes' includes purchase of land, purchase of other consumer durable goods, purchase of motor vehicles, education purposes, medical purposes, investment purposes, and other unspecified purposes.*

Asset quality of household sector remained sound

The asset quality of the household sector was resilient in the face of high debt servicing costs and inflation, resulting to a decline in credit risk. The NPL ratios improved consistently, indicating no widespread strains in the household sector to service its debt obligations. The sustained increase in nominal wages along with fiscal assistance have supported the financial soundness of households.

Chart 2.4: NPL ratio for households



Source: Bank of Mauritius

The NPL ratio fell to 1.8 per cent as at end-December 2023, its lowest point over many years (Chart 2.4). The NPL ratio for the housing sector and for other purposes dropped to 1.3 per cent and 3.0 per cent, respectively, as at end-December 2023 (Chart 2.4).

Household indebtedness metrics on downward trend

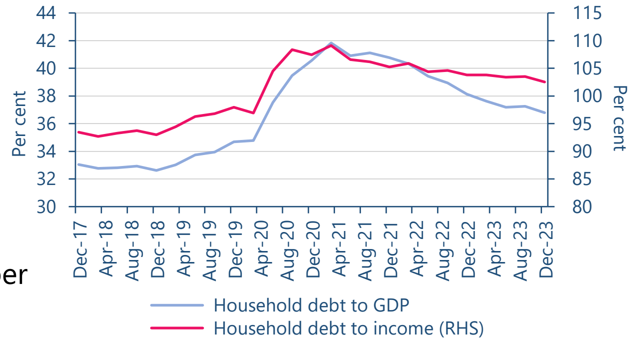
Household debt vulnerabilities receded further in the second half of 2023. The sustained improvement in labour market conditions, coupled with the decline in inflation since the beginning of 2023, supported a rise in household income and an easing of debt servicing for borrowers.

Household indebtedness to the financial system – comprising banks, NBDTIs, insurance, leasing, credit finance companies and pension funds – relative to GDP maintained a downward trend in the second semester of 2023. The measure of household indebtedness has been expanded to cover some additional segments of the financial sector as more data were gathered.[10] The ratio declined to 36.8 per cent in December 2023, from 37.2 per cent in June (Chart 2.5).

[10] *An explanatory note on the computation of the new household debt is provided in Box 1.*

Likewise, the ratio of total household debt to income dropped to 102.5 per cent in December 2023. These two metrics suggest households were in a better financial position to honour their debt obligations. In nominal terms, aggregate household debt to the financial system is estimated to have reached Rs239.8 billion in December 2023, from Rs227.9 billion in June 2023.

Chart 2.5: Indicators of household indebtedness to financial system

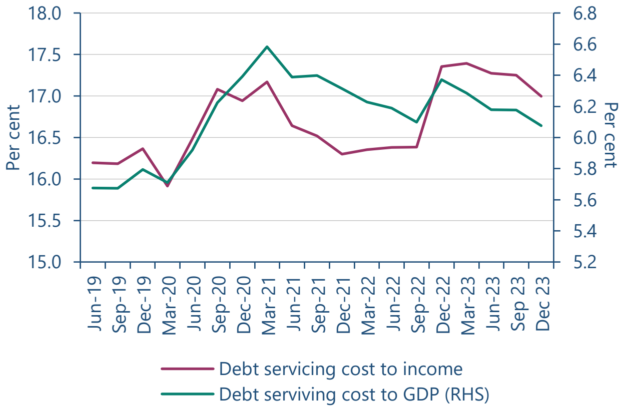


Source: Bank of Mauritius

Households' debt servicing capacity progressed positively

The debt servicing burden of households continued to ease, largely supported by a constant rise in nominal income along with some fiscal support measures. Specifically, individuals having secured a housing loan not exceeding Rs5 million were eligible for a monthly income allowance of Rs1,000 effective July 2023. In addition, the personal income tax was overhauled into a more progressive regime, propping up the disposable income of households.

Chart 2.6: Estimated debt servicing cost to income



Source: Bank of Mauritius

Key indicators of debt servicing capacity of households continued to improve.[11] The debt serviceability metrics are gradually falling to their trend level, supporting the assessment of relatively lower risk from the household sector (Chart 2.6).

Risk from the household sector continued to subside and could moderate further

Risk to financial stability from the household sector subsided further in the second semester of 2023. The continuous drop in households' key indebtedness metrics eased debt burden on their finances. The risk that households could cut back significantly on consumption to meet debt obligations has thus receded. The slowdown in mortgage activity has not hindered residential property price increases, lessening fears of a correction in asset prices. Borrower-based macroprudential requirements, notably the LTV ratio and the debt servicing cost to income limit, remained in place to ensure the financial resilience of households.

[11] *The debt serviceability metrics – debt servicing cost to GDP and income ratios – are now estimated based on new data coverage for household indebtedness, as explained in Box 1 on page 22.*

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Going forward, risk to financial stability from the household sector is expected to remain contained. The income of households strengthened further following the statutory salary compensation that became effective in January 2024. The real income of households is expected to recover with the continuous decline in inflation and contribute towards lowering the risk of financial distress among vulnerable households.

Risk from the corporate sector eased further

The positive performance of the corporate sector in the second half of 2023 continued to lessen vulnerabilities in the sector. The sustained expansion in aggregate demand, driven by the robust performance of key economic sectors, favourably impacted the business environment and was reflected in a general rise in earnings of large corporates, although business margins remain low.[12] Bank credit to the corporate sector grew consistently, supporting business activities and growth. The asset quality of the corporate sector stayed generally sound, though a slight deterioration was noted during the semester.

Systemic vulnerabilities from the corporate sector moderated. The continuous decline in corporate indebtedness to the banking sector relative to GDP, along with improved macroeconomic conditions, placed businesses in a better position to operate in a relatively high interest rate environment. A notable decline of 8.5 per cent was observed in restructured facilities from the corporate sector in December 2023 compared to June 2023. In addition, the prudent lending standards of banks along with regulatory macroprudential requirements have contributed to containing systemic risk from the corporate sector.

Corporate credit by the banking sector expanded steadily in the second semester of 2023, in contrast to the corresponding period in 2022, to reach an annual growth rate of 3.8 per cent as at end-December 2023. From a sectoral perspective, the growth dynamics were primarily driven by a rise in bank loans to non-financial sectors, namely, *Wholesale and retail trade, Administrative and support service activities, Professional, scientific and technical activities* and *Agriculture, forestry and fishing*. Other sectors such as *Accommodation and food service activities, Real estate activities* and *Construction* reduced their indebtedness to the banking sector.

Corporate leverage to the banking sector was mostly in the form of loans, accounting for 81.3 per cent of bank credit to the corporate sector in December 2023. Bank lending to the sector by way of acquisition of debt securities issued by the corporate sector, making up 18.7 per

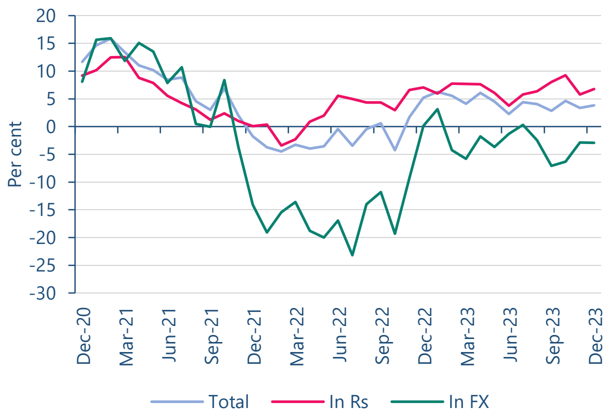
[12] The figures are estimated from a sample of large corporates listed on the SEM. The companies taken in the sample covers business activities in the 'Accommodation and food service activities', 'Construction' and 'Agriculture, forestry and fishing'. Large conglomerates with systemic importance were also taken into consideration.

cent of corporate credit and mostly concentrated with large corporates, expanded at an annual rate of 17.3 per cent as at end-December 2023. In nominal terms, banks extended a total amount of Rs217.2 billion of credit facilities to corporates as at end-December 2023. The *Accommodation and food service activities*, *Wholesale and retail trade* and *Real estate activities* sectors remained the largest beneficiaries of credit from the banking sector.

Financing businesses through debt securities can expose banks to interest rate risk if these securities are held for trading purposes. The absence of a vibrant secondary market in Mauritius for corporate bonds compels banks to hold such securities to maturity mostly which contribute to mitigate interest rate risk. Given that the securities are mostly held up to maturity, banks will not realise any major gains or losses stemming from interest rate changes. As a result, financial stability risk stemming from the portfolio of debt securities held by banks was assessed to be low.

Corporate credit growth in FX lingered in negative territory in the second half of 2023, extending the generalised trend in corporate FX deleveraging that began around November 2021. Corporate credit in FX fell at an annual rate of 2.9 per cent as at end-December 2023 (Chart 2.7). Corporate FX indebtedness relative to total corporate credit dropped to 28.8 per cent. Relatively lower corporate indebtedness in FX suggests businesses were less exposed to adverse FX developments, thus representing benign risk to financial stability.

Chart 2.7: Growth of credit to the corporate sector



Source: Bank of Mauritius

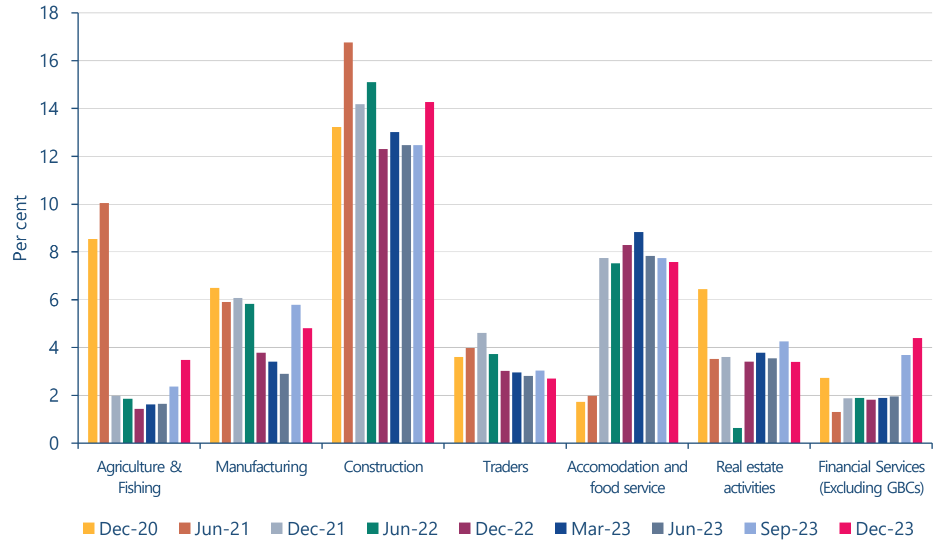
Slight deterioration in aggregate corporate sector asset quality

Credit risk from the corporate sector went up slightly in the second half of 2023, caused mainly by a deterioration in the asset quality of the *'Manufacturing'* sector. The NPL ratio for the corporate sector rose to 5.5 per cent in December 2023, from 5.2 per cent in June 2023. This increase was mostly driven by one bank that was placed under conservatorship in February 2024. The rise in credit risk was, therefore, largely idiosyncratic and did not represent a systemic threat to financial stability. Exclusive of the bank under conservatorship, the adjusted NPL ratio comes to 5.1 per cent in December 2023, from 5.2 per cent in June 2023.

From a sectoral perspective, the increase in the NPL ratio of the corporate sector was primarily led by a deterioration in the asset quality of the *Manufacturing*, *Agriculture and fishing* and

Transportation and Storage sectors (Chart 2.8). Nonetheless, the asset quality of the *Accommodation and food service activities* portfolio, the most leveraged sector to banks, has continuously improved throughout the second semester of 2023. Other highly leveraged sectors, such as *Traders* and *Real estate activities,* also recorded an improvement. Credit impairment in the *Construction* sector remained concentrated among two banks, but these banks were assessed to remain solvent under stressed scenarios (see chapter 3 for more details on stress test).

Chart 2.8: Sector-wise NPL ratio for selected key sectors

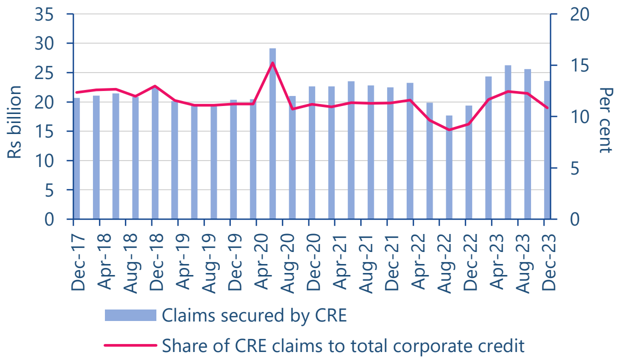


Source: Bank of Mauritius

Risks from the commercial real estate market remained low

Risks from the CRE sector stayed low at the domestic level, owing to the relatively low exposure of banks to the sector. This assessment is, however, in contrast with that at the global level. At the worldwide level, financial stresses from CRE exposures were particularly elevated due to headwinds from higher borrowing costs, changes in demand patterns following the pandemic, and a drop in CRE prices, particularly in the US and Europe. As a result, banks and other financial institutions with significant exposures to the CRE market have faced heightened credit risks globally.

Chart 2.9: Share of claims secured by commercial real estate to total bank credit to the corporate sector



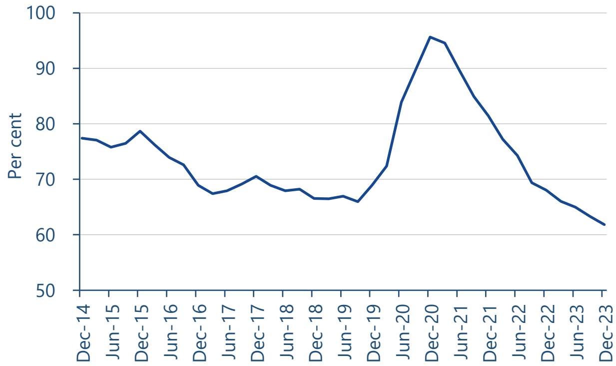
Source: Bank of Mauritius

The exposure of banks to the CRE sector fell in the second half of 2023. This exposure represented a lower share of total credit extended to the corporate sector, with the ratio of loans secured by CRE to bank credit to the corporate sector dropping to 10.8 per cent in December 2023, from 12.4 per cent in June 2023 (Chart 2.9). Macroprudential requirements, such as higher risk weights for CRE exposures, are in place to contain any build-up of systemic vulnerabilities from CRE market. In addition, most banks applied an LTV ratio of up to 80 per cent on CRE exposures, around 64 per cent of banks used an LTV ratio of 70 per cent or below and another 29 per cent of them had an LTV ratio ranging between 75 per cent and 80 per cent.

Financial soundness of businesses continued to improve

Corporate earnings were robust, boosting debt repayment capacity of businesses. The ratio of corporate sector debt relative to earnings fell to 61.8 per cent in December 2023, below pre-pandemic levels (Chart 2.10).[13] The debt repayment capacity of corporate entities, in general, had improved supporting the resilience of corporate borrowers against high interest rates. The ratio was expected to ease further as corporate earnings continued to grow in tandem with economic growth.

Chart 2.10: Share of corporate credit to operating surplus



Source: Bank of Mauritius

Financial stability risk from the corporate sector expected to remain low

The corporate sector remained resilient to the interest rate and inflation environment. Continuous expansion in aggregate demand supported robust growth in business earnings. After adjusting for one bank under conservatorship, the asset quality of banks for the corporate sector was assessed to be strong. The sensitivity stress tests showed that banks were resilient to a range of adverse shocks applied to the corporate credit portfolio (see for chapter 3 for more details).

Looking ahead, the financial soundness of the corporate sector is anticipated to remain healthy with improving economic conditions, robust earnings and decline in inflation. Overall, risk to financial stability from the corporate sector is expected to remain low during 2024.

[13] *Corporate earnings are proxied by Gross Operating Surplus compiled and published by Statistics Mauritius.*

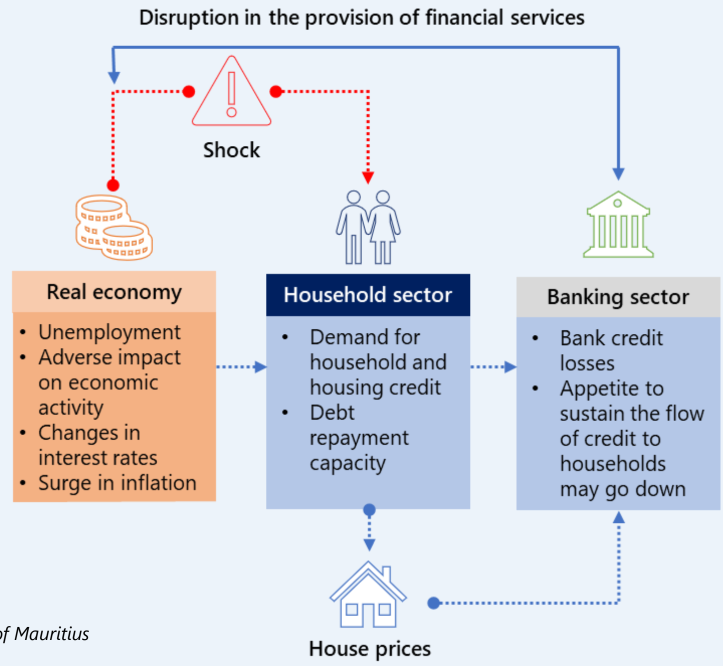
Box 1 - Household sector indebtedness

Household sector indebtedness impacts financial stability

Household indebtedness has played a prominent role in recent financial crises and recessions. The literature on financial stability indicates that an elevated degree of household indebtedness can be a reliable predictor of financial crises as well as economic recessions.[14] The household sector transmits risks to financial stability primarily through its linkages with the financial system and the economy. Some of the key channels through which the household sector can pose a threat to financial stability are the credit risk, the wealth effect and the asset price channels.

The household sector is highly sensitive to macroeconomic shocks and can channel risks to the financial system (Chart I). For instance, a sharp hike in interest rates due to a rise in inflation can exacerbate credit risk from the household sector. Specifically, such increases can curb demand for residential property causing a drop in the value of collaterals for mortgages, with implications on the asset quality of banks. Further, the decline in households' wealth can result in lower consumption and adverse impact on employment and economic growth. On the other hand, a fall in interest rates make borrowing for housing credit cheaper and can trigger a rise in demand for residential properties, thus increasing property prices above their fundamental values. A subsequent correction in prices can result in credit losses to banks in case of widespread defaults by households.

Chart I: Risks from the household sector



Source: Bank of Mauritius

[14] *See Schularick and Taylor (2012) and Jordà et al (2013, 2015 and 2016).*

Updated measure of household sector indebtedness

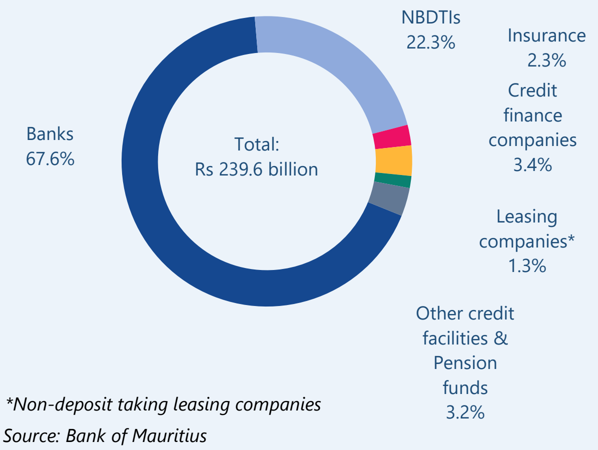
The Bank monitors borrowing activity of households as part of its financial stability assessment. The banking sector remains the main source of credit to the household sector, for around two-third of aggregate household debt. Other financial institutions – namely, NBDTIs, credit finance companies (CFCs), insurance companies, leasing companies and pension funds – also provide credit facilities to the household sector for consumption purposes, purchase of land and property, construction of residential real estate, and purchase of motor vehicles.[15]

The Bank reviewed its measurement of household indebtedness in March 2024 to include credit facilities extended by CFCs and pension funds to households to obtain a more comprehensive coverage of borrowing activity of the household sector. As these data are not available at the required frequency, the data gap is bridged through quarterly data estimates.

The new metrics offer a better view on existing or emerging financial vulnerabilities in the household sector and improve macroprudential surveillance. Still, credit facilities availed by households from other lending counterparties, such as credit unions, the Employees Welfare Fund, the National Housing Development Company Ltd and the Development Bank of Mauritius Ltd, are not captured in the new data series due to data limitation.[16]

Banks are the main source of funding to households, with an estimated market share of 67.6 per cent as at end-December 2023. They are followed by NBDTIs with an estimated market share of 22.3 per cent. CFCs have the highest market share of household credit among the non-deposit taking financial institutions (Chart II).

Chart II: Market share of household credit



*Non-deposit taking leasing companies

Source: Bank of Mauritius

[15] CFCs provide credit finance to households and this is a licensable activity under Section 14 of the Financial Services Act 2007. The FSC Mauritius regulates credit finance providers. A Credit Finance provider can be defined as an entity providing loans and credit facilities to customers to purchase goods. This includes purchase of consumer goods and usually termed as 'Hire Purchase'. The duration of the loan is usually up to a maximum of 4 years.

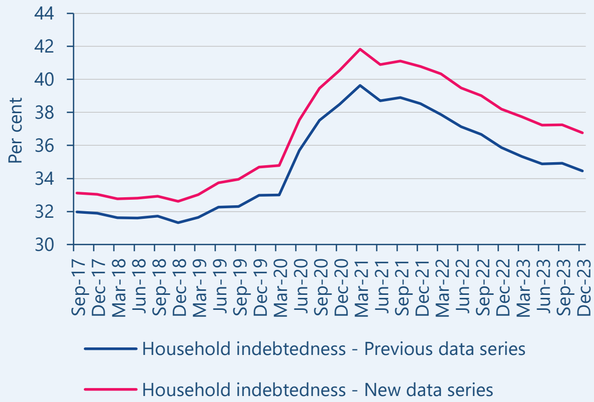
[16] Household indebtedness from these institutions represented around 0.3% of GDP as at end-December 2023 and was therefore not included in the analysis.

Growing income supported leverage capacity of households

The growth in household disposable income since 2017 has reinforced households' financial soundness and boosted their debt repayment capacity. On average, the monthly household disposable income grew by 51.1 per cent from 2017 to 2023 in nominal terms.[17] In real terms, household disposable income expanded by 22.4 per cent, over the same period, which helped to cushion the combined impact of high inflation and debt servicing costs. Credit risk from the household sector has remained low since 2022, as a result of improved debt sustainability.

Household indebtedness relative to GDP continued to fall

Chart III: Household debt-to-GDP ratio



Source: Bank of Mauritius

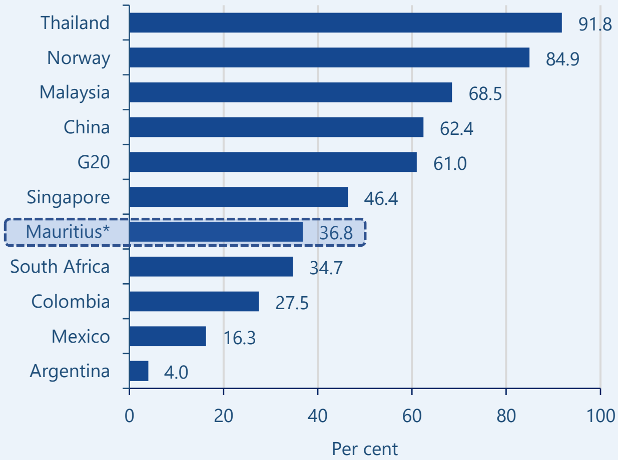
Household indebtedness, measured relative to GDP, under both the previous and new computations, evolved in broadly the same direction since September 2017. Under the previous computation, household debt to GDP ratio stood at 34.5 per cent as at end-December 2023, whilst based on the expanded household debt coverage, the ratio was estimated slightly higher at 36.8 per cent. The difference in the ratio arises from the inclusion of CFCs and pension funds in the new household debt data series.

[17] *As per Household Budget Survey published by Statistics Mauritius, April 2024.*

Comparison of household indebtedness in other countries

The level of household indebtedness relative to GDP for Mauritius is lower than some advanced or peer countries (Chart IV).[18] Malaysia and Thailand, countries with GDP per capita broadly comparable to Mauritius, have a level of household indebtedness much higher than Mauritius. Similarly, Mauritius has an inferior household indebtedness ratio compared to advanced economies such as the G20 countries. Some of the countries in Chart IV have low household debt to GDP ratios, partly because of access to finance considerations.

Chart IV - Household debt-to-GDP - Sep 23



As at end-Dec 23

Source: Bank for International Settlements

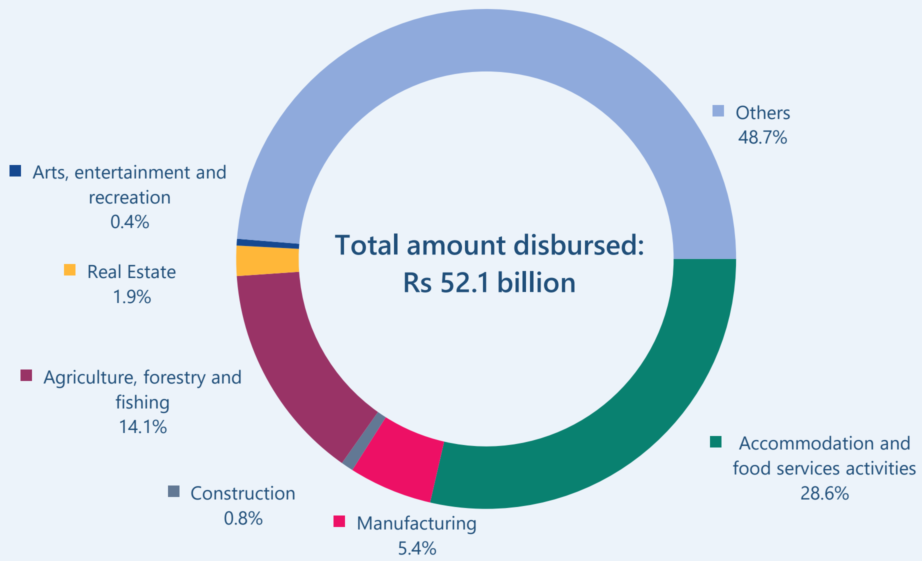
[18] *Household indebtedness ratio, measured by household credit to GDP, is collected from the BIS' 'Credit to the non-financial sector' data set. It includes household credit from all sources, including domestic banks, other domestic financial corporations, non-financial corporations and non-residents.*

Box 2 - The Mauritius Investment Corporation Ltd and financial stability

The Mauritius Investment Corporation Ltd (MIC) provided additional financial assistance to the corporate sector in the second semester of 2023. The financial support extended to systemically important corporates has so far had spill-over effects on the domestic economy, by helping to safeguard employment and maintaining financial stability. A total amount of Rs54.9 billion was approved for disbursement as at end-December 2023, out of which Rs52.1 billion has already been extended to the corporate sector (Chart I).

In the second half of 2023, additional financial support was extended to businesses operating in some key sectors of the economy namely *Accommodation and food service activities*, *Manufacturing*, *Agriculture, forestry and fishing* and *Construction*. The MIC continues to play a critical role in the macrofinancial landscape and has, so far, successfully contributed to contain the transmission of risks from the corporate sector to the financial system.

Chart I: Sectoral share of disbursement by the MIC as at end-December 2023



Source: MIC

3. Banking sector resilience

The resilience of the banking sector was reinforced in the second semester of 2023, driven by sound financial performance of both the domestic and cross-border banking segments. Capital ratios were robust, profitability was elevated and asset quality was sound. Liquidity risk was prudently managed through sustained investments in high-quality liquidity assets (HQLA). Banks mitigated interest rate risk by carefully managing balance sheet exposures and interest rate gaps. Stress tests showed that the banking sector was resilient to plausible hypothetical shocks to the economy, credit portfolios, interest rate, exchange rate and liquidity. Forward-looking stress tests indicated that the banking sector had the capacity to absorb the materialisation of credit risk over the coming quarters.

The banking sector remained resilient to risks to financial stability, bolstered by robust earnings, solvency buffers and ongoing strengthening of its balance sheet. Heightened profitability has reinforced capital buffers. Liquidity buffers were also well in excess of regulatory requirements, continuing to support the financial system and the broader economy. Cross-border banking activities continued to stimulate the expansion of the banking sector, with high global interest rates boosting interest income. The domestic and global interest rate environment impacted the balance sheets and cash flows of banks diversely but these were prudently managed.

The banking sector accounts for nearly 90 per cent of total financial system assets. Aggregate banking sector assets have been growing at an average of 6 per cent annually to reach around 350 per cent of GDP in December 2023. The sector consisted of 19 banks in December 2023.[19] The concentration level in the banking sector was moderate, with a Herfindahl-Hirschman Index (HHI) of 1,976 in December 2023.[20] Two banks – also Domestic-Systemically Important Banks (D-SIBs) – held a major portion of banking assets. As a share of banking sector assets, these two banks held approximately 49 per cent of total deposits, 50 per cent of total loans and advances, and 48 per cent of total assets as at end-December 2023.

The five D-SIBs continued to strengthen their balance sheets during the second semester of 2023.[21] These banks held capital buffers above the minimum regulatory requirements, inclusive

[19] *One bank – with a small market share – went under conservatorship in February 2024.*

[20] *The HHI assesses market competitiveness. A market with an HHI of less than 1,500 is considered a competitive marketplace, an HHI of 1,500 to 2,500 is moderately concentrated, and an HHI of 2,500 or greater is highly concentrated.*

[21] *Based on June 2022 data, the Bank assessed the same five banks as D-SIBs, namely: The Mauritius Commercial Bank Limited, SBM Bank (Mauritius) Ltd, Absa Bank (Mauritius) Limited, The Hongkong and Shanghai Banking Corporation Limited (Branch) and AfrAsia Bank Limited. As from March 2024, the number of D-SIBs was reduced to*

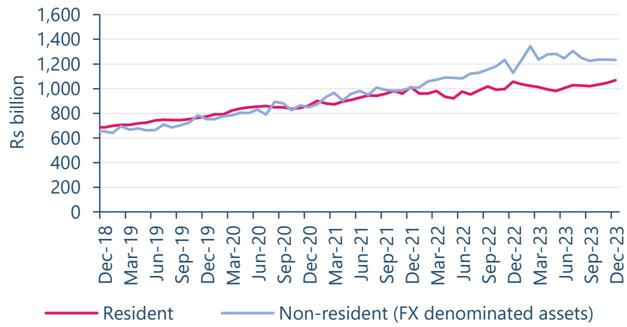
of their respective D-SIB capital surcharge that ranged from 1.0 per cent to 2.5 per cent. The high profitability of D-SIBs supported higher provisions to cushion any materialisation of credit risk. The D-SIBs continued to invest in HQLA – such as domestic and foreign government securities as well as Bank of Mauritius securities – to reinforce their liquidity buffers.

The stress test framework was upgraded to enhance the measurement of the capacity of the banking sector to resist shocks. The existing modules of the framework were upgraded and new modules were introduced to integrate macrofinancial developments and cross-border exposures in the assessment of the resilience of the banking sector. The stress test results, based on actual December 2023 figures and estimates for the subsequent quarters, confirmed the resilience of the banking sector and banks to weather a range of plausible hypothetical exogenous shocks.

Specifically, the findings demonstrated the adequacy of the capital buffers to a series of hypothetical macroeconomic solvency shocks, such as hikes and cuts in interest rates as well as exchange rate depreciation. Liquidity stress tests also confirmed the resilience of banks against a range of plausible withdrawals by counterparties, such as domestic economic agents as well as non-resident customers. The stress tests aimed at identifying and assessing vulnerabilities in the banking sector and, therefore, the results should not be interpreted as a forecast.

Resilient and growing banking sector balance sheet

Chart 3.1: Resident and non-resident bank assets



Source: Bank of Mauritius

The balance sheet of the banking sector retained its strength, with expanding assets (Chart 3.1). The total banking asset was Rs2.30 trillion at the end of 2023, up from Rs2.26 trillion as at end-June 2023. The non-resident segment made up a slightly higher share of the banking sector balance sheet compared to the domestic segment, with the latter including the GB sector. The former was a major driver of the expansion of the balance sheet, even though the annual assets growth fell to 5.3 per cent in December 2023, from 9.4 per cent in June 2023. This deceleration was mostly due to a contraction in lending by banks to other domestic and non-resident banks.

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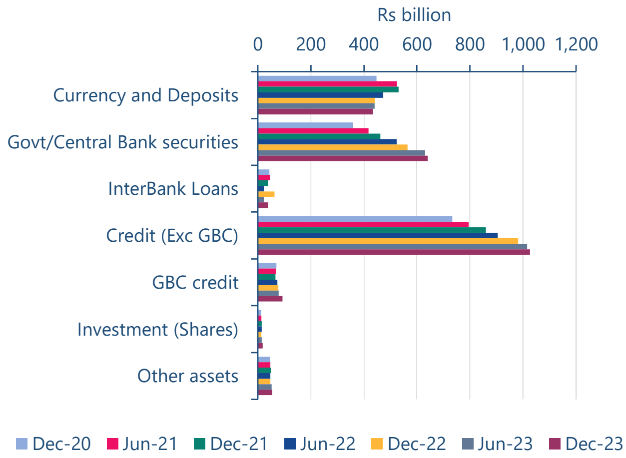
four banks from five previously, namely: The Mauritius Commercial Bank Limited, SBM Bank (Mauritius) Ltd, Absa Bank (Mauritius) Limited, and AfrAsia Bank Limited.

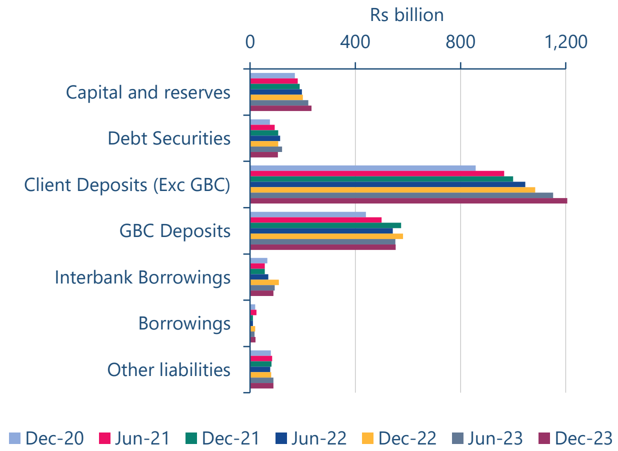
The assets structure of banks consisted mostly of credit portfolio followed by investments in liquid assets (Chart 3.2a). Banks maintained the supply of credit to the economy as well as to the non-resident segment. Credit to non-GBC clients and GBCs grew at an annual rate of 4.5 per cent and 20.4 per cent, respectively, as at end-December 2023. Banks' liquidity was sustained through investment in Government and Bank of Mauritius securities, recording a year-on-year increase of 13.3 per cent at the end of 2023. These investments formed part of the risk management strategies of banks, as they were less risky and liquid.

Chart 3.2: Banking sector balance sheet decomposition

a. Assets decomposition



b. Capital and liabilities decomposition



Source: Bank of Mauritius

On the funding side, banks relied on deposit mobilisation to pursue financial intermediation activities, representing 76.4 per cent of total assets in December 2023. Total deposits aggregated to Rs1.8 trillion and grew at an annual rate of 5.6 per cent in December 2023 (Chart 3.2b). Deposits from resident corporates represented around 68 per cent of aggregate deposits and expanded by 1.8 per cent annually in December 2023.[22] The risks associated with wholesale funding were prudently managed in line with the regulatory requirements and internal risk mitigation strategies, as evidenced by the asset composition and the diversification of sources of wholesale deposits. On the other hand, households' deposits amounted to Rs477 billion as at end-December 2023, rising at an annual rate of 11.5 per cent. Banks also strengthened their capital and reserves. The improvement in interest earnings of banks enabled additional accumulation of reserves.

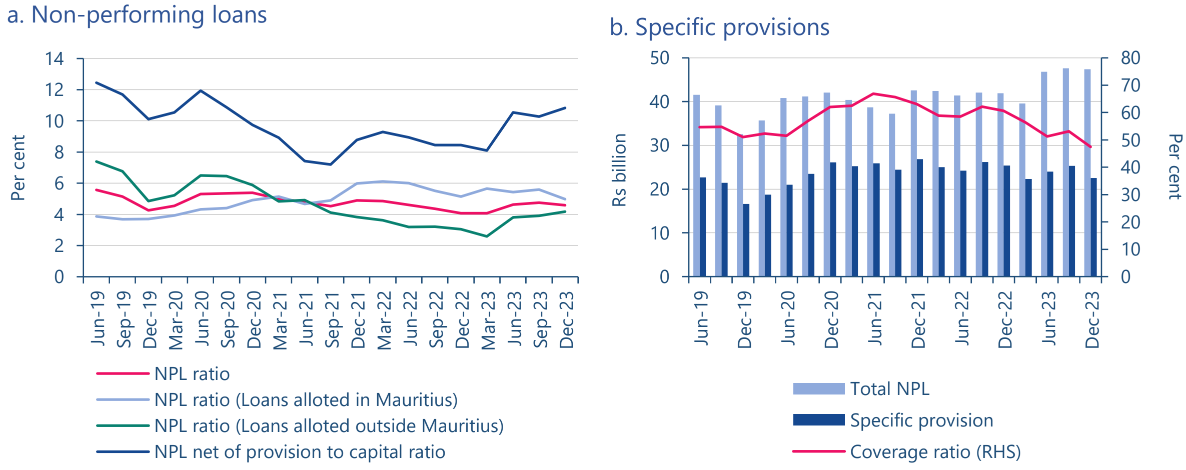
[22] *Corporates comprise non-bank legal entities, both resident and non-resident, including: NBDTIs, Credit Unions, Trusts, Insurance companies, Pension funds, Investment funds, Holding companies, Financial auxiliaries and other financial intermediaries, GBCs, Public non-financial corporations, and other non-financial corporations.*

Cross-border activities of banks represented a higher portion on the balance sheet of the banking sector, compared to resident activities. Non-resident assets aggregated to Rs1.2 trillion as at end-December 2023, with an annual growth of 9.3 per cent, most of which were invested in highly-liquid assets, such as deposits with foreign banks and investments in foreign government securities, due to the attractive returns on these assets. Furthermore, loans in FX to the non-resident segment continued to expand, at an annual growth of 5.7 per cent in December 2023.

Credit risk eased further

Credit risk eased in the second half of 2023. Banks held adequate buffers to absorb such risk. The asset quality of banks remained stable, with the NPL ratio hovering around 4.6 per cent in the second semester of 2023 (Chart 3.3a).[23] Furthermore, improving capital buffers provided sufficient cushion against any materialisation of credit risk, with the ratio of NPL net of provisions to capital standing at 10.8 per cent as at December 2023 from 10.5 per cent as at June 2023. The coverage ratio was 47.4 per cent as at end-2023, down from 51.3 per cent at end of June 2023, following a higher drop in specific provisions due to write-offs (Chart 3.3b).

Chart 3.3: Asset quality



Source: Bank of Mauritius

The asset quality of the banking sector was sustained by developments in the impaired portfolio of D-SIBs. The combined NPL ratio of D-SIBs declined to 4.2 per cent in December 2023, from 4.8 per cent in June 2023. The ratio of specific provisions to impaired loans of D-SIBs was at 59.6 per cent in December 2023, representing a 4.1 percentage improvement since end-June 2023.

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[23] *Asset quality improved after adjusting the NPL numbers for one bank that was put under conservatorship in February 2024.*

One bank, with a very low share of banking sector assets and which came under conservatorship as from February 2024, had a relatively large NPL portfolio. Adjusting for this bank, the NPL ratio would have improved. The adjusted NPL for the banking sector would be 3.9 per cent in December 2023, an improvement from an adjusted NPL ratio of 4.2 per cent in June 2023 (Table 3.1). Similarly, the adjusted coverage ratio would be 55.8 per cent in December 2023, up from 53.3 per cent in June 2023.

The resident segment, including GBCs, registered an improvement in its asset quality, while a deterioration was noted for the non-resident segment. The writing off of bad loans in the GBC credit portfolio in the last quarter of 2023 contributed to lower the NPL ratio for the resident sector. For the non-resident sector, there was a slight increase in its NPL ratio caused by the bank that came under conservatorship in February 2024. Adjusting for this bank, results in an improvement in the asset quality of credit allotted by banks to foreign counterparties.

Table 3.1: NPL ratio

Per cent	Resident segment		Non-resident segment		Banking sector	
	Jun-23	Dec-23	Jun-23	Dec-23	Jun-23	Dec-23
Actual	5.4	↓ 5.0	3.8	↑ 4.2	4.6	⇔ 4.6
Adjustment for the bank under conservatorship	5.2	↓ 4.6	3.2	↓ 3.1	4.2	↓ 3.9

Note: Arrows point to movement compared to June 2023 based on the same adjustment.

Source: Bank of Mauritius.

The prudent management of credit risk in the banking sector was supported by the broadly unchanged IFRS-9 loan classification structure. In June 2023 and December 2023, around 9 per cent of loans remained classified as Stage 2. As for Stage 3, representative of NPLs, the loans accounted for approximately 3 per cent of total outstanding loans.[24]

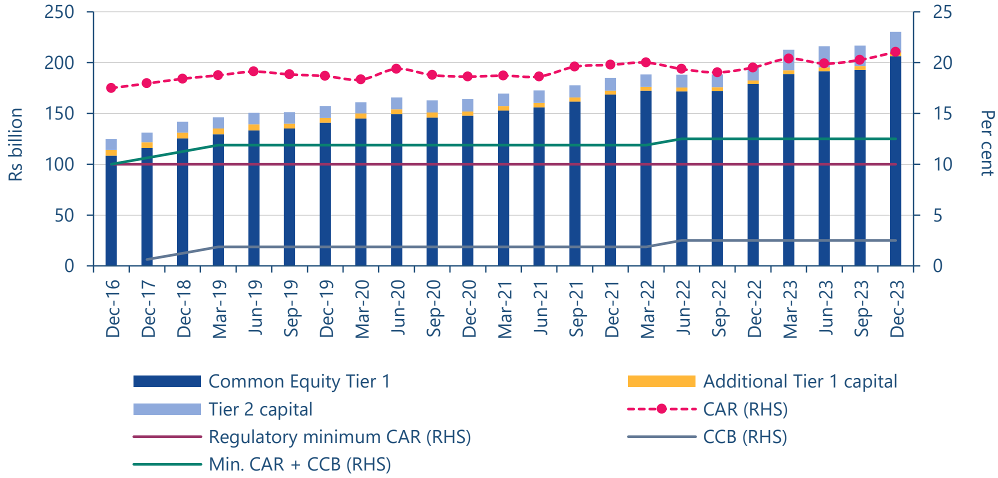
Capital buffers were consolidated

The regulatory capital held by banks was well above regulatory requirements, bolstering their resilience to risks. Total capital increased by 6.5 per cent from end-June 2023 to end-December 2023 to stand at Rs230 billion. This rise was driven by the accumulation of Common Equity Tier 1 that was supported by growing earnings (Chart 3.4). The CAR – i.e., total capital as a share of banks' risk-weighted assets (RWA) – went up to 21.0 per cent as at end-December

[24] *Loans are moved from Stage 1 to Stage 2 if credit risk has increased significantly relative to the initial position. Loans are moved to Stage 3 if they are in serious default and impairment can be expected. Impairment must be based on expected credit losses over the lifetime of the loan.*

2023. The five D-SIBs' capital ratios remain well above their respective loss-absorption capacity requirement, inclusive of the D-SIBs' capital surcharge.

Chart 3.4: Capital adequacy ratio of the banking sector



Source: Bank of Mauritius

Interest rate environment beneficial to the banking sector

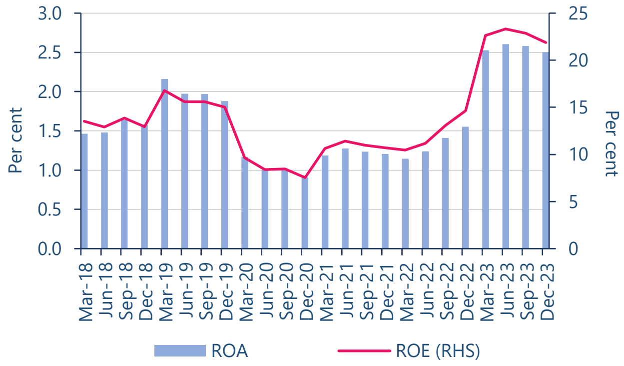
The banking sector benefited from the high interest rate environment, which propped up earnings significantly. Loans and investments in low-risk securities made up around 35.8 per cent and 27.8 per cent of total assets respectively, as at end-December 2023. Banks registered better earnings from borrowers, outweighing interest payments on deposits and resulting in increased net interest margin in the second half of 2023.

The banking sector managed interest rate risk prudently, in compliance with the stringent regulatory framework aligned with international norms. Banks actively hedged against interest rate risks. The interest rate sensitivity gap exhibited positive net position across the various time buckets, ranging from 'up to 30 days' to 'more than 20 years' as at end-2023. Assets allotted by banks in the trading book were at 16.0 per cent of Tier 1 capital as at end-December 2023, up from 14.4 per cent six months earlier. Consequently, the consolidation of capital buffers, together with robust liquidity cushion and prudent management, provided a cushion against any materialisation of interest rate risks.

Robust profitability

The banking sector generated sufficient profits to accumulate additional capital and sustain impairment loss charges. Banks were better positioned to absorb any future loan losses. However, in the last semester of 2023, the combination of non-interest expenses, impairment loss charges and year-end operational costs weighed on profitability.

Chart 3.5: Profitability ratios of the banking sector



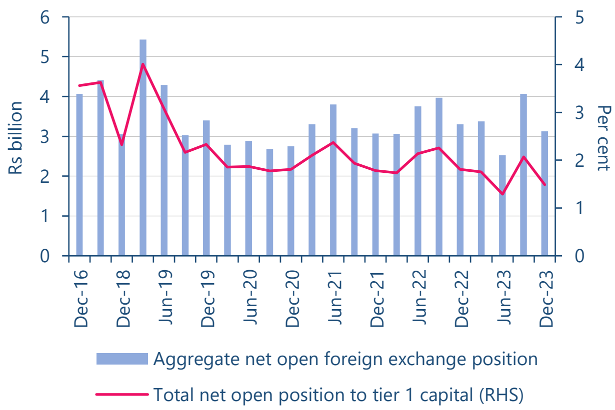
Source: Bank of Mauritius

Consequently, profitability ratios declined slightly in the last two quarters of 2023 (Chart 3.5). The Return on Assets (ROA) was 2.5 per cent in December 2023, compared to 2.6 per cent in June 2023. As for the Return on Equity (ROE), it was 21.9 per cent in December 2023, against 23.3 per cent in June 2023.[25]

Credit concentration and FX exposures prudently managed

Banks cautiously managed risks related to credit concentration and FX exposures. Credit concentration risk was administered in compliance with regulatory requirements. The ratio of large exposures, in both Rupees and FX, to Tier 1 capital was kept within the prescribed limits. Non-exempt large exposures (after set-offs) amounted to Rs654 billion as at end-December 2023, representing 311.6 per cent of banking sector Tier 1 capital in December 2023. The ratio was slightly up from 305.8 per cent in June 2023, but remained well below the aggregate prudential limit 800 per cent. Similarly, the ratio of net open FX exposures to Tier 1 capital did not exceed the regulatory ceiling (Chart 3.6).

Chart 3.6: FX exposure to tier 1 capital



Source: Bank of Mauritius

[25] *The profitability ratios have been computed based on the methodology advocated in the IMF Financial Soundness Guide (2019). The ROA is based on the annualized pre-tax profits and averaged total assets. The ROE is calculated as a ratio of annualized post-tax profits and average equity.*

Resilience of the banking sector to solvency shocks

The Bank conducts regular stress tests to assess the capacity of the banking sector to absorb exogenous shocks. The stress test results supported the adequacy of capital buffers to sustain the resilience of the sector against a range of plausible hypothetical shocks. While most banks displayed commendable soundness, a few showed some weaknesses in the severe scenarios. The bank under conservatorship was excluded from the exercise to avoid biased results.

The Bank upgraded its stress test framework in 2023. New modules were introduced to better evaluate the resilience of the banking system, including over a forecast horizon.[26] The forward-looking module considers the projection of relevant banking sector variables, such as the CAR, RWA, NPL, sectoral NPL and sectoral domestic credit for the banking sector as well as for each bank. Two sets of macro scenarios are applied to better measure the resilience of the banking sector, namely: (i) the macroeconomic scenario and (ii) the augmented macroeconomic scenario.

Macroeconomic scenario

The macroeconomic scenario applies similar assumptions used in previous quarters to compare the strength of the banking sector and banks over time when economic activity drops. Specifically, the scenario was investigated through adverse macroeconomic shocks to GDP at three severity levels: the baseline shock with 6 per cent growth, the moderate shock with zero growth, and the severe shock with 3 per cent economic contraction (Figure 1).

Figure 1: Assumptions under the macroeconomic scenario

Baseline: The economy grows by 6 per cent in 2024	Moderate: The economy stagnates in 2024	Severe: The economy contracts by 3 per cent in 2024
Stronger demand for Mauritius as a holiday destination bolstered the '*Accommodation and food services*' sector.	Recent events and wars lead to an escalation of geopolitical conflicts and undermine global growth outlook.	Geopolitical conflict escalation and supply chain bottlenecks take a toll on key domestic sectors.
The growth momentum of other key sectors of the domestic economy remained on the uptrend.	Shocks from the external environment impact key sectors of the domestic economy.	Weakened global trade creates disruptions in external markets.

Source: Bank of Mauritius

[26] *For more details, refer to Box 4 in the FSR December 2023 at:* *https://www.bom.mu/sites/default/files/financial_stability_report_december_2023.pdf*

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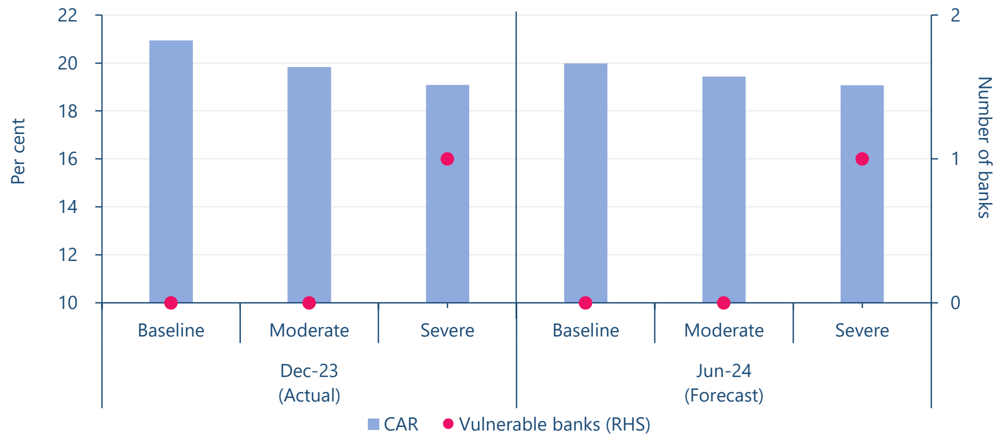
The banking sector demonstrated continued resilience to the three macroeconomic shocks and its transmission to the credit portfolio of banks, based on both the actual and subsequent quarters (Chart 3.7). All banks would be resilient under the baseline and moderate shocks in December 2023. However, under the severe shock, one bank breached the minimum adjusted CAR marginally. Bank-wise results also demonstrated strong performance, with more than 12 out of the 18 banks holding post-shock CAR above 15 per cent under the three shocks. Forward-looking stress tests showed that all banks would be resilient to both the baseline and moderate shocks. However, one bank – with an aggregate market share of 1.9 per cent – would fall in the vulnerability zone under the severe shock.

Chart 3.7: Macroeconomic shock results



Source: Bank of Mauritius

Augmented macroeconomic scenario

The augmented macroeconomic scenario introduces interest rate and exchange rate shocks to the baseline and moderate macroeconomic scenarios as applied in the initial macroeconomic scenario. This scenario assesses the impact of two sets of interest rate and exchange rate shocks (Table 3.2). The first set assumes a reduction in interest rates along with depreciation of the domestic currency, while in the second set, interest rates are presumed to continue increasing with a lower level of depreciation of the Rupee.

Table 3.2: Augmented macroeconomic shocks

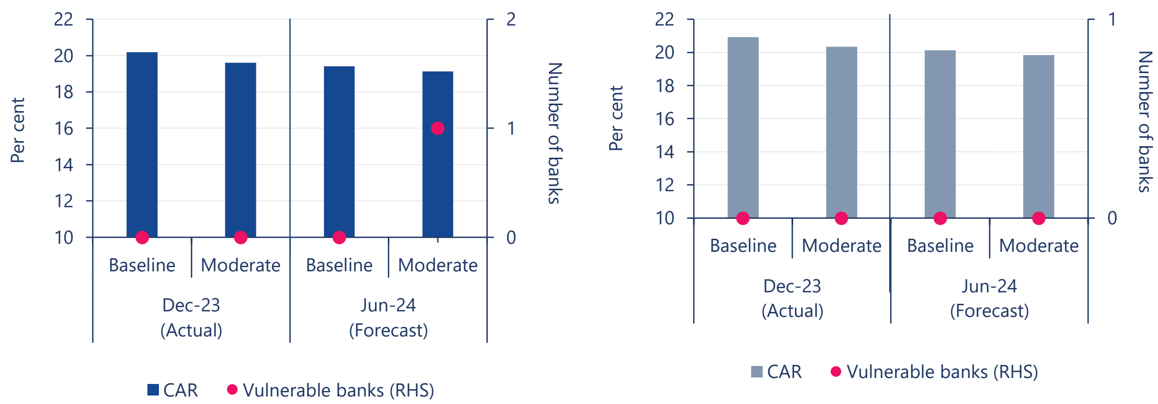
	Augmented macroeconomic: set 1		Augmented macroeconomic: set 2	
	Baseline	**Moderate**	**Baseline**	**Moderate**
Growth rate	6 per cent growth	Zero growth	6 per cent growth	Zero growth
Interest rate	-200bps	-200bps	+200bps	+200bps
Exchange rate	3 per cent depreciation	6 per cent depreciation	2 per cent depreciation	4 per cent depreciation

Source: Bank of Mauritius

The positive net interest rate sensitive assets held by banks would enable the absorption of a hypothetical downward interest rate shock based on actual and forecast figures (Chart 3.8a). All banks were assessed to be resilient for the quarter ended December 2023. They continued to remain sound based in the forecast for June 2024, with the exception of one small bank in the moderate scenario. In the second set, all 18 operational banks in Mauritius would be resilient as interest rate hikes improve profitability resulting in further capital accumulation (Chart 3.8b).

Chart 3.8: Augmented macroeconomic credit shock results

a. Set 1 b. Set 2



Source: Bank of Mauritius

Sensitivity: sectoral credit shock

The sectoral credit sensitivity stress tests evaluate the strength of the banking sector to withstand a deterioration in asset quality of the seven largest portfolios. The shocks applied induced additional impairment in the credit portfolios of: (i) 4 per cent in the baseline scenario, (ii) 8 per cent in the moderate scenario, and (iii) 12 per cent in the severe scenario. These shocks were applied to the performing portfolios of the seven key domestic economic sectors, namely: *Agriculture*, *Manufacturing*, *Wholesale and retail trade*, *Construction*, *Accommodation*

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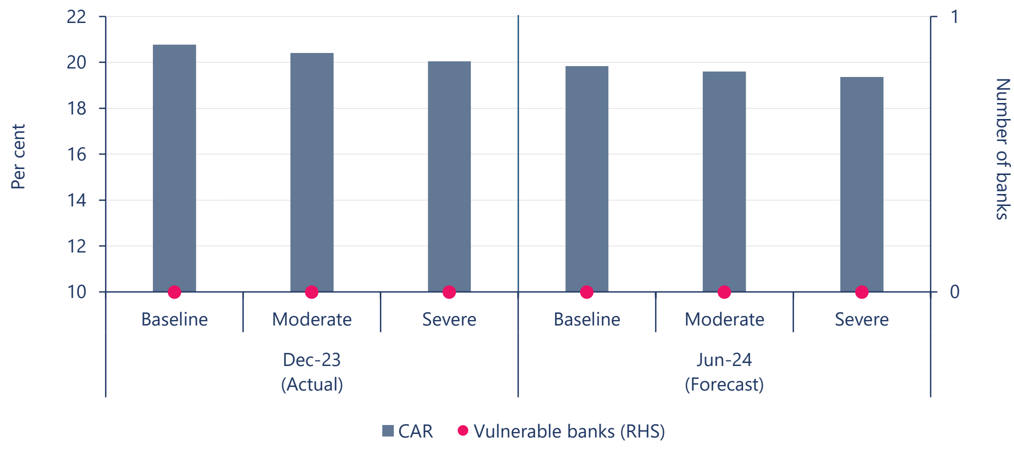
and food services, *Real Estate* and *Housing*. The results showed that all banks were resilient in the three scenarios (Chart 3.9).

Chart 3.9: Sectoral credit shock results



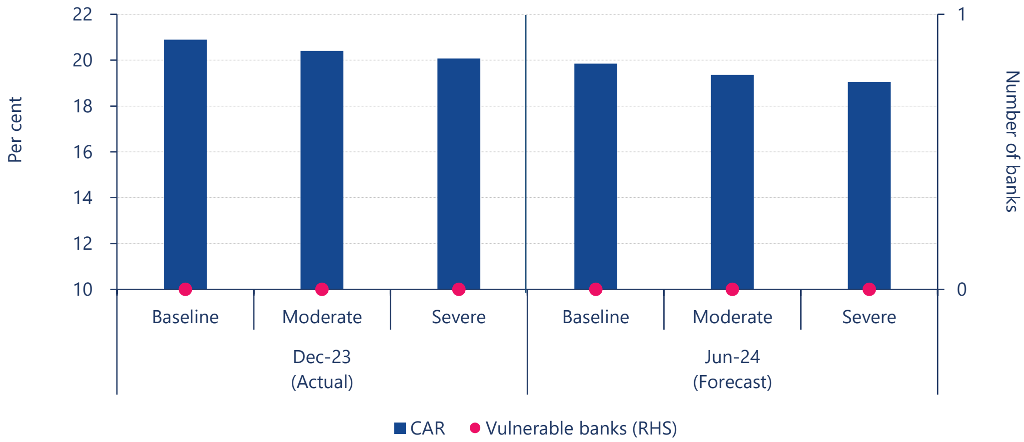
Source: Bank of Mauritius

Sensitivity: credit concentration shock

Credit concentration risk was investigated by considering the hypothetical cumulative default of the top ten single borrowers for each bank. The baseline scenario assumed that the top single borrower of each bank defaulted on its performing loans, while for the moderate and severe scenarios the number of borrowers defaulting rose to the top five and the top ten for each bank, respectively.

The stress test exercise showed that the aggregate post-shock CAR of the banking sector would decline from 21.1 per cent (actual CAR excluding one bank under conservatorship) to: (a) 20.9 per cent in the baseline scenario; (b) 20.4 per cent in the moderate scenario; and (c) 20.1 per cent in the severe scenario (Chart 3.10). All banks would be resilient to the three shocks based on the December 2023 figures as well as in the forecast for June 2024.

Chart 3.10: Concentration credit shock results



Source: Bank of Mauritius

Growing cross-border exposures amid geo-political turbulence

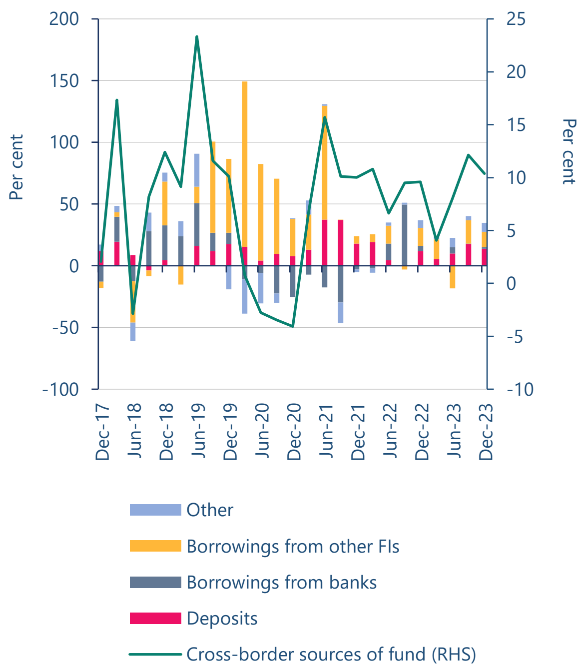
The banking sector expanded its cross-border activities further, as turbulences in the global financial system subsided to some degree. Both external sourcing and deployment of funds gathered pace. Funding from cross-border counterparties rose at annual rate of 10.4 per cent while deployment of funds abroad went up by 4.9 per cent in December 2023. The banking sector deployed abroad around twice the volume of funds it raised from cross-border counterparties, due to the redeployment of the GB sector deposits with external institutions as part of prudent liquidity risk management.

Cross-border sources of fund, comprising mainly deposits and borrowings, made up around a quarter of the overall funding structure of the banking sector, rising to US$12.8 billion in December 2023. One of the main drivers in this expansion was deposits from non-residents, which grew at an annual rate of 13.9 per cent to US$8.8 billion in December 2023 (Chart 3.11a). Borrowings from banks increased annually by 1.2 per cent to US$2.6 billion in December 2023. The annual growth rate of the other components of cross-border sources of funds were also in the positive territory in December 2023.

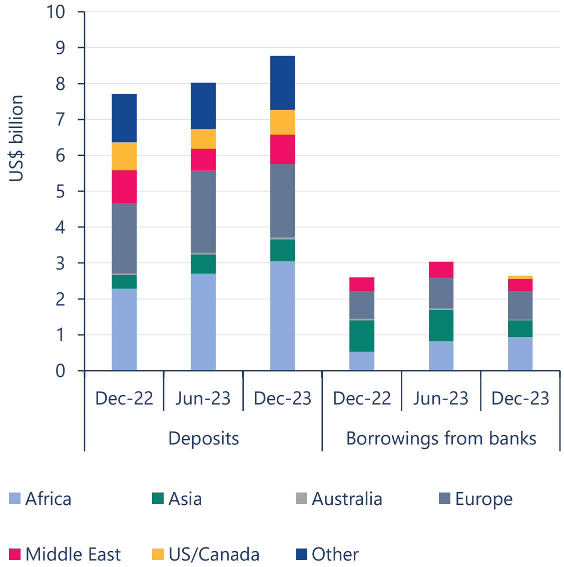
Most of cross-border funding originated from Africa and Europe (Chart 3.11b). Deposits and borrowings from Africa increased on an annual basis by 41.7 per cent in December 2023. The same trend was recorded for funds from Europe, with an annual growth of 5.2 per cent. Conversely, funding in the form of deposits and bank borrowings from Asia, Australia and Middle East declined. In terms of cross-country exposure, the top 3 counterparties for cross-border sources of fund remained South Africa, United Kingdom (UK) and United Arab Emirates.

Chart 3.11: Cross-border sources of fund

a. Annual growth



b. Distribution by continent



Source: Bank of Mauritius

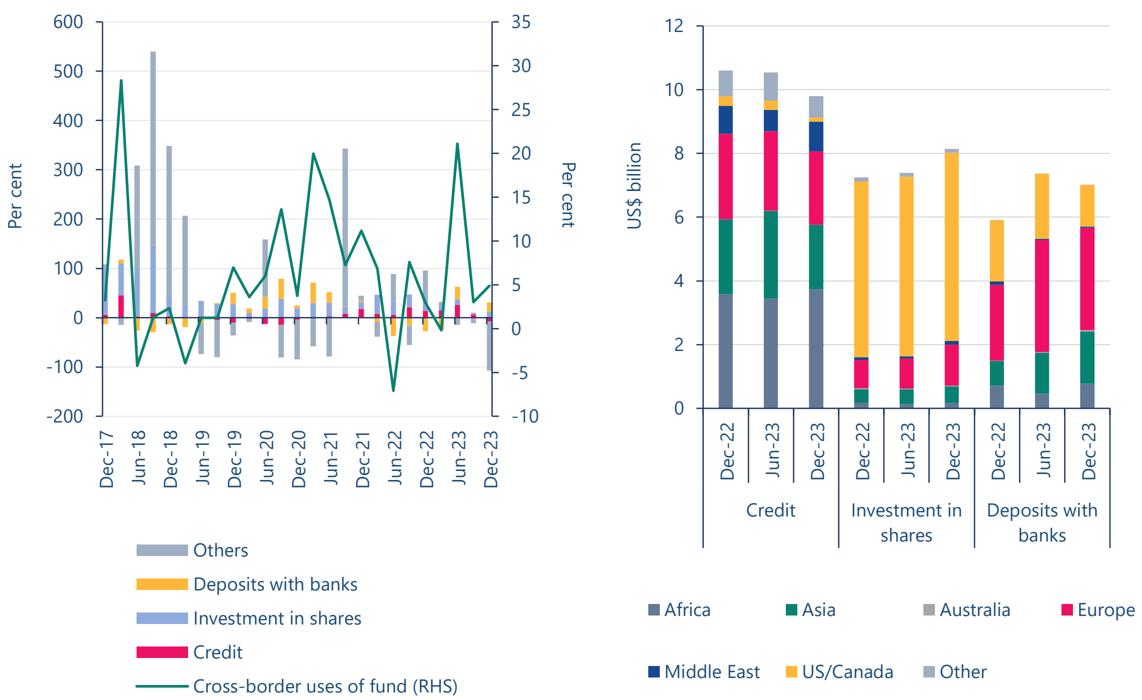
Funds deployed abroad by the banking sector were mostly in terms of credit facilities, investment in shares and deposits. These funds aggregated US$25.0 billion in December 2023, after rising at an annual rate of 4.9 per cent. A large share of these funds comprised deposits placed with banks, which grew by 18.6 per cent (Chart 3.12a). Investment in shares expanded at an annual rate of 12.3 per cent. In contrast, credit facilities granted abroad, one of the major components of cross-border deployment of funds, declined by 7.6 per cent in December 2023.

Most of these funds were channelled to Africa (Chart 3.12b). Investment in shares in the US and Canada increased at an annual rate of 7.2 per cent in December 2023. As for deposits with banks abroad, Europe was the largest recipient with funds aggregating US$3.2 billion. The US, UK and India remained the top 3 recipients of cross-border funds at the end of December 2023.

Chart 3.12: Cross-border uses of fund

a. Annual growth

b. Distribution by continent



Source: Bank of Mauritius

The high degree of interconnectedness of the banking system with the global financial system and economy makes it vulnerable external events and stresses. Risks arising from both the sources and deployment of funds can be transmitted to the banking sector and undermine the stability of the financial system. The regulatory regime established by the Bank fosters a prudent approach by banks in managing cross-border risks.

The banking sector exhibited commendable resilience to cross-border stresses in the second half of 2023, despite a rise in geopolitical risks and strains in some segments of the global financial system. The NPL ratio for credit extended outside Mauritius remained sound at 4.1 per cent in December 2023, supplemented by a coverage ratio of 37 per cent. Moreover, banks were shielded against potential outflows from the non-resident segment, as they held high levels of FX HQLA to cushion any materialisation of liquidity risks. The FX Liquidity Coverage Ratio (LCR) of the banking sector stood at 232.0 per cent as at end-December 2023, well above the regulatory floor of 100 per cent.

The resilience of the banking sector to shocks to its cross-border portfolio was stress tested. Credit risk associated with cross-border banking activities arises from possible default by foreign counterparties or sovereign governments. This risk can be amplified by several factors such as unexpected global economic and financial strains, exchange rate fluctuations, political instability and regulatory changes. For the stress test exercise, credit risk was evaluated by

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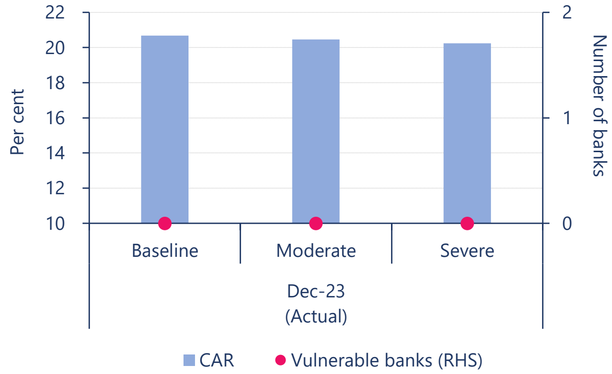
building scenarios based on the level of NPL in jurisdictions to which funds were deployed. The sample of jurisdictions used for the exercise accounted for around 80 per cent of the total cross-border credit facilities in December 2023. The average historical impairment ratio in each of these jurisdictions was applied as the baseline shock to the performing cross-border credit portfolio. For the moderate and severe scenarios, the average historical impairment ratio was amplified by 1.5 times and 2 times, respectively.

The stress test results confirmed that the banking sector and all banks would be resilient to shocks applied in the three scenarios. The banking sector CAR would decline from 21.1 per cent (actual CAR excluding one bank under conservatorship) to 20.7 per cent in the baseline scenario, to 20.5 per cent in the moderate scenario and to 20.2 per cent in the severe scenario. All banks maintained a CAR above the regulatory minimum, indicating well-managed credit risk.

Chart 3.13: Cross-border credit risk stress test



Source: Bank of Mauritius

Liquidity buffers resilient to stresses

Liquidity risk was prudently managed in the banking sector and the liquidity buffers were adequate to cover any unexpected outflows.[27] The share of the aggregate liquid assets averaged almost half of the banking sector's total assets in the second semester of 2023. The portfolio of liquid assets of banks expanded, mainly as a result of higher investments in both domestic and foreign governments securities as well as Bank of Mauritius securities.

The LCR was well above the regulatory requirement. Banks held investments in HQLA mostly in low risk securities, such as those issued or guaranteed by sovereigns and central banks, and deposits with the Bank. In terms of foreign currency exposures, the sovereign securities held by banks were primarily denominated in US dollar. The aggregate LCR in FX reached high of 232.0 per cent in December 2023, from 191.9 per cent in June 2023. The robust liquidity buffers, both in Rupees and FX, ensured that banks mitigated liquidity risk well.

[27] *The implementation of the Guideline on Net Stable Funding Ratio to complement the existing liquidity risk management framework was announced in January 2024 and would become effective in June 2024.*

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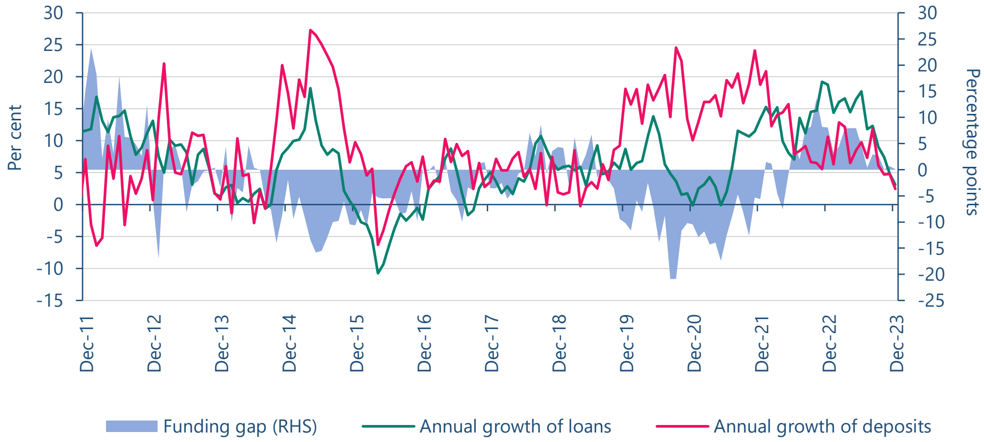
Banks in Mauritius maintained adequate liquidity to intermediate credit to the domestic household and corporate sectors. The loan-to-deposit ratio in terms of Rupees and FX hovered around 63 per cent and 64 per cent, respectively, in the second semester of 2023. As for the funding gap, computed as the difference between annual growth of banks' loans and deposits, it remained in positive territory in the last semester of 2023 (Chart 3.14). The gap declined to 0.15 percentage point in December 2023, from 4.5 percentage points in June 2023, indicative of higher growth of banks' loans compared to banks' deposits.

Chart 3.14: Domestic banking system's funding gap



Source: Bank of Mauritius

Liquidity stress testing

The liquidity stress test module was overhauled to embed the evolving funding structure of banking business models as well as the sources of liquidity risk. The new liquidity stress test module complements the current prudential framework to safeguard the resilience of the banking sector to an exodus of deposits held by households, corporates, GBCs and non-residents. The run-off rates were designed based on plausible but hypothetical deposit withdrawals, with different levels of severity for the three scenarios (Table 3.3).

The sources of liquidity stress events include potential materialisation of operational risk and their impact on the banking system. These would include cyber-attacks, IT system disruptions, fraud or a combination of external and domestic events that could lead to a sudden significant withdrawal of deposits over a short period.

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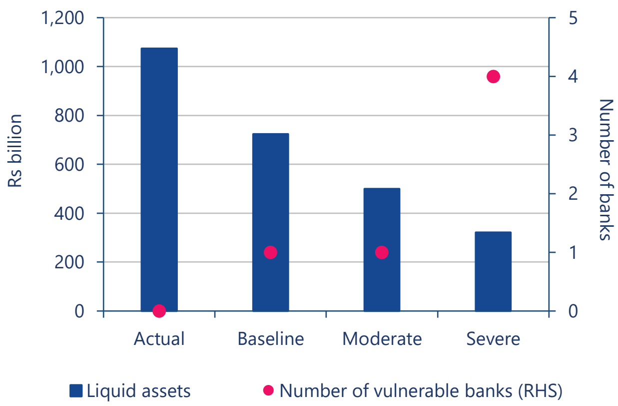
Table 3.3: Liquidity shock parameters

Deposit outflows (in per cent)	Household and Corporate	GBC and Non-resident
Baseline		
Rs	10	20
FX	25	25
Moderate		
Rs	20	30
FX	35	40
Severe		
Rs	30	50
FX	45	50

Source: Bank of Mauritius

The stress test results, based on December 2023 data, showed that the banking sector was deemed to be adequately liquid. The liquidity stress test also indicated that most banks had sufficient resources to withstand the run-off rates, except for a few banks under certain scenarios. Under the baseline and moderate scenarios, only one bank would show signs of vulnerability, whilst in the severe scenario, four banks would fall in the vulnerability zone (Chart 3.15). It is noteworthy that these vulnerable banks represented a small share of the banking sector assets.

Chart 3.15: Liquidity risk – Banking sector liquid assets



Source: Bank of Mauritius

Regulatory developments

The micro-prudential regulatory framework fosters the soundness of individual banks and contributes to the stability of the financial system. The Bank regularly upgrades its regulatory and supervisory framework to remain abreast of latest developments and to ensure that the prudential standards are aligned with international ones.

Guideline on Classification, Provisioning and Write-Off of Credit Exposures

The *Guideline on Credit Impairment Measurement and Income Recognition* was revised and consolidated with the existing guideline for the write-off of non-performing assets. The new *Guideline on Classification, Provisioning and Write-Off of Credit Exposures* was issued and became effective on 15 December 2023. It outlines the minimum prudential requirements in respect of asset classification, provisioning and write-off of credit exposures.

Cyber Security

The MFSCC was established by the Bank to enhance the cyber and operational resilience of the financial sector. The Bank also conducted the first Cyber Attack Simulation Exercise with banks in November 2023, with the assistance of the IMF. A working group comprising the Chief Information Security Officer of all banks and the Bank was also established under the MFSCC to set up a platform for the exchange of threat intelligence and information.

Climate Change and Environmental Risk

The Bank had introduced the *Guideline on Climate-related and Environmental Financial Risk Management* in April 2022 but observed that financial institutions faced challenges to fully comply with the disclosure requirements specified therein. Some flexibility was brought to the disclosure requirements in December 2023. Banks have to report on governance, strategy and risk management in the first instance. Given data challenges, banks will report on metrics and targets on a voluntary basis until further notice.

4. Non-bank financial services sector

The performance of the NBFIs was robust in the second half of 2023 and there were no signs of elevated risks. The challenging global environment coupled with volatile financial market conditions were offset by a favourable domestic macrofinancial environment. The balance sheets of NBFIs expanded further as high interest rate propped up profits and supported solvency. The NBDTIs consolidated their buffers as they pursued the investment mix to benefit from higher yields and maintain sound liquidity. The insurance industry also gained further traction, supported by increased penetration levels. The pension schemes industry sustained its investment in equity, resulting in improvement in its overall financial position.

The performance of the NBFIs was altogether robust during the second semester of 2023. Vulnerabilities and risks were prudently managed, given the favourable domestic macrofinancial environment, in contrast to challenges from global financial markets. The NBFIs showed continued confidence in the economy and sustained the flow of funds to niche markets particularly. Liquidity risk was attenuated through consistent investment in government securities.

The non-bank financial sector in Mauritius plays an important role in the economy by providing alternative financing facilities, targeted and customised to individual needs. The NBFIs held various licences, depending on the nature of the financial activities they are involved in. The major components of the non-bank financial sector were classified as NBDTIs, insurance companies with further break down into life and general insurers, and pension funds.[28] The NBDTIs are regulated by the Bank whilst the other NBFIs fall under the purview of the FSC.

The contribution of the NBFIs to economic activity in the second half of 2023 was sound and was expected to be sustained in 2024. The insurance, reinsurance and pension activities expanded by 3.6 per cent and 7.1 per cent in the third and fourth quarters of 2023, respectively.[29] The NBDTIs equally contributed to economic growth.

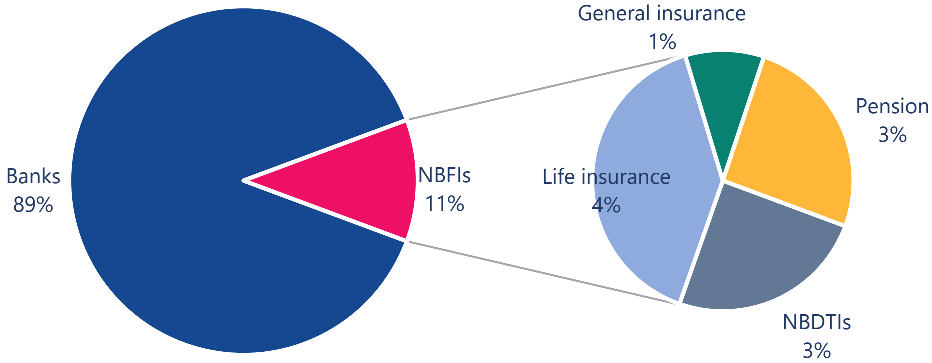
The size of the balance sheet of NBFIs, which represented 22.2 per cent of GDP in December 2023, require close oversight since they can be a source of systemic risk to the financial system,.

[28]*For the purpose of this chapter, the NBFI sector consists of NBDTIs, insurance companies and pension companies. In contrast to the Other Financial Corporations Survey and Financial Corporations Survey, investment funds and financial auxiliaries were excluded in the analyses as they represent a smaller portion of the market as well as due to a lack of regular relevant data. On the other hand, the GBC sector is analysed in-depth in the next chapter.*

[29] *Based on Statistics Mauritius' March 2024 National Accounts Estimates.*

The share of NBFI assets in total financial sector assets hovered around 11 per cent in December 2023. Within the NBFI sector, the insurance sector held a share of 5 per cent, followed by NBDTIs and pension schemes at 3 per cent each. (Chart 4.1).

Chart 4.1: Composition of the financial sector (% of assets as at end-December 2023)



Source: Bank of Mauritius

The NBDTIs demonstrated sound financial performance in the second semester of 2023, supported by balance sheet growth and further moderation in risks to financial stability. Buoyant economic activity and receding risks in the macrofinancial environment stimulated the risk appetite of the NBDTIs, leading to a consistent rise in the volume of loans and finance leases, most of which were allotted to the household sector. The NBDTIs managed liquidity risk by investing in government securities and deposits with banks. Moreover, higher earnings consolidated their capital buffers, bolstering their solvency and capacity to absorb losses. Funding was sustained through the issuance of debt securities to counter the gradual decline in deposits from clients.

The insurance sector, as a whole, remained stable in the last semester of 2023. The underwriting performance of both life insurers and general insurers were moderately impacted by the macroeconomic developments, partly due to inflation. However, despite some challenging macroeconomic conditions, the insurance business, life and general insurers combined, continued to display healthy assets growth. The pension schemes industry was similarly resilient with on-going expansion in balance sheet. The industry on-boarded more risk through further investment in equity, as both the global and domestic economy strengthened over the last semester of 2023.

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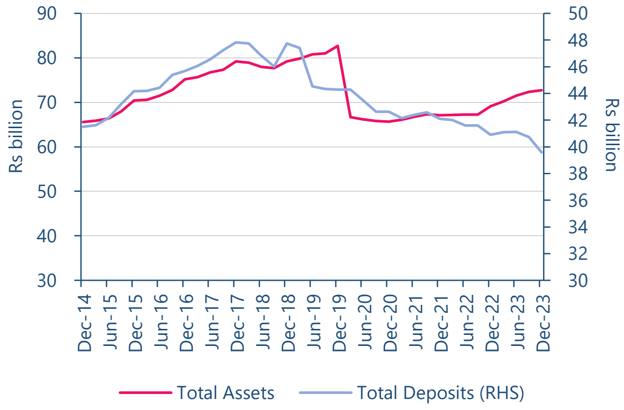
Non-bank deposit takers performed soundly

The NBDTIs were an essential financial intermediary to support the flow of credit to the private sector, with an average share of 13.6 per cent extended by deposit-taking institutions during the second half of 2023. Their total assets expanded further, given higher risk-taking appetite to take advantage of the elevated interest environment and upbeat economic prospects, growing annually by 5.2 per cent to attain Rs72.7 billion in December 2023 (Chart 4.2).

Chart 4.2: Total assets and deposits of NBDTIs



Source: Bank of Mauritius

The NBDTIs shifted their preference in favour of higher yielding instrument whilst scaling back investments in government securities and deposits held with banks. Loans and finance leases were the driving factors of asset growth, aggregating Rs59.1 billion. The highly liquid assets held by NBDTIs were thus significantly impacted. Investment in government securities and deposits with banks, respectively, dropped by 9.2 per cent and 21.7 per cent in December 2023 relative to June 2023.

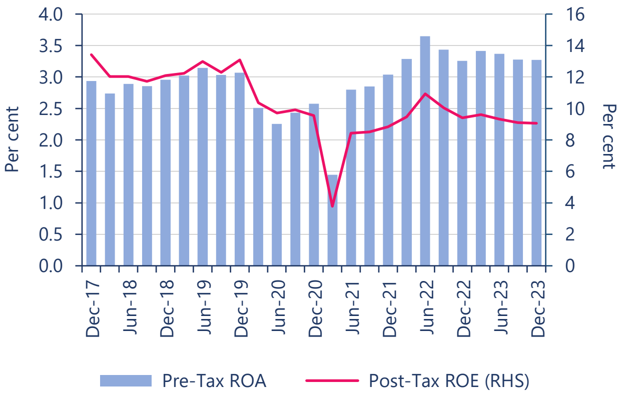
Assets growth was funded mostly through the issue of debt securities. Debt securities were the main source of funding during the second semester of 2023, with the outstanding debt securities rising by 55.6 per cent between end-June to end-December 2023 to Rs4.2 billion. These sources of funds countered a decline in deposits received from clients, which fell by 3.6 per cent between June and December 2023 to reach Rs39.6 billion.

The NBDTIs maintained robust capital buffers, providing adequate loss-absorption cushion and mitigating the transmission of risks. The CAR was 52.4 per cent as at end-December 2023, up by 2.1 percentage points from end-June 2023, and well above the regulatory minimum requirement of 10 per cent. They accumulated additional reserves from the high net interest margin in the second half of 2023, which propped up capital to Rs19.9 billion. The rise in capital more than offset the increase of 3.3 per cent in RWA, resulting into a higher CAR.

The NBDTIs managed credit risk prudently to keep it relatively low. The asset quality of NBDTIs was sound in the second half of 2023, even though the ratio of NPL to total outstanding credit rose to 5.2 per cent in December 2023, from 4.9 per cent in June 2023. This increase in impairment was well cushioned by the capital buffers, as evidenced by the NPL (net of specific provision) to capital ratio of 8.7 per cent in December 2023. The share of specific provision set aside against impairment was 43.4 per cent in December 2023.

Profitability of non-bank deposit takers remained elevated, due to favourable net interest income in the second half of 2023. The annualised profit after tax of NBDTIs hovered around Rs2.0 billion during the period under review. Profitability ratios also remained near a 7-year average, with pre-tax ROA at 3.3 per cent and post-tax ROE at 9.1 per cent in December 2023 (Chart 4.3).

Chart 4.3: Profitability ratios of NBDTIs



Source: Bank of Mauritius

Liquidity risk was judiciously managed in the NBDTIs sector. Liquid assets, comprising deposits with banks and investment in government securities, declined to support the growth of loans and leases. As a share of total assets, liquid assets were 11.8 per cent in December 2023, down from 13.8 per cent in June 2023. In terms of liquidity maturity, the net liquidity gap was positive during the short-term, particularly during a 3-month period. Deposits by clients were estimated to be stable with around 90 per cent having a maturity window between more than 3 months to over 3 years.

Insurance industry gained further traction

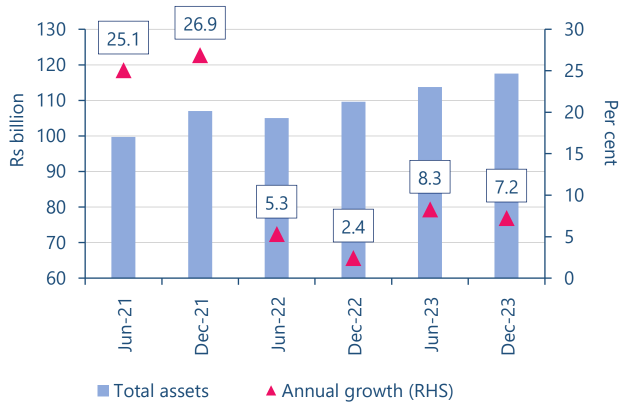
The insurance sector supports macroeconomic and financial stability by offering an array of life and non-life insurance products, providing protection to households and corporates against unforeseen events or risks. The industry comprised 7 life insurers and 15 general insurers at the end of 2023, with market share largely dominated by the former holding around 80 per cent of insurers' total assets. The penetration of the insurance industry in the economy increased to 4.3 per cent in 2023, from 4.1 per cent in 2022.[30] Insurance density also increased to reach Rs22,235 per capital premium in 2023 up from Rs21,395 per capital premium in 2022. Insurance companies employed around 2,700 people and provided protection under 950,000 insurance covers as at end-December 2023.

[30] *Measured as the ratio of total annualised insurance premium to GDP.*

Life insurance industry continued to benefit from investment strategies

Life insurers were more confident in the market outlook and increased their risk appetite to support the expansion of their business, despite lingering contraction in the number of policies. The assets of life insurers grew at an annual rate of 7.2 per cent to reach Rs117.5 billion in December 2023 (Chart 4.4). This increase was partly driven by loans allotted particularly to Other Non-Financial Corporations which are related companies of the life insurers.[31]

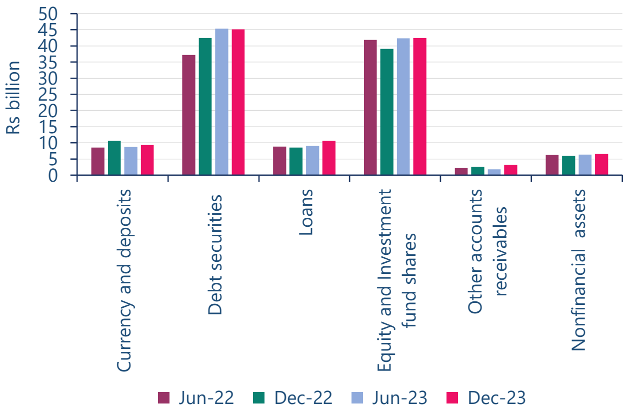
Chart 4.4: Total assets and annual growth



Source: Financial Services Commission

The life insurance companies maintained their investment strategy during the second semester of 2023 and the structure of their balance sheet was generally unchanged. The positive market outlook led an increase of investments in equity and debt securities by 8.4 per cent and 6.5 per cent, respectively, between end-June to end-December 2023 (Chart 4.5). The combined share of these assets on the balance sheet reached 74.7 per cent in December 2023.

Chart 4.5: Assets distribution



Source: Financial Services Commission

The conducive interest rate environment prompted life insurers to invest in fixed income instruments, culminating in improved profitability. They could meet their investment returns target at relatively lower risks than in equity investment. However, the downside risk, recognised as a fall in prices of debt securities, may lead to mark-to-market losses. Such risk was assessed to be mitigated as the debt securities, were held to maturity and any losses would remain unrealised. On the other hand, equity investment continued to represent a lucrative opportunity. The two largest categories of equity issuers were Other Non-Financial Corporations listed on the stock market in Mauritius and non-residents. Equity investments in these instruments were valued at Rs13.1 billion and Rs11.5 billion, respectively, as at end-December 2023.

[31] *Related party transactions are monitored as part of the supervision of conglomerates.*

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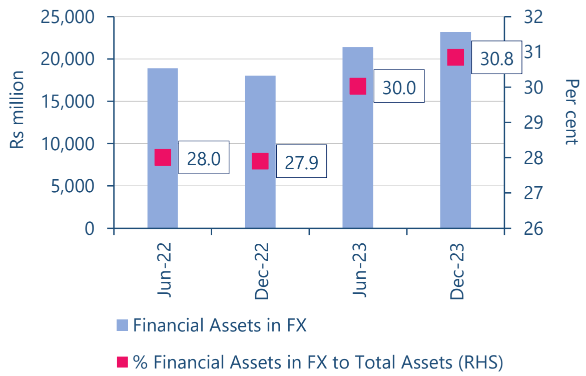
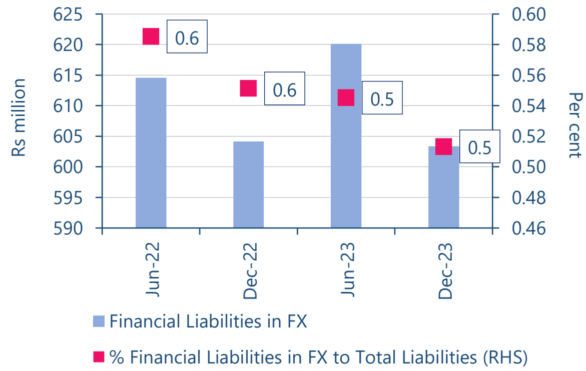
The exposure of life insurers to FX risk was stable. Financial assets denominated in FX was 30.8 per cent of total assets as at end-December 2023, at par with share observed as at end-June 2023 (Chart 4.6). A large share of these financial assets was held in the form of investment in foreign equity, followed by FX deposits with domestic banks. On the liabilities side, life insurers held nearly all instruments denominated in local currency (Chart 4.7).

Chart 4.6: FX financial assets



Source: Financial Services Commission

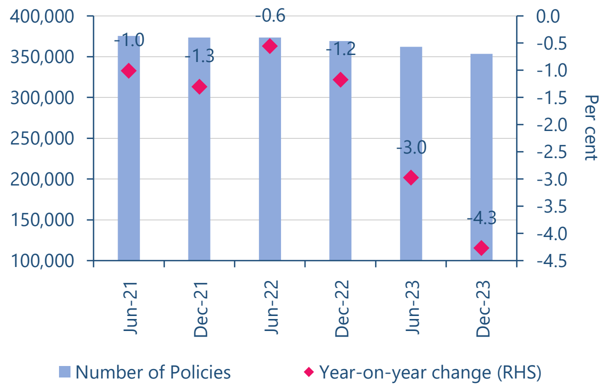
Chart 4.7: FX financial liabilities



Source: Financial Services Commission

The number of life policy covers continued to decline, impacting the underwriting performance of life insurers. Life policies dropped to 353,463 as at end-December 2023, from 362,266 as at end-June 2023 (Chart 4.8). This drop was driven by a fall of 2.6 per cent in new life policy covers issued, over the same period.

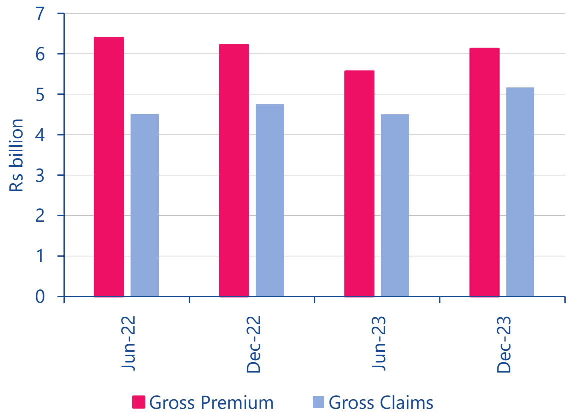
Chart 4.8: Number of policies



Source: Financial Services Commission

The life insurance sector remained profitable, as investment income offset underwriting performance. Gross premium improved, despite the drop in the number of policies in issue, rising by 10.1 per cent from end-June to end-December 2023 (Chart 4.9). Margins were compressed, however, as gross claims also increased by 14.8 per cent. Net income from insurance activities, during the second semester of 2023, contracted by 27.8 per cent relative to the first six months of 2023. Investment

Chart 4.9: Gross premium and gross claims



Source: Financial Services Commission

income largely offset the sluggish underwriting performance. The ROE remained elevated in the life insurance industry, at around 46.0 per cent during 2023.

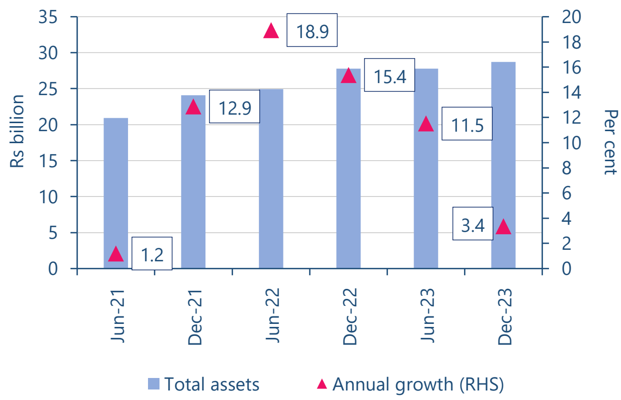
The liquidity position of life insurers improved further, supported by sustained investments in government securities. This investment strategy contributed to boosting interest income and liquidity buffers.[32] Liquid assets rose to 15.5 per cent of total assets as at end-December 2023, up by 3.0 percentage points from end-June 2023.

Life insurers are required to maintain a solvency margin at least equal to their minimum capital requirement, as per the Insurance (Long-Term Insurance Business Solvency) Rules 2007. All life insurers, which have reported their Actuarial Valuation Report (AVR) for year 2022, were deemed solvent. In view of the introduction of IFRS 17, life insurers were given an extension to submit their AVR for the year 2023. In the absence of an updated evaluation of the capital strength of life insurers, the Shareholders' Equity to Invested Assets ratio, a practical financial ratio, though less comprehensive, has been applied to measure the capital soundness of in the industry.[33] This ratio remained quasi-unchanged from end-June to end-December 2023.[34] Capital and reserves of life insurers went up by an average of 0.3 per cent while total invested assets rose by an average of 2.0 per cent.

General insurance industry expanded further

The general insurance sector, covering motor and non-motor segments of the insurance industry, demonstrated continued resilience during the second semester of 2023, backed by strong financial performance. The sector was less susceptible to volatility in FX and interest rate risk given its business model. The aggregate assets of the general insurance industry went up by annual rate of 3.4 per cent to Rs28.7 billion as at end-December

Chart 4.10: General insurance assets and growth



Source: Financial Services Commission

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[32] Liquid assets include cash, transferable deposits, debt securities and loans with original maturity less than 1 year and receivables.

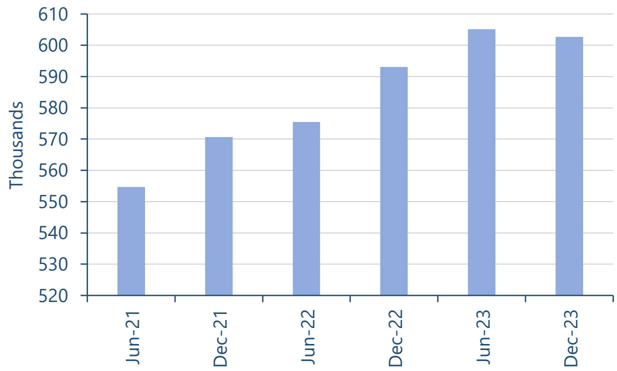
[33] This indicator, recommended in the IMF Financial Soundness Indicators Compilation Guide 2019, uses capital and reserves as the numerator and invested assets inclusive of nonfinancial assets held for investment purposes as the denominator.

[34] In the absence of benchmark range for this ratio, average progression is being analysed rather than the absolute percentages calculated.

2023 (Chart 4.10). Asset growth was largely driven by rising premiums for motor, health and property insurance policies.

The number of policies issued by general insurers stabilised in the second half of 2023. The total number of policies stood at 602,666 in December 2023, broadly unchanged from June 2023 (Chart 4.11). The motor segment held 449,120 of those policies, growing by 0.5 per cent from June 2023 as the number of vehicles expanded further. In contrast, the number of insurance policies for the non-motor segment contracted by 2.9 per cent to 153,547 in December 2023 compared to June.

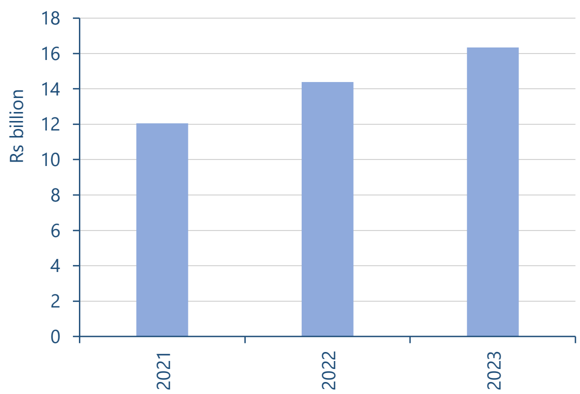
Chart 4.11: Number of policies



Source: Financial Services Commission

The general insurance sector continued to be profitable. Total gross premium rose at an annual rate of 13.2 per cent to attain Rs16.3 billion in 2023 (Chart 4.12). This growth was mainly driven by the non-motor segment, representing around two-thirds of total gross premium which grew at an annual rate of 12.0 per cent.[35] Gross premium collected by the motor segment increased at an annual rate of 17.0 per cent. The rise in gross premium collected by the general insurers outweighed the increase in gross claims, resulting in higher earnings in 2023 (Chart 4.13).

Chart 4.12: Total gross premium



Source: Financial Services Commission

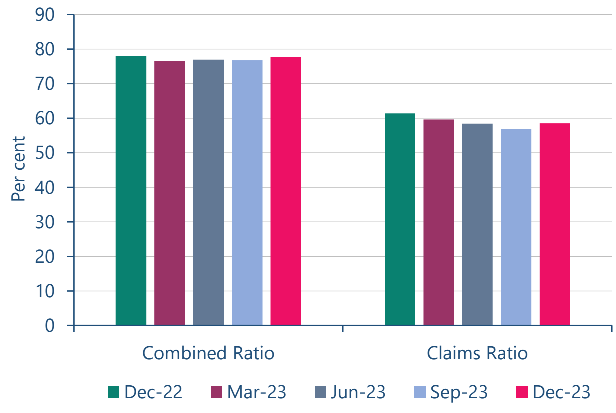
Chart 4.13: Gross premium and gross claims

Source: Financial Services Commission

[35] *Gross premium is analysed on an annual basis to adjust for seasonal fluctuations.*

The general insurers sector registered a substantial increase in underwriting cost that partly offset the increase in net income from insurance activities. The combined ratio, which measures the profitability of insurance underwriting in a given year, was at 77.7 per cent in December 2023, marginally up from 77.0 per cent in June 2023, but below the 100 per cent threshold (Chart 4.14). On the other hand, the claims ratio stayed broadly unchanged at around 58 per cent in the second semester of 2023.

Chart 4.14: Annualised Combined Ratio and Claims



Source: Financial Services Commission

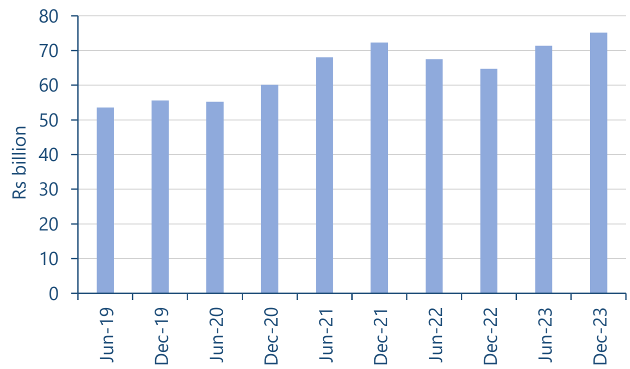
Altogether the general insurers registered a gradual improvement in ROE in 2023. They adapted to higher inflation and built operational efficiency and resilience, leading to a rise in profitability. The variability of the ROE fell significantly, indicating stability in the sector.

Most general insurers had a solvency position above the minimum requirement according to their AVR for the year ended 2022. One insurer reached its target level after the end of 2022. General insurers were given an extension to submit their AVR for 2023, given the introduction of the IFRS17. Another indicator of the financial strength of general insurers is the ratio of shareholders' equity to invested assets. This ratio dropped slightly by 0.6 percentage point between end-June to end-December 2023.[36]

Pension scheme industry expanded its assets

The 73 pension schemes consolidated their financial position, with consistent expansion of their balance sheet supported by the beneficial interest rate environment. The annual growth rate of the pension schemes' assets accelerated to 16.1 per cent, with total assets reaching Rs75.1 billion as at end-December 2023 (Chart 4.15). The main driver of asset growth was higher investments in debt securities, which grew at an annual rate of 31.6 per cent in December 2023.

Chart 4.15: Total assets and annual growth



Source: Financial Services Commission

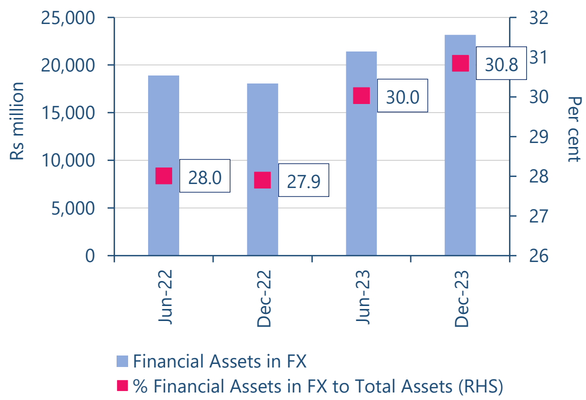
[36] *In the absence of benchmark range for this ratio, average progression is analysed rather than the absolute percentage calculated.*

Pension schemes were more confident in the market outlook, lifting their risk appetite. They expanded exposure to equity and investment fund shares, a strategy also supported by the rise in the MSCI World Index. The sector particularly favoured foreign equity and investment fund shares, showing a higher annual growth of 21.2 per cent compared to 7.2 per cent for similar domestic assets in December 2023. The outstanding value of equity and investment fund shares issued domestically was still valued higher as at end-December 2023, at Rs24.2 billion against Rs15.4 billion for those issued abroad.

The sector held significant exposure to the non-resident segment, representing 25.5 per cent of total assets in December 2023. Funds deposited with the banking sector were the next largest assets, with a share of 17.2 per cent. Investments in Government and Bank of Mauritius securities made up around 11.9 per cent of total assets. Multi-industry investments represented a share of 11.1 per cent. The exposure of pension schemes to financial institutions other than banks was 7.7 per cent of their total assets.

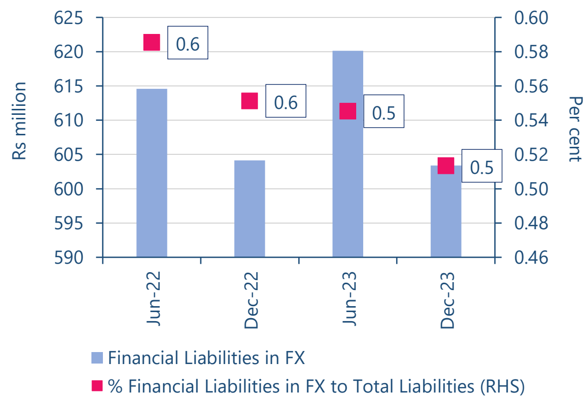
The value of FX financial assets held by pension funds was maintained at around 30 per cent of total assets. These FX assets rose at an annual rate of 28.4 per cent to reach Rs23.2 billion as at end-December 2023 (Chart 4.16). On the liabilities side, FX exposure was negligible with the share of FX liabilities to total assets averaging slightly below 1 per cent (Chart 4.17).

Chart 4.16: Foreign currency financial assets



Source: Financial Services Commission

Chart 4.17: Foreign currency financial liabilities



Source: Financial Services Commission

The liquidity position of pension funds was steady in the second half of 2023, limiting liquidity risk. The share of liquid assets to total assets averaged 5 per cent, after liquid assets went up by an annual rate of 27.8 per cent in December 2023, supported by continuous investments in short-term debt securities.

5. Global business sector

Risk to financial stability from the GB sector moderated further in the second semester of 2023. Activity in the GB sector was buoyant with improved conditions in the global economic and financial environment. The aggregate assets of GBCs remained robust. Licensing figures of GBCs stayed upbeat whilst the number of exits continued to shrink. Volatility in GBC deposits was prudently managed by banks through robust liquidity buffers. Systemic funding vulnerabilities subsided with lower concentration of GBC deposits in the funding structure of the banking system. The asset quality of the sector improved markedly after write-off of impaired facilities and the coverage ratio stayed elevated, reflecting banks' prudent approach in managing credit risk. Looking ahead, risks from the GB sector were expected to remain contained.

Sustained buoyancy in the GB sector, supported by upbeat global economic conditions, financial flows and positive investor confidence, amid growing expectations of a soft landing of the global economy, further moderated risk to financial stability in the second half of 2023. Robust licensing figures and investment flows through the Mauritius International Financial Centre (MIFC) upheld the resilience of the GB sector. The MIFC continued to attract new investors and business with its offerings as a sound and prominent International Financial Centre in the region. The number of entrants has been on an upward trend in the past few years. Still, risk to the GB sector could emerge from vulnerabilities in the global economic and financial landscape such as from geopolitical tensions, global economic fragmentation, and rising public debt in many countries.

The GB sector remained a key contributor to economic activity, employment, fiscal revenue and FX flows. The sector, with a share of 8.2 per cent to GDP, grew by 3.9 per cent in real terms in 2023, supporting the expansion of the financial sector and the economy. The GB sector directly employed around 5,600 people, an increase of 5.7 per cent relative to the first half of 2023. Its broader contribution to employment in the economy extended beyond management companies to other sectors as well – such as banking, professional services (e.g., legal, accounting and auditing services) as well as the insurance sector. Net investment income from the GB sector accounted for nearly 70 per cent of net primary income in 2023, which contributed positively to the current account balance.

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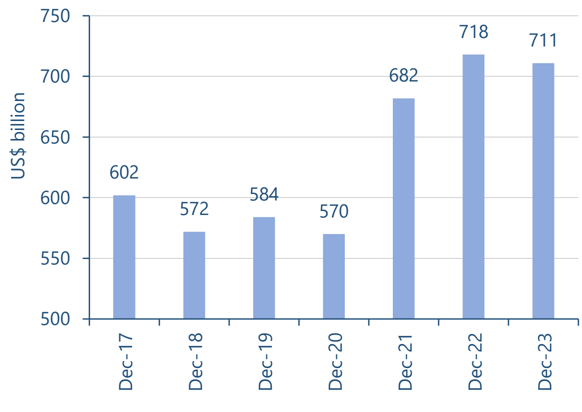
With favourable conditions prevailing in the GB sector, the number of newly licensed GBCs continued to grow whilst the number of exits maintained a downward trend. As a result, the value of assets held by GBCs remained robust at US$711 billion as at end-December 2023 (Chart 5.1). These assets were largely funded by and invested with non-residents, making the GB sector heavily reliant on the external environment and also susceptible to external shockwaves.

Chart 5.1: Total assets of GBC



Source: Financial Services Commission

Investment activities conducted by GBCs are largely transacted through the banking system, making the proper functioning of the sector contingent on a sound, efficient and stable banking system. The GB sector maintained a sizable portion of deposits that complemented the funding structure of banks. The net income received from the investment flows was a core income source in the balance of payments. The resilience of the GB sector is, therefore, important for macrofinancial stability.

The Bank collaborates closely with the FSC to conduct regular assessment of risks to and from the GB sector through an established surveillance framework.[37] Risks to the GB sector were assessed to be well contained, as licensing figures remained healthy and global investment flows remained upbeat, even though gross investment flows through the MIFC witnessed mixed dynamics in the second half of 2023. From a banking sector perspective, there was a fall in funding vulnerabilities as banks reduced deposit concentration to the GB sector. Liquidity buffers of banks stayed sound, contributing towards safeguarding the resilience of the banking sector against any abrupt withdrawal of funds by GBCs. Credit risk from the GB sector had declined from an elevated level and the provisions set aside by banks for the sector was robust.

Conditions in the Global Business sector improved

The operating environment in the GB sector improved further. The risk of a hard landing of the global economy receded considerably in the second semester of 2023, bolstering foreign investors' appetite and reinforcing confidence among operators in the sector. Licensing of new GBCs depicted a consistent rise and was accompanied by a downward trend in exits of GBCs.

[37] *Refer to Box 3 in the December 2023 edition of the FSR accessible at* *https://www.bom.mu/sites/default/files/financial_stability_report_december_2023.pdf*

The attractiveness of the MIFC was underpinned by its compliance with all the 40 FATF Recommendations as well as its Investment Grade status.

The size and heterogeneity of activities in the GB sector warranted a risk-based approach for the assessment of risks in the sector. The prudential regulation landscape is continuously upgraded to ensure that risks from the GB sector are identified and managed in an effective manner. Supervision of GBCs, comprising *inter alia* onsite inspections and offsite reviews, are conducted from a risk-based perspective to assess their risk profile and mitigate any emerging risks, including those associated with Money Laundering and Terrorist Financing (ML/TF). A constant improvement in the compliance level of the sector was observed with the overall compliance rate increased to around 90 per cent over the past 3 years.

Impact of the Base Erosion and Profit Shifting measures remained uncertain

The international community is continuously striving to improve global standards to combat misalignment of taxation and economic activity. One such initiative is the Multilateral Convention to Implement Tax Treaty Related Measures to prevent Base Erosion and Profit Shifting (BEPS), also referred to as the Multi-Lateral Instrument (MLI), designed by the Organisation for Economic Co-operation and Development (OECD).

The MLI is an international agreement that allows countries to modify existing bilateral tax treaties simultaneously to prevent abusive tax practices by multinational enterprises. The MLI addresses inadequacies in thousands of tax treaties worldwide without requiring individual renegotiation of each agreement. A country may choose the Double Taxation Treaties (DTTs) to which it wishes the MLI to apply or it can opt for a bilateral renegotiation to incorporate BEPS minimum standards and other treaty anti-avoidance provisions.

Jurisdictions that sign the MLI are required to notify the OECD which of their DTTs they wish the MLI to apply and modify. Tax treaties covered by the MLI are termed as Covered Tax Agreements (CTAs). The CTA between DTT partner countries will only be amended by the MLI if both jurisdictions share the same position on the provisions of the MLI. The latter provides signatories with flexibility to decide on which portions of MLI they wish to adopt, reject or modify.

The most prominent measure, represented under Article 7 in the agreement, addresses the minimum standards to be respected to prevent treaty abuse through: (i) the Limitation of Benefit (LoB provision); (ii) the Principle Purpose Test ('PPT') clause; or (iii) a combination of both PPT and LoB. These are anti-abuse rules whereby tax benefits can be denied where it is reasonable to conclude that the main purpose of transactions or arrangement is to obtain tax benefits. Mauritius ratified its MLI in late 2019, which came into effect in February 2020. As of date, the MLI process is in progress and the FSC is closely monitoring developments in this area.

Licensing of Variable Capital Company gathered pace

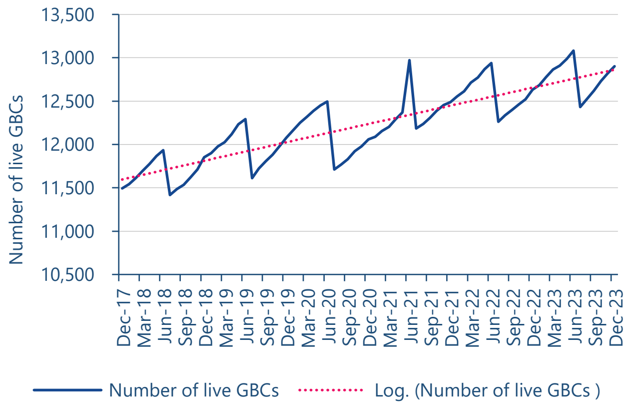
The MIFC endeavours to expand its offerings to meet the demands for diversified financial services and innovative products. The Variable Capital Company (VCC) was introduced in 2022 to bring more value to the existing fund structures in the jurisdiction. A VCC is an entity which conducts its activities through its sub-funds or Special Purpose Vehicles (SPVs).

As opposed to an umbrella fund, a VCC enables both a Collective Investment Scheme (CIS) and Closed End Fund (CEF) to be housed under the canopy of a single corporate entity. The sub-fund of a VCC may have a separate legal personality from that of the VCC Fund and can also act as a feeder fund or a master fund. VCCs have gained prominence from institutional investors given their enhanced flexible nature and cost effectiveness. A total of 26 applications have been received for VCC and 61 for sub-funds as at end-December 2023, out of which 12 and 19 have been licensed, respectively.

Live GBCs continued to rise

Activity in the GB sector was steady in the second half of 2023, with the number of active GBCs expanding at an annual rate of 2.1 per cent in December 2023. When viewed against June 2023 numbers, there was a slight dip in active GBCs with live GBCs falling to 12,901 in December from 13,082 in June 2023 (Chart 5.2). These developments reflect a broadly resilient GB sector despite lingering uncertainties in the global economic environment.

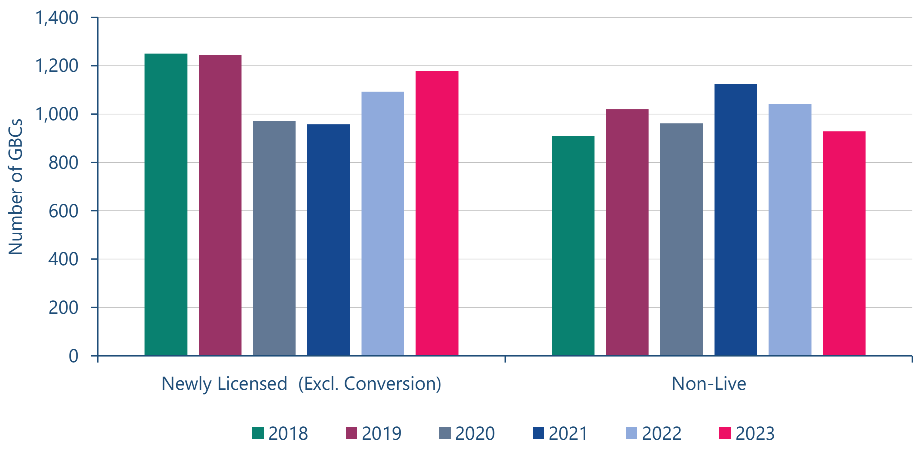
Chart 5.2: Evolution of live GBCs



Source: Financial Services Commission

The business landscape in the GB sector continued to progress favourably, with consistent decline in the number of exits of GBCs in the past three years. The number of non-live GBCs contracted at an annual rate of 10.8 per cent in December 2023 (Chart 5.3). Of importance, the number of newly licensed GBCs (exclusive of conversion cases) rose continuously in the past three years, recording an annual growth of 8.0 per cent in December 2023.[38] This advancement provides further evidence that activities in the GB sector remained steady in 2023.

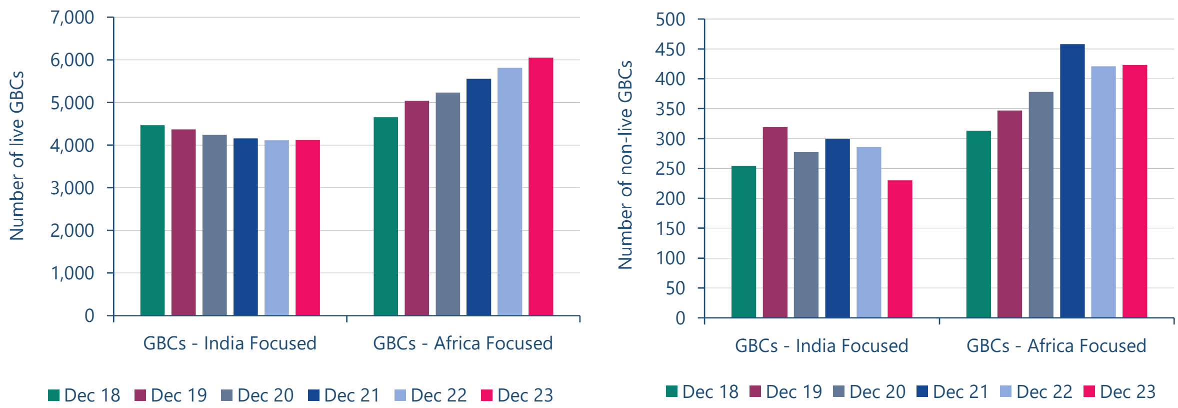
Chart 5.3 - Evolution of newly-licensed and non-live GBCs



Source: Financial Services Commission

Africa retained its status as the preferred destination for GBCs in the second half of 2023. Live GBCs targeting the African continent represented 46.9 per cent of total active GBCs in December 2023. Comparatively, the number of India-focused GBCs accounted for 31.9 per cent of active GBCs. The number of live Africa-focused GBCs maintained an upward trajectory, expanding an annual rate of 4.1 per cent to reach 6,054 as at end-December 2023. The number of live GBCs focused on the Indian market registered a marginal progression of 0.2 per cent to attain 4,120 as at end-December 2023 (Chart 5.4). In terms of exit of GBCs, the number of India-focused GBCs dropping out shrunk further, suggesting improving conditions on the Indian market.

Chart 5.4: Live and non-live GBCs targeting India vs Africa



Source: Financial Services Commission

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[38] *Around 600 GBC2s converted to GBCs following the phasing out of Category 2 Global Business regime in June 2019*

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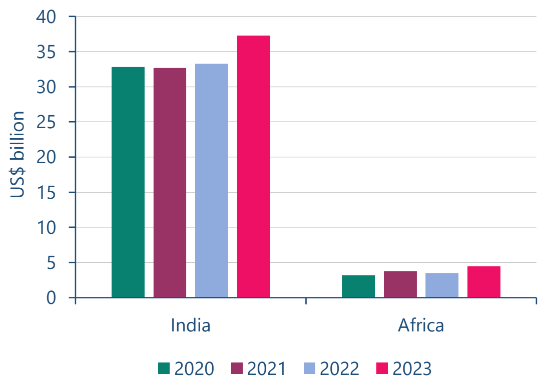
Sound investment flows

The value of foreign portfolio investments (FPIs) channelled through the MIFC progressed further in 2023 reflecting renewed investor confidence in financial markets, as the risk of a hard landing of the global economy and risk to global financial stability receded. Investment flows through the GB sector were mainly in the form of FPIs, accounting for 72.8 per cent of total investment flows in 2023. FPIs comprised primarily equity investments with a share of 84.9 per cent whilst 15.1 per cent consisted of debt instruments.

India continued to attract the largest proportion of FPIs from the MIFC, with 77.3 per cent of total FPIs relative to a share of 9.2 per cent for the African continent (Chart 5.5). FPI flows into India rose at an annual rate of 12.0 per cent as at end-December 2023. This expansion was driven by some large GB funds making substantial acquisition of equities on the stock exchange in India. Similarly, FPIs to Africa expanded by 27.2 per cent on an annual basis as at end-December 2023. The share of FPIs flows was unevenly distributed among African countries, with nearly two third of the FPIs targeting five countries.

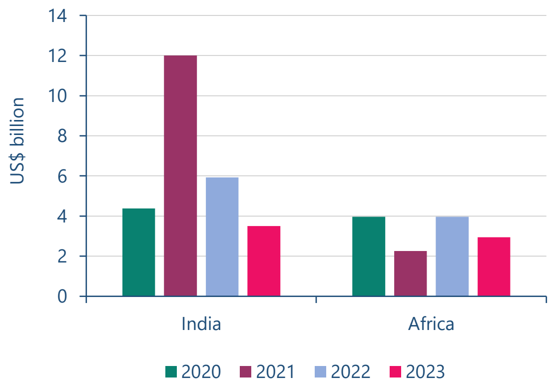
Foreign Direct Investment (FDI) flows were volatile, as they targeted the financing of private equity projects that varied significantly in size. In contrast to FPI flows, FDI flows to both India and Africa slumped on an annual basis, contracting by 40.7 per cent and 26.0 per cent in December 2023, respectively (Chart 5.6).

Chart 5.5: Gross flows of FPI



Source: Financial Services Commission

Chart 5.6: Gross flows of FDI

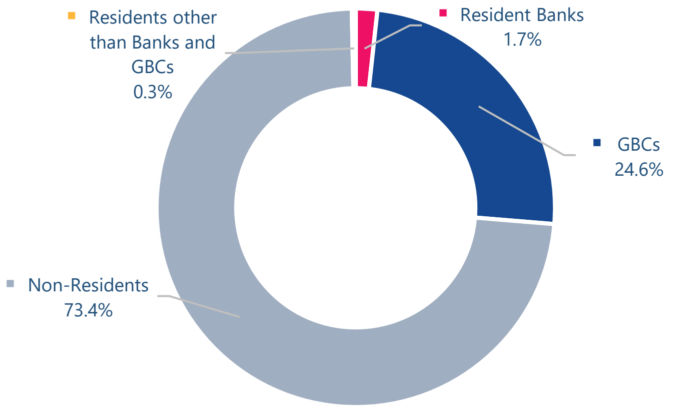


Source: Financial Services Commission

Interconnectedness between the GB and banking sectors

The MIFC remained a favoured financial centre through which the GBCs access the Indian and African markets by leveraging services offered by the banking system. From the MIFC, the GBCs have invested mostly in non-resident entities, that made up 73.4 per cent of their total assets in December 2023 (Chart 5.7). Cross-holdings among GBCs were the second largest exposure at 24.6 per cent. The total monetary and financial assets held by GBCs aggregated US$700.8 billion in December 2023. Linkages with residents other than GBCs primarily involved deposits held with banking institutions, totalling US$12.4 billion and representing around one-third of total bank deposits.

Chart 5.7: Exposures of GBCs by institutional sectors as at end-December 2023



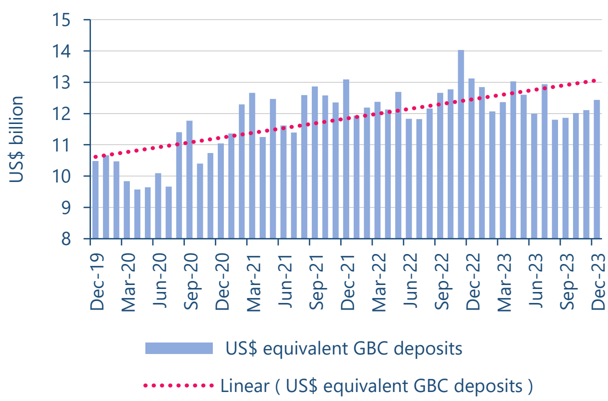
Source: Financial Services Commission

GBC deposits volatility cushioned by robust liquidity risk management and buffers

Risk from the volatility of GBC deposits was mitigated by banks with robust liquidity risk management systems and buffers. Around a third of funding for the banking system was sourced from the GBCs. As GBC deposits were inherently volatile, being characteristically of short-term maturity, they could induce liquidity strains if deployed with large funding gaps. To mitigate liquidity risk, banks generally adopted a prudent approach in managing these deposits, primarily by reinvesting these funds in liquid assets of matching currency and duration.

Aggregate GBC deposits held in the banking system maintained a general upward trend in the second semester of 2023, rising by 3.7 per cent to US$12.4 billion in December 2023 relative to June 2023 (Chart 5.8). Volatility in these deposits persisted in the third quarter of 2023, with a noticeable dip in August 2023 and picking up consistently thereafter. Around 80 per cent of the stock of GBC

Chart 5.8: Evolution of GBC deposits in US$ equivalent



Source: Bank of Mauritius

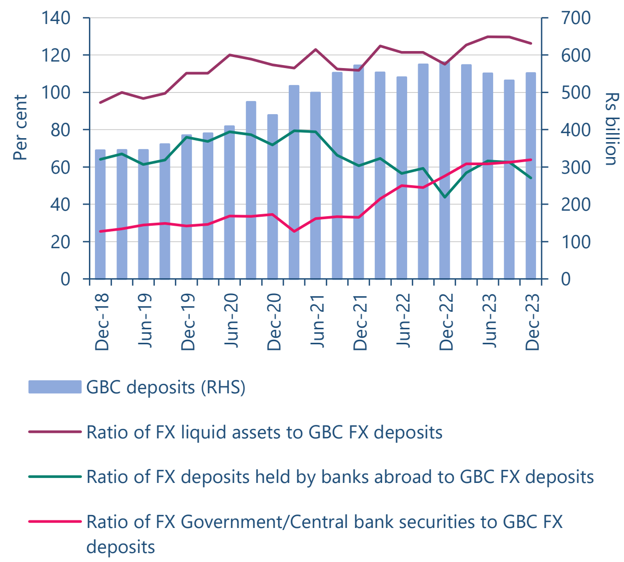
deposits were assessed to be stable, based on an analysis of the stickiness of these deposits over recent years. The liquidity buffers of banks, comprising partly deposits held with banks abroad, remained robust, underpinning their capacity to manage volatility in GBC deposits.

GBCs prevailed as the primary source of FX deposits for the banking system, although this reliance has declined over the years. The funding strategy of banks are increasingly geared towards non-residents for FX deposits. As a result, deposit concentration to the GB sector has been declining gradually. A more diversified FX funding base is expected to reduce structural funding vulnerabilities in the banking system. The share of GBC FX deposits to total FX deposits fell to 48.2 per cent in December 2023, from an average of around 58 per cent recorded from July 2013 to June 2023. As a comparison, non-resident FX deposits to total FX deposits rose to 35.6 per cent in December 2023, from an average of around 28 per cent during the corresponding period.

Cross-border activities played a crucial role in the growth strategy of the banking sector. The regulatory environment is upgraded in a progressive manner to ensure that risks to financial stability emerging from cross-border banking activities are well managed. The Bank's *Guideline on Cross-border Exposure* is revised periodically since its introduction in 2020 to strengthen its relevance in the dynamic financial sector landscape. The prudential liquidity risk framework was also enhanced. After the introduction of the LCR in 2017 to improve the resilience of banks to short-term liquidity shocks, the Bank is implementing the Net Stable Funding Ratio, effective 30 June 2024, to ensure that balance sheet growth of banks is driven by a sustainable funding structure.

The FX liquidity buffers of the banking system remained robust, indicating adequate capacity of banks to respond to FX liquidity shocks. The average share of FX liquid assets held by banks to GBC deposits reached 126.2 per cent in December 2023 (Chart 5.9). As a ratio of GBC FX deposits, deposits held by banks abroad was 54.1 per cent whilst investments in foreign government and central bank securities rose to 63.9 per cent in December 2023.

Chart 5.9: Deployment of GBC deposits



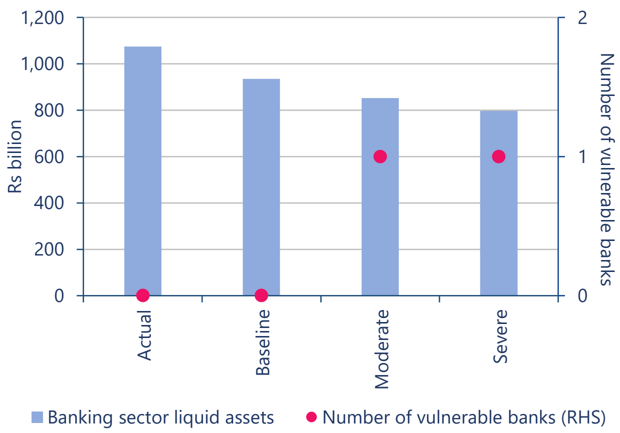
Source: Bank of Mauritius

Stress tests showed resilience to GBC deposit shocks

The Bank conducts quarterly stress tests *inter alia* to assess the adequacy of liquidity buffers to sustain a sudden withdrawal of GBC deposits from an idiosyncratic approach.[39] Liquidity shocks were applied to aggregate GBC deposits at three severity levels: from 30 per cent deposit withdrawal in the baseline scenario, to 40 per cent in the moderate and 50 per cent in the severe scenarios. These shock parameters, derived through statistical analysis of historical GBC deposit flows, are hypothetical and do not represent actual dynamics of GBC deposit flows.

The results confirmed that the liquidity buffers of most banks would be adequate to sustain the isolated liquidity shocks applied to aggregate GBC deposits based on December 2023 figures, except for one bank which displayed signs of vulnerability in the moderate and severe scenario (Chart 5.10). This bank holds a negligible share in the banking sector`s assets. In the baseline scenario, all banks would be resilient.

Chart 5.10: Number of vulnerable banks



Source: Bank of Mauritius

The FSC uses a risk assessment matrix to monitor and measure the degree of risk stemming from the GB sector and its potential impact on the banking sector. GBCs were risk-rated in respect of their probability of leaving the MIFC and the possible impact it could have on banking sector deposits.

Risks to the banking system arising from an increase in the number of GBCs exits moderated in the second semester of 2023. The share of GBCs assessed as high-risk of exiting the MIFC fell to 9.3 per cent in December 2023, from 15.7 per cent in June 2023. As a result, the share of GBC deposits with high-risk of leaving the banking system fell to 21.7 per cent in December 2023, from 26.1 per cent in June 2023 (Table 5.1). Banks maintained a prudent approach to manage such risks by holding sufficient liquid assets to cover abrupt withdrawal of funds.

[39] *Refer to Table 3.3 for details on the comprehensive liquidity shock parameters.*

Table 5.1: Risk map – per cent of total GBC deposits

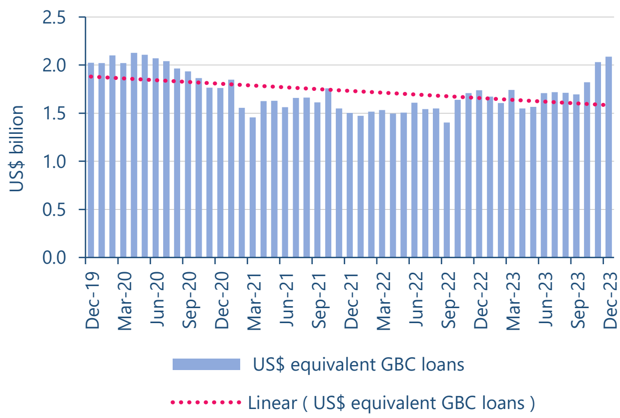
Risk Score – GBCs leaving the Mauritian jurisdiction	Sub-Total Risk scores	Low Impact	Medium-Low Impact	Medium Impact	Medium-High Impact	High Impact
High Risk	9.3	0.0	3.1	3.9	0.5	1.8
Medium-High Risk	17.1	0.1	5.1	6.2	2.4	3.3
Medium-Low Risk	15.8	0.1	4.4	5.7	3.1	2.5
Low Risk	57.8	0.3	22.2	16.5	4.7	14.1
Sub-Total Impact Score		0.5	34.8	32.3	10.7	21.7
		Impact Score – Deposit withdrawals				

Source: Financial Services Commission

Credit risk in the GB sector fell considerably

Bank credit concentration to the GB sector was relatively low compared to other sectors. Loans to GBCs accounted for 8.3 per cent of total loans extended by banks as at end-December 2023, aggregating US$2.1 billion (Chart 5.11). Loans to GBCs rose steadily in the second semester of 2023 to reach roughly the same levels prior to the pandemic, which reflected improving conditions in the global economic environment.

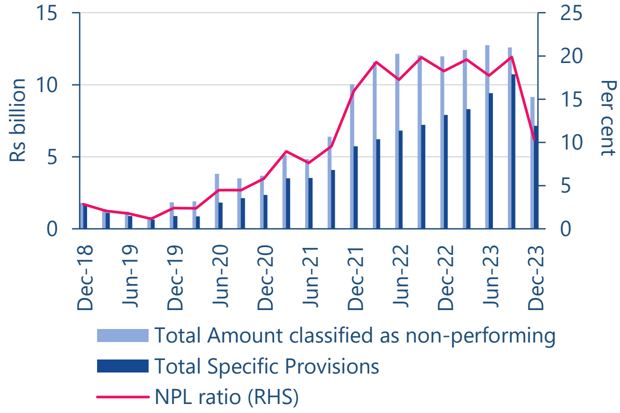
Chart 5.11: Evolution of GBC loans



Source: Bank of Mauritius

A marked improvement in the asset quality of the GB sector was noted in the credit portfolio of banks, primarily due to writing off of impaired facilities. As a result, credit risk from the sector fell considerably in the second semester of 2023. The NPL ratio of the GB sector fell to 10.4 per cent in December 2023, from 17.7 per cent in June 2023. The coverage ratio, which showed the amount of specific provisions set aside by banks to cover impaired assets, stayed elevated at 78.1 per cent (Chart 5.12).

Chart 5.12: Asset quality of GBC loans



Source: Bank of Mauritius

In general, risk to financial stability from the GB sector moderated. The favourable outlook for global economic activity and investment flows improved prospects for the sector. The gradual rise in the number of GBCs, combined with relatively fewer exits of GBCs, exhibited a stable operating environment. Similarly, investment flows through the MIFC to traditional markets remained resilient and contributed to prevent wide volatility in the stock of GBC deposits held in the banking system. As banks continued to diversify their funding structures and reduced reliance on GBC deposits, there was a drop in systemic funding vulnerabilities in the banking sector.

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List of acronyms

ARA	Assessing Reserve Adequacy
Bank	Bank of Mauritius
BEPS	Base Erosion and Profit Shifting
CAR	Capital Adequacy Ratio
CRE	Commercial Real Estate
CTA	Covered Tax Agreements
D-SIBs	Domestic-Systemically Important Banks
DTT	Double Taxation Treaties
DXY	US Dollar Index
FDI	Foreign Direct Investment
FPI	Foreign Portfolio Investment
FSC	Financial Services Commission
FX	Foreign Exchange
GB	Global Business
GBCs	Global business corporations
GDP	Gross Domestic Product
GOIR	Gross Official International Reserves
HHI	Herfindahl-Hirschman Index
HQLA	High-Quality Liquid Assets
IMF	International Monetary Fund
KR	Key Rate
LCR	Liquidity Coverage Ratio
LTV	Loan-to-value
MIC	Mauritius Investment Corporation Ltd
MIFC	Mauritius International Financial Centre
MLI	Multi-lateral Instrument
MPC	Monetary Policy Committee
MSCI	Morgan Stanley Capital International
NBDTIs	Non-Bank Deposit-Taking institutions
NBFIs	Non-Bank Financial Institutions
NPLs	Non-performing Loan(s)
OECD	Organisation for Economic Co-operation and Development
ROA	Return on Assets
ROE	Return on Equity
RPPI	Residential Property Price Index
Rs	Mauritian Rupee
RWAs	Risk-Weighted Assets
SRI	Systemic Risk Indicator
UK	United Kingdom
US	United States
US$	US dollar
VCC	Variable Capital Company
WRI	Wage Rate Index

Glossary

Annual change or growth *compares the value of a variable at one period in time with the same period of the previous year.*

Credit to private sector *has been aligned with the IMF FSI Compilation Guide (2019). Credit comprises loans and debt securities issued by private nonfinancial corporations and private sector encompasses private non-financial corporation, households and non-profit institutions serving households.*

Credit extended to households for other purposes *include purchase of other consumer durable goods, purchase of land, purchase of motor vehicles, education purposes, medical purposes, investment purposes, and other unspecified purposes.*

Credit-to-GDP gap *is the percentage deviation between the credit-to-GDP ratio and an estimate of its trend. The trend in the credit-to-GDP ratio is estimated by using the HP filter.*

Corporate sector *comprises only Other Nonfinancial Corporations in Mauritius.*

Household indebtedness *considers a broader measure that adds up household credit from banks, NBDTIs, insurance and leasing companies.*

Non-performing loans ratio *is measured by the share of non-performing loans to gross loans.*

Percentage point *is the arithmetic difference of two percentages.*

Return on Assets *is the annualised pre-tax return on assets and is measured by the ratio of pre-tax profit to average assets.*

Return on Equity *is the annualised pre-tax return on equity and is measured by the ratio of pre-tax profit to average equity.*

Residential Property Price Index (RPPI), *is an indicator of how the prices of transacted residential properties (houses and apartments) have evolved over time.*

SEMDEX *is an index of prices of all listed shares on the Stock Exchange of Mauritius wherein each stock is weighted according to its share in the total market capitalisation.*

SEMTRI *is an index, which tracks the price performances of the constituents of the SEMDEX and ensures that the dividends paid by these constituents are reinvested.*

Tier 1 capital *is a term used to qualify eligible capital of a bank and is constituted of the components having the highest loss absorbing capacity.*