3. A Review of the Performance of Banks

3.1 INTRODUCTION

The enactment of the Banking Act 2004 has broadened the scope of activities of banks. They may engage in both domestic and offshore banking activities under a single licence. Consequently, banks formerly holding distinct Category 1 or Category 2 Banking Licences have streamlined their banking operations to operate as a single entity.

RMB (Mauritius) Limited ceased to conduct banking business with effect from 1 June 2006 and surrendered its banking licence with effect from 17 July 2006, following the decision of the parent company of the bank in South Africa to consolidate its international activities into its Dublin operations in Ireland.

As at 30 June 2006, the number of banks licensed to carry out banking business stood at twenty.

3.2 PERFORMANCE OF BANKS

During the year 2005-06, the business activities of banks remained buoyant. Many banks were able to re-engineer their financial products to attract more customers and thus maintain their position in the market. The on-balance sheet assets of banks soared to Rs491,788 million at end-June 2006, from Rs420,528 million at end-June 2005, i.e. by 16.9 per cent.

At end-June 2006, five banks recorded a decrease in their total assets ranging from 3 per cent to 70 per cent. For the same period, the assets of the remaining banks rose in the range of 4 per cent to 133 per cent.

Under the single licence regime, banks have combined their domestic and international operations, as a result of which foreign assets represented 60 per cent of total assets of banks at end-June 2006.

Banks continued to derive some of their income from off-balance sheet assets. Those assets, comprising acceptances, guarantees and documentary credits, increased by 8.9 per cent from Rs32,181 million at end-June 2005 to Rs35,056 million at end-June 2006.

Chart 4 depicts the composition of assets and liabilities of banks at end-June 2006. Balances with other banks (35.7 per cent) and advances (25.4 per cent) represented the bulk of assets.

Chart 4:Balance Sheet Structure

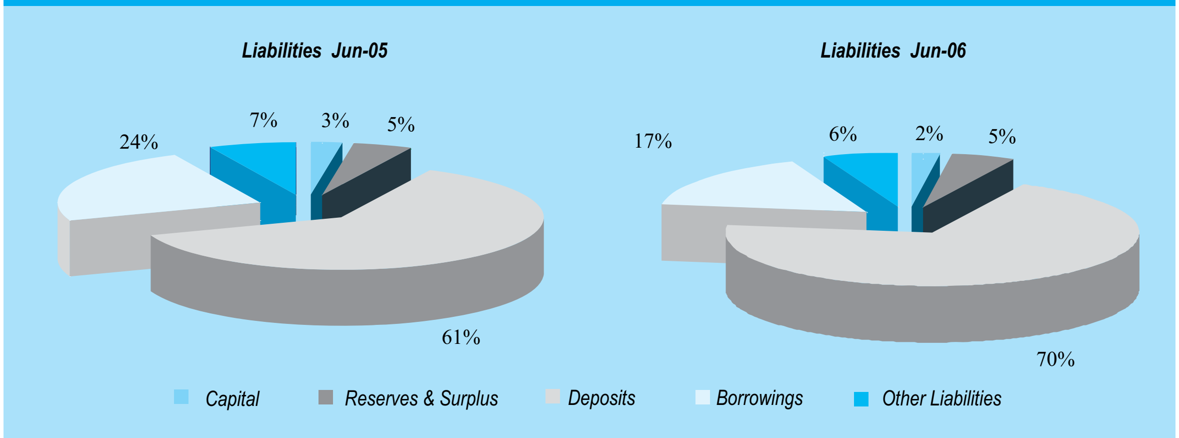
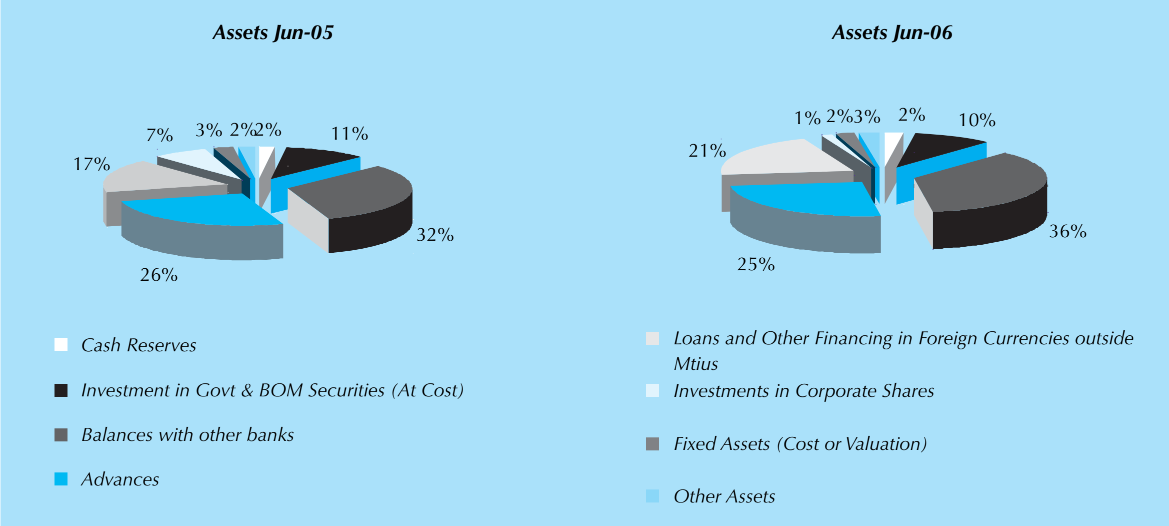


Chart 4:Balance Sheet Structure (cont'd)



3.2.1 CAPITAL ADEQUACY

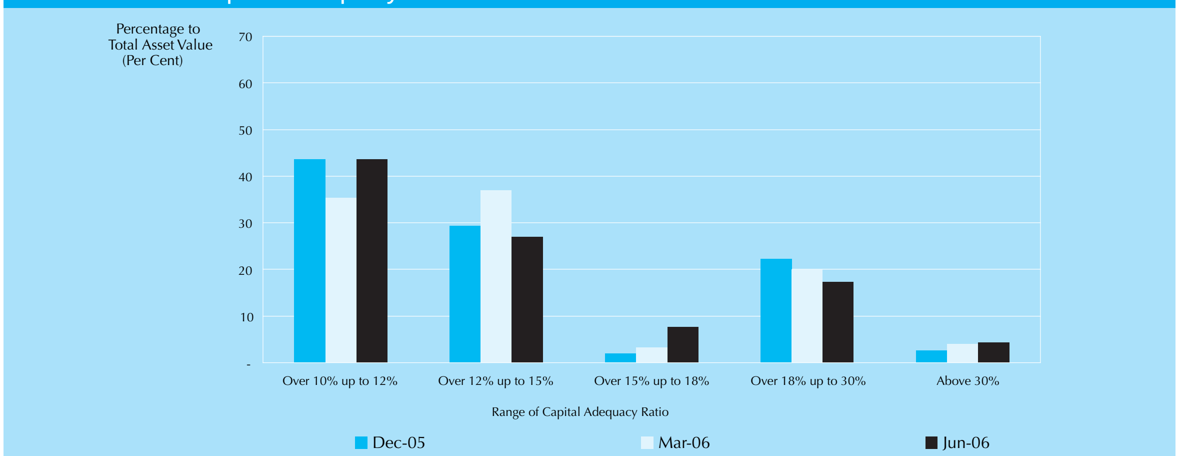
This section relates to banks that fall under the capital adequacy regime as prescribed by the prudential guidelines. Figures have been consolidated for the whole banking sector with effect from the quarter ended December 2005.

During the year under review, all banks were able to maintain the minimum risk weighted capital adequacy ratio of 10 per cent. The consolidated risk weighted capital adequacy ratio of banks ranged from 15 per cent for the quarter ended December 2005 to 16 per cent for the quarter ended 31 March 2006.

3.2.1.1 Capital Adequacy of Banks in terms of their Total Asset Value

Chart 5 shows the capital adequacy ratio maintained by banks in terms of their total asset value. For the quarters ended December 2005 and June 2006, 44 per cent and 45 per cent respectively of total on- and off-balance sheet assets of the banking sector were held by banks maintaining a capital adequacy ratio in the range of 10 to 12 per cent. Banks maintaining a capital adequacy ratio between 12 per cent and 15 per cent had a share of 29 per cent, 37 per cent and 28 per cent of total asset value for the quarters ended December 2005, March 2006 and June 2006 respectively. Those falling in the 15 per cent to 30 per cent band had a share of 24 per cent of total asset value of the sector for the quarters ended December 2005 and March 2006, and a share of 26 per cent for the quarter ended June 2006. Banks with capital adequacy ratios exceeding 30 per cent held total assets ranging from 3 to 4 per cent of total asset value of the sector.

Chart 5:Banks' Capital Adequacy Ratio in Terms of Total Asset Value



It can be observed from the above chart that banks maintaining capital adequacy ratio above 12 per cent had a share of more than 50 per cent of total asset value. As a whole, banks maintained a higher capital buffer than the minimum required. However, to make a sound assessment of the adequacy of capital maintained by banks, the level of their impaired assets needs to be considered.

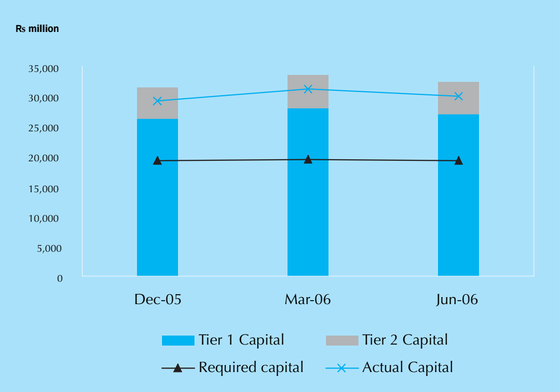
3.2.1.2 Capital Base

At end-June 2006, total capital base of banks amounted to Rs30,067 million against Rs29,296 million at end-December 2005. During the period under review, the aggregate capital base of banks increased by 2.6 per cent while their total risk weighted assets registered a marginal growth of 0.1 per cent. With a stronger capital base, the average capital adequacy ratio of banks at end-June 2006 was slightly higher at 15.5 per cent against 15.1 per cent at end-December 2005. For both quarters, all banks maintained a capital adequacy ratio above the regulatory minimum of 10 per cent.

At end-June 2006, Tier 1 capital of banks which stood at Rs26,987 million represented 83.1 per cent of total gross capital against Rs26,217 million and 89.5 per cent at end-December 2005. On the other hand, Tier 2 capital, the supplementary capital, stayed close to 17 per cent of gross capital for both periods under review. Tier 2 capital hovered around 20 per cent of Tier 1 capital at end-December 2005 and end-June 2006.

Chart 6 shows Tier 1 and Tier 2 capital for the three quarters ended 31 December 2005, 31 March 2006 and 30 June 2006. It can be seen from the chart that banks were maintaining a higher capital than required in all three quarters.

Chart 6:Minimun Required Capital v/s Actual Capital



3.2.1.3 Risk Profile of On and Off-Balance Sheet Assets

Total on-balance sheet assets of banks increased from Rs309,772 million for the quarter ended December 2005 to Rs318,505 million for the quarter ended 30 June 2006, representing a growth of 2.8 per cent. However, at end-June 2006, the corresponding total risk weighted assets value of banks fell slightly to Rs160,054 million from Rs160,488 million at end-December 2005. That fall could be explained by the fact that at end-June 2006, a higher proportion of assets was found in the zero and 20 per cent risk buckets than in the 50 and 100 per cent risk buckets.

Table 1 shows the comparative movements in the riskiness of banks' total on-balance sheet assets between the quarters ended December 2005 and June 2006. The 100 per cent risk-weight band continued to carry the bulk of banks' total on-balance sheet assets at 44.6 per cent and 42.9 per cent at end-December 2005 and end-June 2006, respectively.

Table 1 : Comparative change in the riskiness of banks' portfolios of on-balance sheet assets

	On-balance Sheet Assets (Rs million)	Percentage to Total On-balance Sheet Assets	On-balance Sheet Assets (Rs million)	Percentage to Total On-balance Sheet Assets
Risk Weights (%)	June 2006		December 2005	
0	88,023	27.6	86,980	28.1
10	-	-	-	-
20	78,204	24.6	66,713	21.5
50	15,729	4.9	17,868	5.8
100	136,549	42.9	138,211	44.6
	318,505	100.0	309,772	100.0

		June 2006	March 2006	December 2005
A	Total On and Off-Balance Sheet Assets (Rs million)	384,622	373,456	374,000
B	Total Risk-Weighted Assets (Rs million)	194,182	195,074	193,628
C (B/A)	Average Combined Risk Weighting (Per cent)	50.30	52.40	52.00
D	Capital Adequacy Ratio (Per cent)	15.33	16.04	15.13

Table 2: Total on and off-balance sheet assets of banks, equivalent risk-weighted assets and average combined risk weighting

Table 2 gives comparative figures of total on and off-balance sheet assets of banks with corresponding risk weighted value and their average combined risk weighting for the quarters ended December 2005 to June 2006.

As can be seen from Table 2, total on and off-balance sheet assets of banks grew from Rs374,000 million at end-December 2005 to Rs384,622 million at end-June 2006, or 2.8 per cent. Total risk weighted assets of banks also rose from Rs193,628 million at end-December 2005 to Rs194,182 million at end-June 2006 or 0.3 per cent, indicating a minor shift from higher to lower risk assets held by banks. Similarly, the combined risk weightings improved from 52 per cent at end-December 2005 to 50.3 per cent at end-June 2006.

3.2.2 ASSET QUALITY

On-balance sheet assets of banks increased by Rs74,579 million, or 17.9 per cent, from Rs416,712 million as at end-June 2005 to Rs491,291 million as at end-June 2006, compared to a growth rate of 15.9 per cent in the preceding fiscal year.

Banks' foreign currency assets increased by Rs130,848 million to Rs160,138 million as at end-June 2006 and represented 32.6 per cent of total assets compared to 7.0 per cent as at end-June 2005.

Off-balance sheet exposure of banks, consisting of acceptances, documentary credits and guarantees, increased by 8.9 per cent, from Rs32,181 million as at end-June 2005 to Rs35,056 million as at end-June 2006.

3.2.2.1 Advances

Banks' total credit, including financing by way of subscription to foreign securities, shares and debentures increased by Rs56,809 million, or 31.9 per cent, from Rs178,149 million as at end-June 2005 to Rs234,958 million as at end-June 2006, compared to a rise of 4.0 per cent in the preceding fiscal year. The ratio of total credit to total assets stood at 47.8 per cent as at end-June 2006 compared to 42.8 per cent as at end-June 2005.

Loans and overdrafts denominated in rupees amounted to Rs93,441 million and constituted the highest component of total credit extended by banks at end-June 2006, or 39.8 per cent, followed by loans and other financing in foreign currencies outside Mauritius which amounted to Rs82,283 million or 35.0 per cent of total credit. At end-June 2006, loans and other financing in foreign currencies in Mauritius amounted to Rs23,432 million and represented 10.0 per cent of banks' total credit. Funding by way of investments in foreign securities and other foreign assets amounted to Rs21,684 million and constituted 9.2 per cent of total credit at end-June 2006. Bills purchased and discounted, bills receivable and investments in shares and debentures aggregated Rs14,118 million and represented 6.0 per cent of total credit of banks at end-June 2006.

3.2.2.2 Credit Concentration

Under the Banking Act 2004, all banks are subject to the regulatory credit concentration limits prescribed in the Guideline on Credit Concentration Limits. In accordance with section 29(4) of the Banking Act 2004, the Bank may exempt from credit concentration limits, as it deems fit, that part of a bank's banking business or investment banking business that is conducted in currencies other than Mauritian currency.

As at end-June 2006, total fund and non-fund based facilities of all banks exceeding the threshold of 15 per cent of their capital base, amounted to Rs127,236 million and represented 52 per cent of the overall on- and off-balance sheet commitments. That amount included credit facilities of Rs39,561 million and Rs87,675 million to companies engaged in local activities and international activities respectively. As at end-June 2005, total fund and non-fund based facilities, exceeding the threshold of 15 per cent of banks' capital base, amounted to Rs39,331 million, representing 31 per cent of the overall on- and off-balance sheet commitments of former Category 1 banks. The significant increase of Rs87,905 million in the total fund based and non-fund based facilities is due mainly to the consolidation of credit facilities of former Category 1 and Category 2 banks.

3.2.2.3 Sectorwise Distribution of credit to the Private Sector in Mauritius

The credit exposure of banks to the private sector in Mauritius increased by Rs14,405 million or 13.7 per cent from Rs105,066 million at end-June 2005 to Rs119,471 million at end-June 2006, compared to an increase of 9.6 per cent in the preceding fiscal year. At end-June 2006, banks' credit to the private sector in Mauritius represented 50.8 per cent of total advances compared to 59.0 per cent at end-June 2005.

Table 3 shows the sectors that accounted for more than 1 per cent of banks' total credit to the private sector in Mauritius as at end-June 2005 and end-June 2006.

As at end-June 2006, the highest share of total credit to the private sector had gone to the 'Construction' sector at 16.3 per cent, followed by the 'Traders' sector at 14.8 per cent, the 'Tourism' sector at 12.8 per cent, the 'Manufacturing' sector at 12.5 per cent and the 'Financial and Business Services' sector at 11.2 per cent.

The bulk of the additional credit of Rs14,405 million to the private sector was extended to four sectors, namely 'Financial and Business Services' (Rs3,105 million), 'Public non-financial Corporations' (Rs2,851 million), 'Construction' (Rs2,484 million) and 'Traders' (Rs2,178 million).

3.2.2.4 Non-performing Advances and Provisioning

Non-performing advances (impaired credits) reported by banks aggregated Rs7,740 million at end-June 2006 compared to Rs7,645 million at end-June 2005, or 1.2 per cent. A decline was noted in the ratio of non-performing advances to total advances, from 4.3 per cent at end-June 2005 to 3.3 per cent at end-June 2006.

Provisions made by banks increased by 13.5 per cent from Rs3,478 million at end-June 2005 to Rs3,948 million at end-June 2006. The ratio of provisions to non-performing advances rose from 45.5 per cent at end-June 2005 to 51.0 per cent at end-June 2006. Provisions made on individually assessed credits amounted to Rs3,441 million and provisions on portfolio assessed credits amounted to Rs507 million as at end-June 2006.

Apart from those provisions, banks have also maintained general provisions which rose from Rs1,238 million at end-June 2005 to Rs1,338 million at end-June 2006, or 8.1 per cent. However, the ratio of general provisions to standard advances declined marginally from 0.7 per cent at end-June 2005 to 0.6 per cent at end-June 2006.

Table 3: Sectorwise Distribution of Credit to the Private Sector in Mauritius				
	End-June 2005 (A)	End-June 2006 (B)	Change between (A) and (B)	
	(Rs million)	(Rs million)	(Rs million)	Per cent
Construction	16,991 *(16.2)*	19,475 *(16.3)*	2,484	14.6
Traders	15,535 *(14.8)*	17,713 *(14.8)*	2,178	14.0
Tourism	15,117 *(14.4)*	15,341 *(12.8)*	224	1.5
Manufacturing	14,398 *(13.7)*	14,976 *(12.5)*	578	4.0
Financial and Business Services	10,239 *(9.7)*	13,344 *(11.2)*	3,105	30.3
Personal	9,790 *(9.3)*	11,342 *(9.5)*	1,552	15.9
Public non-financial Corporations	6,088 *(5.8)*	8,938 *(7.5)*	2,851	46.8
Agriculture & Fishing	7,346 *(7.0)*	7,844 *(6.6)*	499	6.8
Infrastructure	1,510 *(1.4)*	2,833 *(2.4)*	1,323	87.6
Transport	1,508 *(1.4)*	1,682 *(1.4)*	174	11.5
Other	6,546 *(6.2)*	5,984 *(5.0)*	-562	-8.6
Total	**105,066**	**119,471**	**14,405**	**13.7**

Figures in brackets are percentages of total credit to private sector
Figures may not add up to total due to rounding

3.2.2.5 Investments in Risk-Free Securities

Risk-free securities comprise Bank of Mauritius Bills, Government of Mauritius Treasury Bills, Treasury Notes and other securities of the Government of Mauritius. Banks' investments in risk-free securities increased from Rs45,683 million to Rs47,887 million between end-June 2005 and end-June 2006, i.e. by 4.8 per cent. At end-June 2006, such investments represented 13.9 per cent of total deposits and 9.7 per cent of total assets of banks. The corresponding figures at end-June 2005 were 17.5 per cent and 10.9 per cent respectively.

3.2.2.6 Balances held with Banks

Aggregate balances held with banks, including inter-bank loans, rose by 31.1 per cent in 2005-06 to reach Rs176,343 million. These balances represented 35.9 per cent of banks' total assets as at end-June 2006 compared to 32.0 per cent at end-June 2005, the bulk of which or 99.1 per cent was held with banks abroad.

3.2.2.7 Investments in Shares

Banks' total investments in shares declined by 18.2 per cent, from Rs7,705 million at end-June 2005 to Rs6,302 million at end-June 2006. Total investments in shares of foreign entities, local public sector entities and local private sector entities constituted 21.6 per cent, 32.3 per cent and 46.1 per cent respectively of banks' total investments in shares at end-June 2006.

3.2.2.8 Fixed Assets

The gross fixed assets of banks increased by 6.4 per cent from Rs10,668 million at end-June 2005 to Rs11,348 million at end-June 2006. The ratio of gross fixed assets to total assets declined slightly from 2.5 per cent at end-June 2005 to 2.3 per cent at end-June 2006. During the year ended 30 June 2006, banks made additional provisions of Rs566 million for depreciation on fixed assets, with the result that the accumulated depreciation rose from Rs4,052 million at end-June 2005 to Rs4,618 million at end-June 2006. Fixed assets of banks net of depreciation stood at Rs6,730 million at end-June 2006 as opposed to Rs6,616 million at end-June 2005. As at end-June 2006, the revaluation reserves of banks, comprising property revaluation surplus, amounted to Rs1,201 million.

3.2.2.9 Cash Reserves

As from July 2005 all banks were required to maintain a minimum of 5.5 per cent of their deposit liabilities as cash reserves comprising cash in hand and balances with Bank of Mauritius. Prior to that period, only former Category 1 banks were required to maintain a cash ratio. The Guideline on Segmental Reporting under a Single Banking Licence Regime provided a transition period for the former Category 2 banks to maintain a special cash ratio. In January 2006, the cash reserve ratio was reduced to 4.0 per cent and only balances with Bank of Mauritius are considered as cash balances for the purpose of maintaining the cash ratio.

At end-June 2006, banks' balances with Bank of Mauritius aggregated Rs9,047 million and constituted 1.8 per cent of their total assets. Cash in hand and balances with Bank of Mauritius amounted to Rs10,864 million and represented 3.2 per cent of total deposits.

3.2.3 PROFITABILITY

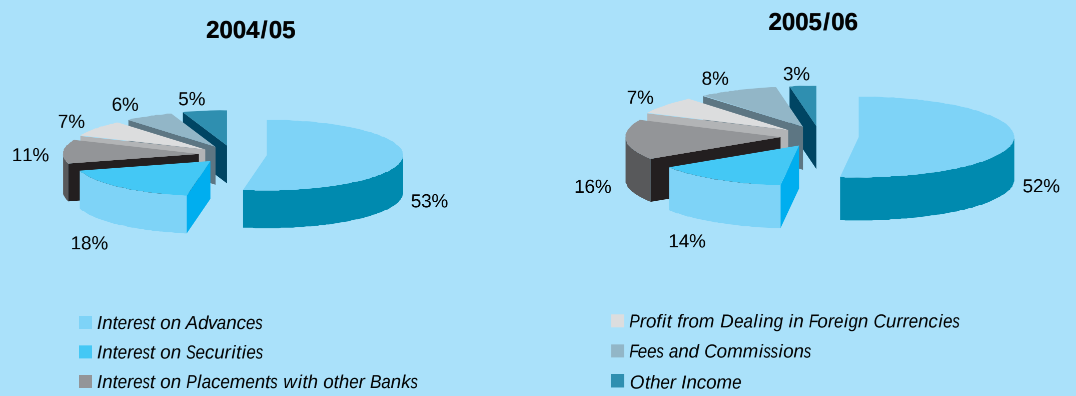
The overall profitability of banks' operations improved during the period under review. Table 4 summarises the performance over the past three financial years. The consolidated profitability figures are based on the audited results of banks as of 30 June, 31 December and 31 March.

Banks realised an overall pre-tax profit of Rs7,854 million in 2005/06 as compared to Rs6,312 million in 2004/05.

Table 4: Consolidated Profit Performance of Banks	2003/04	2004/05 (Rs million)	2005/06
Total Interest Income	**17,123**	**17,741**	**21,252**
Interest Income from Loans (*including debentures*)	11,711	11,395	13,130
Interest on Securities	3,624	3,807	3,578
Other Interest Income	1,788	2,539	4,544
Total Interest Expense	**9,982**	**9,730**	**12,000**
Interest Expense on Deposits	7,518	7,205	8,461
Other Interest Expense	2,464	2,525	3,539
Net Interest Income	**7,141**	**8,011**	**9,252**
Add : Non-interest Income	3,079	3,795	4,091
Operating Income	**10,220**	**11,806**	**13,343**
Less : Staff Costs	1,339	1,763	2,065
Other Operating Expenses	2,719	2,964	3,098
Operating Profit before Bad and Doubtful Debts and Taxation	**6,162**	**7,079**	**8,180**
Less : Charge for Bad and Doubtful Debts	992	855	548
Operating Profit	**5,170**	**6,224**	**7,632**
Add : Share of Profits in Subsidiaries and Associates	163	217	232
Less : Exceptional Items	520	129	10
Profit before Tax	**4,813**	**6,312**	**7,854**

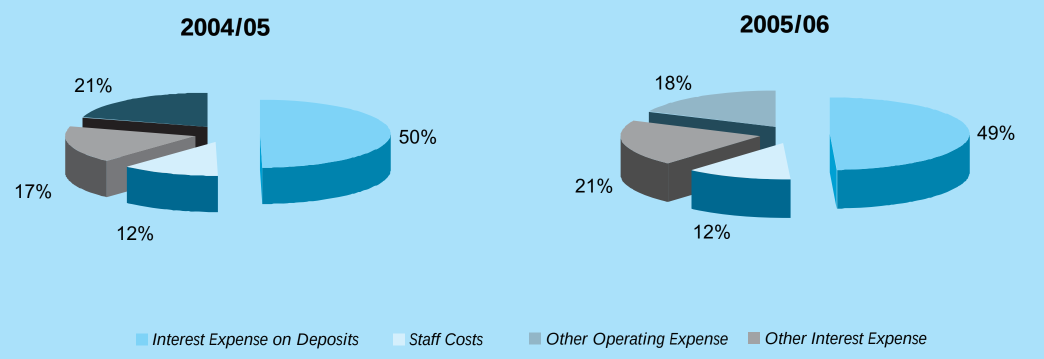
Charts 7 and 8 show the main components of income and expenses for 2004/05 and 2005/06.

Chart 7: Components of Income



Based on combined audited data for financial years ended 30 June, 31 December and 31 March.
All figures are for the period.

Chart 8: Components of Expenses



Based on combined audited data for financial years ended 30 June, 31 December and 31 March. All figures are for the period.

3.2.3.1 Income

During the year 2005/06, growth in profits was driven mainly by higher revenue from lending activities. Total income of banks increased from Rs21,536 million in 2004/05 to Rs25,343 million in 2005/06, representing an increase of 17.7 per cent. Loans including debentures, investments in securities, and placements with other banks remain the main source of income for banks, accounting for an average of 82.5 per cent of total income for the years 2003/04 through 2005/06.

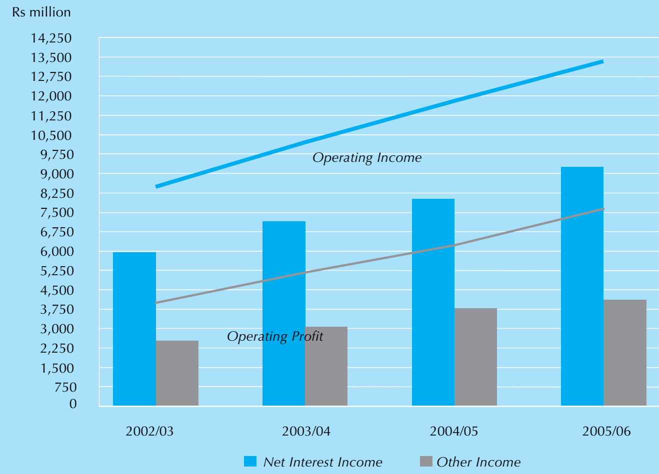
Non-interest income grew by 7.8 per cent in 2005/06 compared to 23.3 per cent in 2004/05, indicating a decline in income generated by non-core activities of banks. Interest income registered a growth of 19.8 per cent during 2005/06 compared to a lower growth of 3.6 per cent in 2004/05 as shown in Table 5.

Table 5: Growth in Interest Income v/s Growth in Non-Interest Income

	2003/04	2004/05	2005/06
Growth in Interest Income (per cent)	11.5	3.6	19.8
Growth in Non-interest Income (per cent)	21.7	23.3	7.8

Chart 9 shows the evolution of net interest income, other income, operating income and operating profit over the past four years.

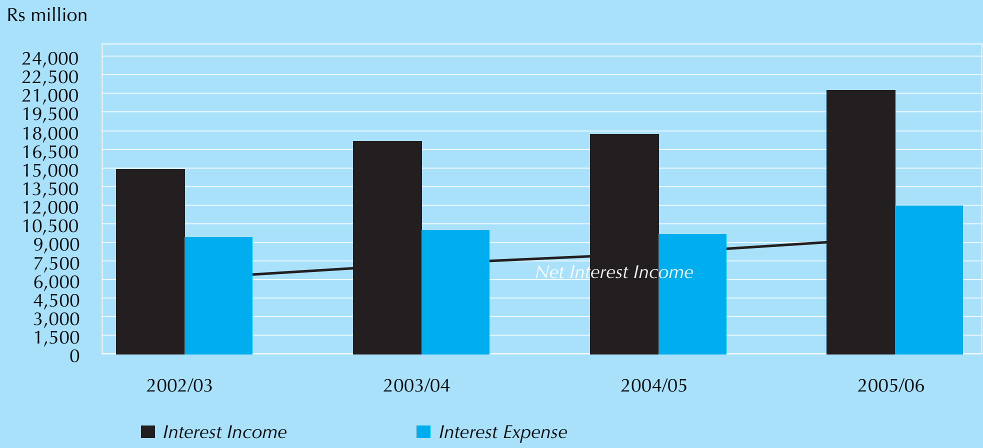
Chart 9: Evolution of Net Interest Income, Other Income, Operating Income and Operating Profit



Based on combined audited data for financial years ended 30 June, 31 December and 31 March.
All figures are for the period.

3.2.3.2 Net Interest Income

Chart 10 : Components of Net Interest Income



Based on combined audited data for financial years ended 30 June, 31 December and 31 March.
All figures are for the period

Chart 10 shows the increasing trend in net interest income for banks for the years 2002/03 through 2005/06.

Rising interest rates on the domestic and international markets during 2005/06, coupled with higher demand for advances, impacted positively on interest income. Total interest income rose from Rs17,741 million in 2004/05 to Rs21,252 million in 2005/06. Interest earned on loans, including debentures, increased by Rs1,735 million to reach Rs13,130 million in 2005/06, representing 61.8 per cent of total interest income as compared to 64.2 per cent in 2004/05. Interest earned on securities fell by Rs229 million from Rs3,807 million in 2004/05 to Rs3,578 million in 2005/06. Other interest income, including income from placements and loans to banks, grew by Rs2,005 million or 79.0 per cent to reach Rs4,544 million in 2005/06.

Table 6: Growth in Interest Earned on Advances v/s Growth in Interest Earned on Securities			
	2003/04	2004/05	2005/06
Growth in Interest Earned on Advances (per cent)	7.9	-2.7	15.2
Growth in Interest Earned on Securities (per cent)	43.6	5.0	-6.0

Total interest expense, comprising interest paid on deposits and borrowings from other banks and financial institutions, stood at Rs12,000 million during 2005/06, rising by Rs2,270 million or 23.3 per cent over the previous period. Interest paid on deposits increased sharply by Rs1,256 million or 17.4 per cent in 2005/06 which was mainly attributable to a general increase in interest rates worldwide. The cost of borrowings from other banks and financial institutions, constituting 29.5 per cent of total interest expense of banks posted a significant increase of Rs1,014 million during 2005/06. Net interest income increased by Rs1,241 million or 15.5 per cent from Rs8,011 million in 2004/05 to Rs9,252 million in 2005/06.

Table 7 shows the interest spread with respect to Segment A activities of banks. As can be observed, interest earned on Rs100 of advances and interest paid on Rs100 of deposits decreased by Rs0.16 and Rs0.41 respectively. Consequently, the interest spread widened from Rs3.84 to Rs4.09 during the year under review. It may be highlighted that Segment A business consists essentially of transactions carried out by banks with residents of Mauritius.

3.2.3.3 Non-Interest Income

Non-interest income registered a growth of 7.8 per cent to reach Rs4,091 million in 2005/06 compared to 23.3 per cent in 2004/05. Fee-related income and profit arising from dealings in foreign currencies grew by Rs859 million and Rs163 million or 67.7 per cent and 10.1 per cent respectively. Income arising from fees and commission and profits from dealings in foreign currencies represented 52.0 per cent and 43.6 per cent of total non-interest related revenue, respectively. The wider use of electronic cards for purchases and other transactions contributed to the higher fee income of banks.

3.2.3.4 Non-Interest Expenses

Non-interest expenses consisting of staff costs and other operating expenses increased by 9.2 per cent to Rs5,163 million in 2005/06 compared to an increase of 16.5 per cent recorded in 2004/05. The banking sector continued to invest in human resources, which is necessary to attract new skills in the industry. However, the ratio of staff costs to operating income rose marginally by 0.6 per cent between 2004/05 and 2005/06. On the other hand, other operating expenses increased by 4.5 per cent to reach Rs3,098 million in 2005/06.

The ratio of non-interest expenses to gross operating income (net of charge for bad and doubtful debts) decreased from 43.2 per cent in 2004/05 to 40.4 per cent in 2005/06.

3.2.3.5 Operating Profit

Banks realised operating profit (before bad and doubtful debts and taxation) of Rs8,180 million during 2005/06, representing an increase of Rs1,101 million or 15.6 per cent compared to 2004/05. Banks realised profit before tax of Rs7,854 million in 2005/06, representing an increase of 24.4 per cent over the pre-tax profit of Rs6,312 million realised in 2004/05. This positive result is partly attributed to lower charge for bad and doubtful debts which decreased by Rs307 million during the year 2005/06. Chart 11 depicts the trend in banks' profit for the years 2002/03 through 2005/06.

Table 7: Interest Spread-Segment A Activities			
	2003/04	2004/05	2005/06
Interest Earned on Rs 100 of Advances	9.72	8.54	8.38
Cost per Rs 100 of Deposits	6.00	4.70	4.29
Interest Spread	3.72	3.84	4.09

Chart 11: Operating Profit and Profit after Tax

Based on combined audited data for financial years ended 30 June, 31 December and 31 March.
All figures are for the period.

3.2.3.6 Return on Average Assets and Equity

The return on average assets and return on equity are key performance ratios providing valuable insights into the efficient use of resources by banks.

The pre-tax return on average assets improved from 1.8 per cent in 2004/05 to 1.9 per cent in 2005/06, reflecting better resource allocation.

The pre-tax return on average assets of individual banks ranged from a negative of 1.2 per cent to a positive of 3.2 per cent in 2005/06. With the exception of two banks, all banks recorded a positive return on average assets in 2005/06. The negative returns on average assets realised by the two banks were mainly attributed to higher provision for bad and doubtful debts and significant start up costs respectively. Eight banks achieved a pre-tax return on average assets of over 2.0 per cent during 2005/06.

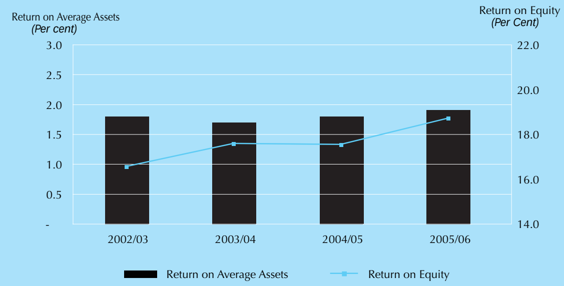
The post-tax return on equity improved from 17.5 per cent in 2004/05 to 18.7 per cent in 2005/06 despite an increase of Rs178 million in tax charge during the year under review. The post-tax return on equity for individual banks, ranged from a negative of 9.7 per cent to a positive of 47.8 per cent in 2005/06, with four banks achieving a return on equity of over 20.0 per cent during 2005/06.

Chart 12 shows the return on average assets and equity over the period 2002/03 to 2005/06.

3.2.4 LIQUIDITY

Liquidity risk is defined as the risk arising from the inability of banks to honour their cash flow commitments, including off-balance outflow commitments, as they fall due.

Chart 12: Return on Average Assets and Equity



Based on combined audited data for financial years ended 30 June, 31 December and 31 March.
All figures are for the period.

Liquidity risk is one of the most important risks inherent in banking business and if not well managed, can lead to serious loss of reputation and confidence in financial institutions. Ultimately it may permeate the whole financial system feeding through to systemic risk.

Banks should adopt a prudent stance in managing liquidity risk and should have robust reporting tools to enable them to assess their liquidity position at all times. In its endeavour to ensure the soundness of the banking system, the Bank issued a Guideline on Liquidity in January 2000. The guideline encompasses the essential elements of the liquidity policy framework, a description of important steps in the management of liquidity and contingency planning.

Effective July 1999, former Category 1 banks were required to maintain a minimum weekly average cash reserve ratio of 5.5 per cent. With effect from 12 January 2006, the cash ratio requirement was scaled down to 4.0 per cent and eligible cash reserves were redefined as balances held with the Bank of Mauritius.

3.2.5 DEPOSITS

Deposits continued to be the major source of funding and constituted the highest proportion of total liabilities. As at end-June 2006, deposits mobilised by banks accounted for 70.0 per cent of total assets, up from 60.0 per cent at end-June 2005. During the year under review, deposits including foreign currency deposits, grew by 32.1 per cent to reach Rs344,441 million from Rs260,692 million at end-June 2005.

3.2.5.1 Advances /Deposits Ratio

The advances/deposits ratio measures the extent to which funds mobilised by way of deposits have been utilised to finance lending activities of banks. The advances/deposits ratio declined from 70.0 per cent at end-June 2005 to 66.0 per cent at end-June 2006.

3.2.5.2 Non-Cash Liquid Assets Ratio

In 1997, the non-cash liquid assets ratio was reduced from 20.0 per cent to zero per cent. Nevertheless, banks set their own thresholds with a view to managing, measuring and controlling their funding requirements in line with sound banking practices.

Investment in Treasury Bills and Government securities, which represents the most easily convertible non-cash liquid assets, increased by Rs2,204 million or 4.8 per cent from Rs44,792 million as at end-June 2005 to Rs45,683 million as at end-June 2006. These investments represented 23.9 per cent of total assets at end-June 2006 compared to 25.7 per cent at end-June 2005.

3.3 DEVELOPMENTS IN ELECTRONIC BANKING

Electronic Banking normally refers to the use of technology for the delivery of banking products and services. These products and services are increasingly being accessed electronically via computers and cellular phones. The development of e-banking, in an environment characterised by deregulation in the banking sector and increased globalisation, poses new challenges to the regulators.

As at 30 June 2006, ten banks were providing electronic banking services in Mauritius. Available data indicate that transactions conducted through electronic delivery channels are gaining popularity. The number of transactions shows an increasing trend from 2,525,605 during the year ended 30 June 2005 to 2,799,201 during the year ended 30 June 2006.

The number of Automated Teller Machines (ATMs) in operation in Mauritius, inclusive of Rodrigues, increased from 293 to 321 during the year ended 30 June 2006. Accordingly, the number of cards in circulation increased by 14.2 per cent from 908,676 as at end-June 2005 to 1,038,089 as at end-June 2006.

The total value of transactions involving the use of credit and debit cards at ATMs and Merchant Points of Sale increased from Rs4,096 million as at 30 June 2005 to Rs4,417 million as at 30 June 2006. Advances due on credit cards amounted to Rs1,010 million as at 30 June 2006, representing an amount of Rs5,275 per card on average.

Table 8 provides a summary of the evolution of electronic banking transactions for the quarters ended June 2005 to June 2006.

Table 8: Electronic Banking Transactions - June 2005 to June 2006

	Jun-05	Sep-05	Dec-05	Mar-06	Jun-06
At end of month					
No. of ATMs in operation	293	308	313	319	321
No. of transactions during the month	2,525,605	2,702,023	3,698,436	2,967,336	2,799,201
Value of Transactions* (Rs mn)	4,096	4,411	6,991	4,736	4,417
No. of credit cards in circulation at end of month	182,860	187,949	190,677	190,203	191,481
Debit cards and other	725,816	750,105	772,049	786,809	846,608
Total Cards	**908,676**	**938,054**	**962,726**	**977,012**	**1,038,089**
Outstanding Advances on Credit Cards (Rs mn) at end of month	907	975	1,039	1,009	1,010

* Involving the use of Credit Cards and Debit Cards at ATMs and Merchant Points of Sale

Internet banking is also becoming an attractive option for customers due to its convenience and cost effectiveness. In fact, the number of Internet banking customers increased from 24,812 as at 30 June 2005 to 33,253 as at 30 June 2006. Customers are also making increasing use of phone banking facilities. At 30 June 2006, 61,185 customers had registered for this service compared to 52,830 as at 30 June 2005. One bank is also offering a service that allows its customers to access their accounts through their mobile phones.

In view of the rapid development of the provision of financial services via electronic delivery channels, the Bank issued a Guideline on Internet Banking in April 2001. The Banking Act 2004 has set out at sections 50, 51 and 52 relating to Electronic Banking, a framework within which banks may conduct e-banking business. Those sections also define the specific circumstances that require the Bank's approval and the minimum security measures that need to be put in place.

3.4 DEVELOPMENT IN PRIVATE BANKING

In Mauritius, the former Category 2 banks, operating on the international market, are involved in the asset management of high net worth customers. Wealthy customers in search of high returns but who desire utmost discretion regarding their financial matters have brought in funds, which have contributed to the expansion of the offshore banking sector. The legislative and regulatory framework incorporating an expanding network of Double Taxation Avoidance Treaties with jurisdictions across the world has been conducive to the development of this sector.

Most of the former Category 2 banks are branches or subsidiaries of large conglomerates with a global reach and expert know-how that give a competitive edge to private banking services. This wide network is contributing to the establishment of private client service in the Mauritian banking industry.

By contrast, banks operating in the domestic market have not fully exploited this segment of the market. However, some banks do offer personalised services that suit the needs of selective affluent clients to whom innovative products are being offered in the wake of enhanced technology and improvements in service delivery in the domestic financial system. In this context, personalised banking services may be regarded as the stepping stone towards the development of private wealth management.