

Structure of the financial system in mauritius finance essay



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3. 1 INTRODUCTION

This chapter focuses on the Mauritian financial system. An outline of the structure of the financial system in Mauritius is provided followed by an overview of the financial services sector in Mauritius.

3. 2 STRUCTURE OF THE MAURITIAN FINANCIAL SYSTEM

A financial system is made up of financial institution, financial markets and financial instruments. The structure of the Mauritian financial system is classified into three components as shown in the diagram below.

Financial System

Financial institutions Financial Markets Financial instruments

-Banks -Money market -Deposits

-Non-bank -Foreign exchange market -Equities

-Stock market -Debentures

-Debentures & rights market -Bills

-Bond market -Bonds

Mauritius has a well-developed and quite large domestic financial system and a emerging offshore sector. Mauritius fits into a select group of developing countries where domestic bank assets represent about 100 percent of Gross Domestic Product (GDP), and contractual savings go beyond 40 percent of GDP. The growing offshore sector is also large comparative to

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GDP, but weakly integrated with the domestic economy. The fundamental financial sector infrastructure, such as securities trading, payment and settlement systems, is well-organized and modern. Access to financial services is really high, with more than one bank account per capita and widespread branch banking and Automated Teller Machine (ATMs).

In the late 1980's and early 1990's, the Mauritian financial sector was marked by the process of financial liberalization. Market deregulation and liberalization was important in order to develop and revise the financial services sector. Market reforms were necessary for the development of the financial services sector which now includes an array of institutions as well as well-established banks, insurance and pension companies, stockbrokers, investment companies, non-bank deposit-taking institutions, leasing companies, credit institutions, money changers and foreign exchange dealers.

In order to move to the next phase in financial sector development, Mauritius needs to expand its financial sector.

3.3 THE BANKING SECTOR

The banking sector is the most vital constituent of the financial sector in Mauritius and at end-December 2009; it encompasses 18 banks engaged mainly in conventional commercial banking activities. A fully fledged Islamic bank has been licensed but is yet to commence operations. Banks stay the major source of funds for real sector operators and the economy at large. The connection which exists between the real sector and banks are bi-

directional. The Bank of Mauritius regulates all banks under the Banking Act of 2004 and provides for a single banking license.

TABLE 3. 1: EVOLUTION OF THE BANKING STRUCTURE IN MAURITIUS

JUNE 2000

JUNE 2002

JUNE 2005

JUNE 2007

JUNE 2009

Number of commercial banks

10

11

11

19

18

Number of branches

145

147

159

178

195

Total assets(Rs Million)

109866

134677

191128

234943

303091

Number of inhabitants per branch

8144

8230

7717

7081

6472

(Source: Bank of Mauritius)

According to Table 3. 1, the number of banks has grown considerably to the last decade. Number of inhabitants per branch has fallen which may imply better banking services

Mauritius has an oligopolistic banking structure with two banks scheming a most important share of the market namely the Mauritius Commercial Bank

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Ltd and the State Bank of Mauritius Ltd. Banks make several services to the country. Besides offering traditional banking services, they offer card-based payment services such as debit and credit cards, give phone banking and internet banking facilities.

Specialized services such as custodial services, fund administration, structured lending, trusteeship, structured trade finance; international portfolio management, private client activities, investment banking, treasury and specialized finance are also offered by banks. The international banks propose a broad range of worldwide banking and financial services to corporate, institutional and private clients..

The IMF's February 2010 Article IV Consultation Report noted that the “ banking system withstood the impact of the global financial turmoil. Banks conservative business practices and their strong balance sheets have kept the financial system sound. Liquidity, capital adequacy , and profitability of the banking system remain sound and the system appears resilient...banks remain well capitalized. They were not holding toxic assets and fund operations through domestic deposits (two-thirds of total liabilities) rather than large scale inter-bank foreign borrowing. A large share (one-third) of total deposits is held in liquid or near-liquid assets.”

3. 3. 1 Contribution of the banking sector to GDP

Commercial banks have been the most significant depository institutions and the major supplier of loanable funds to the private sector. The main attribute of the Mauritian banking system is that there are few banks with a deep concentration of banking activity in two of them. Preceding to the wave of

liberalization in the 1990's the activities of the banking sector were extremely regulated and controlled but the commercial banks still played a major position in the financial intermediation procedure given the lack of other financial institutions and financial markets.

Figure 1: Contribution Of Banks to GDP

(Data source: BOM annual reports)

The chart above demonstrates the positive link between GDP and commercial banks' claims on private sector. Commercial banks are still used although in an indirect way to execute policies of the government.

3. 4 THE STOCK EXCHANGE OF MAURITIUS

The Stock Exchange of Mauritius Ltd (SEM) was incorporated in Mauritius on March 30, 1989 under the Stock Exchange Act 1988, as a private limited company responsible for the operation and endorsement of an efficient and regulated securities market in Mauritius. Since October 6th, 2008, the SEM has become a public company, and over the years the Exchange has witnessed a significant overhaul of its operational, regulatory and technical framework to reflect the ever-changing standards of the stock market environment worldwide.

SEM is today a member of the World Federation of Exchanges (WFE) and one of the leading Exchanges in Africa. In 1997 major innovation and technological change took place; the central depository system (CDS) was implemented. The system brought about liquidity, efficient clearing and settlement of trades and also, reduction of intrinsic risks.

The SEM operates two markets: the Official Market and the Development & Enterprise Market (DEM). The Official Market started its operations in 1989 with five listed companies and a market capitalization of nearly USD 92 million. Currently, there are 37 companies listed on the Official Market representing a market capitalization of nearly US\$ 5, 484. 30 million as at 30 November 2010. The DEM was launched on 4 August 2006 and there are presently 50 companies listed on this market with a market capitalization of nearly US\$ 1, 801. 48 million as at 30 November 2010.

TABLE3. 2: MAIN STOCK MARKET HIGHLIGHTS

YEAR

1989

1993

1997

2001

2005

2007

2008

2009

No of listed COs(equities)(end of period)

6

29

42

40

41

41

40

40

No of listed COs including debentures

6

30

46

46

42

41

40

40

Market capitalization (end of period) Rs Million

1. 4

14. 9

36. 9

32. 1

80. 0

173. 0

109. 3

151. 2

Semdex

117. 34

302. 6

391. 12

340. 92

804. 0

1852. 2

1182. 7

1160. 8

Semtri

118. 95

375. 5

557. 28

626. 75

1951

4868. 6

3233. 7

4712. 7

Sem-7

—

—

—

74. 65

175. 4

477. 4

267

360. 7

Annual Turnover Rs Million

14. 3

691. 6

2996

3292

4547

11825. 5

11405

10473

P/E ratio

6. 56

13. 64

12. 86

5. 91

7. 98

13. 26

6. 17

10. 74

Dividend yield %

5. 42

3. 09

3. 62

8. 30

4. 64

2. 8

5. 14

3. 5

Weekly frequency

1

2

3. 5[^]

5

5

5

5

5

(SOURCE: Stock market of Mauritius fact book 2009)

As can be noted from the above chart, the number of listed company rose from 6 to 40 in the 20-year period. The percentage change in market capitalization rose continuously but it declined in 2008 due to the global

financial crisis. The SEMDEX, which is the all-share price index, reached its all time high in 2007. The performance of the local stock market was on average satisfactory despite the international economic environment prevailing. This was due to the stability in the economy and attractive investment opportunities.

3. 4. 1 Contribution of SEM to GDP

The figure below shows the contribution of stock exchange of market in terms of market capitalization and turnover as a ratio of GDP. Market capitalization to GDP was about 4. 32% in 1989 and it increased progressively until 1998 this indicates the efficiency of the stock exchange of Mauritius since its launching. In 1999 and 2001, the ratio fell harshly to 24. 33%. From 2002 onwards, it increased and reached 74. 93% in 2007. There was a extreme fall in 2008 due to the global financial crisis but it started climbing up in 2009. Market capitalization is expected to increase rapidly in the near future and develop as the main contributor to economic growth.

Figure 2: Contribution of Stock exchange of Mauritius to GDP

(Data sources: the stock market of Mauritius Ltd fact book 2009)

Turnover to market capitalization ratio was only 0. 97% in 1989 but though it increased gradually over years, it fell in 2002 but rose again in 2003 and was at it highest in 2008.

Lastly, turnover/GDP ratio is a measure of trading relative to the size of the economy. It equals the value of traded shares on the stock market as share of GDP. This relative measure was very little in 1989. It is a slow contributor

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to GDP because till 2009 it contributed about 3.78% to GDP. This may reflect low liquidity in the market that can create disincentives to long run investments since illiquid markets do not provide a ready exit options for investors.

3.5 THE OFFSHORE SECTOR

Mauritius' offshore financial center has grown quickly since its beginning in 1988, but remains small compared to the more recognized jurisdictions. The Global Businesses are licensed and supervised by the Financial Services Commission (FSC). Global businesses are attracted to Mauritius by a very low tax environment supported by modern business-friendly legislation for global business, 26 double tax avoidance treaties, capital flows and exchange convertibility, policies favoring open trade, relatively low wages, good telecommunications, a multilingual workforce, and location.

The reported turnover from Management Companies (MCs) grew by 30.1% over the previous year, amounting to a total of USD 118,183,149, as shown in Table 3.3.

TABLE3. 3: Summary of financial results of Management companies**(2004-2008)****2004****2005****2006****2007****2008****Turnover (thousand USD)**

39, 940

48, 646

64, 302

90, 845

118, 183

PBT (thousand USD)

12, 214

21, 042

28, 328

38, 479

48, 167

(Source: BOM)

During the period under review, the total reported Profit before Tax (PBT) generated by MCs recorded a 25. 2% increase over the previous year, to reach USD 48, 166, 667. The 10 leading MCs accounted for 64. 9% of the total turnover.

The sector does not currently represent a systemic risk for the domestic economy, while it does pretend reputational risks associated with money laundering or the financing of terrorism. The authorities are aware of these risks, and are taking steps to alleviate them. The authorities have announced their intention to apply a phased integration of the onshore and offshore sectors, with the objective of finally having a single financial center that provide to both domestic and global business.

Nevertheless, the future of this sector is very considerable and is believed to play a leading role in our financial sector and also contribute significantly to GDP.

3. 6 THE INSURANCE SECTOR

The Mauritian insurance sector includes one of the core of the Non banking financial institution (NBFIs) and it has been identified by the government as an area of high growth potential and with a high capacity of making a important contribution to the economy.

The insurance industry in Mauritius is regulated and supervised by the Financial Services Commission (FSC). As at 30 June 2009, 18 active insurers

were in operation and one insurer was in a overspill situation. In addition, Shariah' compliant insurance products have been introduced in the market.

Insurance business is divided into 2 main classes, namely:

Long term Insurance Business, and

General Insurance Business

Long Term Insurance business is defined as meaning life assurance business, pensions business, and permanent health insurance business.

General Insurance business comprises the following classes: fire, motor, personal accident, transport, miscellaneous, and any other class not referred to in the definition of Long Term Insurance business.

Figure 3: Total assets of Insurance Sector

Assets of the insurance sector which totaled Rs 65, 021 million in 2008 grew by 5. 4 per cent compared to growth rates of 21. 6 per cent and 20. 3 per cent in 2007 and 2006, respectively.

Total assets of the insurance sector, as a percentage of GDP stood at 25. 9 per cent , in June 2008 compared to 28. 2 per cent, a year before. Gross insurance premium totaled Rs 13, 826 million in 2008 compared to Rs 11, 647 million in 2007, representing a growth of 18. 7 per cent.

Growth in gross insurance premium was determined by expansion in both long-term business and general business with the latter being stronger. The insurance industry is concentrated with more than 80 per cent of the gross

insurance premium created by three insurers in the long-term business while in the general business line six insurers hold the mass of the market share.

The industry which had posted a positive performance in 2008 was relatively intact throughout the crisis as most insurance companies remained solvent. Looking further on, the anticipated improvement in economic activity is expected to increase activity in the insurance industry and maintain the profitability of that sector.

3. 7 NON-BANKING DEPOSIT TAKING INSTITUTIONS (NBDTI)

The Non-Bank Deposit Taking sector which comprised 13 operators in June 2009, experienced a remarkable 22. 4 per cent growth in total assets in 2008 compared to 10. 7 per cent growth a year earlier, although, in the first quarter of 2009 total assets grew by 2. 9 per cent against an 8. 0 per cent increase in the resultant period in 2008. This is likely to have resulted from the slowdown in some key sectors of the economy.

NBDTIs recorded credit/deposit ratio in excess of 100 per cent to some extent because of the increase in own funds to comply with the statutory minimum capital of Rs 200 million that was implemented in 2008. Part of the funding gap was met by borrowings from banks. Credit granted was channeled to all economic sectors with more than 65 per cent allocated to the personal and construction sectors. These two sectors also held the largest share in total NPLs in the NBDTI segment. The ratio of non-performing assets rose from 7. 3 per cent in June 2008 to 8. 3 per cent in

March 2009 mainly on account of growth of NPLs in facilities granted to operators in the construction sector.

3. 8 OTHER FINANCIAL INSTITUTIONS

The remaining institutions such as Cash Dealers, Investment Dealers, Asset Management Companies, Factoring Companies and Registrar and Transfer agents which provide financial services are of comparatively small significance in the financial sector, in terms of size but they have a role to play in making the financial sector complete.

3. 9 FINANCIAL DEVELOPMENT IN MAURITIUS

In this section we will consider whether there has been financial development in Mauritius. To measure financial development we use four proxies: the ratios of monetary aggregate(M2), private sector deposit(BNK), market capitalization(MKT CAP) and value traded on stock market (VTD).

Some studies Demetriades and Hussein(1996) have stressed that credit to private sector may be a better proxy for financial development. The use of credit to private sector is based on the assumption, as noted by Levine (2005), that “ financial systems that allocate more credit to private firms are more engaged in exerting corporate control, researching firms, mobilizing savings, providing risk management services and facilitating transactions than financial systems that simply funnel credit to the government or state owned enterprises.”

Given the dominance of the banking sector in Mauritius , bank-based measures of financial development are more appropriate when analyzing

data from developing countries because their stock markets tend to have low activity and the bulk of private saving and borrowing (in the formal market) takes place in the banking sector. Thus, as argued in Balamoune-Lutz (2003), financial development in developing countries tends to center on the development of money and financial intermediation not the development of capital markets which is more prevalent in developed countries. But in the last decade, the stock market has been a major part of the financial system.

A study by Nowbutsing (2010) found that stock market development is an important ingredient for growth in Mauritius. Thus the stock market can also be used to measure the extent of financial development in Mauritius. We can explore the effects of two aspects of stock market development as indicated by total market capitalization and value traded on stock market (combination of size and liquidity).

TABLE3. 4: Indicators of Financial development

YEAR

M2/GDP

BNK/GDP

MKT CAP/GDP

VTD/GDP

1999

0. 5785

0. 8041

0. 3861

0. 00079

2001

0. 5894

0. 7966

0. 2433

0. 00105

2003

0. 5618

0. 8342

0. 3255

0. 00107

2005

0. 6259

0. 9157

0. 4318

0. 00147

2007

0. 6170

1. 0161

0. 7349

0. 00109

2009

0. 6657

1. 0804

0. 5510

0. 00082

[Source: BOM, SEM Fact book 2009.]

The indicators of financial development calculated in the table above indicate that financial deepening has taken place in Mauritius. They also indicate that banking development has taken place in Mauritius even after the establishment of the stock market.

3. 91 Effects of the global financial crisis on the financial sector of Mauritius.

The Mauritius financial system is a bank-based one as banks represent around 70% of the total assets. Although the crisis started in 2008, Mauritius experienced a lagged effect and started to face significant consequences. In early 2009, according to the Financial Stability report of bank of Mauritius, <https://assignbuster.com/structure-of-the-financial-system-in-mauritius-finance-essay/>

the financial crisis did not have significant direct impact on the Mauritian Banking Sector because it does not have any direct exposure to toxic debt that has affected global financial markets.