

# Overview of economy and banking sector of mauritius finance essay

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Mauritius being independent since 1968 had initially a monocrop economy. Years after, the economy diversified into several sectors namely textile, tourism and financial sector. Recently it has developed into information and communication technology, fishing process and property development. Having not only good infrastructures but also highly skilled labour, it is easy to attract Foreign Direct Investment (FDI) and it was noted that above 32,000 offshore companies were being attracted by the country. During the financial crisis in 2008-2009, economic policies and banking practices set by the Government help to minimize the adverse impact in the country. In the year 2010-2011, GDP grew more than 4% per year and Mauritius carries on its trade and investment in the world.

## **The Bank of Mauritius**

In September 1967, the Bank of Mauritius was established as the Central Bank of Mauritius under the Bank of Mauritius Act. The Central Bank usually regulates banking and non-banking deposit taking institutions. The objectives, functions and powers of the Bank of Mauritius are provided by the Bank of Mauritius Act 2004 (BoM Act 2004). Some objects provided by Section 4 of BoM Act 2004: Maintain price stability and a balanced economy. Ensure stability and soundness of financial stability. Act as Central Bank Some functions provided by Section 5 of BoM Act 2004: Conduct monetary policy and manage exchange rate. Regulate and supervise financial institutions carrying activities in or from Mauritius. Manage foreign exchange reserve. The Central Bank's several powers are provided by Section 6 of the Act. It is headed by the Governor who is also a chairman of the Bank of Mauritius. The Governor is normally appointed by the President

of Mauritius. Effective 1 April 2008, Treasury Bills and Bank of Mauritius Bills are auctioned separately by the Bank of Mauritius on different days and there is also a secondary market for these instruments. The Bank of Mauritius intervenes in the money market from time to time by way of repo and reverse repo transactions, Special Deposits Facilities and issue of Bank of Mauritius Bills, as appropriate, in between weekly auctions of Treasury Bills.

## **The Evolution of Monetary Policy in Mauritius**

The Bank of Mauritius' statutory responsibility preset in the BoM act 2004 is to maintain price stability and promote the orderly and balanced economic development". In addition it is responsible to preserve the internal and external currency value of Mauritius. Economic and financial developments, especially trade liberalisation, have been the factors impelling the conduct of monetary policy. After a period with policy rates in excess of 12% in the late 1990s, monetary policy witnessed a substantial growth until end-2004 then tightened once again as inflation started to rise until end 2006. In the late 2007, monetary policy has been loosing due to a slowdown of the economic sector and sharp decline in the growth of private sector credit. The Bank of Mauritius had to reduce its rate by 250 basis points. Moreover, in order to reduce the cost of financial intermediation, the 2 reserve requirements were cut. This helped to keep the overnight interbank rate close to the policy rate. Recently the BoM accumulated reserves through mid-2008 under the floating regime, then allowed them to fall as capital inflows eased in the late 2007. This trend continued when, in step with international developments, monetary policy was in the late 2008. The BoM has hold back interventions

and the floating exchange has depreciated in nominal effective terms by about 4% since January 2009, while remaining relatively constant against the U. S dollar.

## **Banking Sector**

Since 2003, the banking sector had developed into large, profitable and sound sector for Mauritius. Banks play a crucial role in the market economy and are the most important component of the financial system.

### **Definition**

A bank is usually defined as a company incorporated under the Companies Act 2001 licensed by the Central Bank for banking activities. By banking activities, this means accepting sums of money in form of deposits or funds. The bank uses the whole or part of the deposit or fund for loans for its customers in need of money or investment purposes.

### **Economic functions of banks**

**Netting and settlement of payments** Banks act as both collection and paying agents for customers, participating in interbank clearing and settlement systems to collect, present, be presented with, and pay payment instruments. This enables banks to economise on reserves held for settlement of payments, since inward and outward payments offset each other. It also enables the offsetting of payment flows between geographical areas, reducing the cost of settlement between them. Credit

**Intermediation** Banks borrow from agents who have surplus funds in return for payment of interest and lend part of the funds to deficit agents in return of payment of interest and fees Banks therefore act as middle men in the

credit intermediation. Credit Quality Improvement Banks lend money to ordinary commercial and personal borrowers (ordinary credit quality), but are high quality borrowers. The improvement comes from diversification of the bank's assets and capital which provides a buffer to absorb losses without defaulting on its obligations. Maturity Transformation Banks borrow more on short term debt but lend more long term loans. In other words, they borrow short and lend long. With a stronger credit quality than most other borrowers, banks can do this by aggregating issues (e. g. accepting deposits and issuing banknotes) and redemptions (e. g. withdrawals and redemptions of banknotes), maintaining reserves of cash, investing in marketable securities that can be readily converted to cash if needed, and raising replacement funding as needed from various sources.

## **Banks' Services**

Acceptance of money in return for payment of interest  
Payment and Settlement Services  
Domestic and International Funds Transfer  
Currency Exchange  
Renting of Safe Deposit Lockers  
Issuance of Drafts and Office Cheques  
SWIFT Transfers  
Provider of Trade Finance Transactions (Bills for Collection, Documentary Credits, Guarantees, Indemnities and Performance Bonds).

## **Interest Rate in Mauritius**

The Bank of Mauritius official interest rate is the key repo rate. The graph below displays the interest rate since January 2006 to January 2013.

Historical Data Chart  
Since January 2006 till January 2013, the average interest rate was 6.31%. The highest value recorded was 9.25% in June

2007. The Monetary Policy Committee (MPC) decided to raise the Repo Rate by 75 basis points from 8.50% to 9.25% per annum. The low interest rate was 4.75% on September 2010. The Central Bank reduced by 50 point basis from 5.40% to 4.90%. This was so due to downside risks in domestic growth compared to upside risks of inflation. The latest record of interest rate was at 4.90%. The interest rate shown is known as the benchmark interest rate set by the Bank of Mauritius to make loans to commercial banks. The benchmark interest rate was the Lombard Rate. A publication made in 2004 by Vikram Punchoo relates that "The Lombard Rate, the interest rate which commercial banks pay for using the Lombard Facility, is the key interest rate signalling the central bank's monetary policy stance. It is known to all market participants and carries a premium over the overnight interbank market rate. The premium ensures that commercial banks only have recourse to this window as a last resort." By end of December 2006, the Bank of Mauritius decided to use a new framework. The Key Repo Rate (KRR) was introduced to indicate changes in monetary policy position prior to the Lombard Rate. Banks adjust their lending rate and deposit rate according to changes in the Key Repo Rate. Due to recent economic recession, the central bank has been continuously reducing the repo rate with an expectation and instruction that commercial banks will reduce the rate of interest so that loans will become cheaper, causing an increase in quantity demanded of loans. On September 23rd 2010, the rate was decreased to 4.75% by 100 basis point. In March 2011, the Key Repo Rate was increased by 50 point basis and in June by another 25 basis point to 5.50%. There are also other interest rates in the banking sector displayed in the table for the year 2010/2011.

## **Economic Indicators**

### **Inflation**

The inflation rate measures the increase or decrease in prices that customers pay for goods and services. Since 1988 to 2013, the inflation rate has an average of 6.91%. It was recorded in April 1989 that the rate was 18.10% which is the highest up to now. The lowest rate recorded was -1% in January 1992. The total average inflation rate since 1988 is 6.91% and the latest inflation rate recorded was in February 2013 at 3.60%. The graph below indicates the inflation rate since 1988.

### **Gross Domestic Product**

The Gross Domestic Product (GDP) is known to be a basic measurement of a country's economic performance and national income and output. The total expenditure for all domestic final goods and services gives the GDP of the country. The GDP of Mauritius corresponds to 0.20% of the Global economy. In December 2011, the GDP in Mauritius was valued at 11.31 billion US Dollars (USD) which is the highest recorded up to now. Its lowest record was 0.7 USD in December 1976. The graph below shows the GDP in Mauritius since 1976 until 2011.

## **Money and Quasi Money (M2)**

**The definition of the Money and Quasi Money (M2) is given by International Monetary Fund's (IMF) International Financial Statistics (IFS) in line 34 and 35. The composition of M2 includes the summation of currency outside banks, demand deposits except those of the central government, and the time, savings, and foreign currency deposits of resident sectors excluding the central government. According to World Bank Report, the M2 was reported at Rs 333905153695. 49 in 2011.**

**Below shows the M2 supply in Mauritius since 1967 till 2011.**

**There are other indicators for the economy of Mauritius. They are tabulated below.**