Impact of the financial crisis globally and in mauritius

Like almost all economies worldwide, the Mauritian economy has not been spared form the effect of the global financial crisis and subsequently to the recent European crisis. The former is considered to be the worst financial crisis since the Great Depression of the 1930s. This was mainly due to the falling home prices in the United State which consequently spread to all other major economies and those which are dependent on the US economy. The Global Financial Crisis has led to the crisis of public debt in the Eurozone starting with Greece at the end of 2009. Due to the linkage of member countries in the Eurozone and the use of a single currency, the crisis faced by Greece started to spread to other member countries and this became known as the Eurozone crisis. It is obvious that although the measures that would be analyzed have had great effectiveness on mitigating the impact of the two crises, it has not been inevitable to prevent them from affecting the key sectors of the Mauritian economy. One reason is because of its openness and financial integration to the world economy and the other being the fact that Mauritius has longed been and is still very Eurocentric.

The Global Financial Crisis (2007-2009) – Its Origin and Impact on the World Economy

The Global Financial Crisis started when home prices began to fall dramatically in the US Real Estate market at the end of 2006. One of the reasons for the falling prices is because of the housing bubble which peaked in approximately 2005-2006. As a result people who have taken home loans started to default on their repayments as they find it cheaper to buy a house rather than to continue paying for the home loan. Due to the financial linkage and the globalization process, the declining home prices started to spread to other countries. More and more foreclosures and defaults led to banks' financial position to deteriorate rapidly around the world. Investors worldwide started to lose confidence in the US economy and other major economies of the Eurozone. As such stock markets were deeply affected leading to huge loses for investors. Consumption, which is the main component of aggregate demand for many countries and US, started to decline which resulted in many quarters of negative growth in the US and other major economies.

The financial crisis led to a prolonged worldwide recession in 2008. Governments and Central Banks were forced to take necessary actions to fix the crisis. Capital injection and interest rate cuts were common to help borrowers to repay their loans. The low consumer confidence and investors' confidence in the world economy resulted in many firms and financial institutions filed for bankruptcy such as the collapse of Lehman Brothers. Stimulus packages were implemented in many countries to help boosting economic activity. These stimulus packages helped companies which employ thousands of workers not to file for bankruptcy so as not to increase unemployment, for example, the US government agreed to help giant car companies Ford and Crysler in order to prevent them from closing down and laying down workers.

The Global Financial Crisis did not only affected rich countries but also emerging economies and developing countries. Countries like Brazil, Russia, India, China (BRIC) and many other emerging economies experienced significantly high economic growth prior to the crisis but with the global economic downturn they had seen a slowdown in their level of economic activity.

The Impact of the Global Financial Crisis on the Mauritian Economy

With the impact of the Global Financial Crisis on the world economy and the deterioration of banks’ financial position, investors in Mauritius started to react in September 2008 by massively selling their shares. Not surprisingly, companies whose prices declined the most were those in the banking and financial sector such as the Mauritius Commercial Bank (MCB) and the State Bank of Mauritius (SBM). As a result, the SEMDEX, the share price index of shares quoted on the Official Market of the Stock Exchange of Mauritius, started to decline to its lowest level. This indicated the level of pessimism among investors in the Mauritian economy.

The Global Financial Crisis affected all key sectors of the Mauritian economy, such as the textile industry, the tourism industry, the sugar industry, the financial services sector, and the construction industry. This was mainly due to the trade liberalization of Mauritius to the world economy. As such, even though Mauritius is not related to the origin of the financial crisis, the effects of the crisis crossed the Mauritian border uninvited. This is the danger of globalization on small states like Mauritius.

Among all the sectors of the Mauritian economy, the textile and tourism was most affected. Many firms closed down. Low level of tourist arrivals, due to the increasing level of unemployment in key markets, affected the tourism industry deeply. The construction industry experienced a slowdown in its economic activity. Foreign Direct Investment fell significantly during the crisis. Finally, during the same period the sugar industry had to undertake reforms because of the end of the European Union Sugar Protocol in 2006. Rising unemployment was not inevitable and the economic growth rate was declining.

However, it should be noted that Mauritius did not register negative output growth during the global economic downturn. Measures by the government and the Bank of Mauritius successfully prevented the Mauritian economy from entering into a recession.

Policy measures taken to mitigate the Impact of the Global Financial Crisis on the Mauritian Economy.

Since the beginning of the Global Financial Crisis and its impact on the Mauritian economy there has been huge policy coordination between the government and the Bank of Mauritius (BOM). Keynesianism was on the rise and expansionary monetary policies were followed. The government adopted expansionary fiscal policies to boost productivity.

The BOM followed the same policy actions as other Central Banks worldwide, easing monetary policies. In the last quarter of 2008, through its Monetary Policy Committee (MPC), the BOM decided to slash the Key Repo rate by 150 basis points and the Cash Reserve Ratio (CRR) was brought down from 6 percent to 5 percent, thus freeing some Rs2. 5 Billion for commercial banks to be able to increase loans to the private sector and in turn increasing the level of economic activity.

On the government side, although the economic growth projection was still positive at 5. 5 percent for the year ending 2008, expansionary fiscal policies were adopted. The budget deficit was increased but for the benefit of increased productivity. Like the BOM, the government also followed the same course of actions taken by other countries to fight the global financial crisis. An Additional Stimulus Package (ASP) equivalent to 3. 8 percent of Gross Domestic Product (GDP) or Rs6 Billion was put in place.

The ASP was aimed at expanding the airport of Mauritius and to create six funds that would make Mauritius more resilient and thus limiting the impact of the Global Financial Crisis on the Mauritian Economy. These Funds include:

The Maurice Ile Durable (MID) Fund.

Food Security Fund.

The Human Resource, Knowledge, and Arts Development Fund.

The Local Infrastructure Fund.

The Social Housing Development Fund.

The Manufacturing Adjustment and SME Development Fund.

The Implementation of the Additional Stimulus Package in its effort to fight the Global Financial Crisis.

The six funds created under the ASP are detailed below:

The MID Fund would include a solar water heater scheme, energy saving lamps, replacing street lighting lamps, mobilize foreign expertise for sustainable development support for a wind farm project, and financing the Waste Energy Project. All these schemes would help in building the vision of a Green Mauritius and protect the Mauritian Economy from high price volatility for non-renewable energy.

Under the Food Security Fund land would be prepared and provided with irrigation facilities for small farmers. The land resource mobilization would result in the production of some 5000 tons of additional food commodities between 2009 and 2011. The aim of this fund is to increase the food supply for the population and reduce the dependence on imported food supplies.

The Human Resource, Knowledge, and Arts Development Fund would make provisions for scholarships to needy students. A Student Loan Guarantee Scheme and the construction of new campuses for tertiary education are also financed under this fund. The aim of this fund is to provide education for all children and help in eradicating poverty and also to widen the circle of opportunities.

The Local Infrastructure Fund would provide resources in a wide range of areas including multi-purpose complexes, fish landing stations, market fairs, waterfront, crematorium, and tartan track. The aim of this fund is to improve areas where people visit regularly and increase security for the people.

The Social Housing Development Fund would include the rehabilitation of NHDC estates and infrastructures for social housing and support for affordable housing to bring down the cost of mortgage. This fund would help more people to own a home.

The Manufacturing Adjustment and SME Development Fund would facilitate the work undertaken by the Enterprise Mauritius, SEHDA, and the National Women Entrepreneur Council.

Another important scheme that was created under the ASP was the Mechanism for Transitional Support to the Private Sector (MTSP). This mechanism makes provision for a Financial Rescue Package (FRP) to help enterprises in financial difficulties. The MTSP covered all sizes of enterprises whether small, medium, or large. The facilities favored enterprises which have used all available financial tools provided by banks and other financial institutions and still cannot overcome their financial distress. It also applies to those where banks and other financial institutions do not agree to help them.

The 2009 budget also aimed at making provision for a range of actions in light of the global economic crisis. The National Empowerment Foundation (NEF) was created from this budget. Its main aim was to fight the remnants of poverty in Mauritius and the eradication of poverty. The NEF also put an obligation on large companies to give at least 2 percent of their operating profit as Corporate Social Responsibility (CSR). The NEF enhanced its efforts on re-skilling, retraining, and returning retrenched workers to productive employment.

The Euro Crisis (2010) – Its Origin and Impact on the Eurozone economies.

The Global Financial Crisis of 2007-2009 forced many countries to seek help to restructure their economies, especially the Eurozone economies. After the financial crisis another problem was emerged, the public debt or sovereign debt crisis which later became known as the Eurozone Crisis. It started with Greece at the end of 2009 and then spread to other Eurozone member countries such as Ireland, Spain, Portugal, Italy, and Germany. A sovereign debt arises when a country issue government bonds denominated in its own currencies but sold to investors abroad. The problem with Greece was that the cost of financing the debt became so large that the International Monetary Fund (IMF) and the European Central Bank (ECB) agreed on a €110 Billion loan for Greece. Soon after other countries started to have the same problem as Greece and bail outs was necessary. Ireland has also been bailed out with €85 Billion. However, these loans are conditional on the implementation of harsh austerity measures. Austerity measures being cuts in government spending and increased taxes.

One of the main impact of the Euro Crisis was the depreciation of the Euro vis-à-vis other currencies. There was high financial instability in Eurozone economies which consequently led to uncertainty and falling investors' confidence. On 9 May 2010 the 27 member states of the European Union agreed to create the European Financial Stability Facility (EFSF), a legal instrument aiming at preserving financial stability in Europe by providing financial assistance to Eurozone states in difficulty.

The Impact of the Eurozone Crisis on the Mauritian Economy.

Mauritius is highly dependent on the Eurozone and it is obvious that a depreciating Euro would have serious consequences on the economy. The crisis impacted on all key sectors of the Mauritian economy including export, financial services industry, domestic oriented industries, and other emerging sectors.

Most of our exports are billed in Euro while most imports are in US dollars term. Since the beginning of 2010, the Euro has depreciated by around 8 percent while the US dollar has appreciated by around 3 percent against the rupee. Therefore, it is clear that exports revenues are declining while costs are rising for local firms. This is very crucial for domestic firms and this present a threat for their survival and consequently employment.

The Central Statistical Office (CSO) downgraded the real GDP forecast for 2010 from 4. 6 percent to 4. 2 percent after the unfolding of the Euro Crisis. Furthermore, the CSO predicted an unemployment rate of 7. 5 percent in 2010 from 7. 3 percent in 2009. On the other hand, the inflation rate was declining.

Analysts expect the austerity measures to impact negatively on the growth performance of Eurozone economies. This can result in a drop in demand for our exports and lower tourist arrivals. Moreover, some analysts believe that the Eurozone crisis will last for 5 to 7 years.

Policy Response to the Eurozone Crisis and to limit its impact on the Mauritian Economy.

The Mauritian economy is faced with a depreciating Euro which is having serious consequences in terms of low tourist arrivals and low demand for our exports. Furthermore, the Euro crisis is expected to last for 5 to 7 years. There is therefore a compelling need to restructure the Mauritian economy and to diversify from the Eurozone countries to other emerging countries such as the BRIC.

Below is an extract from “ Facing the Eurozone Crisis and Restructuring for Long Term Resilience” which was presented by the Vice Prime Minister and Finance Minister, Pravind Jugnauth in 2010.

“ Thus, The seven pillars of our response to the euro crisis and to the larger challenge of global economic rebalancing are:

Industry and enterprise restructuring

Deleveraging

Supporting the creation of new financing instrument

Fast re-skilling and re-employment of retrenched workers, with a focus on retrenched women workers

Acceleration of public infrastructure

Protecting consumers

Modernizing regulations to improve competitiveness

In order to implement all of the seven policies response mentioned above, many measures was taken, these includes:

The implementation of an Economic Restructuring and Competitiveness Programme (ERCP). This will support firms in the export sectors, especially the textile and clothing industry to help them overcome their financial difficulties.

Support for the SMEs to help them better manages their finance and thus being resilient to external shocks.

Supporting small planters in the sugar industry which are squeezed between reform into the sugar industry and a depreciating Euro.

Help to restructure the tourism sector in diversifying into non-euro based markets.

Help the retrenched workers by providing them support and ensuring their re-employment.

Ensuring that consumers can benefit in the depreciating Euro.

Restructuring the public sector enterprises.

Accelerate public infrastructure projects that are vital to the economic restructuring.

Improving competitiveness by reviewing the regulatory framework.

Setting up a committee to endure the proper implementation of the policy response package and ensure its effectiveness.

Mobilizing the necessary resources to finance the package.

The Mechanism for Transitional Support to the Private sector (MTSP) which was put in place to help firms in difficulties during the Global Financial Crisis was replaced by the ERCP. The ERCP is much more than a financial rescue package. The main features and process of the ERCP is outlined in the next section.

The Economic Restructuring and Competitiveness Package

The main processes of the ERCP are as follows:

A diagnosis will be carried on the company applying for support under the ERCP to determine its viability.

If the company is found viable, it will be granted all support under the ERCP provided that it takes a serious commitment to restructure and deleverage.

An Independent Financial Analyst will be drawn to prepare a restructuring plan for the company.

The restructuring plan will include market diversification, product improvement, efficiency, and productivity.

If the restructuring process requires the laying off of workers, a retrenchment plan should be submitted to the ERCP and the Support Unit for Re-employment of Employees (SURE) for approval.

The deleverage plan will define actions the company needs to take to bring down its gearing ratio to the benchmark established by the ERCP committee.

Inefficient, poorly managed, highly geared companies will not be granted support under the ERCP.

Measures were also taken by the BOM to manage the euro/rupee exchange rate. The Key Repo rate was cut by 100 basis points to 4. 75 percent on the 27th September 2010.

Conclusion

Up to now the Mauritian economy has demonstrated a considerable degree of resilience to external shocks. The Global Financial Crisis of 2007-2009 was the worst economic downturn since the Great Depression of the 1930s and it has dampened the world economy significantly. Mauritius being a small emerging economy was also hit by Global Financial Crisis due to its openness n financial integration to the world economy. However, policy coordination by the government and the Bank of Mauritius in adopting expansionary fiscal and monetary policies has prevented the Global Financial Crisis from damaging the economy further. The effects of the Eurozone crisis on the Mauritian economy were also very high. These were inevitable since Mauritius has always had high dependence of its exports such as tourism, textile and sugar on markets in Europe but the policy response such as reducing the Key Repo rate to 4. 75 percent by the BOM and the implementation of the ERCP by the government will ensure that the Mauritian economy has a long term resilience to external shocks