Rundheersing Bheenick: Special Line of Credit in Foreign Currency

Remarks by Mr Rundheersing Bheenick, Governor of the Bank of Mauritius, at the Signature Ceremony of the Agreement between the Bank of Mauritius and the Mauritius Post and Cooperative Bank in respect of the First Disbursement under the Special Line of Credit in Foreign Currency, Port-Louis, 10 August 2012.

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A very good morning to all of you. I am pleased to welcome you this morning to our Headquarters for a special event: the signing of an Agreement between the Bank of Mauritius and the Mauritius Post and Cooperative Bank Ltd (MPCB) in respect of the First Disbursement under the Special Line of Credit in Foreign Currency.

It is especially heart-warming to note that the management of MPCB, its board and its executive management are once again making a difference. They are the first one to get out of the starting stalls and come up to sign a framework agreement in the form of a Memorandum of Understanding which we will be entering into this morning. You will recall that MPCB was also the first bank to deal with us when we offered a special line of credit to the sugar sector when it was going through a tough time. While other banks were being reticent, MPCB was the first one to come forward, and we agreed to go ahead. Obviously other banks joined afterwards on the same terms and conditions. MPCB therefore deserves our congratulations for their readiness to join the central bank in its endeavours to reach out to sectors in need.

A lot has been said about this foreign currency line of credit. Why are we offering it? Why were the terms what they were? And why have we taken two months? Yes, two whole months. It has, in fact, been two-month period of laborious gestation! We actually announced it on Saturday night of the 9th of June and you would have thought that people would have come queuing to the door of the Central Bank on the following Monday morning itself. But no! We had many carpic critics. Some were thinking that perhaps there were some ulterior motives behind it; others that perhaps the Bank was trying to deflect attention away from the real issue. Such reactions and misconceptions require that we give you some background and explain to you the rationale that lies behind the two measures, the Operation Reserves Reconstitution (ORR) and the Special Line of Credit in Foreign Currency.

One school of thought believes that the real solution lies in depreciating the currency. Depreciating and devaluing massively to bail out key operators in the economy is fraught with difficulty and grossly unfair in terms of the quality of economic development requirements and social welfare losses. Our mandate at the Central Bank is to look at the interest of the entire nation and our responsibility, under the Bank of Mauritius Act, requires us to ensure that there is price stability and monetary stability. Robbing Peter to pay Paul was never a very good policy especially if Peter happens to be poorer than Paul who owns all the assets in the country!

It was clear for us that the economic crisis was not going to be behind us so quickly – in fact, the latest data flow shows that prospects are getting gloomier, and dark clouds continue to hang over the global economic landscape. So we came forward with a proposal to refinance the stock of outstanding debt in rupees of our export operators, which was showing a glaring mismatch with their income streams. In the 45 years of history of the Bank, I don't think the Bank has ever offered this kind of refinancing of the stock of outstanding debt. It was a path-breaking move for an innovative central bank. With the Special Line of Credit in Foreign Currency, our operators, who are now exposed, will probably be in a better position to sit out this crisis, without inflicting heavy costs on the rest of the economy if we take the easy solution of depreciating the currency – definitely not a sustainable solution.

Another school of thought believed that the two solutions that we had offered on the 9th of June actually cancelled each other out. The argument was that, since the ORR was basically aiming at trying to build up our reserves, it would probably lead to a slide-depreciation of the currency. Operators would prefer to wait until the currency had slid enough, and would then come and convert at a very favourable rate through the foreign currency line. We never saw it that way.

We started the process of reserves reconstitution, the ORR, in the light of studies made by the IMF. These studies, using different models, showed clearly that there was a growing misalignment of the rupee in relation to fundamentals, that needed to be corrected. At the start of the implementation of the ORR, the Gross Official Reserves of the country stood at 2.67 billion dollars representing 4.5 months of import cover. Currently, they increased to 2.86 billion dollars for 5 months of import cover. We accumulated around 191 million dollars. We are well on the way of reconstituting our reserves towards the targeted level of 6 months import cover. And we are doing it in a planned and orderly manner.

The ORR has been a calculated move for the exchange rate to reach more competitive levels. We were never in the market to provoke an uncontrolled slide of the Mauritian rupee, for that would have been a very dangerous step. Instead we had a controlled approach to it. In May 2012, before the start of the ORR, $MERI_1$ stood at 91.375. Our $MERI_1$ increased to 94.984 in July 2012 resulting in an adjustment of around 4%, a level with which we are quite comfortable. We are now watching the exchange rate very carefully to make sure it does not have negative repercussions on our CPI. The figures that are coming out up to now show that there has been no direct inflationary impact in this controlled slide of 4%. The kind of currency adjustment that desperate exporters seem to be praying for, cannot be envisaged as the consequences would be unbearable for the rest of the population. We should bear in mind that while the Export-Oriented Enterprises employ around 55,000 people and the tourism sector, some 40,000, against a total employment of 536,700 in 2011, their weights in our GDP represent 6.3% and 7.9% respectively. The other sectors actually contribute more to GDP and would be penalized by currency depreciation. All this needs to be taken into consideration before we envisage any further currency adjustment.

As I was saying earlier, it took two months before seeing the crystallization of our efforts to come to the help of economic operators in these two sectors. It is understandable that the banking community, not used to the kind of measures the Bank was proposing, required some time to reflect upon it to see whether it made sense for them as well. So we listened to them and understood their predicament to adequately cover the risks borne by them in extending such facilities to their clients. And we agreed to share our already very slim margin with them. We gave banks more flexibility to charge rates based on their risk assessment.

The other reason advanced for not using this line of credit is that international banks can actually have access to foreign currency at more competitive rates. The Special Line of Credit in Foreign Currency was offered to give a sense of direction to the industry. So if branches and subsidiaries of foreign banks are prepared to share these competitive rates with the final borrowers, we can but encourage them to go in that direction, so long as the debt conversion does happen and other borrowers can benefit from the line of credit made available by these international banks from their own sources. We are happy to note that there are already a few proposals at advanced stages of finalization.

A final point on the Special Line of Credit in Foreign Currency: had we had a deeper financial market in Mauritius, we would not have spent two months to get this going. Our capital market is very small and very illiquid. One of our targets as a central bank is to achieve a certain deepening of our financial market. Together with our colleagues in the capital market, we are working towards developing the bond market, alongside our own attempts to develop a secondary market of Government paper. This would hopefully result in the issuance of a corporate bond which would have been the ideal vehicle for us to refinance existing rupee debt, by underwriting corporate bonds in foreign currency. We hope to be able to make some progress on this front in the next six months.

The other issue on which we have made some progress is the Task Force on Unfair Terms. The Task Force is well-engaged in the information-gathering stage and various initiatives have been taken to sensitize the general public on the importance to contribute to the exercise. We believe it is high time that we try to give the consumer a fairer deal than what he has been getting so far and for our banks to help the sectors that are hurting, a bit more than they have been doing.

Another project in the pipeline is work on Basel III. As you know we are one of the few countries in Africa that have moved to Basel II, and Basel III is round the corner. Basel III is trying to remedy internationally the kinds of problems identified in the banking sector that have been responsible, amongst others, for the global economic crisis. Soon we will be issuing a consultation paper to the industry indicating our own approach to Basel III. So we will be introducing Basel III in a phased manner and by the end of 2018 approximately, we should be there. Our banks are already meeting by and large many requirements of Basel III e.g. capital buffers, Tier 1 capital, and capital adequacy ratios. However, there are other requirements which we still have to meet.

Among those is the whole issue of domestic systemically important banks, the so-called DSIBs. We have at least two banks in our jurisdiction that would qualify as DSIBs. These DSIBs require a different regime. In other jurisdictions, systemically important institutions (SIFIs) are required to actually come forward with a living will. They are deemed to be too big to fail but they are also too big to bail. Why are they too big to bail? Because the cost of bailing them out is well beyond the resources either of the central bank as a regulator and lender of last resort, or well beyond the resources of the country that holds these institutions in terms of ratio to GDP of the banking sector assets. We fall in that category. Therefore we need to be very careful not to end up with a banking sector bust up like Ireland or like Iceland, which would have tremendous implications for the public sector budget. The Bank is currently working on a framework for the monitoring of such institutions which may be required to maintain additional capital.

So, I am delighted to be proceeding this morning with the first disbursement under the Special Line of Credit in Foreign Currency to an economic operator in the tourism sector, Mr Shakeel Nundlall, who is here with us today and who, I am sure, will open the way for other economic operators to go and convert their stock of debt into foreign currency.

I thank you for your attention.