

Seychelles—Assessment Letter for the African Development Bank

November 25, 2009

Macroeconomic performance of Seychelles under the Stand-by Arrangement (SBA) has been favorable and the reforms continue to be pursued with a high degree of ownership and broad public support. The liberalization of the exchange regime, a strong fiscal adjustment, and prudent monetary policies have contributed to restoring macroeconomic stability. Program implementation has been exemplary and talks to restructure public external debt are progressing well. A debt restructuring agreement with commercial creditors, on terms comparable to those agreed with Paris Club creditors, is a crucial element in reestablishing a sustainable public debt outlook and supporting economic recovery.

Recent Developments and Macroeconomic Outlook

Seychelles has made rapid progress in restoring macroeconomic stability. Inflation has been near zero since March and the exchange rate has appreciated steadily from lows early in the year. Official external reserves have recovered strongly from near depleted levels in mid-2008 to 1.3 months of imports at end-October. Government expenditure has been tightly controlled and revenue has continued buoyant despite the difficult domestic and external environment. The primary surplus reached 13.4 percent in the first 9 months of the year. The economy is responding favorably to the reforms and the contraction in economic activity will be somewhat less than previously forecast, with real GDP now expected to decline 7.5 percent in 2009. Recovering from the impact of the global recession, there are now early signs of a revival of business activity and employment creation. In 2010 economic growth is expected to rise to 4 percent as the economic recovery continues to strengthen.

Program Implementation

Program implementation has been exemplary, even in the face of strong head winds from the global recession. All end-September 2009 quantitative performance criteria were met with margins and all structural benchmarks under the SBA were implemented as scheduled, which provides a good basis for the completion of the third program review, scheduled for December 18, 2009.

The 2008 SBA addressed the foreign exchange distortions, implemented a large fiscal adjustment, and stabilized the macroeconomic environment, while taking first steps toward much-needed structural reform. With these objectives achieved, the focus now shifts to implementation of a second generation of reforms in a medium-term context. The key objectives are to consolidate macroeconomic stability, remove constraints to growth and improve the performance of the public sector. These objectives form the core of a new three year arrangement with the IMF, under the Extended Fund Facility, which has been agreed, ad referendum, with Fund staff and is scheduled to be discussed by the Executive Board at the

same time as the completion of the third SBA review in mid-December 2009. The reforms ahead aim to strengthen public financial management, institutionalize higher governance standards in the public enterprises, reform taxation, bolster the financial system, and improve the business environment.

Progress in Debt Restructuring

Good progress has been made in talks to restructure public external debt, which despite Seychelles' substantial adjustment efforts, remains unsustainable. The authorities are continuing good faith efforts to reach agreement on comparable terms with all creditors, consistent with the Fund's lending into arrears policy.

Following agreement with Paris Club creditors in April 2009, one non-Paris Club bilateral agreement has been signed and discussions with other creditors have advanced. Consideration by the African Development Bank of the authorities' request for a US\$10 million Policy-based Guarantee Operation would substantially increase chances of early success of the commercial debt restructuring, by lowering the risks for creditors. A commercial restructuring is a key component to the overall strategy of securing sustainable public debt and essential for economic recovery.