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Seychelles: 2010 Article IV Consultation and Second Review Under the Extended Arrangement, Request for Rephasing of Disbursements, and Financing Assurances Review—Staff Report; Staff Supplement; Public Information Notice and Press Release on the Executive Board Discussion; and Statement by the Executive Director for Seychelles.

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of a combined discussion of the 2010 Article IV consultation with Seychelles and Second Review Under the Extended Arrangement, Request for Rephasing of Disbursements, and Financing Assurances Review, the following documents have been released and are included in this package:

The staff report for the combined 2010 Article IV consultation and Second Review Under the Extended Arrangement, Request for Rephasing of Disbursements, and Financing Assurances Review, prepared by a staff team of the IMF, following discussions that ended on October 28, 2010, with the officials of Seychelles on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on December 3, 2010. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

A staff supplement of December 3, 2010 updating information on recent economic developments.

A Public Information Notice (PIN) and Press Release, summarizing the views of the Executive Board as expressed during its December 20, 2010, discussion of the staff report on issues related to the Article IV consultation and the IMF arrangement, respectively.

A statement by the Executive Director for Seychelles.

The documents listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Seychelles*
Memorandum of Economic and Financial Policies by the authorities of Seychelles*

*Also included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

SEYCHELLES

Staff Report for the 2010 Article IV Consultation and Second Review Under the Extended Arrangement, Request for Rephasing of Disbursements, and Financing Assurances Review

Prepared by the African Department in consultation with other departments

Approved by Roger Nord (AFR) and James Roaf (SPR)

December 3, 2010

Extended Arrangement. A three-year arrangement under the Extended Fund Facility (EFF) for 225 percent of quota (SDR 19.8 million) was approved by the Executive Board on December 18, 2009 (effective December 23, 2009), replacing a Stand-By Arrangement approved in 2008. An amount equivalent of SDR 7.48 million (85 percent of quota) has been disbursed, and equivalent of SDR 1.76 million (20 percent of quota) is available upon completion of the second review.

Policy discussions. Staff met with President James Michel, Minister of Finance Danny Faure, Governor Pierre Laporte of the Central Bank of Seychelles (CBS), other senior government officials, and representatives of parliament, the private sector, civil society, and the diplomatic community. The mission comprised Messrs. Le Dem (head), Messrs. Gigineishvili and Koehler (AFR), Ms. Mwase (SPR), and Mr. Bartholomew (MCM). Mr. Roger Nord (AFR Senior Adviser) participated in several discussions.

The program is on track. All quantitative performance criteria as of end-September 2010 have been met and the program of structural reforms is broadly on track. In the attached letter of intent and memorandum of economic and financial policies (MEFP), the authorities lay out an updated set of program objectives for the rest of 2010 and 2011.

Past advice. The 2008 Article IV consultation was concluded on November 14, 2008. Directors welcomed the authorities' determination to undertake far-reaching economic reforms aimed at putting the economy back on the track of sustainable economic growth and development, including the upfront liberalization of the exchange regime and float of the rupee, significant fiscal and monetary tightening, and the launching of a comprehensive structural reform program.

Data. Seychelles has joined the General Data Dissemination System (GDDS); data provision is broadly adequate for surveillance. The authorities intend to address weaknesses in the area of national accounts and balance of payments (MEFP, ¶53) and to adhere to the Special Data Dissemination System (SDDS) by mid-2012.

Exchange rate arrangements. Seychelles has a floating exchange rate and has accepted Article VIII obligations. Seychelles maintains an exchange system that is free of restrictions on the making of payments and transfers for current international transactions.

Next steps. The third review under the EFF-supported program is proposed for May 2011, based on end-2010 test dates. Staff is proposing that the next Article IV consultation be held in accordance with the Fund provisions on consultation cycles applicable to countries under a Fund-supported program.

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I. Staff Appraisal and Summary

1. **Two years of stabilization efforts and international assistance have moved Seychelles away from the 2008 balance of payments and debt crises that threatened the country's high living standards.** This was achieved through a remarkable turnaround of economic policies, including foreign exchange market liberalization and floating of the rupee, exceptional fiscal adjustment, and enhanced management of public finances and central bank. The stabilization achievements were all the more remarkable since Seychelles had to confront at the same time a global crisis that lowered tourism receipts, but fortunately spared its financial system.

2. **International assistance contributed significantly to the country's adjustment efforts.** The authorities' program under a Stand-By Arrangement (SBA) and successor Extended Arrangement was supported by the restructuring of most of Seychelles' external debt on favorable terms and fresh financing from official creditors. Renewed confidence of private investors translated into increased foreign direct investment to develop the islands' exceptional tourism potential.

3. **Developments in 2010 indicate that the economy is rapidly recovering on the back of a rebound in tourism, creating some policy margins and trade-offs**. Growth is expected to reach at least 6 percent. Fiscal adjustment is projected to exceed the original budget targets by at least 2 percentage points of GDP. These factors, together with the stabilization of the exchange rate, the return to price stability, and the rebuilding of reserves offer room for more expansionary policies.

4. **The medium-term outlook is favorable, but high risks require caution.** Growth is projected to gradually reach 5 percent over 2011-13. However, the timid global recovery and the large external vulnerabilities (including the threat of piracy) plead in favor of rebuilding policy buffers. The right balance needs to be struck between adopting a less restrictive fiscal policy stance (including for rebuilding the long-neglected infrastructure crucial for fostering the country's growth potential) and following a more ambitious path toward debt sustainability.

5. **Seychelles has returned to external stability but needs to address monetary policy trade-offs and financial sector challenges.** The exchange rate is broadly in line with fundamentals. However, vigilance is needed against the inflationary and exchange rate risks stemming from the large banking excess liquidity that is emerging from the quick reduction of domestic public debt and slow recovery of private sector credit. The authorities agreed on the need to issue treasury bills for monetary operation purposes, and to lengthen maturities. The banking sector appears healthy but efforts need to be directed toward developing financial intermediation through enhanced competition and reduced state intervention, better disclosure requirements and consumer protection. These challenges are being addressed in the EFF-supported program.

6. **The program is on track.** All performance criteria through end-September 2010 were met and the year-end targets are within reach (Table 6). Although the structural reform agenda is progressing broadly as scheduled, capacity bottlenecks have delayed two structural benchmarks for end-September and end-November 2010 respectively. A new customs management act is expected to be submitted to the National Assembly in early December, 2010, but more extensive preparatory work is needed for the introduction of a new chart of accounts (Table 7).

7. **The program targets for 2011 reflect further efforts to consolidate a sound recovery and secure Seychelles's medium-term growth objective**. A primary balance of 5 percent of GDP accommodates a reasonable easing of the fiscal stance while maintaining the original path toward debt sustainability. This easing, made possible by the substantial fiscal overperformance of 2010, will facilitate priority recruitment and an increase in infrastructure projects. Further steps will be taken to rationalize the tax system, including preparations for the launch of a value-added tax (VAT) in mid-2012. Monetary policy will aim at maintaining inflation below 3 percent.

8. **The structural reform agenda aims at enhancing public financial and central bank management, strengthening competition and risk management and reducing the role of the state in the financial system**. It addresses the financial risks posed by key state-owned companies (Public Utility Company and Air Seychelles) to the still fragile public accounts and initiates a reform of the social security system. The authorities have made excellent use of technical assistance and staff welcomes their further requests to the Fund and other international partners to help the country implement its ambitious structural reform program, notably in the tax area.

9. **Risks to the program are adequately contained.** Faced with the continued threat of piracy that may disrupt its tourism and fishing sectors, Seychelles has taken an active role in the international counter-piracy efforts. Despite the electoral context (presidential elections are scheduled for the first half of 2011), the authorities have excluded delays in economic adjustment and reforms. Staff is of the view that the strong track record of policy implementation under the SBA and this successor Extended Arrangement makes this stance credible.

10. **In view of the continued strong performance through end-November 2010, compliance with performance criteria, and consistency with the Fund's Lending Into Arrears Policy, staff recommends completion of the second Extended Arrangement program and of financing assurances reviews.** Staff supports moving to a new program review and disbursement schedule with the new test dates being end-December and end-June.

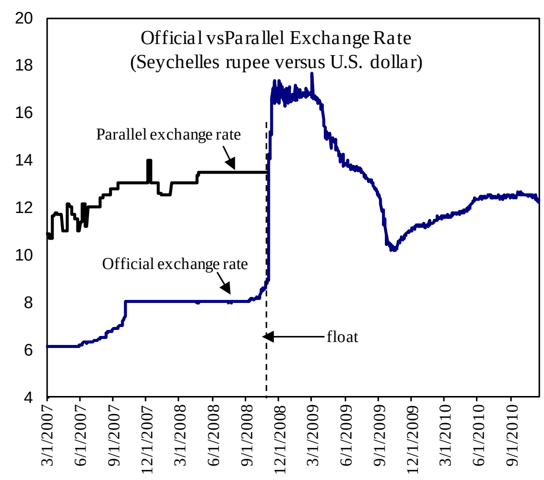
II. Two years of Economic Stabilization and Reforms

A. Rapid Stabilization Following a Severe Crisis

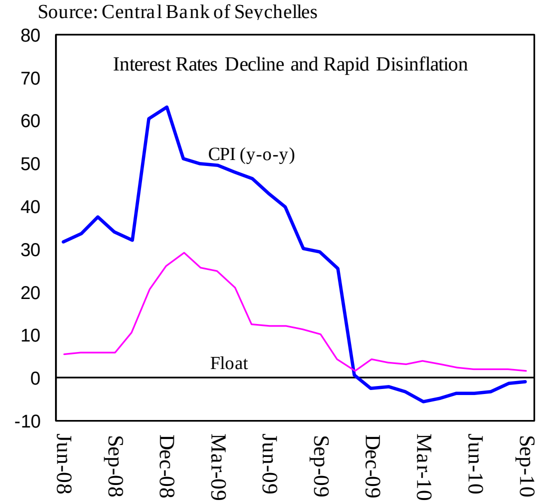
11. **Seychelles experienced an acute balance of payments and debt crisis in 2008.** The build-up of the imbalances over several years led to the erosion of the fiscal position and increased reliance on external borrowing to cover spending needs. By 2007, the overall fiscal deficit had reached 9.8 percent of GDP. Total public debt stood at 146 percent of GDP and was projected to increase by another 20 percent of GDP in the following two years. By this stage, gross official reserves were dramatically depleted: US$9.8 million only covered 0.1 months of imports. External arrears had accumulated to US$160 million and were projected to double by the following year, leading to the Standard and Poor's downgrade to 'selective default' once payments on private foreign debt were missed.

12. **The debt crisis culminated in a currency crisis.** Several step adjustments in the value of the rupee against the US dollar and a series of exchange restrictions and credit rationing had not stemmed the balance of payment crisis, compounded by the 2008 commodity price shock. The parallel market premium over the official pegged rate reached 55 percent.

13. **The policy turnaround launched in November 2008 has been highly successful in stabilizing the exchange rate**. The authorities removed all exchange restrictions and floated the currency. They liberalized interest rates, introduced a modern monetary framework focused on liquidity management with market-based instruments, and increased reserve requirements. Since the floating of the currency in November 2008, the exchange rate overshot, registering a 50 percent depreciation and significant volatility through the first quarter of 2009. Inflation peaked at 63 percent in December 2008, but the pass-through from the subsequent two quarters of currency appreciation triggered a rapid reversal that led to negative inflation from end-2009, facilitating a decline in short-term money market interest rates.



Source: Central Bank of Seychelles

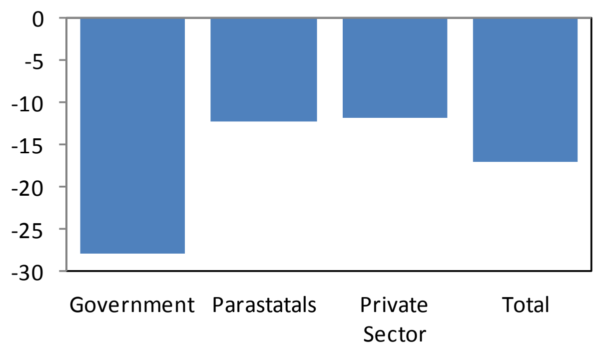


Source: Seychelles authorities.

14. **A strong and continued fiscal adjustment has restored the prospect of sustained medium-term growth and debt sustainability.** The heavily frontloaded fiscal tightening (an improvement of more than 10 percentage points of GDP in the primary fiscal

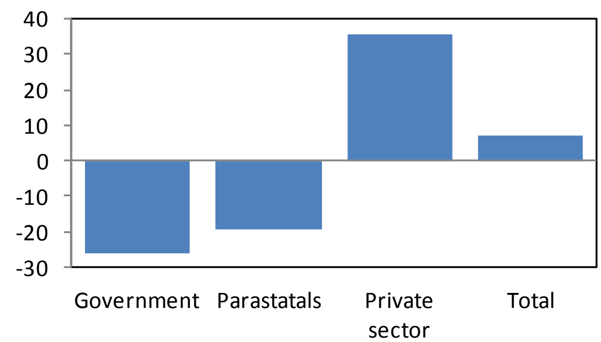
balance in 2009) was achieved through deep cuts in public sector employment, stability in nominal wages, and the removal of all indirect product subsidies. Reduction in public sector employment has been absorbed by the private sector, though at lower real wages. A targeted, modernized social safety net increased the efficiency of transfer expenditure and mitigated the social impact of the reforms.

Real Wage Adjustment
(Percent change 2009 over 2006)



Source: Seychelles authorities; IMF estimates.

Employment
(Percent change 2009 over 2006)

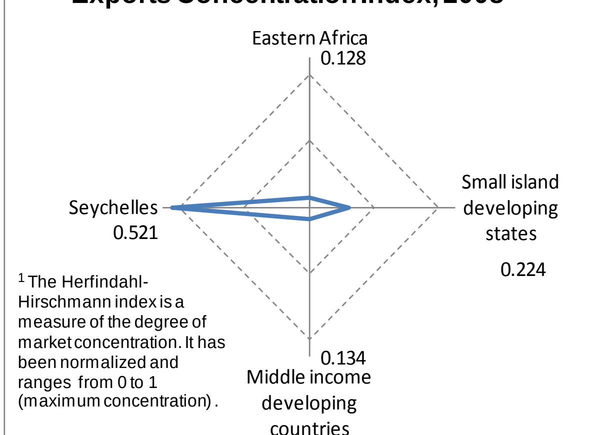


Source: Seychelles authorities; IFS; IMF estimates.

15. **Tax reforms and improvements in revenue administration and expenditure management helped sustain the credibility of the fiscal adjustment.** Several tax exemptions that had long compensated foreign investors for the overvalued currency were removed. The Ministry of Finance (MOF) has built capacity internally to strengthen budget processes. Key achievements include the conduct of mid-year formal expenditure reviews, the adoption of new procurement and transparent tendering processes and the establishment of a macroeconomic and revenue forecasting unit at the MOF.

16. **Under strong stabilization policies and a simultaneous deterioration of the global environment, Seychelles experienced limited output decline and rapid strengthening of its external position.** The drop in real GDP was sharp but did not extend beyond 2008. Tourism declined in 2009 in dollar terms because of the global crisis, exchange rate movements (tourism receipts are mostly denominated in euros), and aggressive price discounting that protected activity in the sector. Most of the external adjustment originated from the sharp decline in imports, reflecting the drop in real incomes. In 2009, the success of the adjustment and the strengthening of the rupee contributed also to significant capital repatriation from residents' accounts abroad, which eased the rebuilding of official reserves. But despite

Exports Concentration Index, 2008 [1]



[1] The Herfindahl-Hirschmann index is a measure of the degree of market concentration. It has been normalized and ranges from 0 to 1 (maximum concentration).

Source: UNCTAD, 2009 Trade Statistics Yearbook.

recent improvements, Seychelles exports remain undiversified, even compared to other countries in the region and small island economies.

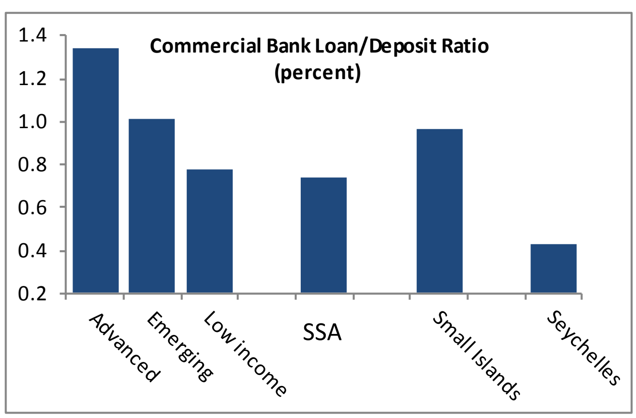
17. **The turnaround in economic policies facilitated exceptional debt restructuring**. First, Paris Club creditors provided a substantial debt write-off (45 percent in nominal terms) for a middle-income country. Second, despite a fragmented private creditor base and the bankruptcy of Lehman Brothers, the single largest commercial creditor, Seychelles' proposed debt exchange (with a 50 percent haircut) was successful (Appendix II).

B. A Strengthening Recovery in 2010

18. **The widespread rebound in economic activity is driving growth above pre-crisis levels.** In recent months, activity has picked up in tourism (on a year-to-date basis, tourist arrivals were 10.8 percent higher in September 2010), and in construction and telecommunications, mainly reflecting an exceptionally large increase in FDI.[1] Real GDP growth is projected to exceed 6 percent in 2010. The large increase in FDI-related imports is projected to substantially widen the external current account deficit in 2010.

19. **The exchange rate appears to have stabilized at a sustainable level.** In real effective terms, the exchange rate depreciation has corrected the overvaluation assessed in 2008, before the float of the currency (Appendix I). The rupee depreciated by about 11 percent against the U.S. dollar in first nine months of the year, partly driven by the weakening euro, but appears to have stabilized since then. Reflecting the exchange rate pass-through, inflation has picked up slightly, returning to positive territory in September.

20. **Given the benign inflation outlook and the return of confidence in the rupee, the monetary policy stance has been accommodative during most of the year.** Through September broad money increased by 26 percent on year-on-year basis, driven largely by accumulation of foreign assets by banks. Private credit, however, increased by only 8 percent.[2] As a result, the loan-to-deposit ratio remained at about 45 percent, which is well below regional and



Source: Seychelles authorities; IFS; IMF estimates.

[1] The surge in FDI reflects mainly the construction of a major residential project, which is fully financed by a foreign investor.

[2] The increase excludes the positive impact on credit growth of the reclassification of about SR 200 million in July 2010 from foreign assets to loans.

other comparator group averages. Ample liquidity in commercial banks pushed interest rates on 3-month government securities to 1.5 percent in September from about 10 percent a year ago.

21. **Buoyant government revenues created fiscal space for extra discretionary spending while accelerating debt reduction.** Revenues are now expected to exceed original budget projections by more than 4 percentage points of GDP, reflecting mainly stronger-than-expected tax collections on turnover and imports.[3] In October, the authorities passed a supplementary budget covering additional current (0.7 percent of GDP, mainly goods and services) and capital expenditures (1 percent of GDP) for infrastructure projects, education, and health in the last quarter.[4] The personal income tax rate was also reduced from 18.75 percent to 15 percent, effective October 1, three months ahead of schedule.

22. **The debt restructuring is close to completion**. Bilateral debt agreements were signed with most Paris Club creditors, several non-Paris Club creditors and all commercial banks. The authorities have continued good faith negotiations with a few remaining non-Paris Club bilateral and private creditors, in line with the Fund's Lending Into Arrears Policy. In recent months, most creditors agreed to grant Seychelles a treatment comparable with that of the Paris Club agreement, and all. Reflecting mostly the second-tranche of the Paris Club debt stock reduction in July and the restructuring of debt with commercial banks—all have been signed—external debt is expected to decline to
45 percent of GDP at year-end.

III. Policy Discussions

23. The 2010 Article IV discussions focused on the medium-term outlook and the challenges that confront Seychelles, including recovering from a severe external debt crisis, reducing the small island state's vulnerability to external shocks, and promoting private-sector led growth. Several interrelated issues were discussed: the use of the fiscal margins that have emerged from the economic recovery, external stability issues, monetary policy trade-offs and the management of commercial banks' growing liquidity, and the development of a sound financial sector.

A. Outlook and Risks

24. **The outlook is favorable.** The projected reduction of FDI inflows is expected to slow down growth temporarily to 4.3 percent in 2011. Medium-term growth could reach 5 percent. The tourism industry is actively promoting Seychelles outside its traditional markets and expanding the stock of accommodations. These factors place the country in a good position to

[3] This was driven by revenue from Goods and Services Tax (GST) on the tourism and telecom sectors, the indirect effects of a large construction project and unforeseen dividends from the partly state-owned tuna cannery as a result of the renegotiated shareholders' agreement.

[4] Capital outlays were included in the supplementary budget law for information because they do not require parliamentary approval under the existing Public Finance Bill. The authorities intend to amend the bill such that parliamentary oversight will cover all budget expenditures (MEFP, ¶23).

benefit from the expected recovery and medium-term growth in tourism activity.[5] Increased fiscal margins will also help sustain domestic demand and address the infrastructure bottleneck. Inflation is expected to remain low. The current account will narrow to 24 percent of GDP in 2011, declining gradually over the medium term to 10 percent of GDP by 2015 on account of lower FDI-related imports and growth in tourism and tuna exports.

25. **Significant risks continue to stem from the volatility of the external environment.** In particular, the continued threat of piracy may disrupt tourism activity, and push up insurance premiums and shipping costs on external trade.

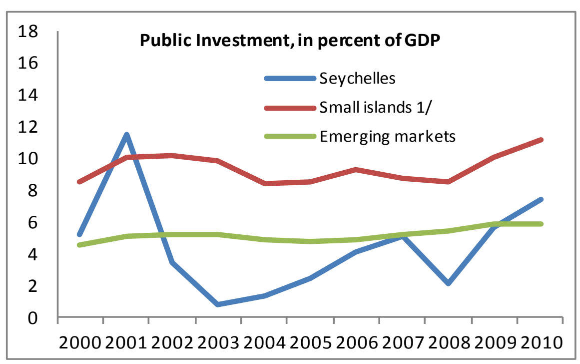
Authorities' views

26. **The authorities concur with the staff's views that a medium-term growth of 4 to 5 percent is within reach.** To achieve this goal, they give priority to the pursuit of sound macroeconomic policies, the promotion of a private sector-led growth, and the removal of infrastructure bottlenecks in energy and water supply, sewage, roads and telecommunications.

27. **To address the large vulnerability that can affect a small island economy like Seychelles, the authorities are actively working on diversifying exports.** They see tourism as the main engine of growth in the medium term, but actively promote Seychelles as a destination outside its predominant European market, most notably in Asia. To address the threats of piracy, they have taken the lead in the coordination of international counter-piracy efforts in this region of the Indian Ocean. They count on the recent change of ownership of the tuna canning factory to develop exports and draw additional benefits for the country. They see the offshore financial sector as a marginal activity (Appendix V), but are actively pursuing offshore oil exploration in Seychelles' large and promising exclusive economic zone.

B. Fiscal Policy Margins

28. **Seychelles's stabilization success offers perspectives for a less painful path toward fiscal sustainability but caution is needed to maintain external stability and growth prospects.** The stronger-than-anticipated fiscal adjustment in 2009-10, coupled with higher growth and a slightly more favorable outturn of debt rescheduling provides space for a combination of a less restrictive fiscal policy stance and a more rapid path toward public debt reduction. In discussing the appropriate balance between the



Source: IMF staff estimates
1/ Defined as emerging market island economies with population below 2 million.

[5] The UN World Tourism Organization projects a 9.2 percent annual growth in international arrivals over 2010–20 and a marked improvement in emerging markets' share.

two, staff argued that rebuilding faster economic policy buffers would help mitigate the external shocks that the country will continue to be exposed to. It emphasized the need for the fiscal policy to take into account Seychelles's still fragile external position. Staff also thought part of the fiscal room should be used to rebuild the public infrastructure neglected in the last decade, compared to small island developing states, thereby removing growth bottlenecks.

Authorities' views

29. **The authorities plan to maintain the programmed medium-term reduction in primary surpluses consistent with bringing the public debt-to-GDP ratio below 50 percent by 2018**. While the return to fiscal sustainability was an essential element of their medium-term strategy, they argued that it was also time to start distributing the dividends of the successful adjustment to the Seychellois and begin reversing the decline in real government wages in recent years. They also noted that the recourse to external project finance would alleviate short-term pressures on the balance of payments, to the extent that it remains consistent with external stability. As a result, most of the envisaged debt reduction will stem from a rapid repayment in domestic liabilities. This entails other complications in terms of liquidity management, as discussed below.

C. External Stability

30. **The updated exchange rate assessment indicates that it is in line with fundamentals (Appendix I)**. At the 2008 Article IV Consultation, the exchange rate was estimated to be overvalued by 11 to 33 percent. The floating of the rupee has led to a 16 percent depreciation in real effective terms. This adjustment has contributed to improved competitiveness in tourism while facilitating strong adjustment in non FDI-related imports in 2009. As of end-September 2010, the exchange rate does not appear overvalued in the three Fund standard approaches if adjustment is made for the large FDI-related imports and other exceptional factors that are expected to temporarily bring the external current account deficit to record levels in 2010.

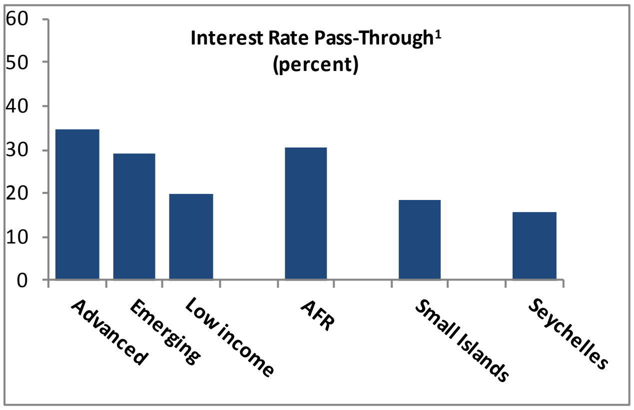
31. **The authorities noted the significant uncertainties surrounding the exchange rate assessment and that the recently introduced currency regime has so far served the country well.** They keep an open mind about the suitability of exchange rate regime changes provided economic fundamentals and circumstances justify them at the time.

D. Monetary Policy and Liquidity Overhang

32. **The key challenge facing the central bank is to preserve price and market stability in light of the persistent liquidity overhang.** Fiscal overperformance in 2009-2010 allowed the government to retire a large amount of domestic debt, leaving banks with (unremunerated) excess reserves of about 4 percent of GDP. If left unaddressed, the liquidity overhang may unwind in a disorderly depreciation and a resurgence of high inflation. The concerns are threefold. First, with the resumption of growth and the recovery in domestic demand, the inflationary environment is likely to become less benign in 2011, with additional pressure

stemming from the liquidity overhang. Second, the situation may quickly turn around in response to adverse external or domestic shocks to which Seychelles remains highly susceptible. Third, given low money market rates, the search for returns may result in capital outflows.

33. **The discussions focused on how to improve the monetary policy transmission mechanism.** Staff's cross-country analysis (Appendix III) confirms that compared to peers, interest rate pass-through is weak in Seychelles. A persistent liquidity overhang and inadequate competition among banks appear to be the main factors behind the sluggishness of monetary transmission, which undermines the central bank's ability to react to inflation.



[1] The pass-through is estimated for the period of December 2005 to March 2010 (methodology explained in Appendix III).
Source: IMF staff estimates

34. **To mitigate these risks, the staff proposed a tighter monetary stance in 2011 than in 2010, and advised mopping up excess reserves.** Given the magnitude of liquidity to be absorbed and the high sterilization costs this implies for the central bank, the authorities should consider issuing of treasury bills for monetary policy purposes.[6] This would provide the CBS with additional tradable securities for open market operations at an estimated annual fiscal cost of 0.1 percent of GDP in additional interest payments. The alternative to the CBS issuing its own paper was considered a less preferable option because it would further fragment an already shallow money market and weaken the CBS's balance sheet. In parallel, to help develop the yield curve and minimize the rollover risk, the government could gradually lengthen the maturity of domestic debt by issuing 2- to 3-year bonds.

35. **Additional options to address the liquidity overhang were discussed.** Raising minimum reserve requirements would absorb part of the structural excess liquidity and provide some additional room for non-inflationary reserve money growth. Moving the large deposits (about three quarters of banks' excess reserves) of the Social Security Fund from commercial banks to the central bank would also help.

Authorities' views

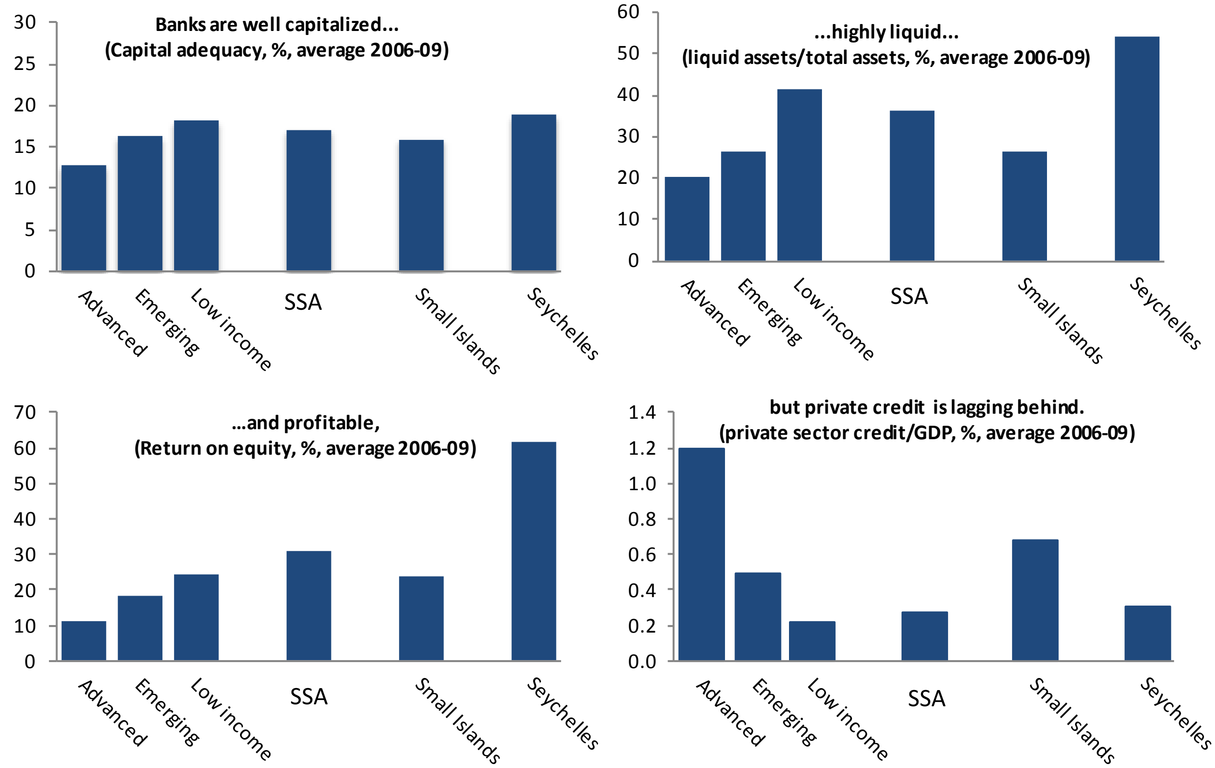
36. **The authorities shared the mission's assessment of risks and agreed with the proposed issuance of T-bills for monetary purposes** (MEFP ¶ 30)**.** They saw the liquidity overhang, however, as a temporary phenomenon that would partially be reabsorbed with the expected credit growth and reduction in lending rates to the private sector. They felt committed

[6] These treasury securities would be used by the central bank for sterilization purposes, but would be repayable by the budget.

to tightening the monetary policy stance if required, but felt that raising reserve requirements after having lowered them in 2009 would undermine monetary policy credibility. A gradual reduction in liquidity has been built into the monetary program for 2011.

E. Financial Sector Development

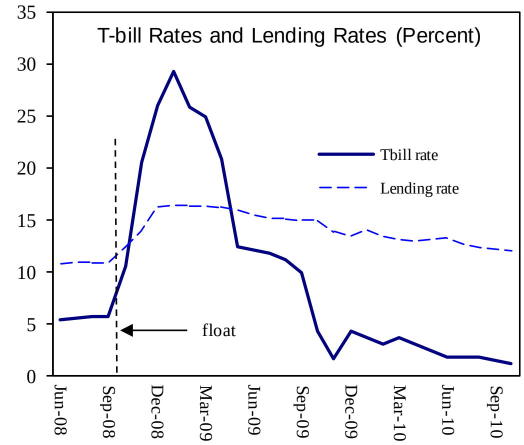
37. **Banks are in good financial health and adequately capitalized (Table 5)**. Compared to end-2009, credit quality deteriorated significantly in 2010 (the percentage of nonperforming loans increased), in large part owing to reclassification of pre-crisis loans from "watch" to nonperforming. Aggregate provisioning as measured against classified assets remained unchanged. Bank earnings were strong and net interest margins high, but declining from 2009 on account of lower interest rates on government securities**.**



Source: IFS, country staff reports, IMF staff calculations.

38. **The stress tests conducted by the mission indicate that banks are most vulnerable to credit risks stemming from increased default rates by borrowers in response to extreme interest rate shocks** (Appendix IV). The likelihood of such events, however, is limited, implying that banks remain well positioned to withstand fairly severe shocks.

39. **The discussion focused on how to promote financial sector development and competition among banks.** High returns on assets and equity, including relative to banks in the region cannot be fully explained by the high risk premium that several foreign-owned commercial banks require on their operations in Seychelles. Together with the disconnect between money market and retail lending rates, this suggests a lack of competition in the banking sector. Lending rates have been slow to react, and interest margins widened in spite of liquidity pressures and sharp drop in short term T-bill rates since the start of the stabilization program. Private sector credit at 25 percent of GDP remains low compared to peers and is growing slowly despite banks' ample liquidity.



Source: Central Bank of Seychelles

40. **Staff made several recommendations to address the issue of insufficient competition among banks and promote financial sector development**. These include removing the obstacles to competition stemming from information asymmetry (enhancing public disclosure of banking products and financial literacy) and high loan prepayment and refinancing fees. Efforts should also be directed toward establishing credit rating systems and eliminating legal barriers related to pledging and foreclosing collateral. Moreover, staff invited the authorities to reflect on the excessive role that state-owned financial institutions play in the economy to the detriment of development of the financial sector. This is particularly the case in the mortgage lending sector, which is dominated by the subsidized loans of the state-owned Housing Finance Corporation (HFC).

41. **The risk posed by the offshore financial sector to financial stability is limited but should continue to be closely monitored to comply with international standards on anti-money laundering and combating the financing of terrorism (AML/CFT).** The offshore sector had featured prominently in the authorities' long-term strategy published in 2007, particularly as a means of diversifying economic activity and reducing the reliance on tourism as a driver of growth. However, offshore banking remains limited, and offshore financial activity is currently concentrated in the registration of international business companies (IBCs), which increases potential exposure to illicit activities (Appendix V).

Authorities' views

42. **The authorities intend to promote bank competition and develop credit markets and mortgage lending through improved transparency and information dissemination.** They plan to improve disclosure practices and strengthen legal protection of borrowers and lenders through legislative and/or regulatory changes (MEFP ¶45). In collaboration with Seychelles Bankers' Association and the Fair Trading Commission, they plan to launch a public awareness campaign. They consider sound competition among banks a precondition for implementation of

their long-term goal of state-owned bank privatization. As part of their financial sector reform agenda, the authorities are developing a housing finance policy to be submitted to the cabinet by June 2011. Among other obstacles to mortgage lending (including legal issues related to collateral) the policy will aim at reducing the role of the state in this area, starting with possible divestiture of HFC (MEFP ¶27). The authorities have also taken steps to tighten the AML/CFT framework and improve the transparency of the offshore financial sector (MEFP ¶40).

IV. Program Review

A. Performance Under the Extended Arrangement

43. **The program is on track: all quantitative performance criteria were met with margins although capacity constraints delayed two structural benchmarks.** All end-September 2010 quantitative performance criteria were met (Table 6). As regards structural benchmarks, budget submission protocols and procedures were introduced by end-July 2010 as planned but the new Customs Management Act was submitted to the National Assembly with two months' delay (Table 7). A plan of action will be submitted to Cabinet by end-April 2011 with the aim of introducing the new Chart of Accounts in the 2012 Budget. The rest of the structural reform agenda remains on track. Preliminary evidence indicates that all quantitative performance criteria for end-December 2010 are within reach.

B. Program for 2011

44. **The program accommodates an easing of the fiscal stance consistent with progress toward debt sustainability and external stability.** After two years of fiscal overperformance, the authorities target a primary surplus of 5 percent of GDP for the 2011 budget, 1 percentage point of GDP less than initially planned. Excluding the one-off net repayments of 3.4 percent of GDP to the government in 2010,[7] the primary balance will decline from 6 percent of GDP to 5 percent in 2011. This will provide fiscal space to finance infrastructure to address the main growth bottleneck in the medium term while keeping public debt on a declining path.

45. **The government is implementing comprehensive tax reforms aimed at further rationalizing the tax system and harmonizing rates across sectors.** The 10 percent personal income tax (PIT) for expatriates introduced in July 2010 will be aligned with the domestic residents' rate of 15 percent in January 2011. Preferential goods and services tax (GST) rates for tourism are being phased out and preparatory work is underway for replacing GST with a VAT in 2012. This entails further tax administration reforms, including at the newly established Large Taxpayer Unit (LTU) of the Seychelles Revenue Commission (SRC) and increased coordination with the Customs Department.

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[7] The national oil company fully reimbursed its government loan in 2010, and no net lending operations are budgeted in 2011.

46. **With one-off positive factors disappearing in 2011, government revenue is projected to decline in terms of GDP; but grants are on the rise.** The net budgetary impact of policy changes to PIT and GST is positive and estimated at 0.4 percent of GDP. However, abstracting from this and the extensive presentational changes in the 2011 Budget, revenue is projected to decline by 1.5 percent of GDP. This is mainly due to the normalization of business tax receipts after exceptionally high corporate profits recorded in 2010 (MEFP ¶11). In addition, dividends from state-owned banks and the tuna cannery (following the renegotiation of the shareholder agreement) are projected at half their 2010 amounts, although they are partly compensated by projected dividends from the national oil company. Grants are projected to increase from 1.5 to 4 percent of GDP as the disbursements delayed in 2010 (e.g., in-kind benefits for the coastguard facility) are carried forward to the following year.

47. **Wage reforms and priority recruitment are expected to increase primary current expenditures.** The overall wage increase of 1.5 percentage points of GDP reflects the inclusion in the 2011 budget of the pension and social security contributions of the government as an employer (MEFP, page 53). It also reflects ongoing policy measures to modernize the civil servant wage grid and strengthen resources devoted to important administrative functions, including the Seychelles Revenue Commission. The consolidation of budget-dependent entities in the 2011 budget also explains part of the 1.6 percent of GDP increase in goods, services and transfers. In net terms, the entities that benefit from expanded budgetary lines in 2011 include the Seychelles Tourism Board, the National Sports Council and the Land Transport Agency.

48. **Capital expenditure will continue to be directed toward improving public infrastructure.** The focus of the 2011 budget is on enhancing the output capacity of the Public Utility Company, rehabilitating the main hospital in Victoria and upgrading educational facilities. A contingency line of about 0.5 percent of GDP has been established in the capital budget to protect the primary balance target against low revenue performance in the first half of 2011 (MEFP, ¶14).

49. **The monetary policy stance will aim at maintaining inflation below 3 percent**. The CBS will retain reserve money targeting under a flexible exchange rate regime as its operational framework, which has been successful in taming inflation in the aftermath of the crisis. To achieve its objective of low single-digit inflation, the CBS will rely mainly on market based policy instruments and will continue to build its analytical and operational capacity.

50. **Enhancing public financial management (PFM) is a key area of structural reforms** (MEFP ¶18-23). To assess the progress made in public financial management, with the assistance of the European Union, the authorities will undertake a new assessment under the Public Expenditure and Financial Accountability (PEFA) standards in early 2011. A new chart of accounts will be introduced for the 2012 budget to support improved decision making on the allocation of resources. The amendments to the Public Finance Act will reflect recent operational improvements in PFM, introducing principles of transparency, accountability, medium-term stability and budget performance and extending its coverage to budget formulation and budget

execution processes; the act will also extend the National Assembly's oversight of the budget to capital expenditures.

51. **Other structural measures intend to achieve greater efficiency and accountability of public enterprises and initiate a reform of the social security system.** The immediate objectives are to improve governance and financial management for two strategic enterprises, Air Seychelles and the PUC (MEFP, ¶25). A strategic assessment report on the national airline, prepared by international aviation consultants, has recently been submitted to cabinet, which will decide on further reform steps to adopt a long-term strategy for Air Seychelles. PUC will reinstate the indexation of electricity tariffs to fuel costs and plans to hire a consultant to conduct a tariff study in the first half of 2011. The objective is to provide recommendations on the optimal structure and levels of tariffs by end-2011, which will be consistent with full cost recovery and meeting future investment needs. Based on the recommendations of the World Bank, the government is currently developing a policy that will outline the investment objectives of the social security fund's assets by September 2011 (MEFP, ¶24).

Structural Benchmarks, 2010-2011

Measure	Target Date	Macroeconomic Rationale
Submit VAT bill to National Assembly, to become effective July 1, 2012 (MEFP ¶16)	End-December 2010	To modernize the tax system and remove tax distortions
Cabinet approval of the amendments to Financial Institutions Act as described in MEFP ¶45	End-April 2011	To strengthen competition in the banking sector and improve risk management
Adopt an action plan for house financing policy that limits the role of the public sector (MEFP ¶27)	End-June 2011	To reduce fiscal risks, strengthen competition and promote development of the banking system
Launch a strategic plan for the reform of the social security system (MEFP ¶24)	End-June 2011	To establish well-targeted and sustainable social security system
Cabinet approval of VAT regulations, including rates, exemptions and thresholds (MEFP ¶16)	End-June 2011	To modernize the tax system and remove tax distortions
Commission and complete a study on optimal tariffs for utilities (MEFP ¶25)	End-July 2011	To ensure cost recovery and long-term sustainability of utilities
Develop a privatization plan for non-strategic public enterprises, which do not serve public policy goals (MEFP ¶26)	End-September 2011	To reduce the role of the state in the economy, improve corporate governance and minimize fiscal risks
Cabinet approval of a new Public Finance Bill extending the National Assembly's oversight on capital expenditure budget. (MEFP ¶23)	End-September 2011	To strengthen public finance management
Reinstate the electricity tariff adjustment for fuel price variation (MEFP ¶25)	End-September 2011	To reduce losses of the public utility company

52. **The program for the remainder of 2010 and for 2011 is financed.** The authorities plan to complete the restructuring of Seychelles' external debt through the signature of bilateral agreements with a few remaining creditors (MEFP ¶47-49). The minor financing residual gaps for 2010 and 2011 are expected to be closed by these restructurings.

C. Program Modalities

53. **Staff proposes a simplified program monitoring framework.** At present, the program is based on semi-annual reviews, with quarterly quantitative performance criteria (PCs), financing assurances reviews, and disbursements. Given the good track record of program implementation under the previous SBA and the current EFF, and an almost-completed rescheduling of external debt, staff proposes that program monitoring be carried out on semiannual basis, including financing assurances reviews, PCs, and disbursements (Table 9). Test dates for the semiannual reviews are set for end-December and end-June for a better synchronization with the budget cycle.

54. **The debt limits have been revised upward to accommodate expected financing in support of large infrastructural needs.** In particular, in 2011 PUC plans to contract loans for electricity and water projects with a government guarantee, both from multilateral sources at concessional rates. In addition, the government will provide a US$8 million guarantee to support a strategic private-public partnership for a submarine cable project that will supply high speed internet connections. Reflecting these developments, public external debt is expected to rise to 49.2 percent of GDP in 2011 but to decline over the medium term as the growth effects of the financing filter through to reach 34.2 percent of GDP in 2015. Although the profile of Seychelles debt is sustainable, it remains vulnerable to shocks, particularly those from export-related shocks (See Appendix II).

55. The next Article IV consultation with Seychelles will take place within 24 months subject to the provisions of the decision on consultation cycles in program countries.

Table 1. Seychelles: Selected Economic and Financial Indicators, 2007–13

	2007	2008	2009		2010		2011	2012	2013
			Prog.	Prel.	Prog.	Proj.	Projections		
National income and prices	(Percentage change, unless otherwise indicated)								
Nominal GDP (millions of Seychelles rupees)	6,828	8,710	10,402	10,726	11,206	11,303	12,000	12,881	13,920
Real GDP	9.6	-1.3	-7.6	0.7	4.0	6.2	4.3	4.8	5.0
CPI (annual average)	5.3	37.0	32.9	31.9	-2.4	-2.2	2.5	3.0	2.9
CPI (end-of-period)	16.8	63.3	1.9	-2.5	1.1	1.2	3.0	2.6	3.0
GDP deflator average	11.4	29.3	28.5	22.3	0.4	-0.8	1.8	2.5	2.9
Money and credit	(Percentage change, unless otherwise indicated)								
Net claims on private sector	9.3	48.6	-12.1	-11.4	22.2	21.5	11.3	…	…
Broad money	-7.6	27.2	-0.7	7.5	19.1	12.5	11.1	…	…
Reserve money	-23.1	0.6	32.2	15.7	35.3	35.3	5.1	…	…
Velocity (GDP/broad money)	1.5	1.5	1.8	1.7	1.5	1.6	1.5	…	…
Money multiplier (broad money/reserve money)	4.2	5.3	4.0	4.9	4.3	4.1	4.3	…	…
Savings-Investment balance	(In percent of GDP)								
External savings	20.8	48.9	22.6	36.3	39.5	47.1	27.3	20.0	17.3
Gross national savings	8.0	-8.8	6.8	-7.1	6.0	6.3	10.1	11.5	11.6
Of which: government savings	-4.4	7.9	2.8	7.8	5.6	7.6	13.1	10.7	9.3
Gross investment	28.8	40.1	29.4	29.3	45.4	53.4	37.4	31.5	28.9
Of which: government investment	5.5	2.1	5.3	5.7	8.0	8.4	10.4	8.5	7.8
Government budget									
Total revenue, excluding grants	32.0	32.9	35.6	35.4	31.4	35.5	36.5	36.5	35.7
Expenditure and net lending	40.9	40.0	35.1	33.8	33.8	34.3	37.8	36.2	35.0
Current expenditure	36.3	28.7	32.8	31.0	28.9	29.3	27.4	27.6	27.2
Capital expenditure and net lending	4.6	11.2	2.3	2.7	4.9	5.0	10.5	8.6	7.9
Overall balance, including grants	-8.7	-3.4	2.8	5.0	0.7	2.7	2.7	2.1	1.5
Primary balance	-2.0	3.9	13.3	14.8	7.4	9.4	5.0	4.7	4.0
Total public debt [1]	129.8	136.7	140.1	128.6	82.4	76.1	71.7	64.3	57.0
External sector	(In percent of GDP, unless otherwise indicated)								
Current account balance including official transfers	-20.8	-48.9	-22.6	-36.3	-39.5	-47.1	-27.3	-20.0	-17.3
Total stock of arrears (millions of U.S. dollars) [2]	160	317	239	251	…	33.3	…	…	…
Total public external debt outstanding (millions of U.S. dollars) [1]	710	759	755	732	492	425	448	451	439
(in percent of GDP)	69	82.8	98.5	92.6	53.6	45.3	46.2	43.9	40.1
Terms of trade (= - deterioration)	-1.2	1.2	-2.1	-3.2	…	…	…	…	…
Real effective exchange rate (average, percent change)	-18.3	-7.1	…	-6.6	…	…	…	…	…
Gross official reserves (end of year, millions of U.S. dollars)	10	51	153	169	224	218	253	286	311
In months of imports, c.i.f.	0.1	0.6	1.5	1.7	2.3	2.3	2.7	3.0	3.1
Exchange rate									
Seychelles rupees per US$1 (end of period)	8.0	16.6	10.6	11.3	…	…	…	…	…
Seychelles rupees per US$1 (period average)	6.7	9.5	14.1	13.6	…	…	…	…	…

Sources: Central Bank of Seychelles; Ministry of Finance; and IMF staff estimates and projections.

[1] Includes the central bank.

[2] The 2010 figure is an estimate as of end-November 2010.

Table 2. Seychelles: Balance of Payments, 2007–15
(Millions of U.S. dollars)

	2007	2008	2009	2010		2011	2012	2013	2014	2015
			Prel.	Prog.	Proj.	Projections				
Current account	**-213**	**-448**	**-287**	**-362**	**-441**	**-265**	**-205**	**-190**	**-179**	**-125**
(Percent of GDP)	-21	-49	-36	-39	-47	-27	-20	-17	-15	-10
Trade balance	**-175**	**-412**	**-228**	**-301**	**-370**	**-222**	**-156**	**-136**	**-121**	**-61**
Exports of goods	392	502	427	460	412	488	516	545	575	609
Of which: oil re-exports	152	200	148	206	141	146	158	170	180	191
Of which: tuna exports	184	216	221	181	213	252	264	277	291	309
Imports of goods	-734	-1,009	-748	-826	-848	-812	-779	-809	-834	-864
of which: Oil imports	-199	-278	-176	-249	-204	-204	-224	-242	-257	-274
FDI-related imports	-153	-288	-176	-177	-263	-165	-138	-129	-117	-105
Other	-382	-390	-379	-399	-380	-399	-417	-438	-461	-485
Exports of services	481	486	398	410	413	437	454	483	514	548
Of which: tourism earnings	284	270	205	215	219	231	239	256	275	295
Imports of services	-313	-391	-305	-346	-348	-336	-347	-355	-376	-354
Income, net	**-68**	**-94**	**-101**	**-74**	**-81**	**-43**	**-46**	**-51**	**-55**	**-61**
Of which: transfers of profits and dividends	-6	-30	-57	-37	-29	-17	-13	-12	-11	-10
Of which: interest payments due [1]	-65	-70	-48	-41	-50	-26	-32	-38	-44	-52
Current transfers, net	**30**	**57**	**41**	**12**	**10**	**0**	**-3**	**-3**	**-3**	**-3**
of which: General government, net	7	32	39	13	11	12	8	8	9	9
Capital and financial account	**255**	**366**	**39**	**385**	**369**	**286**	**234**	**222**	**204**	**145**
Capital account	**8**	**5**	**56**	**304**	**289**	**34**	**10**	**0**	**0**	**0**
o.w. Debt forgiveness	0	…	-45	-270	-270	0	0	0	0	0
Financial account	**247**	**361**	**-17**	**80**	**80**	**252**	**224**	**222**	**204**	**145**
Direct investment, net	112	166	113	133	284	117	90	83	74	67
Portfolio investment, net [1]	138	125	1	1	1	1	1	1	1	1
Other investment, net	-2	70	-131	-53	-206	135	134	138	129	77
Government and government-guaranteed	66	19	-110	-270	-275	12	-2	-5	-9	-7
Disbursements	26	84	12	37	41	24	7	6	0	0
Project loans	26	84	1	10	13	24	7	6	0	0
Program loans	0	0	11	27	27	0	0	0	0	0
Amortization	-65	-65	-79	-35	-46	-11	-9	-11	-11	-11
Private sector [2]	-2	54	7	201	53	112	131	138	133	84
of which: Foreign loans for investment	113	185	110	128	126	113	88	82	75	67
Net errors and omissions	**-3**	**-129**	**133**	**-29**	**88**	**0**	**0**	**0**	**0**	**0**
Overall balance	**40**	**-212**	**-24**	**-7**	**15**	**21**	**29**	**32**	**25**	**20**
Financing	**-40**	**212**	**24**	**-21**	**66**	**-27**	**-33**	**-35**	**-26**	**-21**
Change in net international reserves (increase: –)	-40	38	-43	-42	-36	-27	-33	-35	-26	-21
Change in gross official reserves (increase: –)	49	28	-50	-54	-49	-35	-33	-25	-20	-20
Liabilities to IMF, net	0	10	8	12	13	8	0	-10	-6	-1
Other Net Foreign Assets (increase: –)	0	0	-13	10	10	0	0	0	0	0
Exceptional financing	-89	174	79	11	92	0	0	0	0	0
Change in arrears (increase: +)	-89	174	-74	-159	-162	0	0	0	0	0
Clearance of arrears	0	0	153	170	254	0	0	0	0	0
Financing gap	**0**	**0**	**0**	**28**	**4**	**6**	**3**	**3**	**1**	**1**
Memorandum items:										
Exports G&S growth, percent	1.8	13.2	-16.5	5.6	0.0	12.2	4.8	6.0	5.9	6.3
Tourism growth, percent	25.1	-4.8	-24.4	5.0	6.8	5.9	3.2	7.2	7.3	7.5
Imports G&S growth, percent	5.6	33.7	-24.8	11.3	13.6	-4.0	-1.9	3.3	4.0	0.7
o/w non-FDI and domestic-oil imports	-6.9	6.2	-7.3	3.9	4.2	5.3	5.3	5.4	5.3	5.4
Exports G&S, percent of GDP	85.8	107.8	104.4	94.8	88.1	95.3	94.5	93.8	93.4	93.5
Imports G&S, percent of GDP	102.9	152.8	133.2	127.6	127.6	118.2	109.7	106.2	103.8	98.4
FDI (incl. loans), USD million	225	350	223	260	411	230	178	166	149	134
FDI (incl. loans), percent of GDP	22.1	38.2	28.2	28.3	43.8	23.7	17.3	15.1	12.8	10.8
Gross international reserves (stock, e.o.p.)	225	51	169	224	218	253	286	311	331	351
Months of prospective imports of goods and services	9.8	0.6	1.7	2.3	2.3	2.7	3.0	3.1	3.3	3.4
Months of non-FDI imports of G&S excl. oil re-exports	0.1	0.8	2.6	3.5	3.1	3.7	4.0	4.1	4.3	4.4
o.w. Valuation change (+gain)	…	…	68	…	…	…	…	…	…	…
Scheduled public external debt service	100	221	125	78	98	40	43	51	57	65
(Percent of exports of goods and services)	11.4	22.4	15.1	8.9	11.9	4.3	4.4	5.0	5.2	5.6
Public external debt	710	759	732	492	425	448	451	439	427	419
(Percent of GDP)	69.8	82.8	92.6	53.6	45.3	46.2	43.9	40.1	36.6	33.8
GDP	1,018	916	790	919	937	971	1,027	1,096	1,166	1,238

Sources: Central Bank of Seychelles; Ministry of Finance; and IMF staff estimates and projections.

[1] Including coupons on the eurobonds, amortizing notes and bonds issued after the commercial debt exchange.

[2] Includes parastatals for which data is available.

Table 3. Seychelles: Consolidated Government Operations, 2007–13 [1]

(Millions of Seychelles rupees; cumulative from the start of the year)

	2007	2008	2009	2010								2011				2012	2013
				Q1		Q2		Q3		Q4		Q1	Q2	Q3	Q4		
				Prog.	Prel.	Prog.	Prel.	Prog.	Prel.	Prog.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Total revenue and grants	**2,214**	**3,190**	**4,165**	**835**	**848**	**1,796**	**1,907**	**2,829**	**2,973**	**3,866**	**4,178**	**1,091**	**2,219**	**3,560**	**4,856**	**4,937**	**5,082**
Total revenue	2,197	2,868	3,793	776	822	1,694	1,876	2,576	2,937	3,514	4,008	990	1,981	3,189	4,381	4,704	4,971
Tax	**1,896**	**2,456**	**3,318**	**712**	**747**	**1,513**	**1,638**	**2,265**	**2,557**	**3,090**	**3,527**	**918**	**1,786**	**2,815**	**3,905**	**4,213**	**4,440**
Personal Income Tax	…	…	…	…	…	…	…	69	66	190	181	140	290	430	573	602	650
Social security tax	301	295	384	109	105	200	188	233	220	233	220	…	…	…	…	…	…
Trade Tax	265	410	437	…	…	…	…	…	…	…	369	87	171	264	377	404	429
Excise Tax	…	…	…	…	…	…	…	…	…	…	559	125	251	399	564	608	638
Goods and services tax (GST)	800	951	1,348	…	…	…	…	…	…	…	1,078	271	567	851	1,216	1,304	1,410
Business tax	360	524	802	136	126	284	331	467	554	602	796	134	271	539	772	829	895
Other	170	277	346	80	112	167	169	220	262	286	323	148	209	292	350	389	333
Pension Fund Contribution		…	…	…	…	…	…	…	…	…	…	13	27	40	54	78	84
Nontax	**301**	**412**	**474**	**64**	**75**	**181**	**238**	**311**	**380**	**424**	**482**	**72**	**195**	**374**	**477**	**491**	**531**
Fees and charges	176	145	182	44	55	101	96	148	141	195	181	52	99	150	199	212	229
Dividends from parastatals	95	64	148	10	8	31	94	87	178	129	229	9	53	165	207	206	222
Other	30	203	143	10	12	50	48	76	61	101	72	11	43	59	70	73	79
External grants	**17**	**321**	**373**	**59**	**26**	**101**	**31**	**253**	**37**	**352**	**170**	**101**	**238**	**371**	**475**	**233**	**111**
Expenditure and net lending	**2,810**	**3,483**	**3,625**	**670**	**767**	**1,849**	**1,700**	**2,826**	**2,582**	**3,788**	**3,878**	**1,050**	**2,135**	**3,273**	**4,538**	**4,669**	**4,879**
Current expenditure	2,497	2,503	3,329	655	690	1,679	1,564	2,502	2,349	3,244	3,315	742	1,530	2,344	3,283	3,561	3,783
Primary current expenditure	**2,041**	**1,875**	**2,283**	**556**	**473**	**1,166**	**1,065**	**1,831**	**1,677**	**2,489**	**2,558**	**641**	**1,374**	**2,116**	**3,000**	**3,226**	**3,431**
Wages and salaries	700	688	766	176	158	347	336	541	510	735	694	224	453	679	906	966	1,043
Goods and services	500	489	715	150	133	366	320	578	513	777	925	169	393	622	973	1,046	1,130
Transfers	834	692	783	227	180	446	403	702	648	966	927	246	522	807	1,108	1,203	1,246
Social program of central government	167	192	290	75	49	145	118	237	204	341	224	53	120	180	271	259	259
Transfers to public sector from central government	376	220	199	64	51	131	114	203	188	273	351	90	196	319	426	454	473
Benefits and programs of Social Security Fund	291	279	295	88	80	171	171	261	256	352	352	84	168	252	337	412	432
Benefits Payment of Seychelles Pension Fund	…	…	…	…	…	…	…	…	…	…	…	19	37	56	75	78	82
Other	8	6	19	3	2	6	5	9	7	12	12	2	6	8	12	12	12
Interest payments due	**456**	**629**	**1,046**	**100**	**217**	**513**	**500**	**671**	**672**	**755**	**759**	**101**	**156**	**228**	**284**	**335**	**351**
Foreign interest	219	344	430	24	16	238	263	275	377	316	411	72	97	140	169	197	220
Domestic interest	236	285	616	75	201	275	236	396	295	439	348	30	59	88	115	138	131
Capital expenditure [2]	**376**	**183**	**608**	**104**	**78**	**293**	**182**	**552**	**414**	**833**	**948**	**307**	**604**	**903**	**1,253**	**1,095**	**1,087**
Net lending	-63	796	-315	-90	-1	-123	-47	-263	-181	-349	-385	0	1	1	2	13	9
Primary balance	**-140**	**336**	**1,586**	**265**	**298**	**460**	**707**	**675**	**1,063**	**833**	**1,059**	**142**	**240**	**515**	**602**	**604**	**555**
Overall balance, commitment basis	**-596**	**-293**	**540**	**165**	**81**	**-53**	**207**	**4**	**391**	**78**	**301**	**41**	**85**	**287**	**318**	**269**	**203**
Change in arrears	59	31	96	-25	-8	-38	-46	-69	-10	-100	-41	0	0	0	0	0	0
External interest	4	167	321	0	0	0	-6	0	59	0	59	0	0	0	0	0	0
Budget	56	-136	-224	-25	-8	-38	-40	-69	-69	-100	-100	0	0	0	0	0	0
Overall balance, cash basis (after grants)	**-537**	**-262**	**637**	**140**	**73**	**-92**	**161**	**-66**	**381**	**-22**	**259**	41	85	287	318	269	203
Financing	**537**	**262**	**-637**	**-140**	**-73**	**92**	**-161**	**66**	**-381**	**22**	**-259**	-41	-85	-287	-318	-269	-203
Foreign financing	411	233	-174	-132	-67	-134	-168	-98	-194	42	70	16	64	93	127	-31	-64
Disbursements	859	672	135	11	107	146	147	290	185	442	489	73	145	219	292	93	75
Project loans	859	672	14	11	8	46	48	83	86	118	162	73	145	219	292	93	75
Program/budget support	0	0	120	0	99	99	99	206	99	324	328	0	0	0	0	0	0
Scheduled amortization	-449	-1,630	-1,090	-143	-169	-286	-373	-394	-437	-413	-554	-56	-81	-126	-166	-124	-139
Change in amortization arrears	-3	1,191	-1,213	0	-1,953	-1,945	-1,889	-1,945	-2,293	-1,945	-2,845	0	0	0	0	0	0
Clearance of arrears	0	0	1,938	0	1,947	1,945	1,947	1,945	2,351	1,945	2,980	0	0	0	0	0	0
Debt service relief	0	0	56	0	0	6	0	6	0	12	0	0	0	0	0	0	0
Domestic financing, net	-20	-70	-706	-59	-248	-89	-183	-307	-311	-733	-530	-132	-260	-565	-666	-438	-299
Bank financing	-50	-100	-823	-53	-140	-40	-98	-173	-85	-494	-282	-119	-234	-508	-600	-394	-269
CBS	28	-3	-376	-18	-177	-177	-172	-177	-88	-177	-151	-100	-200	-250	-250	0	0
CBS recapitalization	…	…	…	…	…	63	63	125	125	188	188	…	…	…	…	…	…
Commercial banks	-119	-96	-447	-35	37	74	12	-122	-123	-505	-320	-19	-34	-258	-350	-394	-269
Nonbank financing	31	30	117	-6	-108	13	-85	-9	-226	-51	-248	-13	-26	-56	-67	-44	-30
Privatization and long-term lease of fixed assets	**134**	**219**	**222**	**50**	**51**	**86**	**94**	**119**	**121**	**152**	**153**	**37**	**37**	**37**	**146**	**157**	**118**
Statistical discrepancy	**14**	**-120**	**22**	**0**	**191**	**52**	**95**	**52**	**4**	**52**	**4**	**0**	**0**	**0**	**0**	**0**	**0**
Fiscal financing gap	**0**	**0**	**0**	**-42**	**0**	**177**	**0**	**298**	**0**	**510**	**44**	**38**	**38**	**75**	**75**	**44**	**43**
Memorandum item:																	
External debt service due	668	1,974	1,521	167	185	524	636	669	815	729	965	965	729	965	334	321	359

Sources: The Seychelles authorities and IMF staff estimates and projections.

[1] Includes the central government and the social security system.

[2] Includes contingency spending in 2010.

Table 3. Seychelles: Consolidated Government Operations, 2007–13 [1] (continued)

(Percent of GDP; cumulative from the start of the year)

	2007	2008	2009	2010								2011				2012	2013
				Q1		Q2		Q3		Q4		Q1	Q2	Q3	Q4		
				Prog.	Prel.	Prog.	Prel.	Prog.	Prel.	Prog.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Total revenue and grants	**32.4**	**36.6**	**38.8**	**7.6**	**7.7**	**16.0**	**16.9**	**25.2**	**26.3**	**34.5**	**37.0**	**9.1**	**18.5**	**29.7**	**40.5**	**38.3**	**36.5**
Total revenue	32.2	32.9	35.4	7.0	7.4	15.1	16.6	23.0	26.0	31.4	35.5	8.3	16.5	26.6	36.5	36.5	35.7
Tax	**27.8**	**28.2**	**30.9**	**6.4**	**6.8**	**13.5**	**14.5**	**20.2**	**22.6**	**27.6**	**31.2**	**7.7**	**14.9**	**23.5**	**32.5**	**32.7**	**31.9**
Personal Income Tax	…	…	…	…	…	…	…	0.6	0.6	1.7	1.6	1.2	2.4	3.6	4.8	4.7	4.7
Social security tax	4.4	3.4	3.6	1.0	1.0	1.8	1.7	2.1	1.9	2.1	1.9	…	…	…	…	…	…
Trade Tax	3.9	4.7	4.1	…	…	…	…	…	…	…	3.3	0.7	1.4	2.2	3.1	3.1	3.1
Excise Tax	…	…	…	…	…	…	…	…	…	…	4.9	1.0	2.1	3.3	4.7	4.7	4.6
Goods and services tax (GST)	11.7	10.9	12.6	…	…	…	…	…	…	…	9.5	2.3	4.7	7.1	10.1	10.1	10.1
Business tax	5.3	6.0	7.5	1.2	1.1	2.5	2.9	4.2	4.9	5.4	7.0	1.1	2.3	4.5	6.4	6.4	6.4
Other	2.5	3.2	3.2	0.7	1.0	1.5	1.5	2.0	2.3	2.6	2.9	1.2	1.7	2.4	2.9	3.0	2.4
Pension Fund Contribution	…	…	…	…	…	…	…	…	…	…	…	0.1	0.2	0.3	0.4	0.6	0.6
Nontax	**4.4**	**4.7**	**4.4**	**0.6**	**0.7**	**1.6**	**2.1**	**2.8**	**3.4**	**3.8**	**4.3**	**0.6**	**1.6**	**3.1**	**4.0**	**3.8**	**3.8**
Fees and charges	2.6	1.7	1.7	0.4	0.5	0.9	0.8	1.3	1.2	1.7	1.6	0.4	0.8	1.2	1.7	1.6	1.6
Dividends from parastatals	1.4	0.7	1.4	0.1	0.1	0.3	0.8	0.8	1.6	1.1	2.0	0.1	0.4	1.4	1.7	1.6	1.6
Other	0.4	2.3	1.3	0.1	0.1	0.4	0.4	0.7	0.5	0.9	0.6	0.1	0.4	0.5	0.6	0.6	0.6
External grants	**0.2**	**3.7**	**3.5**	**0.5**	**0.2**	**0.9**	**0.3**	**2.3**	**0.3**	**3.1**	**1.5**	**0.8**	**2.0**	**3.1**	**4.0**	**1.8**	**0.8**
Expenditure and net lending	**41.2**	**40.0**	**33.8**	**6.1**	**6.9**	**16.5**	**15.0**	**25.2**	**22.8**	**33.8**	**34.3**	**8.7**	**17.8**	**27.3**	**37.8**	**36.2**	**35.0**
Current expenditure	36.6	28.7	31.0	5.9	6.2	15.0	13.8	22.3	20.8	28.9	29.3	6.2	12.7	19.5	27.4	27.6	27.2
Primary current expenditure	**29.9**	**21.5**	**21.3**	**5.0**	**4.3**	**10.4**	**9.4**	**16.3**	**14.8**	**22.2**	**22.6**	**5.3**	**11.5**	**17.6**	**25.0**	**25.0**	**24.7**
Wages and salaries	10.3	7.9	7.1	1.6	1.4	3.1	3.0	4.8	4.5	6.6	6.1	1.9	3.8	5.7	7.6	7.5	7.5
Goods and services	7.3	5.6	6.7	1.4	1.2	3.3	2.8	5.2	4.5	6.9	8.2	1.4	3.3	5.2	8.1	8.1	8.1
Transfers	12.2	7.9	7.3	2.1	1.6	4.0	3.6	6.3	5.7	8.6	8.2	2.0	4.3	6.7	9.2	9.3	8.9
Social program of central government	2.4	2.2	2.7	0.7	0.4	1.3	1.0	2.1	1.8	3.0	2.0	0.4	1.0	1.5	2.3	2.0	1.9
Transfers to public sector from central governmer	5.5	2.5	1.9	0.6	0.5	1.2	1.0	1.8	1.7	2.4	3.1	0.7	1.6	2.7	3.5	3.5	3.4
Benefits and programs of Social Security Fund	4.3	3.2	2.7	0.8	0.7	1.5	1.5	2.3	2.3	3.1	3.1	0.7	1.4	2.1	2.8	3.2	3.1
Benefits of the Pension Fund	…	…	…	…	…	…	…	…	…	…	…	0.2	0.3	0.5	0.6	0.6	0.6
Other	0.1	0.1	0.2	0.0	0.0	0.1	0.0	0.1	0.1	0.1	0.1	0.0	0.1	0.1	0.1	0.1	0.1
Interest payments due	**6.7**	**7.2**	**9.8**	**0.9**	**2.0**	**4.6**	**4.4**	**6.0**	**5.9**	**6.7**	**6.7**	**0.8**	**1.3**	**1.9**	**2.4**	**2.6**	**2.5**
Foreign interest	3.2	3.9	4.0	0.2	0.1	2.1	2.3	2.5	3.3	2.8	3.6	0.6	0.8	1.2	1.4	1.5	1.6
Domestic interest	3.5	3.3	5.7	0.7	1.8	2.5	2.1	3.5	2.6	3.9	3.1	0.2	0.5	0.7	1.0	1.1	0.9
Capital expenditure [2]	**5.5**	**2.1**	**5.7**	**0.9**	**0.7**	**2.6**	**1.6**	**4.9**	**3.7**	**7.4**	**8.4**	**2.6**	**5.0**	**7.5**	**10.4**	**8.5**	**7.8**
Net lending	-0.9	9.1	-2.9	-0.8	0.0	-1.1	-0.4	-2.4	-1.6	-3.1	-3.4	0.0	0.0	0.0	0.0	0.1	0.1
Primary balance	**-2.1**	**3.9**	**14.8**	**2.4**	**2.7**	**4.1**	**6.3**	**6.0**	**9.4**	**7.4**	**9.4**	**1.2**	**2.0**	**4.3**	**5.0**	**4.7**	**4.0**
Overall balance, commitment	-8.7	-3.4	5.0	1.5	0.7	-0.5	1.8	0.0	3.5	0.7	2.7	0.3	0.7	2.4	2.7	2.1	1.5
Change in arrears	0.9	0.4	0.9	-0.2	-0.1	-0.3	-0.4	-0.6	-0.1	-0.9	-0.4	0.0	0.0	0.0	0.0	0.0	0.0
External interest	0.1	1.9	3.0	0.0	0.0	0.0	-0.1	0.0	0.5	0.0	0.5	0.0	0.0	0.0	0.0	0.0	0.0
Budget	0.8	-1.6	-2.1	-0.2	-0.1	-0.3	-0.4	-0.6	-0.6	-0.9	-0.9	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance, cash basis (after grants)	-7.9	-3.0	5.9	1.3	0.7	-0.8	1.4	-0.6	3.4	-0.2	2.3	0.3	0.7	2.4	2.7	2.1	1.5
Financing	**7.9**	**3.0**	**-5.9**	**-1.3**	**-0.7**	**0.8**	**-1.4**	**0.6**	**-3.4**	**0.2**	**-2.3**	**-0.3**	**-0.7**	**-2.4**	**-2.7**	**-2.1**	**-1.5**
Foreign financing	6.0	2.7	-1.6	-1.2	-0.6	-1.2	-1.5	-0.9	-1.7	0.4	0.6	0.1	0.5	0.8	1.1	-0.2	-0.5
Disbursements	12.6	7.7	1.3	0.1	1.0	1.3	1.3	2.6	1.6	3.9	4.3	0.6	1.2	1.8	2.4	0.7	0.5
Project loans	12.6	7.7	0.1	0.1	0.1	0.4	0.4	0.7	0.8	1.1	1.4	0.6	1.2	1.8	2.4	0.7	0.5
Program/budget support	0.0	0.0	1.1	0.0	0.9	0.9	0.9	1.8	0.9	2.9	2.9	0.0	0.0	0.0	0.0	0.0	0.0
Scheduled amortization	-6.6	-18.7	-10.2	-1.3	-1.5	-2.6	-3.3	-3.5	-3.9	-3.7	-4.9	-0.5	-0.7	-1.0	-1.4	-1.0	-1.0
Change in amortization arrears	0.0	13.7	-11.3	0.0	-17.7	-17.4	-16.7	-17.4	-20.3	-17.4	-25.2	0.0	0.0	0.0	0.0	0.0	0.0
Clearance of arrears	0.0	0.0	18.1	0.0	17.6	17.4	17.2	17.4	20.8	17.4	26.4	0.0	0.0	0.0	0.0	0.0	0.0
Debt service relief	0.0	0.0	0.5	0.0	0.0	0.1	0.0	0.1	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic financing	-0.3	-0.8	-6.6	-0.5	-2.2	-0.8	-1.6	-2.7	-2.8	-6.5	-4.7	-1.1	-2.2	-4.7	-5.6	-3.4	-2.2
Bank financing	-0.7	-1.1	-7.7	-0.5	-1.3	-0.4	-0.9	-1.5	-0.8	-4.4	-2.5	-1.0	-1.9	-4.2	-5.0	-3.1	-1.9
CBS	0.4	…	-3.5	-0.2	-1.6	-1.6	-1.5	-1.6	-0.8	-1.6	-1.3	-0.8	-1.7	-2.1	-2.1	0.0	0.0
CBS recapitalization	…	…	…	…	0.0	0.6	0.6	1.1	1.1	1.7	1.7	…	…	…	…	…	…
Commercial banks	-1.7	…	-4.2	-0.3	0.3	0.7	0.1	-1.1	-1.1	-4.5	-2.8	-0.2	-0.3	-2.2	-2.9	-3.1	-1.9
Nonbank	0.5	0.3	1.1	-0.1	-1.0	0.1	-0.8	-0.1	-2.0	-0.5	-2.2	-0.1	-0.2	-0.5	-0.6	-0.3	-0.2
Privatization and long-term lease of fixed assets	**2.0**	**2.5**	**2.1**	**0.5**	**0.5**	**0.8**	**0.8**	**1.1**	**1.1**	**1.4**	**1.4**	**0.3**	**0.3**	**0.3**	**1.2**	**1.2**	**0.8**
Statistical discrepancy	**0.2**	**-1.4**	**0.2**	**0.0**	**1.7**	**0.5**	**0.8**	**0.5**	**0.0**	**0.5**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Fiscal financing gap	**0.0**	**0.0**	**0.0**	**-0.4**	**0.0**	**1.6**	**0.0**	**2.7**	**0.0**	**4.5**	**0.4**	**0.3**	**0.3**	**0.6**	**0.6**	**0.3**	**0.3**
Memorandum items:																	
Nominal GDP	6,824	8,710	10,726	11,057	11,303	11,206	11,303	11,206	11,303	11,206	11,303	12,000	12,000	12,000	12,000	12,881	13,920
Domestic debt (percent of revised GDP)	66.4	53.9	36.0	…	…	…	…	…	…	28.8	30.8	28.7	28.5	26.4	25.5	20.4	16.7

Sources: The Seychelles authorities and IMF staff estimates and projections.

[1] Includes the central government and the social security system.

[2] Includes contingency spending in 2010.

Table 4. Seychelles: Monetary Survey and Central Bank Accounts, 2008–11

	2008	2009	2010								2011			
			Mar.		June		Sep.		Dec.		Mar.	June	Sep.	Dec.
			Prog.	Act.	Prog.	Act.	Prog.	Act.	Prog.	Proj.	Proj.	Proj.	Proj.	Proj.
	(Seychelles rupees millions, unless otherwise indicated)													
Monetary survey														
Net foreign assets	2,105	2,897	2,388	3,345	3,079	3,256	3,244	3,641	3,408	4,002	4,183	4,413	4,796	4,954
Central bank	1,050	1,998	1,802	2,397	2,140	2,230	2,304	2,357	2,469	2,560	2,624	2,688	2,834	2,994
Deposit money banks	1,055	899	586	947	939	1,025	941	1,284	939	1,442	1,559	1,725	1,961	1,960
Net domestic assets	3,848	3,504	3,834	3,223	3,684	3,281	3,952	3,222	4,216	3,197	3,223	3,230	3,062	3,046
Domestic credit	5,949	4,796	4,518	4,811	5,028	4,906	5,018	5,320	4,866	5,362	5,300	5,300	5,126	5,112
Net claims on the government	3,082	2,255	1,707	2,115	2,216	2,158	2,082	2,474	1,761	2,277	2,159	2,043	1,769	1,678
Credit to the economy	2,867	2,540	2,811	2,695	2,813	2,749	2,936	2,846	3,105	3,085	3,142	3,256	3,358	3,434
Other items, net	-2,102	-1,292	-684	-1,587	-1,344	-1,625	-1,066	-2,097	-650	-2,165	-2,078	-2,069	-2,065	-2,066
Broad money	5,952	6,401	6,222	6,568	6,763	6,537	7,197	6,864	7,623	7,199	7,406	7,643	7,857	8,000
Currency in circulation	478	500	509	497	519	507	549	512	577	562	608	614	621	628
Foreign currency deposits	1,913	1,610	1,600	1,682	1,655	1,616	1,762	1,828	1,867	1,759	1,802	1,863	1,918	1,954
Local currency deposits	3,593	4,291	4,113	4,388	4,589	4,414	4,886	4,524	5,179	4,878	4,997	5,166	5,318	5,419
Central bank														
Net foreign assets	1,050	1,998	1,802	2,397	2,140	2,230	2,304	2,357	2,469	2,560	2,624	2,688	2,834	2,994
Foreign assets	1,207	2,207	2,044	2,648	2,468	2,490	2,675	2,664	2,908	2,921	2,987	3,052	3,200	3,463
Of which: official reserves	843	1,907	1,740	2,470	2,267	2,273	2,473	2,499	2,704	2,671	2,723	2,775	2,909	3,158
Foreign liabilities	157	210	242	250	329	259	372	307	439	361	363	364	365	468
Net domestic assets	70	-702	-266	-973	-548	-686	-630	-762	-716	-804	-837	-881	-1,007	-1,149
Domestic credit	851	-657	-279	-779	-295	-420	-302	-385	-311	-409	-525	-575	-705	-845
Government (net) [1]	1,099	724	55	547	609	614	672	761	735	761	661	561	511	511
Commercial banks	-22	-1,266	-212	-1,202	-781	-910	-851	-860	-922	-884	-900	-850	-930	-1,070
Other (parastatals)	-226	-114	-122	-123	-123	-123	-123	-286	-123	-286	-286	-286	-286	-286
Other items, net	-780	-45	13	-195	-254	-267	-328	-377	-405	-395	-313	-307	-302	-304
Reserve money	1,120	1,296	1,536	1,424	1,591	1,544	1,674	1,595	1,753	1,756	1,787	1,807	1,827	1,846
Currency in circulation	478	500	509	497	519	507	549	512	577	562	608	614	621	628
Commercial bank reserves (includes cash in vault)	642	796	1,028	927	1,072	1,037	1,125	1,083	1,176	1,194	1,179	1,193	1,206	1,218
o.w. required reserves in foreign currency [2,3]	…	170	161	176	188	181	200	195	212	213	225	238	250	263
required reserves in domestic currency [3]	745	467	411	489	473	508	502	509	532	498	509	526	542	552
Memorandum items:														
Gross international reserves (US$ millions) [4]	51	169	158	210	192	182	207	202	224	218	221	225	235	253
Foreign Currency Deposits (US$ millions)	115	143	145	143	140	130	147	148	154	144	146	151	155	157
Broad money growth (12–month percent change)	27.2	7.5	15.0	21.4	33.5	24.6	33.0	26.9	19.1	12.5	12.8	16.9	14.5	11.1
Credit to the economy (12–month percent change)	48.6	-11.4	-2.7	2.9	14.3	11.7	19.1	15.4	22.2	21.5	16.6	18.5	18.0	11.3
Reserve money (12–month percent change)	0.6	15.7	46.2	35.5	42.2	38.0	43.1	36.4	35.3	35.5	25.5	17.0	14.6	5.1
Money multiplier (broad money/reserve money)	5.3	4.9	4.1	4.6	4.3	4.2	4.3	4.3	4.3	4.1	4.1	4.2	4.3	4.3
Velocity (GDP/broad money; end of period)	1.5	1.7	1.5	1.6	1.5	1.6	1.5	1.6	1.5	1.6	1.5	1.5	1.5	1.5
Change in Net Credit to Government (change in quarter)	-158	148	-15	-140	100	42	-133	317	-321	-197	397	-234	-390	-366

Sources: Central Bank of Seychelles and IMF staff estimates and projections.

[1] Assumes recapitalization of the CBS by SR 188 million in three equal quarterly installments in 2010.

[2] Reserve requirements on foreign currency deposits were introduced in 2009.

[3] Reserve requirements were lowered from 13% to 10% in 2009.

[4] Reflects an increase in SDR holdings following SDR allocation of SDR 7.9 million in 2009.

Table 5. Seychelles: Financial Soundness Indicators for the Banking Sector, 2007–10 [1]
(Percent, end of period)

	2007				2008				2009				2010		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Capital adequacy															
Regulatory capital to risk weighted assets	20.4	21.0	18.2	18.2	18.4	17.6	17.9	19.4	13.6	17.8	22.0	21.7	21.4	22.1	21.7
Regulatory tier 1 capital to risk weighted assets	14.8	16.1	14.8	12.9	12.9	14.0	13.4	10.4	12.9	17.1	21.3	21.0	20.7	21.5	21.1
Capital to assets (net worth)	6.2	6.5	6.4	6.4	6.9	6.6	7.0	8.4	9.6	8.7	9.7	9.9	9.3	8.7	9.1
Net tangible capitalization [2]	6.2	6.6	6.5	6.5	7.0	6.6	7.1	8.4	9.6	8.7	9.8	9.9	9.4	8.8	9.1
Asset quality															
Foreign exchange loans to total loans	24.1	25.1	28.7	30.8	32.7	32.9	31.6	50.8	50.5	43.0	41.1	37.2	34.3	29.7	27.8
Nonperforming loans to gross loans	3.7	2.9	2.5	2.3	2.0	2.1	2.0	2.0	2.3	4.3	4.2	3.8	4.1	6.9	6.4
Provisions as percentage of nonperforming loans	38.2	44.1	45.6	45.9	51.2	50.3	59.6	58.3	56.8	35.2	32.6	33.8	41.7	26.0	26.0
Earnings and profitability															
Return on assets (annualized)	3.9	3.4	5.0	6.6	4.3	3.4	2.8	16.1	5.3	3.0	-0.2	3.2	3.4	5.0	3.0
Return on equity (annualized)	59.1	50.4	68.3	93.0	59.5	47.9	39.3	199.4	55.1	35.4	-2.8	32.4	33.6	54.3	33.7
Interest margin to gross income	60.0	66.1	57.9	46.0	58.7	62.8	58.3	24.2	62.1	83.7	105.5	68.6	56.5	60.2	59.9
Noninterest expense to gross income	35.5	39.7	33.3	32.3	33.2	43.5	49.4	17.8	36.4	48.7	116.5	49.1	44.0	52.0	47.6
Net interest margin (annualized) [3]	3.6	3.7	4.3	4.5	3.8	3.8	3.1	4.8	5.1	4.8	4.2	4.0	3.1	3.6	3.4
Net noninterest margin (annualized) [4]	0.3	-0.3	0.6	2.1	0.5	-0.4	-0.4	11.4	0.1	-1.9	-4.9	-1.0	0.0	-0.7	-0.4
Expense to income	48.5	53.5	44.8	42.2	46.6	55.9	62.5	25.5	52.3	62.2	111.2	58.0	53.0	58.0	53.6
Interest expense to gross income	25.2	29.5	20.8	17.2	25.0	28.0	35.0	10.2	33.2	35.8	47.1	21.2	19.0	14.2	12.8
Liquidity															
Core liquid assets to total assets [5]	19.2	18.6	11.4	10.0	30.8	34.6	36.4	37.8	36.0	35.0	37.7	43.2	43.5	44.7	44.7
Broad liquid assets to total assets [6]	54.8	55.8	44.3	39.4	59.2	60.9	60.0	55.7	50.8	53.0	57.6	58.4	58.6	60.0	58.1
Liquid assets (broad) to short term liabilities	57.3	57.5	46.7	40.8	59.3	61.6	87.1	56.5	53.2	56.2	62.1	62.7	65.0	63.4	62.1
Liquid assets (broad) to total liabilities	58.7	60.1	47.8	42.3	63.9	65.5	64.8	61.2	56.2	58.0	63.8	64.7	64.7	65.7	63.8
Liquid assets to deposit liabilities	64.0	64.5	52.5	46.0	68.3	72.4	71.7	66.4	63.1	63.8	71.4	69.4	72.4	72.0	69.1
Foreign exchange exposure															
Net open foreign exchange position to capital	2.6	14.1	28.3	28.5	24.9	31.3	21.3	58.9	44.4	32.4	21.9	33.1	22.2	24.7	29.2

Source: Central Bank of Seychelles.

[1] Excluding purely offshore banks.
[2] Defined as: equity capital/(assets-interest in suspense-provisions).
[3] Defined as: (Interest income - interest expense)/average assets.
[4] Defined as: (Noninterest income - noninterest expense)/average assets
[5] Core liquid assets include cash, balances with CBS and deposits with other banks.
[6] Broad liquid assets include core liquid assets plus investments in government securities.

Table 6. Seychelles: Quantitative Performance Criteria Under the Extended Arrangement, December 2009–December 2010
(Millions of Seychelles rupees; end-of-period)

	2009	2010									
		March			June			September			December
	Actual	Program	Adjusted	Actual	Program	Adjusted	Actual	Program	Adjusted	Actual	Program
Performance criteria											
Net international reserves of the CBS, millions of U.S. dollars (floor) [1]	153	133	146	192	128	122	167	142	125	174	168
Reserve money (ceiling)	1,296	1,537	…	1,424	1,592	…	1,544	1,676	…	1,595	1,753
Primary balance of the consolidated government (cumulative floor) [2]	1,586	261	…	298	455	…	707	668	…	1,063	823
The contracting or guaranteeing of new external debt by the public sector (Millions of U.S. dollars; cumulative ceiling) [2]	30	2	…	0	3	…	0	13	…	0	37
The contracting or guaranteeing of new short-term external debt by the public sector (Millions of U.S. dollars; cumulative ceiling) [2]	0.0	0.0	…	0.0	0.0	…	0.0	0.0	…	0.0	0.0
The accumulation of external payments arrears by the public sector (ceiling) [3]	0.0	0.0	…	0.0	0.0	…	0.0	0.0	…	0.0	0.0
The accumulation of domestic payment arrears by the public sector (ceiling)	0.0	0.0	…	0.0	0.0	…	0.0	0.0	…	0.0	0.0
Memorandum items:											
External non project financing (millions of U.S. dollars; cumulative) [2]	-9.3	1.7	…	14.4	1.8	…	-4.2	9.0	…	-8.1	31.8
Program financing support	11.2	0.0	…	8.7	0.0	…	8.7	0.0	…	8.7	19.6
Cash payments on foreign debt service	32.0	1.8	…	2.0	5.8	…	20.9	6.9	…	25.3	9.2
External budget grants	11.5	3.5	…	7.8	7.6	…	8.1	15.9	…	8.5	21.4
Program accounting exchange rates											
SR/US$ (end-of-quarter)	11.25	11.00	…	11.00	11.75	…	11.75	11.75	…	11.75	11.75
US$/Euro (end-of-quarter)	1.43	1.48	…	1.48	1.27	…	1.27	1.27	…	1.27	1.27
US$/UK pound (end-of-quarter)	1.62	1.65	…	1.65	1.48	…	1.48	1.48	…	1.48	1.48
US$/SDR (end-of-quarter)	1.57	1.59	…	1.59	1.49	…	1.49	1.49	…	1.49	1.49

Sources: Seychelles authorities and IMF staff estimates and projections.

[1] The floor will be adjusted downward (upward) for any shortfall (excess) in external nonproject financial support from that assumed in the program.

[2] Cumulative flows from the beginning of the calendar year.

[3] The nonaccumulation of new external payment arrears constitutes a continuous performance criterion. Excludes arrears for which a rescheduling agreement is sought.

Table 7. Seychelles: Structural Benchmarks, 2009–10

Measure	Target date	Macroeconomic rationale	Status
Introduce a treasury single account.	End-September 2009	To strengthen public finances, key to sustainability efforts.	Met. The TSA is leveraging progress on PFM.
Adopt foreign reserves management investment guidelines.	End-September 2009	To ensure management of foreign reserves in line with best international practice.	Met. The CBS Board adopted guidelines on September 25, 2009.
Adopt Public Enterprise Monitoring and Control act.	End-September 2009	To improve oversight over public enterprises and reduce quasi-fiscal risks.	Met. Parliamentary approval secured on September 28, 2009.
Complete CBS procedures manual (MEFP, ¶46).	End-December 2009	To support improved efficiency and transparency in monetary policy.	Met. The manual was approved on December 29, 2009.
CBS to publish commercial bank supervision report (MEFP, ¶46).	End-December 2009	To promote competition and transparency in the banking system.	Met. Published on the CBS website on December 29, 2009
Amend the Business Tax Act in line with the tax reform strategy (MEFP, ¶22).	End-December 2009	To broaden the tax base, modernize tax policy, and remove distortions.	Met.
Cabinet approval of customs reform strategy and implementation plan (MEFP, ¶23).	End-March 2010	To transform customs into a modern and efficient entity.	Met. The approval was secured on March 17, 2010.
Publish general government fiscal statistics (MEFP, ¶29).	End-April 2010	To enhance transparency and coverage of public finance.	Met. Fiscal statistics were published on April 23, 2010
Submit to National Assembly a new customs management act (MEFP, ¶23).	End-September 2010	To institutionalize best international practice and a better business climate.	Not met. Expected to be implemented in early December, 2010
Introduce Personal Income Tax (MEFP, ¶22).	July 1, 2010	To broader the tax base and provide for more equitable taxation.	Met.
Introduce budget submissions protocols and procedures (MEFP, ¶28).	End-July 2010	To strengthen budget preparation.	Met.
Adopt a new chart of account for the 2011 budget (MEFP, ¶29).	End-November 2010	To ensure proper classification and increase efficiency of the budget as a policy tool.	Not met. Expected to be introduced in the 2012 Budget.
Submit to National Assembly a bill creating a national clearing house and settlement system (MEFP, ¶44).	End-December 2010	To introduce necessary financial infrastructure for improved efficiency and reduced risks.	Met. The bill was submitted to and approved by the National Assembly in July 2010.

Table 8. Seychelles: Quantitative Performance Criteria Under the Extended Arrangement, December 2010–December 2011
(Millions of Seychelles rupees; end-of-period)

	2010	2011				
	December	March	June		September	December
	Program	Indicative target	Performance Criteria	tua	Indicative target	Performance Criteria
Performance criteria						
Net international reserves of the CBS, millions of U.S. dollars (floor) [1]	168	189	192		202	213
Reserve money (ceiling)	1,753	1,807	1,827		1,847	1,866
Primary balance of the consolidated government (cumulative floor) [2]	823	142	240		515	602
The contracting or guaranteeing of new external debt by the public sector (Millions of U.S. dollars; cumulative ceiling) [2]	37	4	33		46	47
The contracting or guaranteeing of new short-term external debt by the public sector (Millions of U.S. dollars; cumulative ceiling) [2]	0.0	0.0	0.0		0.0	0.0
The accumulation of external payments arrears by the public sector (ceiling) [3]	0.0	0.0	0.0		0.0	0.0
The accumulation of domestic payment arrears by the public sector (ceiling)	0.0	0.0	0.0		0.0	0.0
Memorandum items:						
External non project financing (millions of U.S. dollars; cumulative) [2]	31.8	-1.4	0.0		2.1	5.5
Program financing support	19.6	0.0	0.0		0.0	0.0
Cash payments on foreign debt service	9.2	6.5	9.3		11.7	15.8
External budget grants	21.4	5.1	9.3		13.8	21.3
Program accounting exchange rates						
SR/US$ (end-of-quarter)	11.75	12.30	12.30		12.30	12.30
US$/Euro (end-of-quarter)	1.27	1.36	1.36		1.36	1.36
US$/UK pound (end-of-quarter)	1.48	1.57	1.57		1.57	1.57
US$/SDR (end-of-quarter)	1.49	1.56	1.56		1.56	1.56

Sources: Seychelles authorities and IMF staff estimates and projections.

[1] The floor will be adjusted downward (upward) for any shortfall (excess) in external nonproject financial support from that assumed in the program.

[2] Cumulative flows from the beginning of the calendar year.

[3] The nonaccumulation of new external payment arrears constitutes a continuous performance criterion. Excludes arrears for which a rescheduling agreement is sought.

Table 9. Seychelles: Fund Disbursements and Timing of Reviews Under the Extended Arrangement , 2009–12

Program Review	Date of availability	Conditions	*Amount* (millions of SDR)	(percent of quota)
	December 22, 2009	Board approval of the EFF arrangement.	0.88	10
	March 15, 2010	Compliance with end-December 2009 quantitative performance criteria and completion of a financing assurances review (if needed)	2.20	25
First	June 15, 2010	Completion of first program review and financing assurances review (if needed) and compliance with end-March 2010 quantitative performance criteria.	2.20	25
	September 15, 2010	Compliance with end-June 2010 quantitative performance criteria and completion of a financing assurances review (if needed)	2.20	25
Second	December 15, 2010	Completion of second program review and financing assurances review (if needed) and compliance with end-September 2010 quantitative performance criteria.	1.76	20
Third	March 31, 2011	Compliance with end-December 2010 quantitative performance criteria and completion of a financing assurances review (if needed).	3.52	40
Fourth	September 30, 2011	Compliance with end-June 2011 quantitative performance criteria and completion of a financing assurances review (if needed)	3.08	35
Fifth	March 31, 2012	Compliance with end-December 2011 quantitative performance criteria and completion of a financing assurances review (if needed)	2.64	30
Sixth	September 30, 2012	Compliance with end-June 2012 quantitative performance criteria and completion of a financing assurances review (if needed)	1.32	15
Total			**19.8**	**225**

Table 10. Seychelles: Indicators of Fund Credit, 2008-15
(Millions of SDR)

	2008	2009	2010	2011	2012	2013	2014	2015
		Projections						
Existing Fund credit								
Stock [1]	6.2	11.9	18.5	18.5	15.1	9.6	7.2	5.9
Obligation	0.0	0.0	0.0	0.3	3.7	5.7	2.6	1.4
Disbursements	6.2	5.7	6.6	0.0	0.0	0.0	0.0	0.0
Prospective EFF								
Disbursements		0.0	1.8	6.6	4.0	0.0	0.0	0.0
Stock [1]		0.0	1.8	8.4	12.3	12.3	12.3	11.7
Obligations [2]		0.0	0.0	0.1	0.2	0.2	0.2	0.8
Principal (repayments/repurchases)		0.0	0.0	0.0	0.0	0.0	0.0	0.6
Charges and interest		0.0	0.0	0.1	0.2	0.2	0.2	0.2
Stock of existing and prospective Fund credit 1	6.2	11.9	20.2	26.8	27.4	21.9	19.5	17.6
In percent of quota	70.0	135.0	230.0	305.0	311.3	248.8	221.3	200.4
In percent of GDP	1.0	2.4	3.3	4.2	4.1	3.0	2.5	2.2
In percent of exports of goods and services	0.9	2.3	3.7	4.4	4.3	3.2	2.7	2.3
In percent of gross reserves	18.4	11.1	14.1	16.1	14.6	10.7	9.0	7.7
Obligations to the Fund from existing and prospective Fund arrangements	0.0	0.0	0.0	0.3	3.8	5.9	2.7	2.1
In percent of quota	0.3	0.3	0.1	3.9	43.4	66.6	30.9	24.0
In percent of GDP	0.0	0.0	0.0	0.1	0.6	0.8	0.4	0.3
In percent of exports of goods and services	0.0	0.0	0.0	0.1	0.6	0.9	0.4	0.3
In percent of gross reserves	0.1	0.0	0.0	0.2	2.0	2.9	1.3	0.9

Sources: IMF Finance Department; and IMF staff estimates and projections.

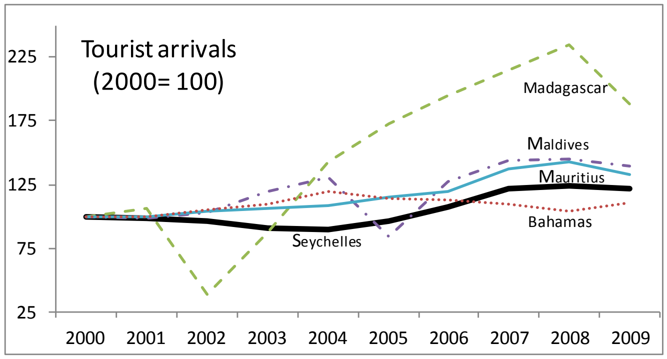
[1] End of period.

[2] Repayment schedule based on repurchase obligations. Obligations to the Fund from Existing and Prospective Fund Arrangements includes charges.

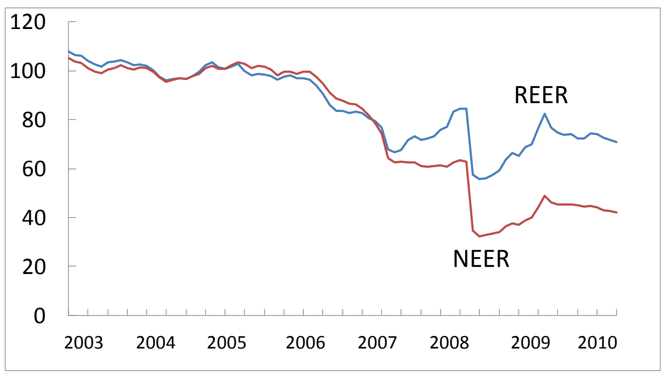
Appendix I. Real Exchange Rate Assessment[8]

Following a severe balance of payment crisis and a depletion of the official reserves, Seychelles fully liberalized its foreign exchange market and moved from a fixed exchange rate to a floating exchange rate in November 2008.

Before the float, the parallel exchange rate flourished with a premium of more than 50 percent. At the 2008 Article IV consultation, indicators pointed to an overvaluation of the real effective exchange rate of 11 to 33 percent. The large external imbalances were related to unsustainable fiscal policies, which drove imports. Since 2005 however, the growth in tourism (Seychelles' main export product) appeared to be in line with its main competitors in the Indian Ocean.



In the last two months of 2008 that followed the float the nominal effective exchange rate (NEER) depreciated by about 40 percent. It then appreciated during 2009 and has since stabilized. It was about 23 percent below the pre-float level at end-September 2010 (the REER depreciation is about 16 percent). The strong policy performance has created a virtuous cycle of falling budget financing costs, rebuilding of official external reserves and emerging confidence in the rupee. Tourism shares also held up well during the crisis.



Staff estimates suggest that as of end-September 2010 **the real exchange rate of the rupee was broadly in line with both current and medium-term (2015) fundamentals,** with sizable differences across methodologies**.** The findings from three formal assessments, using the IMF's Consultative Group on Exchange rate (CGER)-based methodologies, are presented below.

The macroeconomic balance approach estimates an equilibrium current account ('norm') based on economic fundamentals for Seychelles relative to its trading partners and an underlying current account adjusted for large one-off FDI-related imports and debt service payments. In 2010, a significant depreciation would be required to close the gap between the underlying current account and the norm. Based on balance of payments projections presented in this report, this overvaluation almost disappears in 2015.

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[8] Prepared by Nkunde Mwase.

The external sustainability approach calculates the current account that stabilizes the net foreign assets (NFA)-to-GDP ratio. As of 2010, Seychelles is estimated to have net foreign liabilities of about 170 percent of GDP, excluding the large amounts of resident deposits in foreign banks which are reported in BIS statistics (probably reflecting instead offshore banking activity). The stabilization of the NFA within a range 25 percent around the 2010 ratio would require a modest range of depreciation, but this overvaluation is projected to disappear in 2015.

CGER panel-based reduced-form fundamental equilibrium exchange rate assessments estimate the equilibrium REER based on a set of fundamental factors. Contrary to the first two approaches, the results suggest a significant *undervaluation* in 2010 and, to a lesser extent, in 2015.

Selected Indicators of Real Effective Exchange Rate Assessment
(in percent of GDP, unless otherwise indicated)

	Backward[1]	Forward[1]
Actual current account	-47.1	-10.3
(-) Minus temporary factors[2]	-33.9	0.0
Underlying current account (A)	-13.2	-10.3
Trade elasticity (D)	-0.6	-0.6
Macroeconomic balance		
Current account norm (B)	-7.1	-9.9
Current account gap (C=A-B)	-6.1	-0.4
REER gap[3,4] (C/D)	**10.6**	**0.7**
External sustainability[5]		
Current account norm (E)	[-7.9 to 13.1]	[-7.9 to -13.1]
Current account gap (F=A-E)	[-5.3 to -0.1]	[-2.3 to 3]
REER gap[3,4] (F/D)	**[0.1 to 9.3]**	**[-5.2 to 4]**
Reduced-form approach (FEER)[5]		
REER (E)	64.1	66.9
CGER panel-based		
EREER (F)	71.3	71.3
REER gap[3,4] (G)	**-10.6**	**-6.4**

[1] Backward: Estimates for 2010 based on September REER; forward: medium term (2015) based on baseline balance of payments projections presented in the debt sustainability appendix

[2] Detrended, excludes large ad hoc flows such as: large commercial debt restructuring related payments, grants, one-off FDI-related imports and tanker-related imports.

[3] "+"overvaluation; "-" undervaluation

[4] Change in the REER (100* difference in logarithms, an approximation of percentage) needed to close the gap

[5] We update the net external point estimate from Lane and Milesi-Ferretti (2006) using Seychelles data from 2002. Because of the difficulty of estimating the benchmark level of the NFA with any degree of precision, we present a range of estimates for the NFA benchmark if reserves, direct investment and debt liabitilies and assets would be different by a margin of 25 percent.

Appendix II. Debt Sustainability Analysis[9]

I. Overview of External Debt Restructuring

Faced with shortages of foreign exchange and a less benign external environment Seychelles experienced a balance of payments and debt crisis in 2008. Large macroeconomic imbalances from fiscal slippages combined with global commodity price shocks and the global economic slowdown, culminated in mid-2008 with a near-exhaustion of foreign reserves and missed payments on public debt obligations, and resulting in a surge in the current account deficit to 49 percent from the 2003-07 average of 12 percent. Reflecting this, Seychelles sovereign rating was reduced from B to junk grade in late 2008.

The external debt stock stood at about US$760 million, or about 83 percent of GDP at the end of 2008, with about 42 percent in arrears. Commercial creditors accounted for about 62 percent of this debt—mostly reflecting acceleration of amortizing notes—and Paris Club debt amounted to about 18 per-cent of total debt.

The authorities embarked on a comprehensive debt restructuring exercise but faced a number of challenges:

- A fragmented creditor base, particularly for the Eurobond, and bankruptcy of the single largest commercial creditor (Lehman Brothers) complicated the process.
- Paris Club precedent. The Paris Club creditors had only ever provided debt write-off for middle-income countries with major geopolitical influence, for example Iraq.

The authorities have restructured about 91 percent of eligible debt.

Paris Club Agreement: On April 16, 2009, the Government of Seychelles reached an exceptional agreement on approximately US$160 million in bilateral debt.[10]The agreement provided for an overall nominal debt cancellation of 45 percent to be applied to stocks in two tranches (July 2009 and July 2010). The remaining debt would be repaid over 18 years on the basis of a graduating amortizing schedule that includes a five-year grace period. The agreement extends the average life of the debt portfolio from 6 months to 13 years. The Paris Club's treatment obliged Seychelles to seek comparable treatment from other bilateral and private creditors.

Private sector debt: While engaging commercial banks in discussions, the government focused on capital market debt, which could be restructured through a one-off exchange offer and posed a greater risk of potential legal action. Under the exchange offer process, the government would issue a new bond to replace eligible existing claims, but only if it received support from 75 percent of the creditors. In December 2009, the authorities received an unprecedented

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[9] Prepared by Nkunde Mwase with Marie-Therese Trasino and Rainer Koehler.

[10] The agreement includes South Africa which participated in and signed the umbrella agreement.

US$10 million guarantee from the African Development Bank, partially covering its interest obligations under the bond exchange offer.

In February 2010, the government closed the bond exchange offer on US$320 million of private sector debt with 100 percent participation, the first modern sovereign bond restructuring to have no residual holdout creditor problem. The debt restructuring included a collective action clause with a minimum threshold for participation. The amortizing notes and commercial loans were tendered in their entirety, while 84 percent of the Eurobond debt was tendered, triggering the collective action clause. Tenders for the optional par bonds fell below the minimum threshold and the face value of the entire eligible debt (about US$283 million, not including arrears and penalties) was exchanged for about US$169 million of discount bonds on February 11, 2010. About 50 percent of the debt was canceled. This provided a high relief compared to other recent sovereign external debt exchanges. The remaining debt will be repaid over 16 years with a step-up interest rate structure and six-year grace period on principal repayments.

Agreements have been reached in principle with all commercial banks on approximately US$110 million of debt; new loan agreements have been signed with all domestic banks. Commercial banks have agreed to extend repayment over prolonged periods with long grace periods and low interest rates. Most of the commercial bank loans have been converted to local currency loans to ease pressure on the country's foreign reserves.

Non-Paris Club official debt: Most creditors have agreed in principle to negotiate debt restructuring on terms broadly comparable with the Paris Club agreement. Agreements have been signed with Algeria, Libya and Malaysia. South Africa has signed the umbrella Paris Club agreement but is yet to sign the bilateral agreement. Negotiations have advanced with the remaining creditors (Abu Dhabi, China, India and Kuwait).

Reflecting these debt agreements, the debt service profile has extended and external public debt is estimated at US$460 million (or about 49.2 percent of GDP) at end-November 2010. About 53 percent of this debt is owed to commercial creditors, while the Paris Club countries account for about 17 percent of the total. Seychelles has no arrears with multilateral creditors but about US$33 million (or 7.2 percent of total debt) is in arrears with non-Paris Club official and private creditors pending restructuring. In nominal terms, external debt service is projected to peak in 2018 before leveling off for the next seven years. The peak remains manageable as a share of GDP and forecast revenues.

II. Debt Sustainability Analysis

The updated debt sustainability analysis indicates that as a result of the restructuring of most external debt (including a substantial reduction in NPV terms) and strong fiscal adjustment under the program, public debt appears to have a long-run downward path toward sustainability. However, bound tests indicate that Seychelles remains vulnerable to shocks.

Macroeconomic assumptions

The debt sustainability analysis is based on the following medium-term macroeconomic framework (details in the staff report). Output growth is projected to rise gradually stabilizing at 5 percent over the medium term supported by tourism. Inflation is expected to remain at around 3 percent over the medium term in line with major trading partners' inflation. The medium-term current account outlook points to a sharp narrowing of the deficit driven largely by tourism and tuna export earnings and lower FDI (hence FDI-related) imports. With the completion of several large hotel and residential projects, net FDI flows are expected to gradually slow down to about 11 percent of GDP in 2015.

External debt

Baseline scenario

From 92.2 percent of GDP at end 2009, public external debt is projected to decline to 45.3 percent at end-2010, as a result of the debt restructuring (Tables 6a and Figure 1), and to 34.2 percent of GDP in 2015, reflecting mainly the restrictive although gradually loosening fiscal stance. However, the debt profile will increase in 2011 reflecting the impact of expected borrowing by a parastatal for priority infrastructure spending and a central government guarantee for an important cable project.

Sensitivity analysis

The external debt dynamics is particularly sensitive to historically-based assumptions, reflecting the major changes that Seychelles experienced over the last five years. A shock on the noninterest current account is destabilizing, even when these shocks do not account for the volatile but fully financed FDI-related imports, because the large pre and post-debt crisis fluctuations in the current account. As a result, a one-half standard deviation shock to the non-interest current account applied each year during 2011-15 would increase external debt to 69 percent of GDP in 2015. A shock returning key macroeconomic variables (including real GDP, nominal interest rates and non-interest current account) to historical averages would increase external debt to 86 percent of GDP in 2015. To a large extent this shock implies the return to the failed policies of the past, an unlikely move given the authorities' commitment to maintain prudent fiscal and monetary policies.

Public debt

The total public debt-to-GDP ratio follows a similar declining profile, from 76.1 percent of GDP in 2010 to 64.6 percent in 2012 and easing further to just under 50 percent of GDP by 2015. This path suggests that a sustainability profile is achieved, although the standardized bound tests show that Seychelles remains very vulnerable to a variety of shocks (Table II.3, and Figure II.2) including interest rates, the primary balance and growth.

The higher sensitivity of public debt to interest rate shocks, compared to external debt, mainly reflects the higher volatility and magnitude in recent years.

Table II.1 External Debt [1]

	End-2008	2009Q1	2009	2010Q1	2010Q2	2010Q3	Nov 2010 Est.
External debt stock [2]	758.9	743.3	731.7	503.7	494.5	460.1	460.7
Multilateral	52.2	51.8	38.5	46.0	44.1	48.3	48.7
Bilateral	239.5	229.0	197.3	194.0	186.1	160.4	165.8
Paris Club	137.5	121.2	108.7	103.7	98.2	77.1	76.4
Non-Paris Club	102.0	107.8	88.6	90.4	87.9	83.3	89.4
Commercial	467.2	462.5	495.9	263.7	264.3	251.4	246.2
External debt arrears	316.7	367.5	251.1	87.5	97.9	75.3	33.3
Multilateral	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Bilateral	178.8	172.6	33.7	30.3	31.7	36.0	29.8
Paris Club	121.8	106.1	0.0	0.0	0.0	0.0	0.0
Non-Paris Club	56.9	66.5	33.7	30.3	31.7	36.0	29.8
Commercial	137.9	194.9	217.4	57.3	66.2	39.3	3.5

[1] Preliminary and subject to reconciliation with creditors.

[2] Includes arrears.

Table II.2 Country: External Debt Sustainability Framework, 2008-2015
(In percent of GDP, unless otherwise indicated)

	Actual		Projections						
	2008	2009	2010	2011	2012	2013	2014	2015	Debt-stabilizing non-interest current account 7/
Baseline: External debt 1/	82.8	92.6	**45.3**	**49.2**	**46.0**	**40.3**	**36.4**	**33.7**	**-12.5**
Change in external debt	13.0	9.8	-47.2	3.8	-3.2	-5.7	-3.8	-2.7	
Identified external debt-creating flows	32.3	30.7	-26.4	0.5	-3.0	-5.2	-4.8	-3.9	
Current account deficit, excluding interest payments	46.7	31.1	43.1	25.9	18.4	15.7	13.8	8.2	
Deficit in balance of goods and services	45.0	28.8	39.5	22.9	15.2	12.4	10.4	4.9	
Exports	107.8	104.4	88.1	95.3	94.5	93.8	93.4	93.5	
Imports	152.8	133.2	127.6	118.2	109.7	106.2	103.8	98.4	
Net non-debt creating capital inflows (negative)	-24.3	-18.9	-68.7	-25.0	-20.8	-20.3	-18.3	-12.3	
Automatic debt dynamics 2/	10.0	18.4	-0.8	-0.4	-0.7	-0.6	-0.3	0.2	
Contribution from nominal interest rate	2.2	5.2	4.0	1.5	1.6	1.6	1.6	1.9	
Contribution from real GDP growth	1.0	-0.7	-4.8	-1.9	-2.2	-2.2	-1.9	-1.7	
Contribution from price and exchange rate changes 3/	6.8	13.9	...	...	...	...	...	...	
Residual, incl. change in gross foreign assets 4/	-19.3	-20.9	-20.8	3.4	-0.2	-0.5	1.0	1.2	
External debt-to-exports ratio (in percent)	76.8	88.7	51.5	51.6	48.6	42.9	39.0	36.0	
Gross external financing need (in billions of US dollars) 5/	0.6	0.4	0.5	0.3	0.2	0.2	0.2	0.1	
in percent of GDP	69.5	46.4	52.1	28.5	20.8	18.3	16.3	11.0	
Scenario with key variables at their historical averages 6/			**45.3**	**54.3**	**60.8**	**67.7**	**76.7**	**86.6**	**-2.7**
Key Macroeconomic Assumptions Underlying Baseline									
Real GDP growth (in percent)	-1.3	0.7	6.2	4.3	4.8	5.0	5.0	5.0	
GDP deflator in US dollars (change in percent)	-8.8	-14.3	11.6	-0.6	1.0	1.7	1.3	1.1	
Nominal external interest rate (in percent)	2.9	5.4	5.2	3.3	3.3	3.7	4.3	5.5	
Growth of exports (US dollar terms, in percent)	13.2	-16.5	0.0	12.2	4.8	6.0	5.9	6.3	
Growth of imports (US dollar terms, in percent)	33.7	-24.8	13.6	-4.0	-1.9	3.3	4.0	0.7	
Current account balance, excluding interest payments	-46.7	-31.1	-43.1	-25.9	-18.4	-15.7	-13.8	-8.2	
Net non-debt creating capital inflows	24.3	18.9	68.7	25.0	20.8	20.3	18.3	12.3	
B. Bound Tests									
B1. Nominal interest rate is at historical average plus one standard deviation			**45.3**	**49.7**	**47.0**	**41.8**	**38.4**	**36.0**	**-12.1**
B2. Real GDP growth is at historical average minus one standard deviations			**45.3**	**50.0**	**47.0**	**40.7**	**35.7**	**32.2**	**-13.7**
B3. Current account, excluding interest payments and FDI imports, is at historical average minus one standard deviations			**45.3**	**53.3**	**54.1**	**52.2**	**52.2**	**53.5**	**-12.6**
B4. Combination of B1-B3 using 1/2 standard deviation shocks			**45.3**	**51.9**	**51.1**	**47.4**	**45.3**	**44.6**	**-12.7**
B5. One time 30 percent real depreciation in 2011			**45.3**	**70.2**	**65.6**	**57.4**	**51.9**	**48.0**	**-17.9**

1/ Includes external debt held by parastatals and government-guranteed debt.

2/ Derived as $[r - g - \rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock, with r = nominal effective interest rate on external debt; ρ = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate,

ε = nominal appreciation (increase in dollar value of domestic currency), and α = share of domestic-currency denominated debt in total external debt.

3/ The contribution from price and exchange rate changes is defined as $[-\rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock. ρ increases with an appreciating domestic currency ($\varepsilon > 0$) and rising inflation (based on GDP deflator).

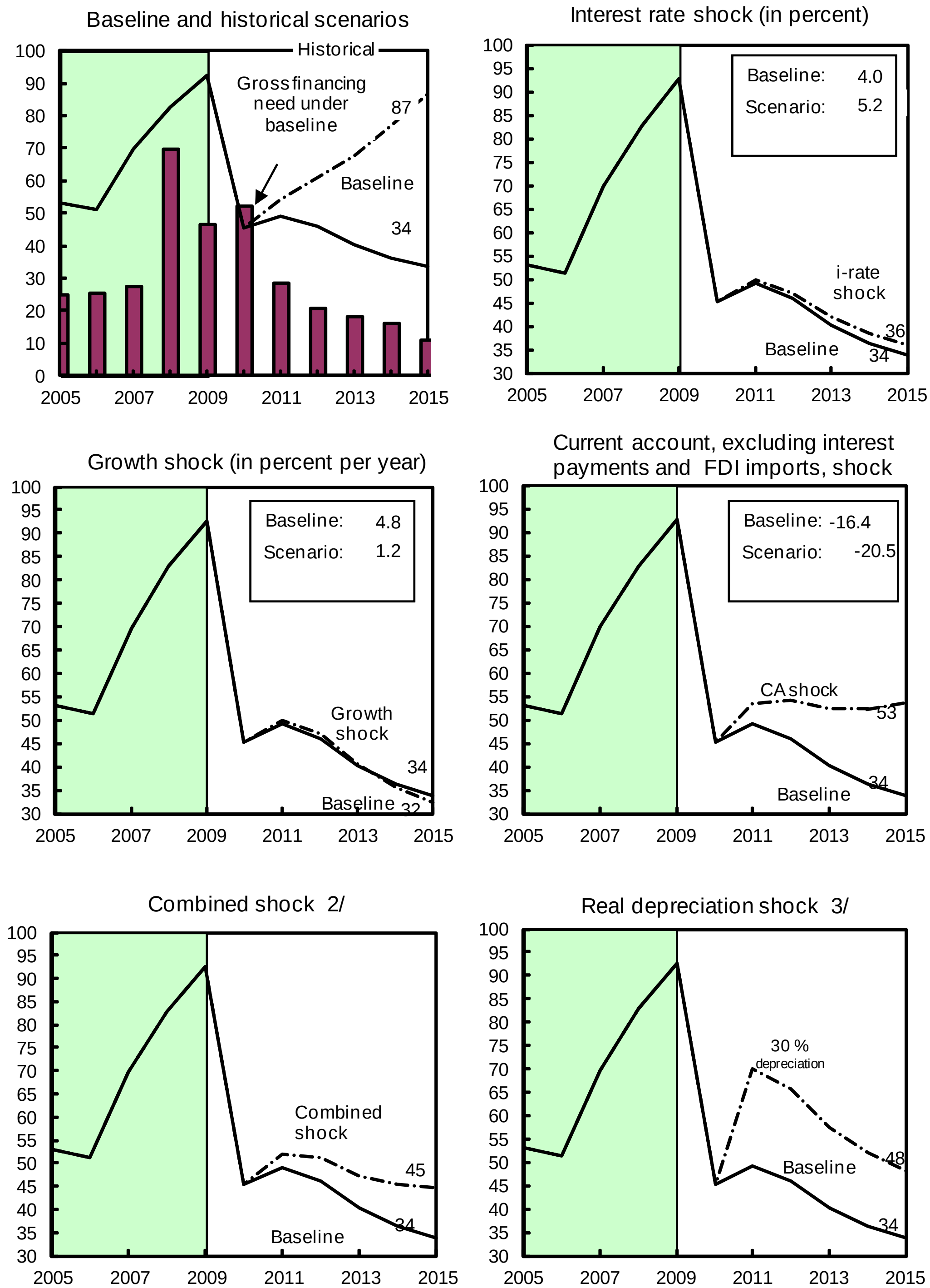
4/ For projection, line includes the impact of price and exchange rate changes.

5/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

6/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

7/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Figure II.1 Seychelles: External Debt Sustainability: Bound Tests 1/
(External debt in percent of GDP)



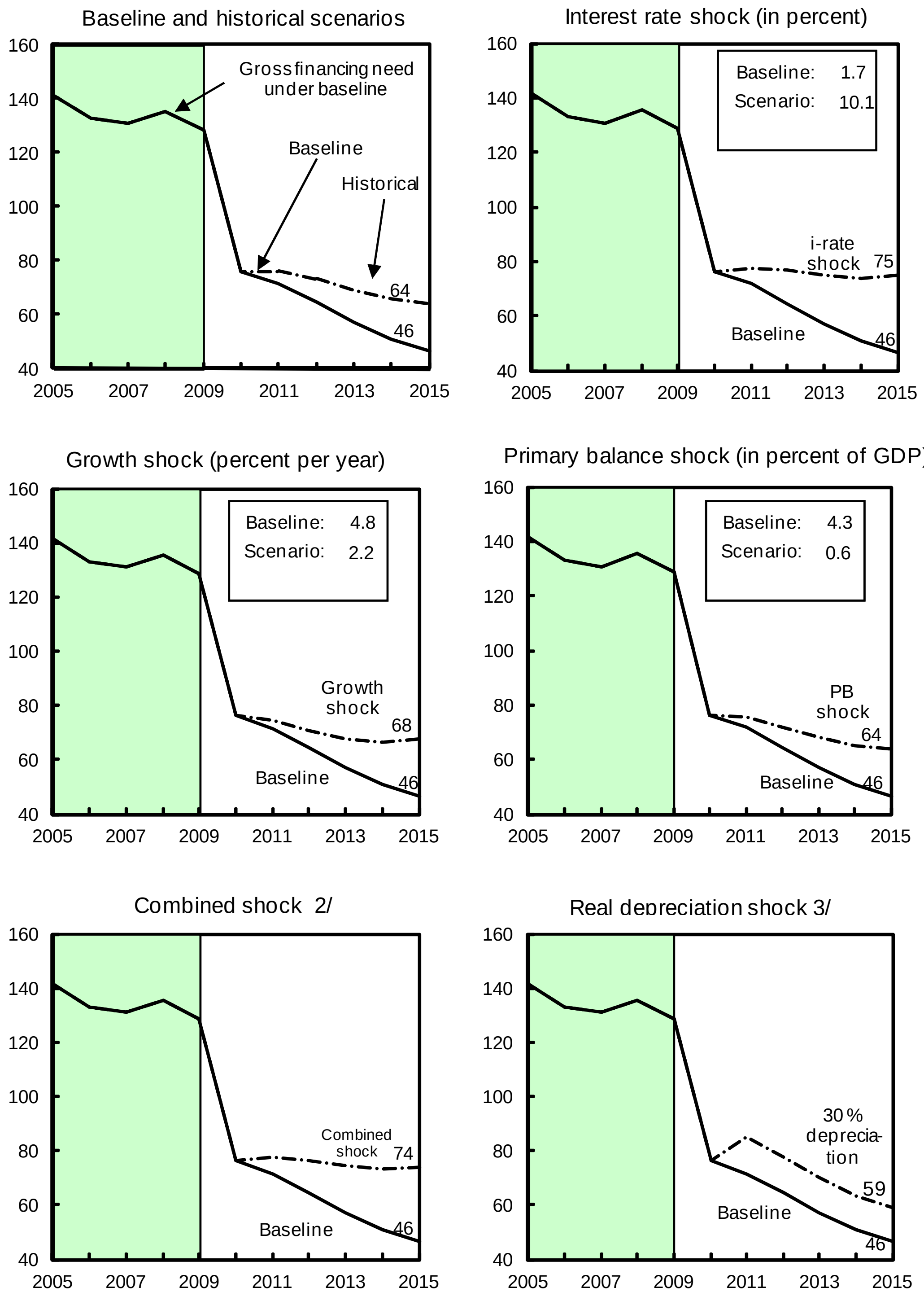
Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
3/ One-time real depreciation of 30 percent occurs in 2011.

Table II.3. Public Sector Debt Sustainability Framework, 2008-2015
(In percent of GDP, unless otherwise indicated)

	Actual		Projections					
	2008	2009	2010	2011	2012	2013	2014	2015
				I. Baseline Projections				
Public sector debt 1/	135.4	128.6	**76.1**	**71.7**	**64.6**	**57.2**	**50.8**	**46.4**
o/w foreign-currency denominated	82.8	92.6	45.3	46.2	44.3	40.6	37.3	34.4
Change in public sector debt	4.6	-6.8	-52.5	-4.4	-7.1	-7.4	-6.4	-4.4
Identified debt-creating flows	29.6	-52.5	-0.7	-6.5	-5.8	-5.8	-5.1	-4.4
Primary deficit	-3.9	-14.8	-9.4	-5.0	-4.7	-4.0	-3.9	-3.8
Revenue and grants	36.6	38.8	37.0	40.6	38.8	36.9	36.7	36.6
Primary (noninterest) expenditure	32.8	24.0	27.6	35.6	34.1	32.9	32.8	32.8
Automatic debt dynamics 2/	33.5	-37.7	8.6	-1.5	-1.1	-1.8	-1.3	-0.7
Contribution from interest rate/growth differential 3/	-21.1	-15.7	0.1	-2.1	-2.3	-2.3	-1.8	-1.2
Of which contribution from real interest rate	-22.4	-15.0	7.7	1.0	0.9	0.7	0.9	1.2
Of which contribution from real GDP growth	1.3	-0.7	-7.6	-3.1	-3.2	-3.0	-2.6	-2.4
Contribution from exchange rate depreciation 4/	54.6	-22.0	8.5	0.5	1.2	0.5	0.5	0.5
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Residual, including asset changes	-25.0	45.7	-51.7	2.1	-1.3	-1.5	-1.3	0.0
Public sector debt-to-revenue ratio 1/	369.8	331.2	206.0	176.6	166.7	154.9	138.6	126.9
Gross financing need 5/	14.3	10.1	23.1	20.5	19.7	18.8	15.9	14.6
in billions of U.S. dollars	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2
Key Macroeconomic and Fiscal Assumptions								
Real GDP growth (in percent)	-1.3	0.7	6.2	4.3	4.8	5.0	5.0	5.0
Average nominal interest rate on public debt (in percent) 6/	7.0	8.9	5.5	3.3	3.9	4.3	4.7	5.6
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	-22.2	-13.4	6.3	1.5	1.4	1.3	1.8	2.6
Inflation rate (GDP deflator, in percent)	29.3	22.3	-0.8	1.8	2.5	2.9	2.9	2.9
Growth of real primary spending (deflated by GDP deflator, in percent)	-6.2	-26.1	21.9	34.5	0.3	1.5	4.7	5.0
Primary deficit	-3.9	-14.8	-9.4	-5.0	-4.7	-4.0	-3.9	-3.8
				II. Stress Tests for Public Debt Ratio				
A. Alternative Scenarios								
A1. Key variables are at their historical averages in 2010-2015 7/			**76.1**	**76.0**	**73.2**	**69.3**	**65.9**	**64.0**
A2. No policy change (constant primary balance) in 2010-2015			**76.1**	**49.1**	**37.6**	**25.8**	**14.7**	**5.2**
B. Bound Tests								
B1. Real interest rate is at baseline plus one standard deviations			**76.1**	**77.7**	**76.7**	**74.9**	**74.0**	**75.1**
B2. Real GDP growth is at baseline minus one-half standard deviation			**76.1**	**74.6**	**71.1**	**67.8**	**66.2**	**67.7**
B3. Primary balance is at baseline minus one-half standard deviation			**76.1**	**75.3**	**71.9**	**67.9**	**65.0**	**64.0**
B4. Combination of B1-B3 using one-quarter standard deviation shocks			**76.1**	**77.5**	**76.2**	**74.3**	**73.1**	**74.0**
B5. One time 30 percent real depreciation in 2011 8/			**76.1**	**85.2**	**77.9**	**70.1**	**63.4**	**58.9**
B6. 10 percent of GDP increase in other debt-creating flows in 2011			**76.1**	**81.7**	**74.5**	**66.8**	**60.2**	**55.7**

1/ Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.
2/ Derived as $[(r - \pi(1+g) - g + \alpha\varepsilon(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; α = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value
3/ The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi(1+g)$ and the real growth contribution as -g.
4/ The exchange rate contribution is derived from the numerator in footnote 2/ as $\alpha\varepsilon(1+r)$.
5/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.
6/ Derived as nominal interest expenditure divided by previous period debt stock.
7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.
8/ Real depreciation is defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Figure II.2. Seychelles: Public Debt Sustainability: Bound Tests 1/
(Public debt in percent of GDP)



Sources: International Monetary Fund, country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.
3/ Real depreciation is defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Appendix III. Determinants of Interest Rate Pass-Through[11]

Retail lending interest rates in Seychelles appear weakly connected to short-term money market rates. From the start of the stabilization program in late 2008, short-term rates on government securities declined considerably, but lending rates remained high, suggesting that this phase of monetary transmission–market-to-retail interest rate pass-through–is weak and incomplete. Our cross-country study finds empirical support of this observation. It also finds that undeveloped financial markets, excess liquidity and lack of banking competition are the key factors undermining monetary transmission.

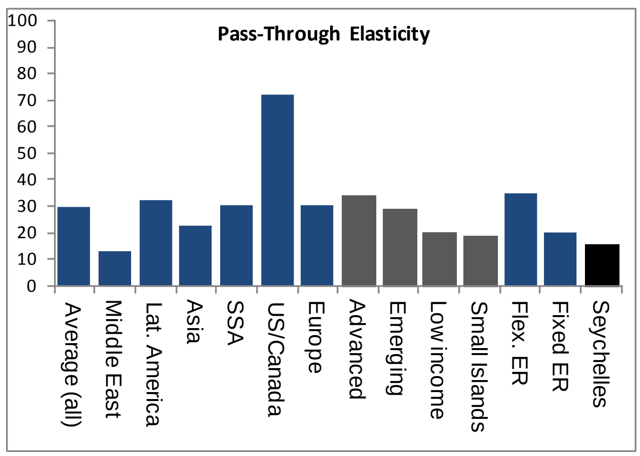
International Comparisons of Interest Rate Pass-Through

Market-to-retail pass-through is formalized using the cost of funds approach, which applies the standard marginal cost pricing model to financial markets. The underlying idea is that money market rates reflect marginal costs of funds because banks rely on them for short-term borrowing needs. As banks will be passing their interest costs to customers, the theory implies a positive relationship between market and retail lending rates.

Empirical Methodology and Data

Interest rate pass-through is estimated using the following ARDL specification: $\Delta i_t^R = \sum_{k=0}^{2} \beta_k \Delta i_{t-k}^M + \sum_{k=1}^{2} \alpha_k \Delta i_{t-k}^R + \varepsilon_t$, where i^R and i^M are logs of lending and money market rates (90-day T-bill or interbank rate) respectively. β_k's are short-term interaction coefficients between retail and market rates. The long-term pass-through elasticity is calculated as $\beta = \sum_{k=0}^{2} \beta_k / (1 - \sum_{k=1}^{2} \alpha_k)$. The data sample includes monthly interest rates from Dec. 2005 to March 2010 for 81 countries.

The results confirm the weakness of interest rate pass-through in Seychelles compared to that of peer groups.[12] The long-run pass through elasticity (β) for Seychelles is lower than the average of any subgroup, except Middle Eastern countries, where pass-through is likely to be constrained by the rules of Islamic banking. The chart reveals that interest rate pass-through tends to be weaker in less developed countries and small island states.[13]



Determinants of Interest Rate Pass-Through

Banks may react differently to market rate changes for different reasons, including those related to macroeconomic conditions and characteristics of the financial sector. To determine the causality, the estimated individual country pass-through elasticities were regressed on country-

[11] Prepared by Nikoloz Gigineishvili.

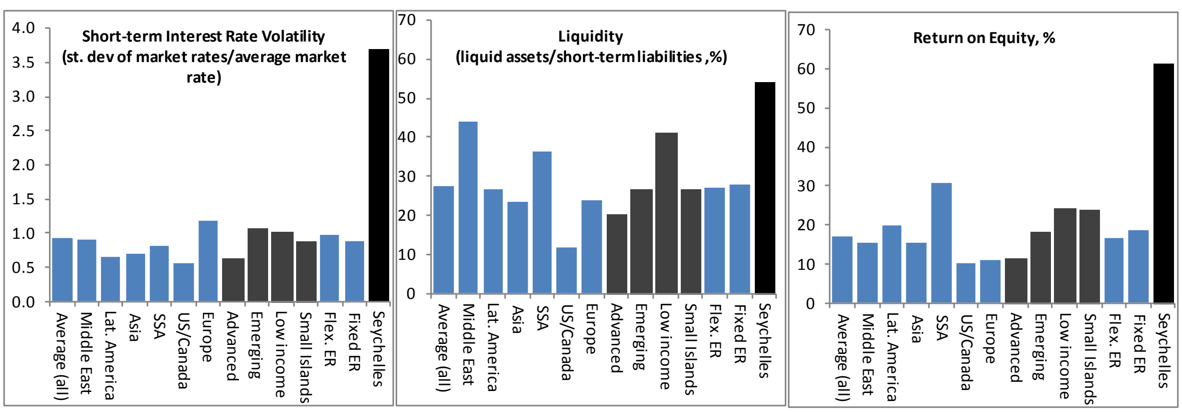
[12] Part of the pass-through weakness in Seychelles could be due to the fact that the data sample covers the pre-reform period of exchange controls and financial sector repression. The re-estimation of the model for the post reform period only (once sufficient time series become available), may yield more favorable results.

[13] Defined as island economies with population below two million.

specific macroeconomic variables (per capita GDP, market volatility, inflation, etc.), financial sector indicators (liquidity, asset quality, profitability, cost structure, etc.), and a set of dummy variables to control for country size, geographic region and exchange regime.

The main findings can be summarized as follows:

- *Island economies tend to have weaker pass-through.*
- *More-developed countries have stronger pass-through*. Richer borrowers are likely to be less sensitive to interest costs, which makes it easier for banks to pass these costs to them. GDP growth and inflation do not have an impact, possibly because of their cyclical nature, even though a priori one would expect positive relationships.
- *Market volatility weakens the pass-through.* Interest rate fluctuations increase uncertainty and dampen banks' reaction to noisy market signals.
- *Excess liquidity weakens pass-through.* In overly liquid money markets all participants tend to be on the sell side of the market; interbank borrowing dries up, and money market rates fail to reflect true marginal cost of funds. As a consequence, retail lending rates become less elastic to money market rates and the connection between the two weakens.
- *High profitability of the banking sector, which is often a reflection of inadequate competition and market power, weakens pass-through*. This is not surprising since competition is likely to force banks to adjust their pricing more quickly.



Policy implications for Seychelles

Being an island economy already puts Seychelles at a relative disadvantage, thereby increasing importance of other measures to strengthen pass-through. Compared with peer groups, markets in Seychelles are more volatile, and banks are considerably more liquid and profitable (high returns on equity)–the factors that, according to the study, undermine monetary transmission and therefore the effectiveness of monetary policy. To strengthen pass-through, Seychelles should develop financial markets to reduce market volatility; reduce excess liquidity in the banking system; and strengthen banking competition.

Appendix IV. Financial Sector Vulnerabilities and Stress-Testing Results[14] [15]

Based on September 2010 data, the banking sector is adequately capitalized, liquid and profitable. Although mismatched in asset/liability maturity, it appears to be reasonably resilient to risks.

The major risk facing Seychelles banks is credit risk, but not abnormally. Banks are well positioned for first round effects of interest rates changes, but appear more vulnerable to second round effects due to higher default rates on loans. The exchange rate risk, which was the main source of vulnerability prior to the float at the time of the 2008 Article IV Consultation, has been mitigated by the net open position requirements introduced in early 2009.

Credit risk: As banks have the capacity to reprice domestic loans as fast as their liabilities, they can maintain their net interest margins and largely be unaffected by first-round interest rates effects. The real risk comes from second-round effects. To maintain interest margins, banks would have to increase interest rates on customer loans, which in turn would result in higher default rates.[16] If all collateral in the system were valued at zero, industry capitalization would have been 6.7 percent with two banks less than well capitalized.[17] With the new standard of classification and provisioning, adopted in November 2010, the first bank would fail if 22 percent of current loans became a loss and the industry would have unweighted Tier 1 capitalization of 2.8 percent.

The industry seems reasonably resilient to other standard stress tests. ***Credit quality stress tests***: With a 40 percent increase in non-performing loans (NPL) and an extreme assumption that all were a total loss, the industry capitalization would have declined to 4.8 percent. One bank would have failed, and three banks would have been less than well capitalized. Alternatively, if additional NPLs were provisioned, a 260 percent increase in provisioning would be needed to cover bad loans, which would result in the first failure and industry capitalization of 5.5 percent. Finally, it would take 22 percent of pass loans to be classified as a loss for the first bank to fail. ***Liquidity stress tests****:* a 30 percent drop in deposits funded by a corresponding reduction in liquid assets would reduce the industry liquidity ratio to 28.3 percent, and only one bank would exhaust its liquidity and two banks would fall below 10 percent.[18] ***Exchange rate stress tests***: An appreciation or depreciation of the rupee will not cause any bank failures. Depreciation from SR/US$12.1 to SR/US$16 would improve Tier 1 capitalization from 7.3 percent to 7.8 percent, while an appreciation to SR/US$8 would deteriorate it to 6.5 percent.

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[14] Prepared by Phillip Bartholomew.

[15] Simple static stress-tests employed in this exercise are intended to identify potential bank vulnerabilities and do not reflect actual projections. The shocks applied were extreme, meant to stretch the system to its limits. Therefore, the results should also be interpreted from this angle and not as scenario simulations.

[16] When interest rates spiked in early 2009, default rates did increase, but much less than feared.

[17] Capitalization is defined as equity over assets net of interest in suspense and provisions.

[18] The test assumes banks cannot borrow from each other or the CBS.

After adjusting bank capital for credit risk, the possible consequences of changes in interest rates and the exchange rate would leave banks with capital coverage of 27 to 34 percent of their loan portfolio. Distribution of this risk is fairly even, however, two banks are slightly more at risk than others.

Table 1: Credit Quality Stress Tests: End-August 2010 Data

	Current Net Capitalization	New Net Capitalization with New Bad Loan Provisioning Requirement	New Net Capitalization with Collateral Discounted to Zero	New Net Capitalization with a 40% Increase in NPLs All Treated as Loss	New Net Capitalization with a 260% Increase in Required Provisions Owing to an Assumed Loss	Percentage of Pass Loans Needed to Be Classified as Loss to Cause First Failure
Tier1 Capitalization (in percent)	7.3	7.0	6.7	4.8	5.5	22.0

Appendix V. Offshore Finance[19]

The authorities have revisited their offshore development strategy, taking into account AML/CFT issues. The offshore financial center (OFC) had featured prominently in Seychelles' long-term strategy, published in 2007. It was seen as a means to diversify an economy heavily reliant on tourism. Several pieces of key legislation were enacted. A location that bridges time zones in Europe and the Middle East and low registration costs were key selling points for Seychelles, which sought to exploit a niche market in view of high barriers to entry and reputational risks of substandard business.

OFC activity is limited in Seychelles (annual turnover is estimated in the area US$25 million) and clusters around international business companies (IBCs), raising transparency concerns. Two offshore banks operate in Seychelles: one is a subsidiary of a locally established foreign bank, and a government bank holds equity in the second. The brisk growth in registration of IBCs has ranked Seychelles second, worldwide. The absence of information on IBCs' beneficiary ownership and their use for asset management purposes has been criticized by the OECD transparency forum. Indeed IBCs, which are not subject to taxation (except for a registration fee of US$100), are neither required to divulge information on ownership in their articles of association, nor to the registrar of companies. They maintain a share register but only members can access accounts and records held at the registered office.[20] The establishment of Special License Companies (SLCs), Corporate Services Providers (CSPs) and trusts is also noteworthy.[21]

Well established OFCs continue to thrive, but newcomers face less encouraging prospects. The success of small island OFCs highlights factors such as partner-country investment and tax laws, which are not easily replicated. In Mauritius for example, the Fund estimated the OFC impact on local employment and economic activity to be marginal initially, but representing an increasing share of financial activity over time, with positive effects on telecommunications, professional services and worker retention.[22] Newcomer OFCs face a choice between opening their doors to second-rate business and experiencing fast growth in the sector, or limiting themselves to high-quality legitimate business and gaining very little or no market share. The danger of the former is that it only takes one scandal to unravel a reputation and several years to

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[19] Prepared by Marie-Therese Trasino.

[20] BIS statistics include $1.3 billion in Seychelles residents' bank deposits, probably reflecting IBCs' deposits.

[21] SLCs and CSPs differ from IBCs in that the registrar is privy to information on ownership that is outside the public domain. These are considered as tax-residents, are covered by provisions of the Business Tax Act and benefit from extensive double taxation agreements. In addition, CSPs are required to know and identify their principal clients and owners of client companies and to subject their professional intermediaries to similar due diligence. As far as trusts are concerned, the trust deed and letter of wishes are not deposited with the competent authority but they must be produced if required for regulatory inspection.

[22] Indeed, the Mauritius FSSA (SM/03/202) suggests that cost-efficiency considerations were important but secondary, and that the comparative advantage of its OFC stems from DTTs and investment laws in India and South Africa.

reverse the damage, while the latter carries high start-up costs with uncertainty in the magnitude and timing of any pay-off.

In view of potential exposure to illicit activities, the authorities are focusing on AML/CFT. Seychelles participates in several international initiatives, the most recent of which is the ESAAMLG peer review. In reviewing the institutional and legal framework, and examining the capacity, implementation and effectiveness of all regulatory systems, ESAAMLG identified weaknesses which the authorities are addressing. The recently created Financial Intelligence Unit conducts frequent on-site examinations and strengthened its operating procedures. In addition to regulatory changes, the authorities regularly interact with peers (as in the Egmont Group). Changes include a reorganization of the police force, the creation of a national drugs enforcement agency, the review of criminal justice and capacity building for the FIU, police, attorney general's office and offshore practitioners.

APPENDIX VI

SEYCHELLES: LETTER OF INTENT

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
December 3, 2010

Dear Mr. Strauss-Kahn:

1. The attached Memorandum of Economic and Financial Policies (MEFP) describes Seychelles' performance through September 2010, and updates the policies that were laid up in the MEFPs dated December 3, 2009 and June 1, 2010 for the remainder of 2010 and for 2011.

2. **We request completion of the second review under our Extended Arrangement (EFF), the release of the fifth tranche of SDR 1.76 million (20 percent of quota), rephasing of disbursements and establishment of end-June 2011 and end-December 2011 performance criteria (PCs)**. All the quantitative performance criteria at end-September 2010 were met. We remain committed to implement two reforms that are structural benchmarks for end-September 2010 and end-November 2010 respectively. The Customs Management Act was submitted in November 2010 to the National Assembly. We have initiated the work on the new Chart of Accounts and we plan to complete the work in the next 18 to 24 months with the assistance of the Fund.

3. **The EFF continues to accompany a comprehensive medium-term structural reform strategy** aimed at consolidating macroeconomic stability and securing growth; and to **guide our macroeconomic policies** over the next two years. **With the successful conclusion of our public debt restructuring** we have restored the prospect of debt sustainability.

4. **We believe that the economic and financial policies set forth in the MEFP are sufficient to ensure that the objectives of the program will continue to be met**. We stand ready to take any further measures that may prove necessary to meet our objectives. We will consult with the Fund on the adoption of these measures, and in advance of revisions to the policies contained in the MEFP, in accordance with the Fund's policies on such consultations. We remain committed to full implementation of the recommendations of the Fund's safeguards assessment of the Central Bank of Seychelles (CBS).

5. **It is expected that the third review of the arrangement under the EFF will be completed by end-March 2011, that the fourth review will be completed by end-September 2011, and that the fifth review will be completed by end-March 2012.** Financing assurances reviews will continue as long as public debt arrears remain outstanding.

6. **In line with our commitment to transparency, we request that the IMF publish this letter, the MEFP, the technical memorandum of understanding (TMU), and the staff report**. We will simultaneously publish these documents in Seychelles.

Sincerely yours,

/s/
Danny Faure
Minister of Finance and Vice President,
Republic of Seychelles

/s/
Pierre Laporte
Governor
Central Bank of Seychelles

ATTACHMENT 1

SEYCHELLES: SUPPLEMENTARY MEMORANDUM OF ECONOMIC, FINANCIAL AND STRUCTURAL REFORM POLICIES FOR 2010–11

I. INTRODUCTION

This document:

- Reviews macroeconomic and financial performance under our Extended Arrangement (EFF) arrangement through end-September 2010 and;
- Updates the MEFP of June 1st, 2010, detailing our policy commitment through December 2011.

II. MACROECONOMIC AND FINANCIAL CONTEXT AND SHORT TERM OUTLOOK

1. **Macroeconomic trends evolved favorably over 2010, exceeding expectations.** We have revised our GDP growth forecast for 2010 upwards from 4 percent to more than 6 percent, driven by higher than expected activity in the tourism, construction and manufacturing sectors. Tourism arrivals are projected to grow by around 10% in 2010, reflecting a resurgence in the sector after weakness immediately following the global financial crisis in 2008-09. As a result, the turnover in euro terms of the tourism sector is increasing, contrary to our initial projections at the start of the year. Local manufacturers have benefitted from increased domestic demand, resulting in higher levels of production, particularly in the first half of the year.

2. **Inflationary pressures remain contained despite monetary policy easing.** Inflation has been virtually flat over the course of the year, climbing at an average rate of 0.2 percent per month since April 2010. The 91-day T bill rate is around 1.5 percent, down from 4 percent at the start of the year. Private credit growth has gained momentum, rising by around 18 percent in the month ending September 2010 compared to December last year despite the slow decrease of banks' lending rates. After depreciating modestly against the US dollar earlier in the year, the rupee has remained stable over the past few months.

3. **With the rebound of growth, the external current account deficit is expected to widen in 2010.** Imports have been growing faster than exports reflecting the impact of stronger domestic demand as well as foreign direct investment (FDI) inflows and some large construction projects entirely financed from abroad. Foreign exchange reserves have continued to grow, reaching 2.2 months of imports in September.

III. PROGRAM IMPLEMENTATION

4. **All quantitative performance criteria at end-September were comfortably achieved (Table 2)**. The government has exceeded its primary balance target by 2.4 percentage points of GDP**.** This has been driven primarily by higher revenues, reflecting stronger-than-expected

imports, higher business tax receipts and dividends from public enterprises. We introduced the new income tax regime in July this year, and increased the GST on tourism from 10 percent to 12 percent from November 1. The new personal income tax (PIT) introduced in July 2010 replaces the previous social security contributions and expands the tax base. The primary fiscal surplus for 2010 is now projected to be 9.4 percent of GDP, representing an over-performance of two percentage points of GDP compared with the program target. The reserve money and NIR targets have also been met with comfortable margins, while inflation remained low, reflecting appropriateness of the monetary policy stance.

5. **However, two structural benchmarks have been delayed.** The first is the new Customs Management Act which is expected to be submitted to the National Assembly in early December, 2010. The delay from September arose as a result of the capacity constraints in processing a 300-page piece of legislation. The second is the adoption of a new chart of accounts for the 2011 budget. Following discussions with IMF advisors, we agree that the scope of changes that could potentially be taken to upgrade our chart of accounts is considerably greater than originally anticipated. We are aiming to introduce a new version of the chart of accounts in the 2012 Budget. Other than these two measures, our ambitious structural reform agenda – focused on reducing the role of Government in the economy and improving the business environment – remains on track. The details of the measures are covered below, and our work with other development partners (World Bank, AfDB and EU) continues.

Medium Term Macro Framework

6. **The outlook for the economy is a continued recovery over the medium term, albeit at a slower rate than in 2010.** After rebounding strongly in 2010, we expect growth in the tourism sector to slow to single digits, consistent with the sluggish growth forecast for Europe (the source of most of our tourists). Similarly, growth in the construction sector will slow in 2011 following the completion of a major construction project that boosted growth in 2010. Nonetheless, we expect a real GDP growth in 2011 of 4.3 percent, rising to 5 percent in 2012-13. Inflation, after having been close to zero in 2010, is expected to revert to an average rate of 3 percent in 2011 and 2012. The current account deficit is expected to decline in 2011 and 2012, reflecting mostly lower FDI-related inflows and robust export growth. We continue to target an increase in gross international reserves to 3 months of imports by 2012, up from a projected 2.3 months at end-2010.

7. **Fiscal rebalancing remains on track.** With the maintenance of a substantial government budget primary surplus in 2011 and 2012, the stock of public debt will continue to decline, from 76 percent of GDP at end 2010 to around 65 percent at end- 2012; the bulk of the decline will come from a reduction in the domestic government debt. Beyond 2012 the Government plans to gradually reduce primary budget surpluses in line with our strategy to limit public debt to less than 50 percent of GDP by 2018.

8. **Despite our forecasts, we are mindful of the risks to our medium-term projections.** Downside risks include: a sluggish global economic recovery and a weak euro, which would

dampen the number of tourists emanating from Europe; inadequate public infrastructure such as utilities and roads to support continued economic growth; and security risks associated with the threats to shipping routes from piracy. We are working hard to mitigate these risks, including through promoting Seychelles as a tourism destination outside Europe, stepped-up investment in and reforms of public utilities, and international cooperation to counter piracy disruptions.

Policies for 2011

9. **The major objectives of our EFF-supported program remain to:**

- consolidate macroeconomic stability;
- improve economic efficiency and durably raise growth through the implementation of a second generation of structural reforms; and
- maintain a path of debt reduction consistent with external sustainability.

The policies we will pursue in 2011 to achieve these objectives are outlined below.

A. Fiscal Policy

10. **The 2011 budget aims at achieving a primary surplus of 5 percent of GDP.** This target is lower than the original target under the EFF supported program of 6 percent of GDP, but remains consistent with the medium-term debt and fiscal sustainability targets. The Government's strong fiscal performance in 2010 has created the fiscal space for additional spending, in particular on priority infrastructure investment and social expenditure.

11. **Growth in government revenue in 2011 reflects mostly accounting changes, including the consolidation of government entities in the budget and one-off factors affecting 2010.** Abstracting from budget presentation changes (which increase revenue by 2.2 percentage points of GDP), the government revenue to GDP ratio will decline by 1.5 percent as the 2011 Budget estimates are adjusted to reflect one-off factors affecting 2010 (such as exceptionally high business tax rates and payments from Nouvobanq and the renegotiated shareholders agreement of the tuna cannery). The changes are accounted for in the table below. Policy changes (in GST and Income Tax) are aimed at further rationalizing the tax system and harmonizing rates between sectors, they represent an increase of 0.4 percent of GDP.

12. **Current primary expenditure is expected to rise as the Government implements wage reforms and some recruitment for priority sectors.** Abstracting from classification changes (2.0 percentage points of GDP), the net increase is equivalent to 0.8 percent of GDP. The key drivers of expenditure increase are outlined in the table below.

Impact of 2011/2010 Projected Changes in Government Revenues and Grants (% of GDP)		
Tax Policy Changes	**Description**	**+0.4**
GST in Tourism	Increase in GST rate from 10 percent to 12 percent	+0.6
Income Tax	Reduction in PIT rate from 18.75 percent to 15 percent (in October 2010)	-0.4
	Harmonization of rates across all employees from January 2011	+0.2
Reclassification	**Description**	**+2.0**
Grossing up of Wages	Government employee PIT contributions counted as revenue	+1.1
Pension Fund	Contributions from employers and employees consolidated into Budget and incorporation of dividends and interests from Pension Fund investments	+0.6
Contributions to SFA	License fees and other contributions from EU	+0.1
Budget dependent entities	Incorporation of entities revenue sources into 2011 budget	+0.3
Other Changes	**Description**	**-1.4**
o.w. Business Tax	Downward revision of projected business tax income after exceptionally high levels in 2010 following revaluation gains in the banking sector after the float of the rupee	-0.6
o.w. Dividends	Changes to dividend income including the combination of exceptionally high Nuovobanq dividends and one-off payments from the IOT renegotiated shareholders agreement in 2010 and projected SEYPEC dividends in 2011	-0.3
	Change in government revenues:	**+1.0**
Grants	Increase in grants projected for 2011 due to delay in timing of disbursements in 2010 (including EU budget support and UAE in-kind benefits for coastguard)	+2.5
	Impact of overall change in government revenues:	**+3.5**
Impact of 2011/2010 Projected Changes in Government Primary Expenditure and Net Lending (% of GDP)		
Reclassification	**Description**	**+2.0**
Grossing up of Wages	Government employee contributions counted as expenditure	+1.0
Pension Fund	Benefits consolidated in the budget	+0.6
Reclassification of several budget-dependent entities	Inclusion of all expenditures of budget-dependent agencies in line with budget re-classification policy	+0.4
Other Changes	**Description**	**+2.4**
o.w. Scheme of Service	Full-year effect in education and health and new schemes for immigration, social affairs, finance, police, and defence	+0.3
o.w. Recruitment	Priority areas only	+0.4
o.w. Budget Entities	Higher spending by certain budget-dependent agencies such the Land Transport Agency (on roads), the Tourism Board and the National Sports Council.	+0.6
o.w. Capital expenditures	Priority infrastructure projects such as investment in public utilities and rehabilitation of the Victoria hospital	+2.0
	Change in government primary expenditure:	**+4.4**
Net Lending	No net repayment projected in 2011 Budget since Government loan to state-owned oil company was fully reimbursed in 2010.	-(-3.4)
	Impact of overall change in government primary expenditure:	**+7.8**
	Overall Impact on the Primary Balance:	**-4.4**

13. **Capital expenditures will continue to be directed to priority areas to support continued economic growth.** In percentage of GDP, capital expenditures will rise by 1.5 percent in 2011. This includes some large foreign-financed projects, such as a new coast guard facility and landfill. Capital grants to the Public Utilities Company will amount to 1.5 percentage points of GDP. Other key projects include the rehabilitation of the main Victoria hospital, and of education facilities, and the pursuit of an important housing project in Perseverance Island, that also benefits from important external financing.

14. We will establish a contingency reserve of SR 50 million in the 2011 budget. We plan to release this reserve for capital investments by a number of ministries, starting in July 2011, provided that the revenue targets for June 2011 are met.

B. Tax Reform

15. **The reform of the tax system launched at the start of 2010 continues**. The base has been broadened, and the system is becoming increasingly simple, fair and equitable as the various stages of reform come into effect, with no new tax incentives and exemptions. From January 1, 2011 with the increase in the personal income tax rate paid by expatriates, there will be one harmonized rate of personal income tax for all employees in all sectors.

16. **The final major tax scheduled for introduction is the Value Added Tax (VAT).** The introduction of the VAT is aimed at improving integration in the economy, broadening of the base, elimination of cascading, and increased efficiency and fairness. We have already started discussions with a number of stakeholders – including the Chamber of Commerce, retailers association and civil society organizations – to ensure that the legislative framework is a practical one, understood by both users and administrators. The legislation work is advanced, and we aim to present the bill to the National Assembly by end-December 2010. This will give us 18 months to carry out an extensive education campaign for the population; recruit new staff; install necessary infrastructure; and ensure that the staff of the Seychelles Revenue Commission (SRC) are sufficiently equipped for the introduction of the VAT. The VAT regulations including rates, thresholds and exemptions will be submitted for approval by Cabinet by end-June 2011.

17. **In addition, we are pursuing further reforms to the administration of the tax system.** The improvement of the SRC governance continues, with the creation of a Large Taxpayer Unit already complete. The newly created unit will segregate its staff to particular sectors to ensure better understanding of sector-trends, allowing for more targeted use of the Audit Team. We will also pursue the simplification of the various systems for identifying taxpayers and greater cooperation between customers and SRC to monitor the consistency of compliance with VAT and customs taxation.

C. Public Financial Management

18. **Our progress in strengthening public financial management continues, in line with Fund recommendations.** The revised Budget Classification policy for public entities will be fully implemented by the end of 2010. Under this system, budget-dependent public bodies are classified into three groups: (1) providers of specialized services that are core to the running of the country; (2) regulatory authorities; and (3) providers of commercial services essential to the socio-economic development of the country. The classification policy sets out the operational and budget arrangements for each group, and has resulted in most entities in groups 1 and 2 being included in the budget documents. The information generated by this enhanced budget reporting will facilitate assessments of the commercialization and privatization of certain public entities, in line with our broader strategy of reducing the role of the state in the economy.

19. **To assess the progress already made and identify the next steps**, we will undertake a new assessment of the government's financial operations under the EU's Public Expenditure and Financial Accountability (PEFA) standards in early 2011 with the assistance of the European Union.

20. **We will update our Chart of Accounts to support improved decision-making on the allocation of resources.** We will establish a cross-agency committee in January 2011 which will identify our key needs and possible reforms, with the assistance of the IMF. A plan of action will be submitted to the Cabinet of Ministers before end of April 2011 with the aim of introducing the new Chart of Accounts in the 2012 Budget. We will also review the Accounting Standards of Financial Statement to ensure it is consistent with International Public Sector Accounting Standards (IPSAS), by September 2011.

21. **We continue to invest in the capacity of Government officials to oversee and contribute to public financial management.** We are providing budget management training for departmental budget officers and will revise the Financial Instructions and Accounting Manual by June 2011. Within the Ministry of Finance we are building capacity to analyze capital expenditure proposals, which will facilitate improved allocation of our capital expenditure budget.

22. **Our fiscal policy objectives will be supported by strengthened budget processes.** The main changes from the 2010 Budget process, which have been put in place since the last MEFP are:

a. Our 2011 Budget has moved to a medium-term budgeting framework, *presenting the government's fiscal and economic projections over a three-year horizon*.

b. The 2011 budget process commenced in June 2010 with Cabinet's discussion of the *Budget Strategy and Outlook (BSO) document*, which set the fiscal context and established the government's priorities.

c. *All ministries and budget dependent entities used a standard template* to submit their recurrent and capital expenditure proposals to the Ministry of Finance providing detailed costing. The Ministry of Finance's capacity to scrutinize these expenditure proposals has been enhanced through increased resources.

d. *Mid-year formal expenditure reviews were carried out*, with detailed reconciliation of budget estimates with quarterly and year-end outcomes.

e. In parallel, our *macroeconomic and revenue forecasting capacity has been enhanced* through the establishment of a dedicated branch within the Ministry of Finance, which is now fully operational.

23. **Further improvements will be made through amendments to our Public Finance Bill**. These amendments will seek to reflect recent operational improvements in public financial management in the legal framework, introducing principles such as transparency, accountability, medium-term stability and budget performance into the Bill and extending its coverage to budget formulation and budget execution processes, in line with Fund recommendations. The law would also extend the National Assembly's oversight of the budget to include the capital expenditure budget, in addition to current expenditures. Given the complexity and significance of this reform we will seek further Fund advice on developing and implementing the legislation. The Public Finance Bill will be submitted to Cabinet for approval by the end of September 2011.

24. **We are improving the management and operation of the Pension Fund and the Social Security Fund**. As the first step toward achieving actuarial equilibrium in the Pension Fund, we are modifying the contribution system for all employees from January 1, 2011. Instead of a fixed contribution paid by the employee and the employer, the contribution will become a fixed *percentage* of the employee's salary, payable by both parties. The rate will be 1.0 percent for 2011 and move to 1.5 percent from January 2012. On the Social Security Fund, the Social Security Act was passed in July, and the Government has appointed a Board of Trustees under the new Act in order to ensure professional and independent management of its assets. Going forward, a policy will be formulated outlining the investment objectives of these assets by September 2011, using the recommendations of the recent report of the World Bank.

D. Public Enterprise Reform

Non-Financial Institutions

25. **Our commitment to improving our capacity to invest in public infrastructure has not abated, particularly regarding the urgent needs in the utilities sector.** We are in negotiations with BADEA regarding the sourcing of an expert to carry out the study on the tariffs of the Public Utilities Company (PUC) planned for the first half of 2011. The government's objective is to improve the quality of service provision in the utilities sector, which over the long-term will require PUC to implement a tariff policy that is consistent with full cost recovery and meeting future investment needs. We will complete a study on the optimal structure and levels of tariffs by end-July 2011. In addition, we will implement tariff adjustments to fuel price variations after September 2011.

26. **The government is pursuing a public enterprise reform strategy aimed at achieving greater efficiency, transparency and accountability.**

a. Following the introduction of the Public Enterprise Monitoring and Control Act in late 2009, the Public and Financial Accounts Committee has started its monitoring work, including through hearings of the management of several public enterprises. The Committee, established by the Act to enhance governance, comprises members of the National Assembly, and has access to the audited accounts of the public enterprises.

b. The bulk of the recommendations made by the management audits of the public entities have been put in force, resulting in improved governance standards of these entities. The Public Enterprise Monitoring Division (PEMD) will also present a policy paper to Cabinet recommending a set of procedures for the selection criteria for Board members in the first quarter of 2011.

c. A report following a strategic assessment of the national airline has been submitted by the international aviation consultants who conducted their work in the latter half of this year. The airline has recently presented its reply to these recommendations to Cabinet, which is considering its response.

d. Since the last MEFP, the new Postal Sector Act has come into force which establishes the postal service as a fully independent commercial entity, outside of the Government budget.

e. Following the implementation of the new Budget Reclassification policy, we will develop a privatization plan for non-strategic public enterprises which do not serve public policy goals by the end of September 2011.

Financial Institutions

27. **The government, together with the CBS, is strengthening the management and oversight of public financial institutions** and assessing the case for continued state ownership.

a. The financial audit of the Housing Finance Corporation has been completed, and the recommendations submitted to the CBS. In addition, by June 2011, we will submit for Cabinet's adoption, an action plan for house financing policy that limits the role of the public sector, drawing on the recommendations of the FIRST Initiative's report.

b. It is government's policy to privatize Nouvobanq in the context of our medium-term strategy. The IFC is scheduled to conduct an evaluation of the state-owned banks in December 2010 and make recommendations regarding the feasibility of their privatization shortly thereafter. The Government is expected to respond to these recommendations and formulate a privatization strategy by the end of June 2011. We recognize that, in the longer term, privatization of the two publicly-owned deposit taking institutions – Seychelles Savings Bank and Nouvobanq - could bring new technology, strengthen management and fresh capital to our banking system, stimulate competition and enhance the quality of bank services.

In the near-term, however, both institutions are performing well financially, present limited risk to the government's balance sheet and are playing a leading role in promoting financial intermediation and credit creation.

E. Monetary and Financial Sector Policies

Monetary and Exchange Rate Policies

28. **The Central Bank of Seychelles (CBS) will continue to rely on reserve money targeting as its monetary policy framework.** In the short to medium term CBS will continue to use Repos as the main instrument to guide short-term interest rates while Deposit Auction Arrangement (DAA) and Credit Auction Arrangement (CAA), and foreign exchange Swaps will be used for fine tuning. The Bank will continue to increase its range of monetary instruments to allow it to achieve greater flexibility in its market interventions.

29. **The CBS and the Ministry of Finance (MOF) will seek to enhance the effectiveness of liquidity management to ensure the effectiveness of monetary policy framework and to contribute to financial sector deepening**. In the context of its liquidity forecasting and reserve money programming framework, the CBS and MOF will continue to work closely on the T-bill issuance profile to promote the smooth functioning of the market and provide for the development of a benchmark yield curve. A calendar of weekly T-bill issuance is communicated four weeks in advance in order to inform the market of the quantity of paper to be issued. This has helped improve the predictability of the securities market and has helped banks in better managing their liquidity.

30. **The reduction in Government's domestic debt poses a major challenge for monetary policy.** A reduction in the issuance of treasury bills as the Government continues to retire its domestic debt has resulted in a marked increase in commercial bank liquidity. The CBS will work in tandem with the Ministry of Finance to devise a strategy for dealing with this situation to ensure that the objective of debt reduction does not compromise the effectiveness of the transmission mechanism of monetary policy and the development of the financial system. Specifically, should liquidity persist, the MoF stands ready to issue up to SR 250 million of T-bills for monetary policy purposes, to help the CBS absorb at least part of excess liquidity and thereby share the burden of sterilization costs.

31. **We remain committed to a floating exchange rate regime, which has served Seychelles well since the beginning of the economic reforms.** The CBS will maintain its policy of intervening in the foreign exchange market only to smooth out excessive volatility and ensure orderly market conditions. The CBS will continue to work closely with banks and make use of technical assistance from the IMF and other institutions to improve the efficiency of the inter-bank market. In this context we are working on a code of conduct which will guide all participants in the foreign exchange as well as in the money market.

32. **The implementation of an integrated (core) banking system is on course to go live on December 01, 2010.** This project will assist the CBS in improving the efficiency of its operations and significantly mitigate risks associated with having a multitude of software.

33. **The recapitalization of the CBS has progressed well.** The Government made two rounds of capital injection for R63 million each through treasury bills in June and September 2010, and a final injection of R62 million is planned in December. This will boost CBS' capitalization level to 10 percent of monetary liabilities by the end of the year, as per the requirements of the CBS Act, as amended in 2009. This will strengthen the balance sheet of the CBS and enhance its portfolio of tradable securities to be used in open market operations.

34. **As external reserves continue to accumulate, the CBS will need to continue to strengthen its reserve management activities.** Given its internal capacity constraints, the CBS has taken a prudent approach to its reserve management program, limiting the use of external parties to manage its reserve asset to the World Bank through its Reserve Advisory and Management Program (RAMP), the Asset Management services of the Bank for International Settlement (BIS), and the Crown Agent, which also has a long standing reputation of working with central banks. Discussions with all three institutions are at an advanced stage and CBS expects to enter into formal arrangements with them in early 2011. Besides their more favorable terms in investing a portion of CBS' external reserves, these institutions will also provide technical assistance in the area of capacity building and training of CBS internal managers to better equip CBS staff in management of reserves.

35. **The CBS continues to make good progress in modernizing the national payment system.** Several important steps were taken in 2009 and continue in 2010, including: (i) establishment of a complete requirements and standards document for electronic funds transfers that replaced the manual settlement system; (ii) adoption of the new cheque standard documents in July 2009; (iii) formalization of the new clearing house rules in April 2010; and (iv) introduction of the National Clearing and Settlement system Act in July 2010. This legislation provides a formal legal base for the National Payment Systems and creates it as a legal entity. Furthermore it will provide a clear mandate for the undertaking of the payment systems oversight, entry and participation criteria, recognition and supervision of systems for clearance and settlement. Following the implementation of the Core Banking System, the new platform will facilitate the introduction of new payment systems such as an Electronic Clearing House and the introduction of a local rupee Switching System to facilitate the settlement of local ATM/POS transactions. Additionally, the CBS will continue to promote the use of electronic funds transfer and the use of plastic card, as well as implement a real time gross settlement system in 2011/2012.

36. **The CBS has embarked on an exercise to introduce a formal risk management framework.** In May 2010 a full risk assessment of the CBS was conducted at its own initiative, by a reputable international audit firm. The draft reports of this evaluation along with a draft risk policy and necessary tools to implement a robust strategic risk framework have been submitted to CBS for comments. The CBS has set up a risk implementation committee (RIC) to

drive the risk framework by addressing the risks identified and taking responsibility of ongoing risk assessments through Division Heads and risk monitoring through the Internal Audit Division (IAD). This risk assessment and its findings will also allow the CBS to adopt a risk-based internal audit framework in line with the recommendations of the latest Safeguards Assessment report. This will induce a training plan to support the new internal audit and risk oversight functions of CBS.

37. **CBS has completed its business continuity plan (BCP), ahead of the planned deadline of end-2010.** The BCP was prepared by a reputable international consulting firm in close consultation with CBS staff. An action plan has been submitted to the CBS Management and this will act as the roadmap for implement of this plan.

Financial Sector Reforms

38. **Substantial progress has been made in developing a risk-based supervision framework, with IMF technical assistance.** The CBS Board recently fully approved the CAMELS[1] bank rating system, and it has already been fully adopted in a recent onsite examination of a commercial bank. Frequent examinations are being conducted as per the procedural manuals on each component of the bank rating system. In the context of this risk-based approach the CBS will require banks to submit business plans on an annual basis by end-2011. This will allow the supervision staff to enhance micro-prudential supervision of financial institutions and beef up staff capacity in terms of analysis of these business plans on an ongoing basis. The CBS is also working toward further developing the CAELS[2] approach to offsite supervision as well as the enhancement of macroprudential supervision. In addition minimum capital for banks has been doubled, with a three year transition period granted to existing banks which do not meet the new requirement.

39. **The CBS continues to be proactive in its effort to safeguard financial sector stability.** At the request of CBS, the Toronto Centre carried out a four day workshop to a team of Central Bank, Ministry of Finance and Seychelles International Business Authority staff on crisis preparedness in October 2010. This has initiated work on Seychelles' crisis binder which contains tabs on, *inter alia* communication and co-ordination strategies, resolution options and challenges which may impede effective resolution of a crisis. An action plan will be devised to address gaps which have been identified during the exercise. The first draft of the crisis binder will be submitted to Toronto Centre for its review.

40. **Seychelles will continue its efforts to promote transparency in the offshore financial sector** through strengthened supervision by CBS in coordination with the Seychelles

[1] Acronym for **C**-Capital Adequacy, **A**-Asset Quality, **M**-Management, **E**-Earnings Performance, **L**-Liquidity and **S**-Sensitivity to Market Risk.

[2] Acronym for **C**-Capital Adequacy, **A**-Asset Quality, **E**-Earnings Performance, **L**-Liquidity and **S**-Sensitivity to Market Risk.

International Business Authority, and the Financial Intelligence Unit. To that effect, further to a review which has been conducted by the Global Forum on Transparency and Exchange of Information for Tax Purposes, Seychelles has expressed to the organization its commitment to ascertain that the country's legal framework supports and upholds the principle of transparency and exchange of information.

41. **We are committed to encouraging a sound and efficient insurance sector that promotes policyholder confidence.** The FIRST Initiative has agreed to give technical assistance to CBS to strengthen insurance supervision. A mission is slated for December 2010 and will include a review of the regulatory framework and preparation of manuals for conducting examination of insurance and insurance-related companies.

42. **CBS will continue to strengthen supervision of banks and other non-bank financial institutions under its supervisory ambit.** New regulations on Capital Adequacy and Credit Classification and Provisioning have been formally adopted in November 2010. These regulations ensure conformity with international best practices, including provisioning standards as per international norms and certain components of Basel II.

43. **In line with its new mandate the CBS has already began supervising the Housing Finance Company (HFC) and the Development Bank of Seychelles (DBS).** The CBS will use the results of the recent special audits by external auditors of HFC and DBS as a basis to begin its supervision of the institutions on a risk-based approach, which will include offsite as well as onsite examinations of these institutions. Moreover the recent strategic assessment of these same institutions by the FIRST Initiative will allow the Government to make a more fundamental decision on the future of these institutions.

44. **CBS will make increasing use of stress testing in its effort to evaluate the safety and soundness of institutions under its supervision**. To that effect the recently conducted stress test devised by the MCM expert will be used as benchmark. The stress test results will guide the CBS examiners to target specific areas of concern.

45. **The banking system currently suffers from a lack of competition that is hampering credit growth and the development of the banking sector.** Existing barriers to credit development include excessive prepayment penalties, long delays in registering guarantees and collateral, as well as excessively long periods for the court system to liquidate the collaterals. Moreover, the absence of a credit rating system and limited disclosures by banks under the Financial Institutions Act (FIA) prevent adequate assessments of potential clients' creditworthiness. In light of these constraints the CBS is carrying out a study to identify current uncompetitive practices and barriers, and based on the results it will draw up an action plan to address these shortcomings. Some of these measures will require an amendment of the FIA, which is planned for end-April 2011.

46. **The CBS is committed to promoting fair competition in the financial sector to ensure consumer protection and maintain a healthy and competitive financial system**. In that respect the CBS will work in close liaison with the Fair Trading Commission and the

Seychelles Bankers Association to achieve this goal. The initial step is to launch a public awareness campaign on different financial products. CBS will also review its requirements for disclosure of banks' fees and charges to ensure greater transparency toward the public.

Devise action plan to address gaps identified in crisis preparedness exercise	December 2010
Amend CBS Act to strengthen CBS independence and improve internal control as per safeguard assessment recommendations	March 2011
Finalization of Seychelles' crisis binder	March 2011
Submit FIA amendments to Cabinet of Ministers	April 2011
Require banks to submit business plans	December 2011
Review regulatory framework of insurance sector, preparation of manuals for insurance supervision	December 2011
Conduct onsite examinations of DBS and HFC	December 2011

F. Balance of Payments

External Debt Restructuring

47. **We are making headway in normalizing relations with those remaining external creditors with whom restructuring agreements had yet to be concluded at the time the last MEFP was prepared.** As of end-November, restructuring agreements covering approximately US$631million, or around 91 percent of the debt eligible for restructuring have been reached. In aggregate, these agreements have cancelled approximately US$310 million in principal, accrued interest, and other charges. The remaining balances have by and large been rescheduled over periods exceeding 17 years at low rates of interest, with the bulk of the foreign currency debt owed to local commercial banks converted into rupees.

48. **The entirety of foreign currency debts owed to locally-based commercial banks has now been successfully restructured.** In total, agreements covering nine facilities outstanding to local and local affiliates of foreign banks have been concluded. Two of these facilities were bought back at a steep discount. Almost all of the remaining claims have been converted into rupees at market rates, and rescheduled over the long term, often for periods exceeding 30 years. Material grace periods on principal apply to all. Floating interest rates have been agreed in most cases, at modest fixed margins over six-month or one-year treasury bills. The Government has also concluded, or is in the process of concluding, eight of the 11 bilateral agreements that implement the April 2009 Paris Club agreement. Another is in the advanced

stages of negotiation. We expect to receive the two remaining draft agreements from creditors shortly.

49. **The Government will persevere with its efforts to conclude restructuring agreements on comparable terms with the few remaining commercial bank and non-Paris Club official bilateral creditors holding unresolved claims.** In principle agreements have been reached with all non-Paris Club official bilateral creditors holding unresolved claims, and implementation is expected over the course of the fourth quarter of 2010. In principle agreements have also been reached with the two remaining commercial bank creditors, both of which are foreign institutions. The smaller of these two claims is the uninsured portion of an export credit officially supported by a non-Paris Club official bilateral creditor that has already agreed to restructure its claim on Paris Club terms.

Trade Policies

50. **We remain committed to a liberal foreign trade policy.** Our import tariff regime is already highly liberal, with more than 94% of all tariff lines set at zero. Nonetheless, we are undertaking measures to modernize our trade regime to bring it into conformity with our regional, bilateral and international trade obligations. We remain committed to the WTO accession process, which we are pursuing as a priority.

51. **We are pursuing trade negotiations with the European Union.** We have signed in August 2009 with the EU an interim European Partnership Agreement (EPA) together with Comoros, Madagascar, Mauritius, Zambia and Zimbabwe. The agreement ensures that our exports into the EU are not subject to duties or quota. In exchange, we will gradually phase out the maximum duty rates applicable to 98 percent of our imports from the EU.

G. National Statistics

52. **We remain strongly committed to improving the quality, periodicity, and timeliness of macroeconomic and financial statistics.** A new National Statistics Act (NSA) was approved by the National Assembly in July 2010, creating the National Bureau of Statistics (NBS), reinforcing its independence and strengthening its mandate to collect data compared to its predecessor (NSB). The governing Board, which is independent of government, comprises members from organizations (both public and private) that are directly affecting and/or affected by the NBS statistics. The Bureau has seen its current budget increased in a bid to increase capacity building.

53. **We are moving to address deficiencies in key macroeconomic data – especially GDP estimates and external sector statistics – to improve their usefulness for economic analysis and policy formulation.** To this effect, a strategic plan will be adopted by end-February 2011 which will map out our path toward SDDS and IIP6 compliance. The IMF sent a mission to work on quarterly National Accounts in November 2010, and another to assist with the development of an Industrial Index and Producer Price Index to bring us in line with international best practice, and implementation of the IMF’s Special Data Dissemination

Standard (SDDS). We aim to submit an advance release calendar for SDDS compliance by mid-2012. We will increase co-ordination across government agencies to improve quality and consistency in the FDI statistics. The Ministry of Employment will reinforce its efforts to produce high-frequency labor market data. We have requested further technical assistance from the Fund (on fiscal and national accounts) and the World Bank (to strengthen the management and operations of the NSB).

IV. Program Monitoring

54. **The EFF-supported program will be monitored by semi-annual program reviews, with semi-annual quantitative performance criteria and disbursements.** We propose to move to a new program review schedule to better synchronize with our budget cycle, with the new test dates being December and June. The semi-annual quantitative performance criteria (QPCs) for 2011 are shown in Table 2. The structural benchmarks for 2011 are shown in Table 3.

55. **The attached Technical Memorandum of Understanding (TMU) defines the quantitative performance criteria, indicative targets and adjusters under the program.** Seychelles will avoid introducing new exchange restrictions, multiple currency practices, or bilateral payments agreements in contradiction with Article VIII of the IMF's Articles of Agreement and imposing any import restrictions for balance of payments reasons. We stand ready to adopt any additional measures, in consultation with IMF staff, which may become necessary to ensure program success.

Table 1: Structural Benchmarks, 2010-2011

Measure	Target date	Macroeconomic rationale
Submit VAT bill to National Assembly, to become effective July 1, 2012 (MEFP ¶16)	End-December 2010	To modernize the tax system and remove tax distortions.
Cabinet approval of the amendments to financial institutions' act as described in MEFP ¶45	End-April 2011	To strengthen competition in the banking sector and improve risk management
Adopt an action plan for house financing policy that limits the role of the public sector (MEFP ¶27)	End-June 2011	To reduce fiscal risks, strengthen competition and promote development of the banking system
Launch a strategic plan for the reform of the social security system (MEFP ¶24)	End-June 2011	To establish well-targeted and sustainable social security system
Cabinet approval of VAT regulations, including rates, exemptions and thresholds (MEFP ¶16)	End-June 2011	To modernize the tax system and remove tax distortions
Commission and complete a study on optimal tariffs for utilities (MEFP ¶25)	End-July 2011	To ensure cost recovery and long-term sustainability of utilities
Develop a privatization plan for non-strategic public enterprises, which do not serve public policy goals (MEFP ¶26)	End-September 2011	To reduce the role of the state in the economy, improve corporate governance and minimize fiscal risks
Cabinet approval of a new Public Finance bill extending the National Assembly's oversight on capital expenditure budget. (MEFP ¶23)	End-September 2011	To strengthen public finance management
Reinstate the electricity tariff adjustment for fuel price variation (MEFP ¶25)	End-September 2011	To reduce losses of the public utility company

Table 2. Seychelles: Quantitative Performance Criteria Under the EFF, December 2010–December 2011
(Millions of Seychelles rupees; end-of-period)

	2010	2011			
	December	March	June	September	December
	Program	Indicative target	Performance Criteria	Indicative target	Performance Criteria
Performance criteria					
Net international reserves of the CBS, millions of U.S. dollars (floor) [1]	168	189	192	202	213
Reserve money (ceiling)	1,753	1,804	1,824	1,844	1,862
Primary balance of the consolidated government (cumulative floor) [2, 3]	823	142	240	515	602
The contracting or guaranteeing of new external debt by the public sector (Millions of U.S. dollars; cumulative ceiling) [2]	37	4	33	46	47
The contracting or guaranteeing of new short-term external debt by the public sector (Millions of U.S. dollars; cumulative ceiling) [2]	0.0	0.0	0.0	0.0	0.0
The accumulation of external payments arrears by the public sector (ceiling) [3]	0.0	0.0	0.0	0.0	0.0
The accumulation of domestic payment arrears by the public sector (ceiling)	0.0	0.0	0.0	0.0	0.0
Memorandum items:					
External non project financing (millions of U.S. dollars; cumulative) [2]	31.8	-1.4	0.0	2.1	5.5
Program financing support	19.6	0.0	0.0	0.0	0.0
Cash payments on foreign debt service	9.2	6.5	9.3	11.7	15.8
External budget grants	21.4	5.1	9.3	13.8	21.3
Program accounting exchange rates					
SR/US$ (end-of-quarter)	11.75	12.30	12.30	12.30	12.30
US$/Euro (end-of-quarter)	1.27	1.36	1.36	1.36	1.36
US$/UK pound (end-of-quarter)	1.48	1.57	1.57	1.57	1.57
US$/SDR (end-of-quarter)	1.49	1.56	1.56	1.56	1.56

Sources: Seychelles authorities and IMF staff estimates and projections.

[1] The floor will be adjusted downward (upward) for any shortfall (excess) in external nonproject financial support from that assumed in the program.

[2] Cumulative flows from the beginning of the calendar year.

[3] The nonaccumulation of new external payment arrears constitutes a continuous performance criterion. Excludes arrears for which a rescheduling agreement is sought.

ATTACHMENT 2

SEYCHELLES: TECHNICAL MEMORANDUM OF UNDERSTANDING

1. This technical memorandum of understanding presents the definitions of variables included in the quantitative performance criteria and indicative targets set out in the memorandum of economic and financial policies (MEFP), the key assumptions, and the reporting requirements of the Government and the Central Bank of Seychelles (CBS) needed to adequately monitor economic and financial developments. The quantitative performance criteria and indicative targets, and the benchmarks for 2010-11 are listed in Tables 1 and 3 of the MEFP, respectively.

I. QUANTITATIVE PERFORMANCE CRITERIA

A. Net International Reserves of the CBS (Floor)

Definition

2. Net international reserves (NIR) of the CBS are defined for program monitoring purposes as reserve assets of the CBS, minus reserve liabilities of the CBS (including liabilities to the IMF). Reserve assets of the CBS are claims on nonresidents that are readily available (i.e., liquid and marketable assets, free of any pledges or encumberments and excluding project balances and blocked or escrow accounts, and bank reserves in foreign currency maintained for the purpose of meeting the reserve requirements), controlled by the CBS, and held for the purpose of intervening in foreign exchange markets. They include holdings of SDRs, holdings of foreign exchange, demand and short-term deposits at foreign banks abroad, fixed-term deposits abroad that can be liquidated without penalty, and any holdings of investment-grade securities. Reserve liabilities of the CBS comprise liabilities to nonresidents contracted by the CBS, any net off-balance-sheet position of the CBS (futures, forwards, swaps, or options) with either residents or nonresidents, including those to the IMF.

Calculation method

3. For program monitoring purposes, reserves assets and liabilities at each test date, must be converted into U.S. dollars using the end of period exchange rates assumed in the program.

MONITORING AND REPORTING

4. At each program test date, the quarterly net international reserves data submitted by the CBS to the IMF will be audited by the CBS external auditors in accordance with International Standards on Auditing, to ensure conformity with the program definition and calculation methods. Reports will be submitted to the CBS, with a copy to the IMF, no later than two months after each test date.

Adjusters

5. The floor on the CBS's NIR will be adjusted upward (downward) by the amount by which the external non-project loans and cash grants exceeds (falls short of) the amounts assumed in the program (MEFP Table 1). The floors will also be adjusted upwards (downwards) by the amount that external debt service payments fall short (exceed) the amounts assumed in the program.

B. Reserve Money (Ceiling)

Definition

6. Reserve money is equivalent to currency issued and deposits held by financial institutions at the central bank (bank reserves), including those denominated in foreign currencies. Evaluation of performance of reserve money with respect to the program ceiling will be done at the program accounting exchange rate.

Monitoring and reporting

7. For each program test date, the quarterly reserve money data submitted by the CBS to the IMF will be audited by the CBS' external auditors in accordance with International Standards on Auditing, to ensure conformity with the program definition. Reports will be submitted to the CBS, with a copy to the IMF, no later than two months after each test date.

C. Primary Balance of the Consolidated Government (Cumulative Floor)

8. The consolidated government primary balance from above the line on a commitment basis is defined as total consolidated government and social security fund revenues (excluding privatization and long-term lease income receipts) less all noninterest (primary) expenditures of the government and social security fund.

D. Public External Debt (Ceiling)

9. The ceiling applies to the contracting or guaranteeing of new external liabilities by the public sector (including the central government, the CBS, and all public agencies and parastatals for operations that are not directly linked to commercial activities). The ceiling does not apply to the use of Fund resources, operations related to external debt restructuring; normal import related credits; purchases of treasury securities by nonresidents; or borrowing by parastatals in the conduct of normal commercial operations. The non-zero ceilings on the contracting or guaranteeing of external debt are to allow for normal public project finance and program support from multilateral institutions exclusively. Debt shall be valued in U.S. dollars at program exchange rates. A zero sub-ceiling on short-term external debt applies continuously to the contracting or guaranteeing of short-term external debt by the public sector, with an original maturity of up to and including one year.

10. For the purpose of this performance criterion, the term "debt" has the meaning set forth in point No. 9 of the Executive Board's Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274-(00/85)). Debt is understood to mean a current, non contingent liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future points in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. The ceiling on contracting official and officially guaranteed external debt includes all form of debt, including:

a. loans, i.e., advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans, and buyers credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements);

b. suppliers credits, i.e., contracts where the supplier permits the obligor to defer payments until some time after the date on which the goods are delivered or services are provided; and,

c. leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the leasor retains title to the property. The debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair, or maintenance of the property.

d. Arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt.

E. External Arrears of the Public Sector

11. The nonaccumulation of arrears to external creditors will be a continuous performance criterion under the program. External payments arrears for program monitoring purposes are defined as the amount of external debt service due and not paid within the contractually agreed period, including contractual and late interest. Arrears resulting from the nonpayment of debt service for which a clearance framework has been agreed or a rescheduling agreement is sought are excluded from this definition.

F. Budget Expenditure Arrears

12. The nonaccumulation of budget expenditure arrears will be a continuous performance criterion under the program. Budget expenditure arrears are defined as the sum of (1) any invoice that has been received by a spending agency from a supplier of goods, services, and

capital goods delivered and verified, and for which payment has not been made within the contractually agreed period, or in the absence of a grace period, within 30 days; (2) unpaid wages, pensions, or transfers, pending for longer than 30 days to domestic or foreign residents, irrespective of the currency denomination of the debt.

II. Data and Information

13. The Seychelles authorities (government and CBS) will provide Fund staff with the following data and information according to the schedule provided.

The CBS will report

Weekly (within one week from the end of the period)

- Reserve money.
- Foreign exchange reserves position.
- A summary table on the foreign exchange market transactions.
- The results of the liquidity deposit auctions, primary treasury bill auctions, and secondary auctions.

Monthly (within 4 weeks from the end of the month)

- The monetary survey in the standardized report form format.
- The foreign exchange cash flow, actual and updated.
- Financial soundness indicators.
- Stock of government securities in circulation by holder (banks and nonbanks) and by original maturity and the debt service profile report.

The Ministry of Finance will report

Monthly (within 2 weeks from the end of the month):

- Consolidated government operations on a commitment basis and cash basis in the IMF-supported program format.
- The detailed revenues and expenditures of the central government and social security fund.
- Monthly accounts of the public nonbank financial institutions.
- Import and export data from the customs department.
- Monthly public debt report.

14. The government and CBS will consult with Fund staff on all economic and financial measures that would have an impact on program implementation, and will provide any additional relevant information as requested by Fund staff.

INTERNATIONAL MONETARY FUND

SEYCHELLES

Staff Report for the 2010 Article IV Consultation and Second Review Under the Extended Arrangement, Request for Rephasing of Disbursements, and Financing Assurances Review—Informational Annex

Prepared by the African Department
(In consultation with other departments)

December 3, 2010

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SEYCHELLES: RELATIONS WITH THE FUND

(As of October 31, 2010)

I. Membership Status: Joined 6/30/1977. Article VIII member since 01/03/1978

II. General Resources Account	SDR Million	% Quota
Quota	8.80	100.0
Fund holdings of currency	27.28	309.97
Reserve Position in Fund	0.003	0.04

III. SDR Department	SDR Million	% Allocations
Net cumulative allocation	8.28	100.0
Holdings	7.70	92.97

IV. Outstanding Purchases and Loans:

Stand-by Arrangement	11.00	125.00
Extended Arrangement	7.48	85.00

V. Financial Arrangements:

Type	Arrangement	Expiration	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
EFF	Dec 23, 2009	Dec. 22, 2012	19.80	7.48
Stand-By	Nov.14, 2008	Dec. 22, 2009	17.60	11.00

VI. Projected Obligations to the Fund (SDR Million: based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2010	**2011**	**2012**	**2013**	**2014**
Principal			3.41	5.50	2.42
Charges/interest	0.06	0.26	0.25	0.19	0.13
Total	0.06	0.26	3.66	5.69	2.55

VII. Implementation of HIPC Initiative: Not applicable

VIII. Safeguards Assessments:

The Central Bank of Seychelles (CBS) was subject to a safeguards assessment with respect to the Stand-By Arrangement for Seychelles. The assessment completed in 2008 found high risks in all areas of the CBS's safeguards framework, and several measures were included in the program. An update assessment in relation to the Extended Fund Facility, which was completed in July 2010, has found that the authorities have implemented most of the measures recommended by the 2008 assessment. In particular, governance oversight at the CBS is now exercised by the Board and management committees, and transparency improved through application of International Financial Reporting Standards and the publication of financial statements that have been audited in accordance with international standards. Some additional measures have been proposed to address the remaining risks related to CBS governance and internal audit.

IX. Exchange Rate Arrangement:

The exchange market was liberalized in November 2008 and resulted in elimination of all the restrictions on the making of payments and transfers for current international transactions that are subject to Fund approval under Article VIII Sections 2, 3, and 4. The exchange rate policy is floating. On Nov 22, 2010, US$ 1 = SR 12.26 (mid rate).

X. Article IV Consultations:

Seychelles is currently under a 24 month consultation cycle.

XI. Technical Assistance (2007–October 2010): Trimming this to the last three year?

Department	Head of Mission	Subject	Date
MCM	Mr. Bartholomew	Multipurpose mission: Monetary operations, monetary research, banking supervision, payment systems, foreign exchange markets, and nonbank financial institution supervision.	November/ December 2007
STA	Mr. Dessart	Dissemination of GDDS National Summary Data Page	April 2008
STA	Mr. Armknecht	Consumer price index	April 2008
MCM	Mr. Faulk	Banking supervision, drafting of new financial sector related regulations	April 2008
MCM	Mr. Robotham	National payment systems project	May/June 2008
FAD	Mr. Khemani	Strengthening expenditure rationalization and budget management	July 2008
LEG	Mr. Baban	Exchange Rate and Exchange Control Regimes	September 2008
FIN	Mr. Hauge	Safeguards assessment	October 2008
FAD	Mr. Krelove	Reform of Tax Policy	January/February 2009
MCM	Mr. Bartholomew	Central Bank Capacity Building after the 2008 Float	February 2009
LEG	Mr. Baban	Reform of Exchange Rate Law	May 2009

Department	Head of Mission	Subject	Date

STA	Mr. Jones	Government Finance Statistics	May 2009
MCM	Mr. Faulk	Bank Supervision	June 2009
MCM	Mr. Vollan	Monetary Operations	June 2009
MCM	Mr. Robotham	Payments Systems	June 2009
FAD	Mr. Ljungman	Public Financial Management	July 2009
LEG	Mr. Burns	Fiscal Law	July 2009
FAD	Mr. Kloeden	Tax Administration	September 2009
STA	Mr. Hughes	National Accounts Statistics	September 2009
MCM	Mr. Sullivan	Accounting	October 2009
MCM	Mr. Faulk	Bank Supervision	October 2009
MCM	Mr. Robotham	Payments Systems	November 2009
STA	Ms. Razin	BoP Statistics	December 2009
MCM	Mr. Bartholomew	Central Bank Capacity Building	March 2010
MCM	Mr. Sullivan	Central Bank Accounting and Audit	October 2010
MCM	Mr. Vollan	Monetary Operations	October 2010
FAD	Mr. Bodin	Tax Policy (VAT)	October 2010
STA	Mr. Hughes	Quarterly National Accounts Statistics	November 2010

XII. Resident Representative None

SEYCHELLES: JOINT WORLD BANK-IMF WORK PROGRAM, 2010

(As of November 22, 2010)

Title	**Products**	**Provisional timing of mission**	**Expected delivery date**
A. Mutual Information on Relevant Work Programs			
Bank	**A. Strategy and analytical work**		
	Public Expenditure Review (PER, Phase 2)	October 2009	December 2010
	Joint Country Procurement Assessment Report (CPAR) and Country Financial Accountability Assessment (CFAA)		Ongoing
	Tuna industry management (TA – P118247)	July 2010	Delivered
	National Climate Change Strategy (TA – P118246)	n.a.	April 2011
	B. Ongoing and new projects		
	GEF grant implementation (tsunami reconstruction, disaster management)	March 2010	
	Development Policy Loan (DPL 2)	March 2010	Delivered
	Statistical Capacity Building Project (STATCAP)	March 2010	October 2011
	Public Administration Reform Project (PAR IDF)	October 2010	On going
	Technical assistance on social security net and enhancing targeting of social assistance	June 2010	Delivered
	Technical assistance on public enterprise reforms.	December 2010	February 2011
	Technical assistance on health reforms	October 2010	December 2010
Fund	**Program and surveillance work**		
	Article IV Consultation and Second Review under EFF, including Debt Sustainability Analysis	October 2010	December 2010
	Third Review under EFF	March 2011	June 2011
	Technical assistance and capacity building		
	FAD technical assistance on tax and customs reform	Ongoing	Ongoing
	MCM technical assistance on reforming the monetary policy framework (long-term monetary advisor, automation of interbank market, reserve money management) strengthening bank supervision, payments systems, and CBS governance.	Ongoing	Ongoing
	STA technical assistance on external sector statistics.	January 2011	Ongoing

Title	Products	Provisional timing of mission	Expected delivery date
B. Requests for Work Program inputs			
Bank request to Fund	Medium-term macro-economic and fiscal framework to inform Public Expenditure Reviews and Development Policy Lending	n.a.	Ongoing
Fund request to Bank	IFC assistance on strategic plans for Nouvobanq	December 2010	January 2011
	FIRST Initiative support for strategic reform of government owned non-bank financial institutions	October 2010	December 2010
	Strategy on improving business environment and promoting private sector investment	..	June 2011
	Develop strategy and policy recommendations to improve transparency and management of the fisheries sector	Ongoing	December 2010
	Assist in designing a medium-term reform plan for the Social Security system	March 2011	April 2011
C. Agreement on Joint Products and Missions			
Joint products	Joint mission in the context of the third review under the EFF to discuss a medium-term structural reform agenda focusing on: social safety net targeting; civil service reform, parastatal reform; and promoting private sector investment	March 2011	June 2011

SEYCHELLES: RELATIONS WITH THE AFRICAN DEVELOPMENT BANK GROUP

(As of October 31, 2010)

The African Development Bank Group commenced operations with the Republic of Seychelles in 1978 and has since approved 24 operations comprising 15 projects, five studies, three lines of credit and one emergency assistance operation. There were no approvals between February 2000 and November 2006 when the country was under sanctions, except for an emergency assistance grant worth US$500,000 to deal with the Tsunami disaster in January 2005. Cumulative approvals as of October 2010 amounted to UA 86.89 million,[25] of which 72 percent was from the African Development Bank (ADB), 14 percent from the Nigeria Trust Fund (NTF), and the remaining 14 percent from the African Development Fund (ADF) and Technical Assistance Funds (Table 1). Reflecting Government priorities, most of the operations were in the social sector (34 percent), followed by multi-sector (23 percent), transport (13 percent), agricultural (12 percent), water supply and sanitation (11 percent) and the financial sector (8 percent).

The country was under sanctions with the African Development Bank Group since February 16, 2000 due to the arrears situation. The country cleared all the arrears (amounting to US$46.75 million) in November 2006 and the African Development Bank Group consequently lifted all sanctions and started discussions on possible reengagement with the country. The process was boosted by the launching of a comprehensive reform program by the Government in November 2008. Following this, an Interim Strategy Note was approved by the Board on April 22, 2009. The ISN covers 2009 and 2010 and focuses on a single pillar namely supporting the Government's reform program to achieve sustainable growth.
The lending program during this period consists of a policy-based operation in the form of a budget support loan amounting to €15 million, to be disbursed in two equal tranches of €7.5 million in 2009 and 2010. The operation was approved in July 2009 and the first tranche was disbursed in November 2009 while the second and final tranche is expected to be disbursed in the fourth quarter of 2010 pending fulfillment of one outstanding condition, namely the revision of the Investment Code. In addition, there is an ongoing non-lending program under which the Bank Group is providing grant resources to the country, from the African Water Facility and the Middle Income Countries' (MIC) Technical Assistance Fund to provide assistance needed to underpin, over the longer term, more substantial engagement. Under the African Water Facility, a grant amounting to € 955,000 was signed in May 2008 to finance the preparation of the Water Development Plan aimed at improved water management and governance, and identifying priority investment projects for funding, in order to meet Seychelles' water needs up to 2030. The study is expected to be completed by the first quarter of 2011. Under the MIC Technical Assistance Fund three grants have been approved. A grant to finance a study (amounting to UA 600,000) was approved in December 2008 aimed mainly to support human resource development, training and capacity building as well as the establishment of the Seychelles University Foundation. However, the study did not take off as

[25] UA 1 = US$ 1.55619 as at October 31, 2010.

planned, mainly due to the inability of the Seychelles University Foundation to carry out the proposed activities and is due for cancellation. A second grant (amounting to US$ 500,000) was approved in February 2009 to undertake the feasibility on a Submarine Cable System to link Seychelles to East Africa. It has already been completed while a third grant focusing on the Development of a Mariculture Master Plan (amounting to UA 280,000) was approved in July 2010.

The Bank approved an unprecedented policy-based partial guarantee operation for US$10 million on December 12, 2009 in support of an exchange bond offered to external commercial creditors in the context of the public debt restructuring effort. The guarantee was instrumental in generating a high participation in the debt exchange offer.

Table 1. Operations Summary as at 31 October, 2010

Operations since: 1978

Total Number of operations 24: 15 Projects, 5 Studies; 3 Lines of Credit, 1 Emergency Operation

Source of Financing	Commitments (UA milliion)	Percentage Share	Disbursed Amount UA million)	Percentage Disbursed
ADB	62.19	72	44.12	70.9
ADF/TAF	12.70	14	11.29	88.9
NTF	12.00	14	10.39	86.6
Total	86.89	100	65.80	75.7

An assessment of the ISN has been undertaken through the formulation of a Completion Report that is due to be presented to the Board in December 2010. The overall finding is that the Strategy has been relevant and considerable progress has been made in the outputs and outcomes under the single pillar. Going forward, the major lessons that will need to be taken into account when preparing the next strategy (scheduled in 2011) are to maintain:(i) a candid dialogue with Government to ensure strategic responsiveness and flexibility; (ii) close cooperation and coordination with other Development Partners; and (iii) close supervision and follow-up of all operations (regardless of size) to ensure that weaknesses/delays are identified and addressed when they arise.

SEYCHELLES: STATISTICAL ISSUES

Data provision has some shortcomings, but it is broadly adequate for surveillance. The country participates in the General Data Dissemination System (GDDS) since December 2006 and in government finance statistics modules of the Anglophone Africa project funded by the U.K. Department for International Development (DFID). Good progress has been achieved in improving statistical capacity, but sustained technical assistance and additional resources will be required for statistical development over the medium term in order to improve the quality of economic statistics. Ten out of the seventeen applicable data categories of Special Data Dissemination System (SDDS) meet the coverage, periodicity and timeliness prescriptions of SDDS.

Real Sector Statistics

National accounts data are prepared on a calendar-year basis with 2006 serving as the base year for constant price measures. In May 2010, the National Statistics Bureau (NSB) published new provisional national accounts estimates for 2004-2009. There are considerable delays in compiling and disseminating volume measures of GDP. The NSB has recently started to compile quarterly national accounts data for the period 2004-2008, but these were not disseminated, further work is underway. Tourism statistics are compiled on a weekly and monthly basis. Production indicators are compiled quarterly, and both are reported to the IMF in a timely manner. Data on average earnings and employment by sector are collected on a quarterly basis by the NSB, but there are no data on unit labor costs. A new consumer price index (CPI) was introduced from October 2007. It utilizes expenditure weights derived from the household budget survey of 2006- 2007. The base period is July 2007. CPI meets all the SDDS requirements. The Producer Price Index is not yet compiled in Seychelles.

Government Finance Statistics

General government operations data meet all the SDDS requirements. Government finance statistics are recorded on a cash basis broadly consistent with the *Government Finance Statistics Manual* (1986). The authorities have participated in a GFS pilot study that presented government finance statistics in the *GFSM 2001* analytic framework and are currently participating in a DFID financed technical assistance project.

The project – as a follow-up to the pilot study – aims at improving the cash-based statistics for operational and reporting purposes while also laying the foundations for the implementation of accrual-based measures of fiscal performance and extending the institutional coverage to include nonfinancial public corporations. Annual data on consolidated central government transactions are reported for publication in the *Government Finance Statistics Yearbook (GFSY)*. The authorities have recently prepared 11 cash data on central government budgetary operations for publication in the *IFS* using the *GFSM 2001* Statement of Sources and Uses of Cash. Since April 2010, the authorities are presenting fiscal reports on a consolidated government basis, and further to an extensive reclassification of budget dependent entities, the 2001 Budget will be presented on a general government basis.

Monetary and Financial Statistics

Monetary and financial sector data meet SDDS requirements and are reported regularly to STA for publication in the *IFS*. The analytical framework underlying the compilation of monetary statistics is generally sound. An integrated monetary database has been developed and is fully operational using the standardized report forms (SRF) for reporting monetary data to the Fund. The SRF-based monetary data have been published in the *IFS Supplement* since its March 2007 issue.

External Sector Statistics

The authorities have made substantial progress in adopting the methodology of the fifth edition of the *Balance of Payments Manual*. Annual balance of payments data are reported to the Statistics and African Departments nine months after the reference period, but provisional estimates are provided to missions earlier. Quarterly BOP data are being compiled including 2009, and are now publicly available . Merchandise trade data are reported on a quarterly basis, and meet SDDS requirements. Since the hiring of financial advisors, considerable progress has been made recently in collecting and updating data on public sector external debt and debt-service and external payments arrears.

SEYCHELLES: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE
(As of November 24, 2010)

	Date of latest observation	Date Received	Frequency of data	Frequency of reporting	Frequency of publication
Exchange rate	11/24/10	11/24/10	Daily	Daily	Daily
International reserve assets and reserve liabilities of the monetary authorities	11/19/10	11/24/10	Weekly	Weekly	Monthly
Reserve money	11/24/10	11/24/10	Daily	Daily	Monthly
Broad money	Sept. 2010	10/26/10	Monthly	Monthly	Monthly
Central Bank balance sheet	11/19/10	11/24/10	Daily	Weekly	Monthly
Consolidated balance sheet of the banking system	Sept. 2010	10/26/10	Monthly	Monthly	Monthly
Interest rates	11/19/10	11/19/10	Weekly	Weekly	Weekly
Consumer price index	Oct. 2010	11/05/10	Monthly	Monthly	Monthly
Revenue, expenditure, balance and composition of financing of the central government	Sep. 2010	10/14/10	Monthly	Monthly	Monthly
Stock of central government and government guaranteed domestic debt	Sep. 2010	10/25/10	Monthly	Monthly	Monthly
External current account balance	Sep. 2010	10/20/2010	Quarterly	Quarterly	Quarterly
Exports and imports of goods and services	Sep. 2010	10/20/2010	Quarterly	Quarterly	Quarterly
GDP	2009		Annual	Annual	Annual
Gross external debt	Sep. 2010	11/11/2010	Monthly	Monthly	Monthly
International investment position	…	…	NA	NA	NA

INTERNATIONAL MONETARY FUND

Public Information Notice

EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 10/162
FOR IMMEDIATE RELEASE
December 22, 2010

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2010 Article IV Consultation with the Seychelles

On December 20, 2010, the Executive Board of the International Monetary Fund (IMF) concluded the 2010 Article IV consultation with the Seychelles.[26]

Background

The economic outlook is favorable. Developments in 2010 confirm a quick progress toward stabilization and have freed up some margins for more expansionary policies. The exchange rate has stabilized, price stability has been restored and reserves rebuilt. The medium-term outlook is favorable as growth is projected to gradually reach 5 percent, but the timid global

[26] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

recovery and large external vulnerabilities plead in favor of rebuilding policy buffers and diversifying the economy.

The 2010 Article IV discussions focused on the medium-term challenges that confront Seychelles, including recovering from a severe external debt crisis, reducing the small island state's vulnerability to external shocks, and promoting private-sector led growth. Several interrelated issues were discussed: the use of the fiscal margins that have emerged from the economic recovery, external stability issues, the management of the growing banking liquidity, and the sound development of the financial sector.

The program is on track. All performance criteria through end-September 2010 were met and the end-year targets are within reach. Although most of the structural reform agenda is progressing as scheduled, capacity bottlenecks have delayed two measures that were structural benchmarks for end-September and end-November 2010 respectively.

The program targets for 2011 reflect further efforts to consolidate economic stabilization gains and secure Seychelles's medium-term growth objective. The program accommodates an easing of the fiscal stance consistent with debt sustainability and external stability. After two years of fiscal over-performance, the authorities target a primary surplus of 5 percent of GDP for the 2011 budget, 1 percentage point of GDP less than initially planned. This will provide fiscal space for the financing of infrastructure, addressing the main growth bottleneck in the medium term, while maintaining public debt on the initial declining path. Further steps are taken to rationalize the tax system, including preparations for the launching of a value-added tax (VAT) in mid-2012. Monetary policy will aim toward maintaining inflation below 3 percent.

Executive Board Assessment

Directors commended the authorities' stabilization efforts that helped Seychelles overcome the 2008 balance of payments and debt crisis and the recent global recession. Directors noted a remarkable turnaround of economic policies, including foreign exchange market liberalization and floating of the rupee, exceptional fiscal adjustment, and enhanced management of public finances and the central bank. They also noted the important role played by international assistance, which facilitated successful restructuring of external debt and the return of investor confidence.

Directors agreed that, with improved economic fundamentals, the medium-term outlook is positive, but risks remain. They observed that upbeat growth projections, a benign inflationary environment, and the strong revenue performance in 2010 offer room for more expansionary fiscal policies in 2011 in support of the country's development needs, including priority recruitment in the public sector and infrastructure investment. At the same time, uncertainty about the global economy and large external vulnerabilities favor the rebuilding of policy buffers. Directors welcomed further steps to rationalize the tax system, including the launch of a value-added tax in mid-2012, enhanced transparency and accountability of public finances, and the planned reform of the social security system.

Directors took note of the staff's assessment that the exchange rate is broadly in line with fundamentals, and welcomed the authorities' intention to maintain a flexible exchange regime, which has played an important role on the recovery path. However, vigilance is needed against the inflation and exchange rate risks stemming from excess liquidity in banks, which is emerging from the quick reduction of domestic public debt. In this context, Directors welcomed the authorities' commitment to mop-up liquidity, including by issuing treasury bills for monetary policy purposes, and to maintain inflation in the low single digits.

Directors noted the soundness of the banking system and welcomed improvements in financial regulations. At the same time, they thought that greater competition among banks would facilitate credit growth and intermediation. They encouraged the authorities to reduce state intervention in the financial system, and enhance disclosure requirements and consumer protection.

Directors commended the authorities for successful implementation and strong ownership of the reform program, and were encouraged by their commitment to sustain the reform momentum. They stressed the need to address capacity bottlenecks, which have delayed two structural benchmarks.

Directors emphasized the need to maintain an ambitious path toward debt sustainability. They welcomed the measures aimed at enhancing efficiency of public enterprises, underscoring the importance of ensuring financial sustainability of the national airline and Public Utilities Company.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Seychelles: Selected Economic and Financial Indicators, 2008–13

	2008	2009		2010		2011	2012	2013
		Prog	Prel.	Prog.	Proj.	Projections		
National income and prices	(Percentage change, unless otherwise indicated)							
Nominal GDP (millions of Seychelles rupees)	8,710	10,402	10,726	11,206	11,303	12,000	12,881	13,920
Real GDP	-1.3	-7.6	0.7	4.0	6.2	4.3	4.8	5.0
CPI (annual average)	37.0	32.9	31.9	-2.4	-2.2	2.5	3.0	2.9
CPI (end-of-period)	63.3	1.9	-2.5	1.1	1.2	3.0	2.6	3.0
GDP deflator average	29.3	28.5	22.3	0.4	-0.8	1.8	2.5	2.9
Money and credit	(Percentage change, unless otherwise indicated)							
Net claims on private sector	48.6	-12.1	-11.4	22.2	21.5	11.3	...	...
Broad money	27.2	-0.7	7.5	19.1	12.5	11.1	...	...
Reserve money	0.6	32.2	15.7	35.3	35.5	5.1	...	...
Velocity (GDP/broad money)	1.5	1.8	1.7	1.5	1.6	1.5	...	...
Money multiplier (broad money/reserve money)	5.3	4.0	4.9	4.3	4.1	4.3	...	...
Savings-Investment balance	(In percent of GDP)							
External savings	48.9	22.6	36.3	39.5	47.1	27.3	20.0	17.3
Gross national savings	-8.8	6.8	-7.1	6.0	6.3	10.1	11.5	11.6
Of which: government savings	7.9	2.8	7.8	5.6	7.6	13.1	10.7	9.3
Gross investment	40.1	29.4	29.3	45.4	53.4	37.4	31.5	28.9
Of which: government investment	2.1	5.3	5.7	8.0	8.4	10.4	8.5	7.8
Government budget								
Total revenue, excluding grants	32.9	35.6	35.4	31.4	35.5	36.5	36.5	35.7
Expenditure and net lending	40.0	35.1	33.8	33.8	34.3	37.8	36.2	35.0
Current expenditure	28.7	32.8	31.0	28.9	29.3	27.4	27.6	27.2
Capital expenditure and net lending	11.2	2.3	2.7	4.9	5.0	10.5	8.6	7.9
Overall balance, including grants	-3.4	2.8	5.0	0.7	2.7	2.7	2.1	1.5
Primary balance	3.9	13.3	14.8	7.4	9.4	5.0	4.7	4.0
Total public debt [1]	136.7	140.1	128.6	82.4	76.1	71.7	64.3	57.0
External sector	(In percent of GDP, unless otherwise indicated)							
Current account balance including official transfers	-48.9	-22.6	-36.3	-39.5	-47.1	-27.3	-20.0	-17.3
Total stock of arrears (millions of U.S. dollars) [2]	317	239	251	…	33.3	...	...	...
Total public external debt outstanding (millions of U.S. dollars) [1]								
(in percent of GDP)	82.8	98.5	92.6	53.6	45.3	46.2	43.9	40.1
Terms of trade (= - deterioration)	1.2	-2.1	-3.2	…	…	...	...	...
Real effective exchange rate (average, percent change)	-7.1	…	-6.6	...	...	...	...	...
Gross official reserves (end of year, millions of U.S. dollars)	51	153	169	224	218	253	286	311
In months of imports, c.i.f.	0.6	1.5	1.7	2.3	2.3	2.7	3.0	3.1
Exchange rate								
Seychelles rupees per US$1 (end of period)	16.6	10.6	11.3	...	...	...	...	...
Seychelles rupees per US$1 (period average)	9.5	14.1	13.6	...	...	...	...	...

Sources: Central Bank of Seychelles; Ministry of Finance; and IMF staff estimates and projections.

[1] Includes the central bank.
[2] The 2010 figure is an estimate as of end-November 2010.

INTERNATIONAL MONETARY FUND
EXTERNAL RELATIONS DEPARTMENT

Press Release No. 10/507
FOR IMMEDIATE RELEASE
December 21, 2010

International Monetary Fund
Washington, D.C. 20431 USA

IMF Completes Second Review and Financing Assurances Review Under the Extended Arrangement for Seychelles and Approves US$2.7 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) has completed the second program review and financing assurances review under Seychelles' program supported by a three-year extended arrangement under the Extended Fund Facility (EFF). The completion of the second review allows the immediate disbursement of an amount equivalent to SDR 1.76 million (about US$2.7 million), bringing total disbursements under the arrangement to an amount equivalent to SDR 9.24 million (about US$14.2 million).

The Extended Arrangement for Seychelles became effective on December 23, 2009 in the amount of SDR 19.8 million (about US$30.3 million, or 225 percent of Seychelles' quota in the Fund (see Press Release No. 09/472).

Following the Executive Board's discussion on December 20, 2010, Mr. Naoyuki Shinohara, Deputy Managing Director and Acting Chair, made the following statement:

"The Seychellois authorities' strong stabilization efforts have helped the economy overcome the 2008 balance of payments and debt crisis and the recent global recession. This was achieved through a remarkable turnaround of economic policies, including foreign exchange market liberalization and floating of the rupee, exceptional fiscal adjustment, enhanced management of public finances and the central bank, and successful external debt restructuring, now close to completion.

"With the economy rapidly recovering on the back of a rebound in tourism and higher foreign direct investment, strong revenue performance in 2010 offers fiscal room to support the country's development needs, including priority recruitment in the public sector and infrastructure investment in 2011, while maintaining an ambitious path toward debt sustainability.

"Sustained private sector-led economic growth will also require further modernization of public finances. The ongoing rationalization of the tax system, including preparations for the launch of a value-added tax in mid-2012, and measures to improve transparency and efficiency of the budget are important steps in this direction.

“Measures by the authorities to enhance the efficiency of state-owned enterprises are crucial for improving the growth prospects. Further efforts should focus on strengthening the governance and financial viability of the national airline and the public utility company.

“The authorities’ intention to maintain a flexible exchange rate regime is welcome, and vigilance is needed against the inflation and exchange rate risks stemming from excess liquidity in banks, which is emerging from the reduction of domestic public debt. The programmed monetary tightening and the authorities’ commitment to mop-up liquidity are appropriate responses.

“While the banking system appears healthy, efforts to promote competition among banks, reduce state intervention in the financial system, and enhance disclosure requirements and consumer protection will promote credit growth and intermediation.”

Statement by Christopher Legg, Executive Director for Seychelles and Susan Bultitude, Advisor to the Executive Director
December 20, 2010

Our Seychellois authorities have achieved a remarkable turnaround in the economy and public finances since the 2008 Article IV consultation. Their ambitious economic reform delivered the country from a severe balance of payments and debt crisis, brought on by the intersection of global crises with a legacy of an unsustainable development model. The authorities have also made considerable progress with a second phase of reforms, directed at consolidating stability, achieving external debt sustainability and supporting growth.

The three-year EFF that commenced in December 2009 continues to provide a solid foundation for this medium-term agenda. It is providing a framework to guide policymakers and maintain the impetus for reform now that the initial crisis has passed, including through Presidential and Parliamentary elections. It is also helping to coordinate the assistance of donors and other stakeholders. The program is on track, with growth and the budget surplus exceeding targets in 2010, and the recovery is expected to continue in 2011 and 2012. Key structural reforms for 2011 and 2012 will further enhance public financial management, improve the efficiency and accountability of public enterprises, and improve the sustainability of public finances. In pursuing its reforms, the authorities continue to assimilate and adopt a large proportion of advice from the Fund and other advisers.

Economic developments and outlook

The Seychelles economy exceeded expectations over 2010. The real GDP forecast has been revised upwards from 4 percent to more than 6 percent, driven by higher than expected activity in the tourism, construction and manufacturing sectors. Inflation, which had peaked at over 60 percent at the height of the 2008 crisis, was virtually flat, allowing an easing of monetary policy. The outlook is for continued recovery over the medium term, albeit at a slower rate than 2010.

The authorities are taking steps to mitigate downside risks to the outlook. They are diversifying export markets, securing goods exports by participating in international efforts to counter piracy, and investing in public infrastructure to prevent growth bottlenecks.

Program implementation

Our Seychellois authorities have maintained their exemplary program performance, comfortably meeting all quantitative targets and broadly meeting the structural benchmarks. Two structural benchmarks were behind schedule at the time of the Staff mission, reflecting capacity constraints within the public service. One of these has since been met, with the submission of the new customs management act to the National Assembly on December 14. The authorities remain committed to implementing the other outstanding benchmark, the adoption of a new chart of accounts, which has been delayed until the 2012 Budget context as more extensive preparatory work is required.

Fiscal policy

Stronger than expected revenues in 2010 enabled the Government to exceed its primary surplus target by 2.4 percent of GDP, while increasing spending for priority areas such as infrastructure, education and health. This strong fiscal performance, combined with better than expected progress on debt rescheduling, has provided space for the authorities to build the capacity of the public service and address infrastructure bottlenecks. Capital expenditures over 2011 will include a new coast guard facility, a new landfill, improvements to electricity and water distribution networks, rehabilitation of the Victoria hospital and education facilities, and a new housing project.

Going forward, the Government will continue to deliver the budget surpluses required to ensure medium-term debt sustainability, while accommodating pro-growth investment.

Monetary and exchange rate policies

The authorities continue to invest in the Central Bank of Seychelles' (CBS's) capacity to undertake effective monetary policy, such as through capital injections of almost SR 190 million in 2010, the implementation of an integrated (core) banking system on 1 December 2010 and the expected introduction of a formal risk management framework in 2011. CBS is also increasing its range of monetary instruments to give greater flexibility in its market interventions.

The recent strong fiscal surpluses have created challenges for monetary policy, with banks' excess reserves rising to about 4 percent of GDP as the Government retired debt. The CBS and Ministry of Finance are working closely together to ensure that the Government's debt reduction efforts do not compromise the effectiveness of monetary transmission or the development of the financial system. As an interim measure, the authorities will transfer SR 200 million of Social Security Fund deposits from commercial banks to the CBS for at least one year, while it reviews the investment strategy for these assets. In addition, the Ministry of Finance is prepared to issue up to SR 250 million of T-bills for monetary policy purposes, to help the CBS absorb some excess liquidity. Over the longer-term, continued credit growth and a reduction in lending rates will help to offset the overhang.

Our Seychellois authorities remain committed to a floating exchange rate, which has served their economy well through its reforms, despite the volatility that followed the float. The CBS is implementing measures to improve the efficiency of the inter-bank foreign exchange market, such as a code of conduct to guide market participants.

Financial sector policies

Seychelles' banks are well-capitalised and profitable, and the Fund's stress tests indicate that they are well-positioned to withstand significant shocks. The authorities have made substantial progress towards implementing a modern, risk-based supervisory framework. They have also doubled minimum capital requirements and prepared protocols for managing a financial sector crisis. The CBS will continue to strengthen supervision of financial institutions in accordance with the new regulations on capital adequacy and credit adopted in November 2010.

The authorities are keenly aware that banks' high margins and ample liquidity are likely to reflect the financial sector's lack of development, which may unduly restrict credit flows. Private sector credit grew by 8 per cent over the year to September 2010, off a low base and well below the growth in broad money. To nurture competitive forces, the authorities are promoting improved transparency and information dissemination. The CBS is also carrying out a study to identify uncompetitive practices and barriers, and policies to address them.

Debt restructuring and sustainability

The Government of Seychelles has made remarkable progress in restructuring its debt facilities, with around US$631 million, or around 91 percent of eligible debt, restructured to date. Around US$310 million in principal, interest and other charges have been cancelled, and the remainder has been rescheduled at concessional rates for periods of 17 years or more. Bilateral debt agreements have been signed with most Paris Club creditors, several non-Paris Club creditors and all commercial banks, and the Government continues to negotiate in good faith with remaining creditors.

Reflecting these negotiations, external debt is expected to decline to 45 percent of GDP by the end of 2010, down from 92 percent at end-2009. The Government remains on track to limit total public debt (external and domestic) to less than 50 percent of GDP by 2018. This takes into account an upward revision to debt limits for 2011 to accommodate infrastructure financing, including concessional loans for electricity and water projects, and a guarantee in support of the installation of submarine cable for high-speed internet connections.

Structural reforms

The following are key areas of structural reforms that will be pursued over the remaining two years of the EFF, as Seychelles continues its transition to a modern market-based economy:

- **Taxation**. The Government delivered significant tax reform in 2010, broadening the base of business and personal income taxes and eliminating exemptions and sectoral preferences. The final major tax reform will be the introduction of the Value Added Tax in July 2012. The Government is also pursuing improved tax administration.

- **Pension Fund and Social Security Fund**. An increase in pension contributions from 1 January 2011 is a first step towards a more sustainable Pension Fund. Going forward, the authorities will launch a strategic plan for the funding structure of the social security system by June 2011, using the recommendations of a recent World Bank report. A policy will be formulated outlining the investment objectives of Social Security Fund assets by September 2011.

- **Public financial management**. The authorities will amend the Public Finance Bill to reflect recent improvements in budget processes in the legal framework, and to extend the National Assembly's oversight of the capital expenditure budget. An assessment of the Government's financial operations under the EU's Public Expenditure and Financial Accountability (PEFA) standards is scheduled for 2011.

- **State-owned enterprises**. The Public Enterprise Monitoring and Control Act introduced in late 2009 and the recently implemented Budget Reclassification policy have facilitated greater transparency in the operation of state-owned enterprises. The Government has also established the postal service as an independent commercial entity and undertaken a strategic assessment of the national airline. Going forward, the Government will develop a privatization plan for non-strategic public enterprises which do not serve public policy goals by the end of September 2011. It will also undertake a study of utility tariffs, with the objective establishing a tariff structure that covers costs and investment needs.

- **Public financial institutions**. The Government has committed to privatizing Nouvobank and will formulate a privatization strategy by July 2011, based on the findings of impending technical assistance from the IFC. The authorities are also using the recent strategic assessments of the Housing Finance Corporation and Development Bank of Seychelles under the FIRST initiative to inform decisions about the future of these institutions, and will submit to Cabinet an action plan that limits the role of the public sector in housing finance, by June 2011.

- **Trade policy**. Seychelles already operates a liberal foreign trade policy, with more than 94 percent of all tariff lines set at zero. Nonetheless, the authorities have begun modernizing the trade regime, are pursuing trade negotiations with the European Union, and have committed to WTO accession.