INTERNATIONAL MONETARY FUND

January 2014
IMF Country Report No. 14/25

SEYCHELLES

EIGHTH REVIEW UNDER THE EXTENDED ARRANGEMENT

January 2014

In the context of the Eight Review Under the Extended Arrangement, the following documents have been released and are included in this package:

- **Staff Report** for the Eight Review, prepared by a staff team of the IMF, following discussions that ended on October 31, 2013, with the officials of Seychelles on economic developments and policies underpinning the IMF arrangement under the Extended Arrangement. Based on information available at the time of these discussions, the staff report was completed on December 5, 2013.
- A **Press Release**

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

Copies of this report are available to the public from

International Monetary Fund • Publication Services
700 19th Street, N.W. • Washington, D.C. 20431
Telephone: (202) 623-7430 • Telefax: (202) 623-7201
E-mail: publications@imf.org Internet: http://www.imf.org

International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

SEYCHELLES

EIGHTH REVIEW UNDER THE EXTENDED ARRANGEMENT

December 5, 2013

KEY ISSUES

Context. Economic growth and macroeconomic stability improved in 2013. A robust rise in tourism earnings supported growth, as well as a reduction in the current account deficit as a share of GDP. The exchange rate has strengthened slightly, at the same time as the central bank accumulated more international reserves than expected. Inflation has decelerated and the government is on track to achieve its 5 percent of GDP primary surplus target.

Focus. Discussions centered on the 2013 fiscal performance, the 2014 budget framework, monetary policy challenges (particularly responses to excess liquidity), and reforms in public enterprises, utility tariffs, and public financial management to reduce fiscal risks, strengthen the business environment, and improve the quality of public service provision.

Program performance. All performance criteria for end-June 2013, the program's last test date, were met. All the third quarter indicative targets were also met. The measures in the structural benchmarks were all completed, although there were short delays compared to initial plans for technical reasons. Staff recommends completion of the eighth review under the Extended Arrangement.

Policies in the period ahead. The authorities remain resolute in their objective of reducing public debt below 50 percent of GDP by 2018, which leaves little scope to relax fiscal policy. Policies in 2014 aim to continue debt reduction while responding to some social pressures. Monetary policy will continue to stabilize inflation at low levels and aim for international reserves accumulation. Structural reforms aim to extend improvements in financial discipline to the broader public sector, including through utility price adjustments that reduce implicit subsidies and through better oversight of parastatals. The authorities indicated their intention to request a successor arrangement with the IMF to consolidate and extend the progress made during this EFF.

Risks. The largest risks to the economic outlook and program performance are external, including most notably a downturn in Europe or global financial turbulence, which could lead declines in tourism receipts, drops in FDI and/or bank retrenchment. Homegrown risks to the program center on additional losses of key public enterprises that could jeopardize the government's debt reduction objectives.

Approved by
David Robinson and Vivek Arora

Discussions were held in Victoria October 17–31, 2012. The staff team comprised Mr. Mills (head), Mr. Moheeput, Mr. Roy, Mr. Thornton (all AFR), and Ms. Riad (SPR). Ms. Luu (OED) participated in the mission. Mr. Robinson (AFR) also participated at the conclusion of the mission, including a conference with key stakeholders on October 31.

The four-year Extended Arrangement under the Extended Fund Facility (EFF) for SDR 26.4 million (242.3 percent of quota) expires on December 22, 2013. SDR 23.1 million has been disbursed, and SDR 3.3 million will be available upon completion of this review. The arrangement aims at consolidating macroeconomic stability and external sustainability, and implementing second-generation structural reforms.

CONTENTS

CONTEXT

1. **The EFF-supported economic program has met its goals** (Box 1). The arrangement approved in December 2009 aimed to reach a sustainable external and fiscal path and support structural reforms to raise growth and buttress macroeconomic stability. Strong policies coupled with debt restructuring have achieved solid growth, low unemployment,[1] a substantial reduction in the debt burden, a build-up in international reserves, and improvements to macroeconomic policy-making. With this eighth and final review the EFF-supported program will come to an end.

Box 1. Seychelles' EFF-Supported Program: Objectives and Achievements

The program aimed to place the economy firmly on the path to external and fiscal sustainability. Its design was based on the implementation of a strong macroeconomic framework, anchored by a large primary fiscal surplus and supported by a comprehensive debt restructuring. This framework was supported by structural agenda intended to raise growth performance and reduce fiscal risks by focusing on four priorities: (i) improving public financial management (PFM); (ii) reforming the tax system; (iii) redefining the role and raising the performance of parastatal entities; and (iv) bolstering the financial system.

The program has successfully achieved these objectives. The public debt-to-GDP ratio has been brought down from 124 percent of GDP at end-2009 to an estimated 71 percent at the end of 2013. This reduction reflects both the successful implementation of the debt restructuring and robust fiscal consolidation: in the years 2010–2013, the Seychelles has run an average primary surplus of over 6 per-cent of GDP. Growth has remained relatively strong since the immediate crisis in 2008-09. Inflation has fallen below 5 percent, although this is somewhat higher than the low single digits targeted at the start of the program. External reserves, a vital buffer for such an open economy, have improved from just over 2 months of imports at the start of the program to over 3½ months at the end of 2013.

Structural reforms have helped raise economic performance and address important macroeconomic risks, although more remains to be done. On tax policy, the tax base has been broadened and the system simplified with the introduction of a flat-rate personal income tax and a VAT. Budget processes have been reformed, such as with the adoption of new procurement and transparent tendering processes and the establishment of a Public Enterprise Monitoring Commission under the PEMC Act. On public enterprises, reporting requirements have been clarified and the process of rebalancing tariffs initiated. And on the financial sector, there was the introduction of a credit information system, an electronic clearing house, the Leasing Act and a commercial court.

2. **Despite the success of the program, important risks and challenges remain.** As a small tourism-dependent island economy still dealing with the legacy of a debt crisis, Seychelles remains highly vulnerable to exogenous shocks. Sources of external risk include: tourism suffering from a possible downturn in Europe (still the source of more than two-thirds of tourism earnings); financial turbulence

[1]Survey-based data suggest an estimated 4.1 percent of the labor force in Seychelles was unemployed in 2011–12.

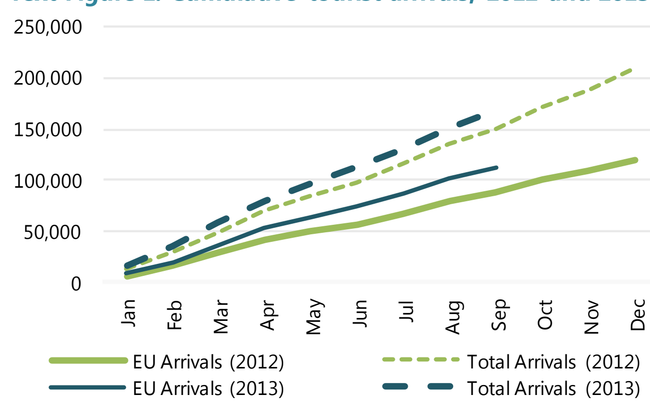
caused by a prospective unwinding of unconventional monetary policy in the advanced economies leading to a retrenchment by the foreign-owned banks that dominate the Seychellois banking system; and possible repercussions from the OECD Global Forum's recent decision to declare Seychelles non-compliant with standards designed to combat tax avoidance.[2] To address possible risks, macroeconomic buffers need to be strengthened further through reducing the still high debt burden and building up external reserves. On the domestic front, although public enterprises have improved their performance recently, they still pose medium-term risks to fiscal sustainability and growth potential, in the absence of further reforms. Also, social expectations are rising after five years of tight macroeconomic policies, and if increases in average wage levels were very large, they could pose a risk to macroeconomic stability by stoking inflation, boosting imports, and weakening international competitiveness.

RECENT ECONOMIC DEVELOPMENTS

3. **Growth continues to be resilient** (Figures 1 and 2, Tables 1-4).[3] Real GDP growth for 2013 is projected to accelerate slightly more than previously expected (3.5 percent), driven by a projected 11 percent gain in tourism earnings. Total tourist arrivals have risen sharply, up 15 percent in the first three quarters of 2013; not only did new markets (Germany, Gulf States, China, and Russia) show some growth, but traditional markets in Europe (France and Italy) exhibited resilience despite the elimination of direct flights from Europe (Text Figure 1). Moreover, production indicators for canned tuna, electricity, and telecommunications remain strong, despite modest growth in credit to private sector.

4. **The external position improved modestly in 2013, supported by robust tourism earnings and private sector financial inflows**. The current account deficit is projected to narrow to 22.6 percent of GDP in 2013 (4½ percentage points lower than in 2012). Private sector inflows grew strongly in 2013, including both FDI and other private investment (such as loans to local subsidiaries); in combination with external borrowing, they fully

Text Figure 1. Cumulative tourist arrivals, 2012 and 2013



Source: Seychelles authorities and IMF staff estimates

[2]This decision was made public in the context of the Sixth Meeting of the Global Forum on Transparency and Exchange of Information for Tax Purposes on November 21-22, 2013 in Jakarta. While the Global Forum itself does not have the power to impose sanctions, this decision could potentially affect private transactions involving Seychelles, although this is hard to anticipate. The authorities are developing a comprehensive plan to bring Seychelles into full compliance with the requirements, which should mitigate risks.

[3]In late October the National Bureau of Statistics released a preliminary GDP estimate for 2012 and revised the historical series. If confirmed, this preliminary estimate would result in some substantial revisions: notably 2012 nominal GDP would be 9.5 percent higher than previously estimated. Staff is working with the authorities to investigate the source and implications of these revisions. In the meantime, the revised numbers have not been incorporated into the current report, though they will be reflected in future analysis as appropriate.

financed the current account deficit. The considerable net inflows from tourism and private investment have supported a somewhat stronger exchange rate, while allowing the Central Bank of Seychelles (CBS) to consolidate its substantial reserve accumulation for the year. Reserve cover is projected at 3.7 months of imports at end-2013, up from 2.9 months in 2012.

5. Inflation has stabilized at a low level in 2013, aided by exchange rate strength. Following some initial pressures in the first quarter stemming from VAT implementation, annual inflation fell to 3.7 percent in August 2013 (yoy). Higher than expected average monetary aggregates have not spilled over into inflation as credit growth has remained moderate. Adjustments in utility tariffs, postponed to November from July, are expected to push inflation to 4.5 percent in December 2013 (yoy). Throughout the next year, second-round effects from the large water tariff increases for commercial customers and robust wage increases (particularly the 20 percent hike in the minimum wage introduced with the 2014 budget) are expected to limit further declines in inflation (projected at 4.3 percent for end-2014).

6. Fiscal policy continues to be anchored by the debt consolidation strategy. The government remains broadly on track to achieve its target primary surplus of 5 percent of GDP, consistent with its debt reduction strategy. A slight revenue under-performance has been offset by lower-than-anticipated capital expenditure (reflecting technical delays in project implementation). While maintaining the primary surplus target, a mid-year supplementary budget reallocated some expenditure items toward health services and combating piracy. The public-debt-to-GDP ratio is expected to fall to 71.6 percent by the end of the year.

7. The financial system appears sound and resilient, but suffers from a high cost of credit and a lack of competition. Soundness indicators point to strong earnings and a solid capital base. Recent stress tests undertaken by the banking supervisor are in line with the results of the stress tests conducted in the context of the 2013 Article IV—the financial sector is resilient to exchange rate risk, but somewhat less so to credit and interest-rate risk. Nonperforming loans, while still high at 9.4 percent of total loans, are fully provisioned and on a declining trend. However, loan-deposit spreads are still high, and the small size of the financial system comes with high concentration (the two largest banks together hold 70 percent of the system's assets), hampering competition.

PROGRAM PERFORMANCE

The performance on fiscal and reserves program targets has continued to be strong in 2013 (Appendix 1, Table 1), while the measures in the structural benchmarks have also been completed, albeit with some delays relative to original target dates (Appendix 1, Table 2).

8. The authorities met their fiscal targets and are on track to meet the end-year target. The primary surplus targets for March (indicative target) and June (performance criterion) were observed with the June target of 2.8 percent of GDP exceeded by 0.4 percentage points, as a result of under-execution of the investment budget.[4] The September indicative target was met despite

[4]The Ministry of Finance, Trade and Investment's Financial Planning and Control Division has begun holding regular meetings with the implementation ministries in an attempt to avoid such delays in the future.

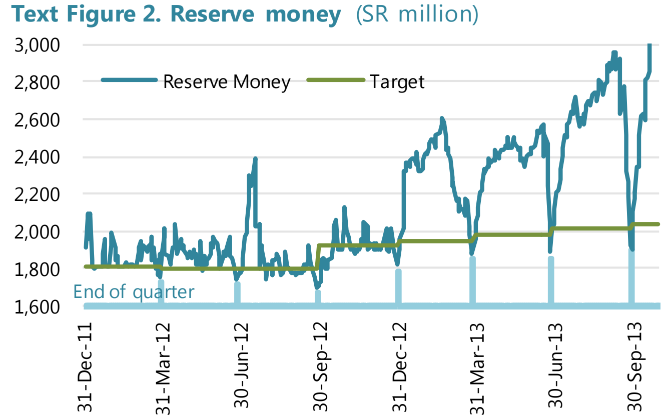
some weaknesses in tax revenues.[5] The authorities are investigating the cause of this unanticipated weakness with a view to ensuring increased compliance, and they plan to restrain non-priority expenditure in order to attain the target for the year as a whole.

9. **The net international reserves (NIR) targets were met by substantial margins**. The CBS took advantage of the strong inflows to purchase a total of US$45 million through end-June, compared to a program projection of US$15 million, and a total of US$75 million by end-October 2013—all in the context of a strengthening exchange rate. As a consequence, gross official reserves stood at just above three months of imports as of end-June, and are on track to reach US$400 million at end-2013, equivalent to 3.7 months of imports.

10. **The monetary policy stance has been broadly appropriate, meeting its key objectives**. As inflation gradually came down, the CBS allowed interest rates on treasury bills to fall, with deposit and lending rates gradually following (Figure 1). Lending to the private sector, which had been largely stagnant through 2012, began picking up slowly, with nominal credit growth rising to 2.5 percent by June 2013 and to 4.9 percent by September.

11. **However, the authorities' reluctance to sterilize more forcefully has led to an increase in excess liquidity and volatility in money markets, as they meet end-quarter reserve money targets**. Concerned over the cost of sterilization, the central bank has mopped up liquidity for only a few days to meet end-quarter reserve money targets (Text Figure 2). As a result, excess liquidity reached SR1.2 billion (equivalent to 15 percent of broad money) at end-October. This approach has not undermined stability in the short-run. There appears to be little risk at present that excess liquidity could spill over into inflation or a sudden rush into foreign currency, since banks have not significantly increased lending[6] and are constrained by prudential limits on net open foreign exchange positions.[7] Nevertheless, continued excess liquidity undermines efforts to enhance the effectiveness of monetary policy tools over the medium-term. Moreover, the high degree of excess liquidity undermines the interbank money market. Although the liquidity positions of individual banks vary, current high levels of excess liquidity preclude any interbank transactions. The CBS aims to reduce the aggregate

Text Figure 2. Reserve money (SR million)



Source: Seychelles authorities and IMF staff estimates

[5]Shortfalls occurred in VAT receipts, due to lower than expected collections from the tourism sector (despite the strong tourist arrival numbers) and a few new VAT exemptions, and in excise revenues, reflecting a fall in motor vehicle imports and reductions in certain excise tax rates.

[6]While there is unsatisfied demand for credit in Seychelles, structural problems in the credit market restrict its growth (these issues were discussed during the 2013 Article IV consultations).

[7]Under Seychelles' prudential regulations, the net open foreign-currency position of any bank cannot exceed 30 percent of its equity capital. Banks are currently "long" on foreign currency and would not be able to swap significant amounts of domestic liquidity into dollar-denominated assets without violating the limits.

liquidity position of the system to a level that would incentivize interbank trading and strengthen the signaling role of the short-term interest rate.

12. The implementation of the structural reform agenda remains on track for completion during the program, despite some delays. The adjustment of utility tariffs, a first step in the vital process of rebalancing tariffs between residential and commercial customers, was initiated in November, four months later than originally planned, as stakeholder consultations took longer than expected. The approval of the Leasing Bill by the National Assembly, planned for end-June, took place in October, owing to changes in the legislative schedule. Finally, due to a longer than expected internal legal review, the authorities received approval for the financial instructions and accounting manual in November, rather than by end-June as originally planned.

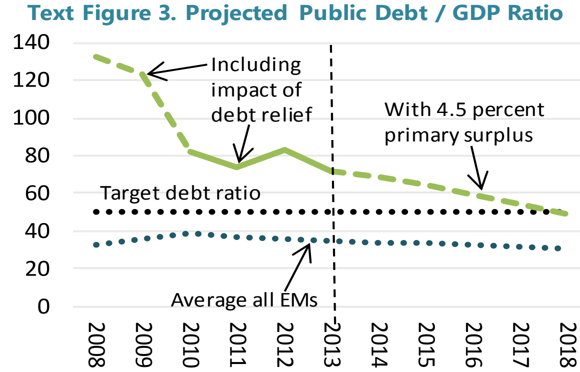
POLICIES FOR 2014 AND BEYOND

The authorities will need to balance their objective of reducing public debt—which requires continued large primary surpluses over the medium term—with the need to provide the necessary investment in physical and human capital to support longer-term growth. The central bank is moving toward a more flexible monetary policy framework, but needs to iron out implementation of an agreement with the government on sharing the costs of mopping up excess liquidity. Structural reform should continue to reduce the fiscal risks posed by the parastatal sector, while seeking to promote the contribution of this and other sectors to growth.

A. Fiscal Policies

13. The authorities remain fully committed to their objective of reducing public debt to 50 percent of GDP by 2018. Staff agreed that this objective remains desirable and realistic, though it will require continued strong fiscal discipline. In this context, the authorities are targeting a primary surplus of 4½ percent of GDP in 2014 (the surplus would be 5 percent of GDP if net lending to the Public Utilities Corporation (PUC) for investment of about ½ percent of GDP were excluded). Under current projections, primary surpluses of around 4½ percent of GDP would enable Seychelles to achieve its 50 percent goal by 2018 (Text Figure 3).[8]

Text Figure 3. Projected Public Debt / GDP Ratio



Source: Seychelles authorities and IMF staff estimates

[8]Public debt projections are liable to shift over time, because they are sensitive to a number of variables and assumptions, including the exchange rate. Indeed, the external debt-to-GDP ratio is slightly lower than projected during the seventh review reflecting the continued strength of the currency. Other considerations include the fiscal risks from public enterprises (e.g., Air Seychelles' financial problems added 2.5 percent of GDP to public debt in 2012) and treatment of debt issued for monetary purposes (the projections above include this debt, currently equivalent to 5 percent of GDP, and the objective would be met even earlier excluding such debt). Possible revisions to GDP could also have some impact on debt projections.

14. After five years of tight macroeconomic policies, the authorities are facing some pressures to increase certain spending and ease the tax burden. The authorities have announced plans to increase both the minimum wage and civil service wages, and investment needs in utility infrastructure have built up.

- **Civil service wages**. The draft budget includes a step increase in civil service wages of 10 to 20 percent, which could be accommodated within the budget envelope. Tight control over other current expenditure items should ensure that primary current spending remains roughly stable as a percent of GDP in 2014. Staff noted that large public sector salary increases could limit the resources available for priority investment spending, and could encourage equally large private sector wage increases, which could weaken macroeconomic balances and competitiveness. The authorities and staff agreed that going forward it would be advisable to keep growth in the government wage bill broadly in line with growth in the economy as a whole, to preserve the quality of fiscal expenditure.

- **Investment spending**. Both domestically and foreign financed investment will fall as a proportion of GDP; the former is squeezed by falling revenue and the primary surplus target and the latter by an expected fall in external project support. The authorities and staff concurred on the objectives of improving revenue performance, restraining current spending, and allocating the proceeds to increasing investment spending over the medium term.

- **Tax policy**. The authorities decided to focus on enhancing revenue collection rather than implementing any major changes to tax policy in 2014. After the broadly successful introduction of VAT in 2013, the authorities are continuing with their plan to reduce the threshold for VAT registration. While the authorities are interested in introducing some progressivity in the current 15 percent flat-rate personal income tax, they recognized the need for more preparatory work prior to implementing any changes. Given the recent fall in the revenue-to-GDP ratio, staff cautioned against issuing further exemptions and encouraged the authorities to consider further measures over the medium term, particularly on compliance and on specific taxes (whose value is eroding over time with inflation).

- **Minimum wage increase**. The authorities and staff concluded that a 20 percent increase in the minimum wage—much of it catch-up in real terms—in 2014 would not harm macroeconomic stability. More broadly, staff noted the importance for the fiscal position, balance of payments, and inflation of keeping wage increases in line with the capacity of the economy and government finances.

B. Monetary, Financial, and External Sector Policies

15. The CBS plans to make its monetary policy framework both stronger and more flexible. The CBS will continue to enhance international reserves coverage in 2014, albeit at a more moderate pace. The ministry of finance and the CBS have agreed in principle on a division of responsibilities for absorbing the stock of excess liquidity, including through the issuance of longer maturity treasury bills. The amounts and modalities are still being developed. This cooperation will enable the CBS to fine-tune liquidity control with its own instruments, which will also require further developing liquidity forecasting capacity. Under a new approach to setting quarterly reserve money targets,[9] they will be higher (including for end-December 2013), while average excess liquidity will be stabilized at significantly lower levels, strengthening the monetary policy transmission mechanism. The CBS and staff regard this as an important first step in moving toward a more forward-looking regime anchored by stable market expectations regarding inflation, interest rates, and the exchange rate. The latter will continue to adjust in line with fundamentals.

16. Policies toward strengthening the financial sector will focus on further improving bank supervision, fostering bank competition, and enhancing financial deepening. AFRITAC technical assistance on moving toward risk-based bank supervision will continue. More broadly, the authorities have recently launched a project for developing a Financial Sector Development Strategy, with the support of the World Bank's FIRST initiative and the involvement of IMF staff. Final recommendations are expected as early as May 2014.

17. Despite recent improvements, external vulnerability remains high. Notwithstanding an improvement this year relative to GDP, the current account deficit remains elevated, owing in large part to substantial imports connected to the temporary surge in FDI. As this exceptional factor tapers off, imports and current account deficits are expected to adjust progressively. Nevertheless, there are some risks and uncertainty surrounding this adjustment process, which are related to the magnitude of the financial flows and data reliability issues. While key indicators of external resilience, such as debt dynamics and reserves import coverage, have improved markedly and are projected either to continue to improve or to remain roughly stable, these indicators are sensitive to shocks and the projections' assumptions of continued policy discipline.[10] In addition, new preliminary data have provided evidence of Seychelles' substantially negative International Investment Position (IIP).[11] Moreover, under the terms of the debt restructuring, service on public external debt will double from 2013 to 2017 (reaching 3.8 percent of GDP), generating some moderate pressure on the balance of payments that is expected to be manageable under the baseline scenario.[12] Overall, staff assess that the external position remains broadly in line with fundamentals.

[9] The CBS' gradual reformulation of its monetary policy framework is being guided by TA delivered by MCM in February 2013. As a first step under these recommendations, reserve money targets will be set to stabilize the desired level of surplus liquidity reserves in the banking system, rather than being derived from a broad money target, assuming a stable money multiplier.

[10] The civil service salary increases proposed in the draft 2014 budget are assumed to not have a significant impact on private sector wages.

[11] External sector data still exhibit some weaknesses, which the authorities are working to address with TA from the Statistics Department (Annex 2). The measurement of private investment inflows in particular poses challenges. The new IIP series, which IMF staff are still assessing, shows a negative IIP of 135 percent of GDP at end-2012; however, this position is a substantial improvement from end-2010 (230 percent) and liabilities are overwhelmingly direct investment, which poses less risk. Generally, external data revisions are expected to affect levels but not the projected improving trend in Seychelles' external position.

[12] Public external commercial borrowing is not envisaged at this juncture given the focus on reducing external vulnerabilities.

C. Structural Reforms

18. Oversight of public enterprises continues to improve, although risks remain significant. The authorities highlighted the healthier financial performance of parastatals and their commitment to enhancing monitoring. The new Public Enterprise Monitoring Commission is now operational, although further capacity-building is needed to analyze the financial data and governance in parastatals to monitor any build-up of risks, such as occurred with Air Seychelles. At the same time, the shares of ten of the main commercial parastatals are being transferred to a holding entity, the *Société Seychelloise d'Investissement* (SSI), which will provide strategic direction and oversight. In this initial stage, there is substantial overlap between the board of SSI and senior managers of the parastatals, and it will be important to establish a fully independent board, especially to review investment plans. Staff welcomed these steps to improve monitoring and stressed the need for further progress on clearly defined roles, adequate capacity, and independence, which are required for effective oversight. Staff also stressed that the increasing importance of strategic oversight as certain public enterprises propose maintaining or even expanding commercial activities outside their core mandates (in sectors such as retail, construction, and shipping), exposing the state to commercial risk and in some cases potentially crowding out private sector activity.

19. The multi-year rebalancing of utility tariffs has been launched, and strong or even accelerated implementation is crucial to reaping its benefits. The rebalancing is vital to the financial and operational health of the PUC, as well as reducing substantial cross-subsidies that hamper competitiveness. The phase-in period for rebalancing was stretched to eight to ten years, rather than seven years, as recommended by the consultants. In addition, the adjustments for smaller residential electricity consumers will be back-loaded, with no increase for two years (during which direct government subsidies will offset the financial impact of no rate increase). Water and sewerage tariff increases were more front-loaded for larger users (over 40 percent this year) than small residential users (less than 10 percent). Under current plans, sewerage will continue to rely on cross-subsidization over the next 10 years. The authorities' decision to extend the phase-in period and backload adjustments for smaller users reflected a desire to soften the potential social impacts of the tariff adjustments. IMF staff welcomed the launch of rebalancing, while emphasizing that the slower pace will delay many of its benefits and that more targeted transfers could mitigate its impact more affordably. IMF and World Bank staff urged the authorities to sustain implementation of the rebalancing and even consider accelerating it—by, for example, reducing downward revisions of tariffs that might occur under the adjustment mechanism for fuel costs.

20. On broader public financial management issues, further progress is also crucial to consolidating benefits from ongoing initiatives. In mid-2013, the cabinet approved a Public Investment Management action plan which aims to standardize procedures for project appraisal, monitoring, and review. The Public Sector Investment Plan (PSIP) is under revision to ensure prioritization and adequate financing for public investment, and it will be a key component of the planned medium-term fiscal framework. With World Bank support, the ministry of finance has also launched Program Performance Based Budgeting (PPBB) on a pilot basis in departments (Education and Natural Resources), with a view to extending these pilots in 2015. Moreover, additional improvements in the quality of public financial management are called for, including regular procedures to reconcile data on fiscal revenue and expenditure with the below-the-line financing data, to ensure that the budget out-turn data provide a comprehensive picture of government activity. In addition, the authorities will need to manage the debt reduction process carefully to cope with its effects, particularly building capacity, seeking to extend maturities on domestic borrowing, and taking into account the full costs of external borrowing (including the implications for domestic liquidity sterilization).[13]

D. Relations with the Fund

21. Seychelles' capacity to repay the Fund remains satisfactory (Table 7), and financing assurances are in place to complete the review. Obligations to the Fund peak in 2018, but remain less than half a percent of GDP. Budget support is being provided by the World Bank and African Development Bank, with disbursements expected in December 2013, and further loan programs are being developed for subsequent years. Agreements have been reached to fully complete the restructuring of the external debt.

22. The authorities have indicated their intention to request a successor arrangement, in a continuation of the close cooperation with the Fund. While noting the progress made under the current Extended Fund Facility (EFF), they highlighted the continuing vulnerabilities from still high debt levels, low reserve coverage, and an unfinished reform process. A follow-on arrangement could provide policy continuity and support for further progress in addressing these vulnerabilities and in advancing structural reforms to buttress growth. The authorities and staff will continue discussions on a possible successor arrangement early next year.

23. The staff and authorities jointly organized a stakeholder conference to take stock of the program, build support for further reform, and examine priorities for the future. Participants representing a wide range of Seychellois society broadly supported continued macroeconomic discipline and public debt reduction. They also generally recognized the need for further structural reform, with discussion focused on the pace and priorities for public enterprise and banking sector reforms. Participants also explored the future drivers of growth and inclusiveness.

STAFF APPRAISAL

24. Strong policies and an expansion in tourism have brightened Seychelles' near-term outlook, although the small island economy remains highly vulnerable to external shocks. Growth and employment have remained solid, supported by robust tourism earnings. Determined fiscal adjustment has continued reducing public debt, anchoring macroeconomic stability and confidence. As a result, the exchange rate has strengthened, inflation has fallen below 5 percent, and the current account deficit is projected to narrow as percent of GDP.

25. Sustained implementation of the EFF-supported program has strengthened macroeconomic stability, and particularly public finances. The authorities met all end-June quantitative targets, in some cases by significant margins, and agreements have now been concluded

[13]The authorities received TA mission on developing a medium-term debt strategy from the World Bank and IMF in October 2013.

to fully complete the debt restructuring begun in 2009. Public debt has continued to fall, even somewhat faster than anticipated. While budget execution has generally improved, the quality of spending would benefit from more timely implementation of capital projects.

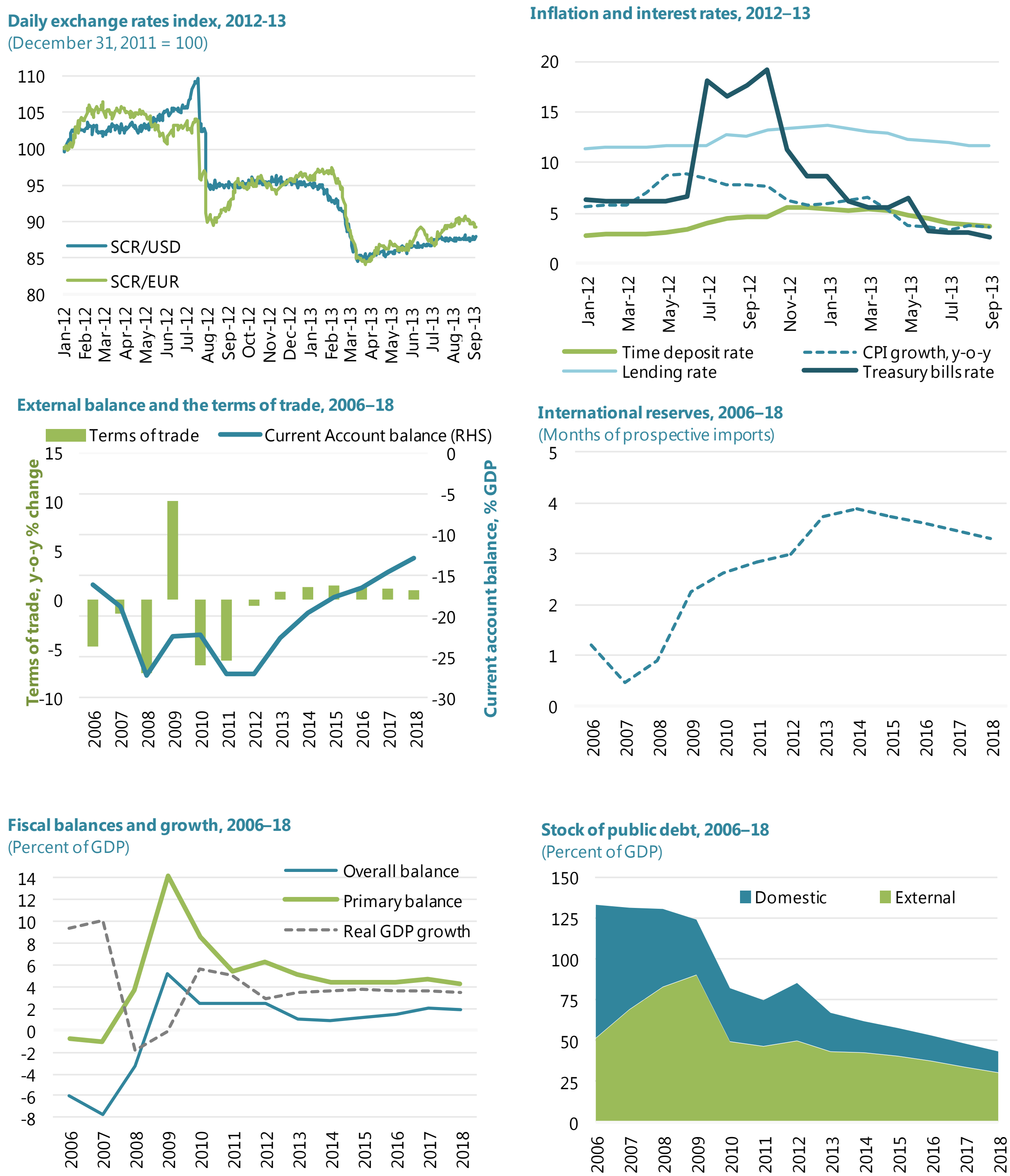
26. Monetary policy and a strong exchange rate have successfully brought down inflation while the international reserves buffer has been built up. The CBS' opportunistic purchases of foreign exchange have improved import coverage, and the pace of international reserves accumulation has significantly exceeded program targets, reflecting the stronger than anticipated gains in tourism and investment inflows. The authorities' intention of pursuing further precautionary reserve accumulation is appropriate for a small, open, and highly import-dependent economy, although the liquidity implications need to be suitably managed. Mopping-up excess liquidity is an essential next step in developing the monetary policy framework, and the subsequent enhancements of liquidity forecasting and management should strengthen the framework and transmission mechanism. In this connection, it is important that the monetary and fiscal authorities reach a final agreement on sharing the cost of sterilizing excess liquidity, preferably within a medium-term framework.

27. The 2014 macroeconomic framework provides a solid basis to continue to reinforce external and fiscal sustainability. Despite pressures after five years of tight economic policies, the government remains appropriately determined to reduce public debt, maintain a strong primary surplus, and restrain current primary expenditure. The falling revenue-to-GDP ratio and the accompanying drop in investment spending raises some concerns about the growth implications of fiscal policy, and these should be addressed in coming years. The recent reforms to the tax system are an appropriate basis for raising domestic revenues and these reforms should be safeguarded by resisting further exemptions and continued efforts to improve compliance. The authorities are taking a suitably careful approach to any further tax policy changes. The authorities need to remain vigilant to external risks, including the implications of possible international financial turbulence for Seychelles' financial system.

28. Important progress has been achieved on the structural agenda, although significant priorities still remain. The VAT, financial leasing bill, and financial instructions and accounting manual, constitute important steps forward. While also an important step, the utility tariff rebalancing reform seems to address risks and weaknesses only over a long period. The effective oversight of public enterprises is still developing, particularly concerning governance and investment decisions, and is becoming more important as some public enterprises seek to broaden their activities beyond their core mandates. This expansion could risk reversing recent gains in reducing fiscal risks from public enterprises and enhancing the role of the private sector—a vital element of the future growth strategy. Going forward, key priorities include macro-fiscal risks from public enterprises, efforts to deepen financial markets, and reforms to promote inclusive growth. Staff also encouraged the authorities to move forward expeditiously with their plans to ensure full compliance with Global Forum's standards for transparency and exchange of information for tax purposes.

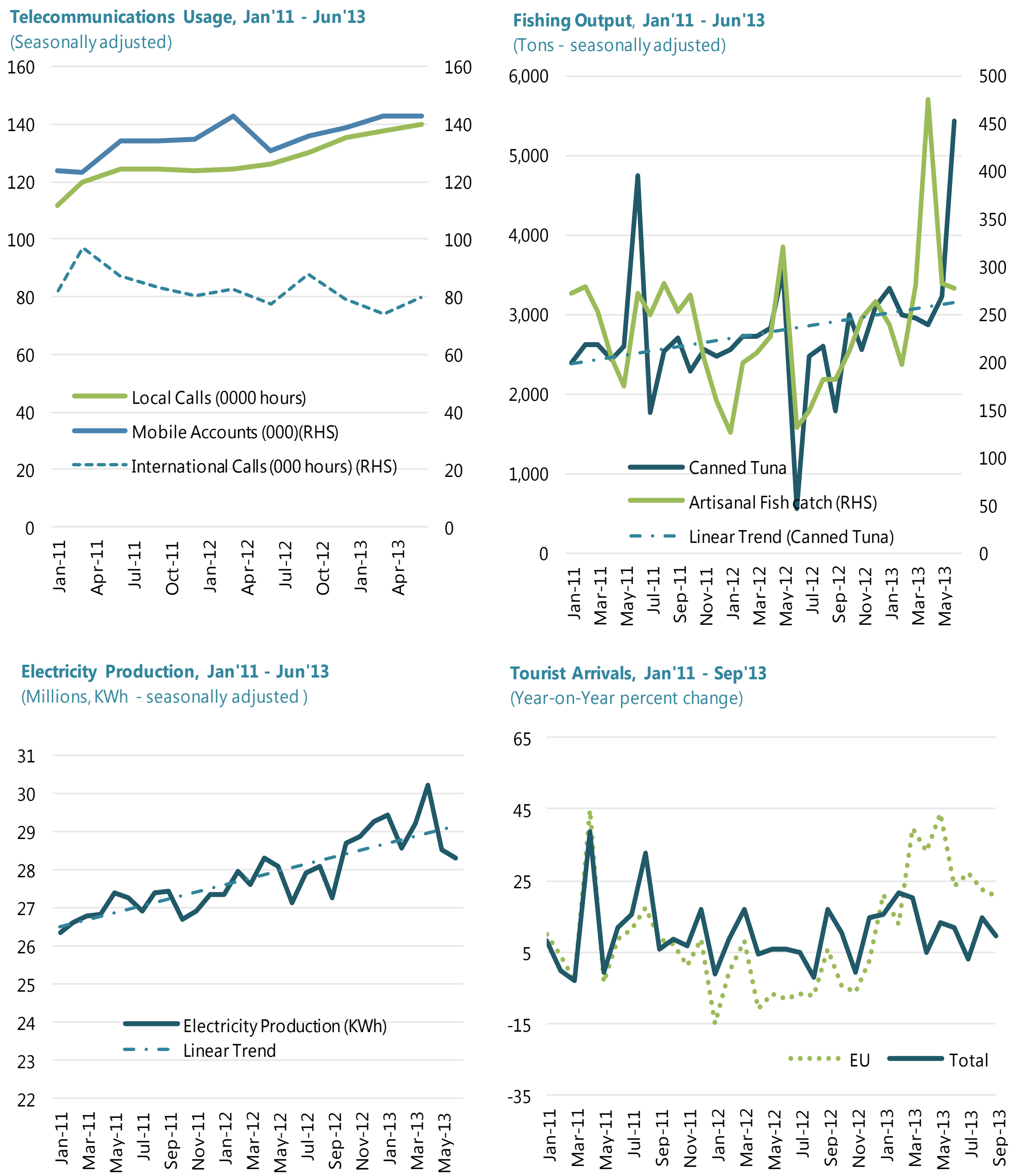
29. In view of the good performance under the program, staff recommends the completion of the Eighth review under the Extended Arrangement and the associated purchase of an amount equivalent to SDR 3.3 million.

Figure 1. Seychelles: Macroeconomic Development and Projections



Source: Seychelles authorities and IMF staff estimates

Figure 2. Seychelles: Monthly Indicators of Economic Activity



Source: Seychelles authorities and IMF staff estimates

Table 1. Seychelles: Selected Economic and Financial Indicators, 2011–18

	2011	2012	2013		2014	2015	2016	2017	2018
		Est.	Prog.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
National income and prices	(Percentage change, unless otherwise indicated)								
Nominal GDP (millions of Seychelles rupees)	13,119	14,145	15,292	15,288	16,544	17,731	18,974	20,286	21,667
Real GDP	5.0	2.9	3.3	3.5	3.7	3.8	3.6	3.6	3.5
CPI (annual average)	2.6	7.1	4.5	4.5	4.2	3.5	3.0	3.0	3.0
CPI (end-of-period)	5.5	5.8	4.3	4.5	4.3	3.0	3.0	3.0	3.0
GDP deflator average	6.4	4.8	4.6	4.4	4.4	3.3	3.3	3.2	3.2
Money and credit	(Percentage change, unless otherwise indicated)								
Credit to the private sector	5.2	8.5	14.0	4.7	5.7	...	...	...	...
Broad money	4.5	-0.6	0.1	16.3	8.2	...	...	...	...
Reserve money	-2.7	6.9	12.3	26.0	13.9	...	...	...	...
Velocity (GDP/broad money)	1.7	1.9	2.1	1.7	1.7	...	...	...	...
Money multiplier (broad money/reserve money)	4.5	4.2	3.6	3.8	3.6	...	...	...	...
Savings-Investment balance	(Percent of GDP)								
External savings	27.0	27.1	23.2	22.6	19.5	17.8	16.6	14.6	12.8
Gross national savings	8.1	11.9	15.1	14.5	14.9	14.4	15.0	15.0	17.1
Of which: government savings	10.6	14.4	12.1	9.4	8.0	8.0	8.6	9.0	9.3
Gross investment	35.1	39.0	38.2	37.1	34.5	32.2	31.5	29.6	29.9
Of which: government investment	8.1	12.0	9.2	8.1	6.5	6.2	6.5	6.6	7.4
Government budget									
Total revenue, excluding grants	35.8	37.6	36.4	36.3	34.6	34.8	35.0	35.1	35.2
Expenditure and net lending	35.7	40.2	38.5	38.1	36.0	35.1	34.8	34.3	34.5
Current expenditure	27.6	28.8	28.8	30.1	29.2	28.6	28.0	27.6	27.3
Capital expenditure and net lending	8.1	11.4	9.8	8.1	6.8	6.5	6.8	6.7	7.1
Overall balance, including grants	2.5	2.4	1.8	1.0	0.9	1.2	1.5	2.0	1.9
Primary balance	5.4	6.2	5.1	5.2	4.4	4.4	4.4	4.6	4.3
Total public debt	74.3	84.8	72.0	71.6	69.0	64.4	59.4	54.0	48.8
Domestic [1]	28.0	35.2	25.7	28.6	26.7	24.2	22.1	20.5	18.6
External	46.2	49.6	46.3	43.0	42.4	40.3	37.3	33.6	30.2
External sector	(Percent of GDP, unless otherwise indicated)								
Current account balance including official transfers	-27.0	-27.1	-23.2	-22.6	-19.5	-17.8	-16.6	-14.6	-12.8
Total public external debt outstanding (millions of U.S. dollars)	490	512	558	545	571	572	561	535	510
(percent of GDP)	46.2	49.6	46.3	43.0	42.4	40.3	37.3	33.6	30.2
Terms of trade (= - deterioration)	-6.2	-0.5	0.6	0.9	1.4	1.5	1.3	1.2	1.0
Real effective exchange rate (average, percent change)	-7.4	-1.0	...	...	...	...	...	...	...
Gross official reserves (end of year, millions of U.S. dollars)	277	307	317	400	436	436	436	436	436
Months of imports, c.i.f.	2.8	3.0	2.7	3.7	3.9	3.7	3.6	3.5	3.3
Exchange rate									
Seychelles rupees per US$1 (end of period)	13.7	13.0	...	...	...	...	...	...	...
Seychelles rupees per US$1 (period average)	12.4	13.7	...	...	...	...	...	...	...

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

[1] Includes debt issued by the Ministry of Finance for monetary purposes.

Table 2. Seychelles: Balance of Payments, 2010–18

	2010	2011	2012	2013		2014	2015	2016	2017	2018
			Est.	Prog. [5]	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
	(Millions of U.S. dollars)									
Current account	-217	-286	-280	-279	-286	-263	-252	-249	-233	-217
(percent of GDP)	-22.2	-27.0	-27.1	-23.2	-22.6	-19.5	-17.8	-16.6	-14.6	-12.8
Balance of goods and services	-207	-219	-240	-251	-214	-202	-183	-168	-152	-133
Exports of goods	400	477	497	505	547	534	558	580	606	634
Of which: oil re-exports	158	194	201	196	204	207	210	214	217	222
Of which: tuna exports	210	242	249	269	312	302	321	337	357	376
Imports of goods	-781	-915	-967	-976	-1,011	-1,057	-1,102	-1,139	-1,174	-1,221
Of which: oil imports	-219	-255	-301	-307	-305	-326	-338	-345	-353	-362
FDI-related	-120	-88	-97	-120	-96	-89	-88	-88	-88	-87
grants- and loans-related	-46	-80	-127	-97	-99	-94	-67	-58	-64	-64
other	-396	-492	-442	-452	-511	-548	-609	-648	-670	-708
Exports of services	441	470	435	632	471	553	602	650	698	748
Of which: tourism earnings	274	291	310	331	344	379	411	446	482	521
Imports of services	-266	-251	-205	-412	-221	-232	-241	-259	-282	-295
Income, net	-14	-73	-63	-48	-74	-65	-55	-64	-63	-62
Of which: interest due [1]	-32	-22	-25	-22	-30	-21	-22	-23	-22	-21
transfers of profits and dividends	-6	-21	-18	-12	-15	-19	-19	-20	-20	-21
Current transfers, net	5	6	24	20	2	3	-13	-16	-18	-21
Of which: general government, net	26	29	55	20	39	41	26	24	24	24
Capital and financial account	500	180	317	289	377	303	255	253	239	223
Capital account	275	61	64	40	24	21	14	12	20	20
Of which: debt forgiveness	267	0	0	0	0	0	0	0	0	0
Financial account	224	119	253	249	354	281	241	241	219	203
Direct investment, net	154	110	150	174	138	111	109	109	108	108
Portfolio investment, net [1]	10	-48	-7	33	41	45	43	39	39	39
Other investment, net	61	57	110	42	175	125	89	93	71	56
Government and government-guaranteed	2	5	10	32	22	27	-4	-13	-26	-24
Disbursements	32	7	21	48	36	43	22	22	19	19
Project loans	4	7	14	31	19	26	22	22	19	19
Program loans	28	0	7	17	17	17	0	0	0	0
Amortization	-46	-10	-9	-16	-14	-16	-25	-35	-45	-42
Private sector [2]	-27	18	45	26	118	77	93	108	87	76
Net errors and omissions	-14	115	-14	0	0	0	0	0	0	0
Overall balance	269	9	24	10	91	39	3	4	6	6
Financing	-269	-9	-24	-10	-91	-39	-3	-4	-6	-6
Change in net international reserves (increase:	-45	-17	-25	-10	-91	-39	-3	-4	-6	-6
Change in gross official reserves (increase:	-58	-23	-31	-12	-93	-35	0	0	0	0
Liabilities to IMF, net	13	6	5	2	2	-4	-3	-4	-6	-7
Other net foreign assets (increase: –)	10	0	0	0	0	0	0	0	0	0
Exceptional financing	-234	8	1	0	0	0	0	0	0	0
Financing gap	0	0	0	0	0	0	0	0	0	0
Memorandum items:										
Exports G&S growth, percent	-1.1	12.7	-1.6	4.4	9.1	6.8	6.7	6.1	6.0	6.0
Tourism growth, percent	7.0	6.1	6.6	6.7	11.0	9.9	8.5	8.5	8.1	8.1
Imports G&S growth, percent	5.7	11.3	0.5	5.1	5.1	4.6	4.2	4.1	4.1	4.1
Exports G&S, percent of GDP	86	89	90	94	80	81	82	82	82	82
Imports G&S, percent of GDP	108	110	114	115	97	96	95	93	91	90
FDI, percent of GDP	15.8	10.4	14.6	14.4	10.9	8.2	7.7	7.2	6.8	6.4
Gross international reserves (stock, e.o.p.)	254	277	307	317	400	436	436	436	436	436
Of which: program definition[3]	238	254	277	289	370	405	405	406	406	405
(Months of imports of goods & services)	2.6	2.8	3.0	2.7	3.7	3.9	3.7	3.6	3.5	3.3
Scheduled public external debt service	72	22	22	35	28	30	33	43	50	46
(Percent of exports of goods & services)	8.6	2.3	2.4	3.1	2.8	2.8	2.9	3.5	3.8	3.3
Public and publicly guaranteed external debt [4]	478	490	512	558	545	571	572	561	535	510
(Percent of GDP)	49.1	46.2	49.6	46.3	43.0	42.4	40.3	37.3	33.6	30.2
GDP	973	1,060	1,032	1,205	1,267	1,348	1,420	1,504	1,594	1,689

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 are available.

[3] Excludes foreign-currency denominated required reserves held by banks and project and blocked accounts at the CBS.

[4] Includes outstanding IMF credit.

[5] Program numbers (for 2013) based on old BOP compilation. See Annex 2 for more details.

Table 3. Seychelles: Consolidated Government Operations, 2011–16 [1]

	2011	2012	2013								2014	2015	2016
			Q1		Q2		Q3		Q4				
			Prog.	Act.	Prog.	Act.	Prog.	Prel.	Prog.	Proj.	Proj.	Proj.	Proj.
	(Millions of Seychelles rupees; cumulative from the start of the year)												
Total revenue and grants	5014	6024	1444	1121	2972	2601	4509	4060	6172	5979	6110	6437	6891
Total revenue	4695	5322	1220	1051	2620	2513	4041	3903	5566	5556	5716	6169	6643
Tax	4165	4600	1042	896	2206	2212	3516	3436	4897	4715	5051	5457	5883
Personal income tax	612	702	184	160	380	361	566	549	764	766	858	919	985
Social security tax	…	…	…	…	…	…	…	…	…	…	…	…	…
Trade tax	421	401	101	87	204	187	314	326	433	395	198	213	230
Excise tax	727	726	175	151	362	325	548	454	751	650	831	929	996
Goods and services tax (GST) / VAT [2]	1208	1465	334	340	687	777	1108	1183	1564	1631	1643	1773	1934
Business tax	893	816	164	126	394	459	703	676	935	919	989	1052	1126
Other	304	491	84	31	180	103	277	248	450	355	533	571	611
Nontax	530	722	179	155	414	302	525	467	670	842	666	712	760
Fees and charges	306	398	81	73	150	134	219	210	275	291	267	287	307
Dividends from parastatals	161	266	85	70	241	147	266	208	330	433	226	240	255
Other	63	58	13	12	24	20	41	49	64	118	173	185	198
External grants	319	702	224	70	352	87	468	157	605	422	394	268	248
Expenditure and net lending	4689	5682	1413	1106	2804	2416	4224	3764	5893	5831	5957	6226	6602
Current expenditure	3620	3992	1030	953	2027	1991	3093	3088	4323	4541	4787	5022	5258
Primary current expenditure	3236	3452	884	738	1772	1693	2694	2619	3817	3900	4219	4450	4709
Wages and salaries	891	998	281	260	561	537	843	817	1129	1121	1261	1350	1431
Goods and services	999	1134	220	205	493	503	789	813	1212	1270	1275	1339	1405
Transfers	1330	1298	365	265	696	635	1037	960	1448	1479	1655	1741	1859
Social program of central government	266	290	76	60	164	136	253	221	355	330	358	384	411
Transfers to public sector from central government	727	660	195	114	343	309	500	434	715	708	767	778	816
Benefits and programs of Social Security Fund	338	348	95	92	189	190	284	305	378	441	530	580	632
Other	15	23	18	7	23	18	26	28	28	30	28	20	14
Interest due	384	540	146	215	254	297	399	470	506	641	568	572	549
Foreign interest	137	174	64	74	90	97	153	156	178	185	171	193	211
Domestic interest	247	366	82	141	164	200	246	314	328	456	397	379	338
Capital expenditure	1060	1613	368	131	622	385	921	619	1339	1185	1021	1049	1189
Domestically financed	743	872	84	55	211	280	402	436	689	687	615	704	827
Foreign financed	318	741	284	76	412	105	519	183	650	498	406	346	362
Net lending	9	-6	-3	-1	110	0	149	0	157	48	99	105	105
o/w lending to PUC for investment in water/sanitation	…	…	…	…	110	0	149	0	157	55	118	118	118
Contingency	0	83	19	25	45	41	60	56	75	58	50	50	50
Primary balance	709	882	176	229	422	482	684	766	785	789	721	782	838
Overall balance, commitment basis [3]	325	342	31	14	168	185	285	296	279	148	153	211	289
Change in arrears	16	0	0	0	0	0	0	0	0	0	0	0	0
Change in float	-217	0	0	0	0	0	0	0	0	0	0	0	0
Overall balance, cash basis (after grants)	124	343	31	14	168	185	285	296	279	148	153	211	289
Financing	-124	-343	-31	-14	-168	-185	-285	-296	-279	-148	-153	-211	-289
Foreign financing	2	53	42	-11	119	-62	192	-78	405	261	241	-120	-205
Disbursements	83	168	60	6	208	10	299	10	609	432	437	198	235
Project loans	83	79	60	0	208	4	299	4	393	227	228	198	235
Program/budget support	0	89	0	6	0	6	0	6	216	205	209	0	0
Scheduled amortization	-126	-121	-18	-17	-89	-72	-106	-88	-203	-171	-196	-318	-441
Change in amortization arrears	44	6	0	0	0	0	0	0	0	0	0	0	0
Domestic financing, net [4]	-177	-493	-91	-81	-322	-110	-530	-233	-754	-434	-458	-129	-84
Bank financing	-181	-642	-82	7	-290	64	-477	190	-679	-391	-413	-116	-75
CBS	45	-1194	0	-64	0	-219	0	82	0	-325	-500	-32	-21
Commercial banks	-226	552	-82	71	-290	283	-477	108	-679	-65	87	-84	-54
Nonbank financing	4	148	-9	-88	-32	-174	-53	-423	-75	-43	-46	-13	-8
Privatization and long-term lease of fixed assets	99	84	18	7	35	34	53	45	70	55	65	38	0
Statistical discrepancy	-47	14	0	71	0	-48	0	-30	0	-30	0	0	0
Fiscal financing gap	0	0	0	0	0	0	0	0	0	0	0	0	0
Memorandum item:													
Pension Fund contribution	67	105	26	29	51	62	77	108	102	138	188	199	210
Pension Fund benefits payment	78	100	26	33	53	67	79	100	105	133	140	146	153
Pension Fund operating expenses	…	…	5	9	12	15	17	21	23	28	28	29	30
External debt service due	263	294	82	91	179	169	260	244	382	356	367	511	652

Sources: Seychelles authorities and IMF staff estimates and projections.

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

[2] VAT replaced GST in January 2013.

[3] Only interest payments on foreign debt are on a commitment basis. Other expenditures are recorded when checks are issued or transfers initiated.

[4] Includes one-off operations in 2011: repayment of recently recognized domestic obligation (SR 90 million) and the increase in IMF quota (SR 10 million).

Table 3. Seychelles: Consolidated Government Operations, 2011–16 [1] (concluded)

	2011	2012	2013 Q1		2013 Q2		2013 Q3		2013 Q4		2014	2015	2016
			Prog.	Act.	Prog.	Act.	Prog.	Prel.	Prog.	Proj.	Proj.	Proj.	Proj.
	(Percent of GDP; cumulative from the start of the year)												
Total revenue and grants	38.2	42.6	9.4	7.3	19.4	17.0	29.5	26.6	40.4	39.1	36.9	36.3	36.3
Total revenue	35.8	37.6	8.0	6.9	17.1	16.4	26.4	25.5	36.4	36.3	34.6	34.8	35.0
Tax	31.8	32.5	6.8	5.9	14.4	14.5	23.0	22.5	32.0	30.8	30.5	30.8	31.0
Personal income tax	4.7	5.0	1.2	1.0	2.5	2.4	3.7	3.6	5.0	5.0	5.2	5.2	5.2
Social security tax	…	…	…	…	…	…	…	…	…	…	…	…	…
Trade tax	3.2	2.8	0.7	0.6	1.3	1.2	2.1	2.1	2.8	2.6	1.2	1.2	1.2
Excise tax	5.5	5.1	1.1	1.0	2.4	2.1	3.6	3.0	4.9	4.3	5.0	5.2	5.3
Goods and services tax (GST) / VAT [2]	9.2	10.4	2.2	2.2	4.5	5.1	7.2	7.7	10.2	10.7	9.9	10.0	10.2
Business tax	6.8	5.8	1.1	0.8	2.6	3.0	4.6	4.4	6.1	6.0	6.0	5.9	5.9
Other	2.3	3.5	0.5	0.2	1.2	0.7	1.8	1.6	2.9	2.3	3.2	3.2	3.2
Nontax	4.0	5.1	1.2	1.0	2.7	2.0	3.4	3.1	4.4	5.5	4.0	4.0	4.0
Fees and charges	2.3	2.8	0.5	0.5	1.0	0.9	1.4	1.4	1.8	1.9	1.6	1.6	1.6
Dividends from parastatals	1.2	1.9	0.6	0.5	1.6	1.0	1.7	1.4	2.2	2.8	1.4	1.4	1.3
Other	0.5	0.4	0.1	0.1	0.2	0.1	0.3	0.3	0.4	0.8	1.0	1.0	1.0
External grants	2.4	5.0	1.5	0.5	2.3	0.6	3.1	1.0	4.0	2.8	2.4	1.5	1.3
Expenditure and net lending	35.7	40.2	9.2	7.2	18.3	15.8	27.6	24.6	38.5	38.1	36.0	35.1	34.8
Current expenditure	27.6	28.2	6.7	6.2	13.3	13.0	20.2	20.2	28.3	29.7	28.9	28.3	27.7
Primary current expenditure	24.7	24.4	5.8	4.8	11.6	11.1	17.6	17.1	25.0	25.5	25.5	25.1	24.8
Wages and salaries	6.8	7.1	1.8	1.7	3.7	3.5	5.5	5.3	7.4	7.3	7.6	7.6	7.5
Goods and services	7.6	8.0	1.4	1.3	3.2	3.3	5.2	5.3	7.9	8.3	7.7	7.6	7.4
Transfers	10.1	9.2	2.4	1.7	4.6	4.2	6.8	6.3	9.5	9.7	10.0	9.8	9.8
Social program of central government	2.0	2.0	0.5	0.4	1.1	0.9	1.7	1.4	2.3	2.2	2.2	2.2	2.2
Transfers to public sector from central government	5.5	4.7	1.3	0.7	2.2	2.0	3.3	2.8	4.7	4.6	4.6	4.4	4.3
Benefits and programs of Social Security Fund	2.6	2.5	0.6	0.6	1.2	1.2	1.9	2.0	2.5	2.9	3.2	3.3	3.3
Other	0.1	0.2	0.1	0.0	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.1	0.1
Interest due	2.9	3.8	1.0	1.4	1.7	1.9	2.6	3.1	3.3	4.2	3.4	3.2	2.9
Foreign interest	1.0	1.2	0.4	0.5	0.6	0.6	1.0	1.0	1.2	1.2	1.0	1.1	1.1
Domestic interest	1.9	2.6	0.5	0.9	1.1	1.3	1.6	2.1	2.1	3.0	2.4	2.1	1.8
Capital expenditure	8.1	11.4	2.4	0.9	4.1	2.5	6.0	4.1	8.8	7.7	6.2	5.9	6.3
Domestically financed	5.7	6.2	0.5	0.4	1.4	1.8	2.6	2.9	4.5	4.5	3.7	4.0	4.4
Foreign financed	2.4	5.2	1.9	0.5	2.7	0.7	3.4	1.2	4.2	3.3	2.5	1.9	1.9
Net lending	0.1	0.0	0.0	0.0	0.7	0.0	1.0	0.0	1.0	0.3	0.6	0.6	0.6
o/w lending to PUC for investment in water/sanitation	…	…	…	…	0.7	0.0	1.0	0.0	1.0	0.4	0.7	0.7	0.6
Contingency	0.0	0.6	0.1	0.2	0.3	0.3	0.4	0.4	0.5	0.4	0.3	0.3	0.3
Primary balance	5.4	6.2	1.2	1.5	2.8	3.2	4.5	5.0	5.1	5.2	4.4	4.4	4.4
Overall balance, commitment basis [3]	2.5	2.4	0.2	0.1	1.1	1.2	1.9	1.9	1.8	1.0	0.9	1.2	1.5
Change in arrears	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Change in float	-1.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance, cash basis (after grants)	0.9	2.4	0.2	0.1	1.1	1.2	1.9	1.9	1.8	1.0	0.9	1.2	1.5
Financing	-0.9	-2.4	-0.2	-0.1	-1.1	-1.2	-1.9	-1.9	-1.8	-1.0	-0.9	-1.2	-1.5
Foreign financing	0.0	0.4	0.3	-0.1	0.8	-0.4	1.3	-0.5	2.7	1.7	1.5	-0.7	-1.1
Disbursements	0.6	1.2	0.4	0.0	1.4	0.1	2.0	0.1	4.0	2.8	2.6	1.1	1.2
Project loans	0.6	0.6	0.4	0.0	1.4	0.0	2.0	0.0	2.6	1.5	1.4	1.1	1.2
Program/budget support	0.0	0.6	0.0	0.0	0.0	0.0	0.0	0.0	1.4	1.3	1.3	0.0	0.0
Scheduled amortization	-1.0	-0.9	-0.1	-0.1	-0.6	-0.5	-0.7	-0.6	-1.3	-1.1	-1.2	-1.8	-2.3
Change in amortization arrears	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic financing, net [4]	-1.3	-3.5	-0.6	-0.5	-2.1	-0.7	-3.5	-1.5	-4.9	-2.8	-2.8	-0.7	-0.4
Bank financing	-1.4	-4.5	-0.5	0.0	-1.9	0.4	-3.1	1.2	-4.4	-2.6	-2.5	-0.7	-0.4
CBS	0.3	-8.4	0.0	-0.4	0.0	-1.4	0.0	0.5	0.0	-2.1	-3.0	-0.2	-0.1
Commercial banks	-1.7	3.9	-0.5	0.5	-1.9	1.9	-3.1	0.7	-4.4	-0.4	0.5	-0.5	-0.3
Nonbank	0.0	1.0	-0.1	-0.6	-0.2	-1.1	-0.3	-2.8	-0.5	-0.3	-0.3	-0.1	0.0
Privatization and long-term lease of fixed assets	0.8	0.6	0.1	0.0	0.2	0.2	0.3	0.3	0.5	0.4	0.4	0.2	0.0
Statistical discrepancy	-0.4	0.1	0.0	0.5	0.0	-0.3	0.0	-0.2	0.0	-0.2	0.0	0.0	0.0
Memorandum items:													
Nominal GDP (millions of Seychelles Rupees)	13,119	14,145	15,292	15,288	15,292	15,288	15,292	15,288	15,292	15,288	16,544	17,731	18,974
Pension Fund contribution	0.5	0.7	0.2	0.2	0.3	0.4	0.5	0.7	0.7	0.9	1.1	1.1	1.1
Pension Fund benefits payment	0.6	0.7	0.2	0.2	0.3	0.4	0.5	0.7	0.7	0.9	0.8	0.8	0.8
Pension Fund operating expenses	…	…	0.0	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.2
Public domestic debt (% GDP) [5]	28.0	35.2	30.1	32.2	28.6	33.1	27.2	29.3	25.7	28.6	26.7	24.2	22.1
Excluding t-bills issued for monetary purposes	…	28.5	25.1	25.4	23.5	26.1	22.2	24.3	25.7	23.5	19.0	17.0	15.4
Publicly guaranteed domestic debt (% GDP)	2.4	2.2	0.0	0.0	1.2	1.2	1.2	1.2	1.2	1.2	1.0	0.3	0.2

Sources: Seychelles authorities and IMF staff estimates and projections.

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

[2] VAT replaced GST in January 2013.

[3] Only interest payments on foreign debt are on a commitment basis. Other expenditures are recorded when checks are issued or transfers initiated.

[4] Includes one-off operations in 2011: repayment of recently recognized domestic obligation (SR 90 million) and the increase in IMF quota (SR 10 million).

[5] Includes debt issued by the Ministry of Finance for monetary purposes.

Table 4. Seychelles: Monetary Survey and Central Bank Accounts, 2010–14

	2010	2011	2012	2013								2014
				Mar.		Jun.		Sep.		Dec.		
				Prog.	Act.	Prog.	Act.	Prog.	Act.	Prog.	Proj.	
	(Millions of Seychelles rupees)											
Monetary survey												
Net foreign assets	3,644	4,450	5,297	5,172	4,814	5,235	5,593	5,309	6,520	5,474	6,737	7,635
Central bank	2,709	3,303	3,434	3,378	3,215	3,377	3,575	3,386	4,188	3,495	4,334	4,917
Deposit money banks	935	1,147	1,863	1,794	1,599	1,858	2,018	1,923	2,332	1,979	2,403	2,718
Net domestic assets	3,622	3,145	2,257	2,238	2,859	2,051	2,795	2,007	2,154	1,952	2,049	1,873
Domestic credit	5,652	5,657	5,295	5,118	5,361	4,970	5,454	4,951	5,701	4,900	5,188	4,969
Net claims on the government	2,567	2,380	1,786	1,704	2,028	1,496	2,143	1,309	2,271	1,107	1,691	1,278
Credit to the economy	3,085	3,277	3,510	3,414	3,333	3,474	3,310	3,643	3,430	3,793	3,497	3,691
Of which: credit to the private sector	2,861	3,011	3,266	3,171	3,232	3,230	3,226	3,399	3,351	3,550	3,419	3,613
Other items, net	-2,029	-2,511	-3,039	-2,880	-2,501	-2,919	-2,658	-2,944	-3,547	-2,948	-3,139	-3,097
Broad money	7,266	7,596	7,554	7,410	7,674	7,286	8,389	7,316	8,674	7,426	8,786	9,508
Currency in circulation	580	623	629	678	618	688	627	699	662	709	734	795
Foreign currency deposits	1,708	2,406	2,441	2,437	2,492	2,427	2,785	2,282	2,718	2,281	2,940	3,178
Local currency deposits	4,979	4,566	4,484	4,296	4,563	4,171	4,977	4,335	5,294	4,435	5,112	5,536
Central bank												
Net foreign assets	2,709	3,303	3,434	3,378	3,215	3,377	3,575	3,386	4,188	3,495	4,334	4,917
Foreign assets	3,087	3,800	3,972	3,881	3,671	3,922	4,075	3,908	4,678	4,052	4,863	5,411
Foreign liabilities	379	497	538	504	456	545	499	522	490	557	529	493
Net domestic assets	-962	-1,604	-1,617	-1,428	-1,336	-1,397	-1,691	-1,376	-2,266	-1,455	-2,046	-2,312
Domestic credit	-506	-883	-1,113	-1,036	-1,110	-967	-1,541	-920	-1,911	-976	-1,676	-1,929
Government (net)	780	835	-358	-358	-422	-358	-577	-358	-277	-358	-684	-1,184
Commercial banks	-1,135	-1,512	-636	-559	-553	-490	-867	-443	-1,501	-499	-858	-611
Other (parastatals)	-151	-206	-119	-119	-134	-119	-96	-119	-134	-119	-134	-134
Other items, net	-456	-721	-504	-392	-226	-431	-150	-456	-355	-479	-370	-383
Reserve money	1,746	1,699	1,816	1,950	1,879	1,980	1,884	2,010	1,921	2,040	2,288	2,606
Currency in circulation	580	623	629	678	618	688	627	699	662	709	734	795
Commercial bank reserves (includes cash in vault)	1,166	1,075	1,187	1,272	1,261	1,292	1,257	1,311	1,259	1,331	1,554	1,811
Of which: vault cash	74	84	110	…	103	…	112	…	126	…	140	151
Of which: excess reserves (excl. bank vault cash)	355	-10	59	…	130	…	32	…	-65	…	250	400
Of which: required reserves in foreign currency [1, 2]	193	322	350	348	315	357	361	365	367	372	382	413
required reserves in domestic currency [2]	545	679	667	704	713	688	752	709	832	722	782	847
Memorandum items:												
Gross international reserves (millions of U.S. dollars) [3]	254	277	307	309	315	310	343	307	389	317	400	436
Foreign currency deposits (millions of U.S. dollars)	141	175	188	194	215	192	234	179	227	178	242	256
Broad money growth (12–month percent change)	13.5	4.5	-0.6	-5.2	-3.4	-7.5	4.9	0.5	17.0	0.1	16.3	8.2
Credit to the private sector (12–month percent change)	23.6	5.2	8.5	4.0	1.7	6.8	2.5	11.1	4.9	14.0	4.7	5.7
Reserve money (12–month percent change)	34.7	-2.7	6.9	11.5	7.4	13.5	8.0	18.8	13.5	12.3	26.0	13.9
Money multiplier (broad money/reserve money)	4.2	4.5	4.2	3.8	4.1	3.7	4.5	3.6	4.5	3.6	3.8	3.6
Velocity (GDP/broad money; end of period)	1.6	1.7	1.9	2.1	2.0	2.1	1.8	2.1	1.8	2.1	1.7	1.7

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

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

[2] Reserve requirements were lowered from 13% to 10% in 2009, but raised back to 13% in April 2011.

[3] The definition was revised in June 2011 to include foreign-currency denominated required reserves held by banks and project and blocked accounts at the CBS.

Table 5. Seychelles: Financial Soundness Indicators for the Banking Sector, 2009–13 [1]

	2009				2010				2011				2012				2013	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
	(Percent, end of period)																	
Capital adequacy																		
Regulatory capital to risk weighted assets	13.6	17.8	22.0	21.7	21.4	22.1	21.7	21.5	23.3	24.8	26.3	24.2	24.9	25.9	26.2	26.7	26.9	26.0
Regulatory tier 1 capital to risk weighted assets	12.9	17.1	21.3	21.0	20.7	21.5	21.1	20.8	16.8	21.0	21.1	17.3	18.1	21.6	19.9	19.3	18.6	22.0
Capital to assets (net worth)	9.6	8.7	9.7	9.9	9.3	8.7	9.1	9.2	9.3	9.6	10.1	9.0	9.1	9.5	9.8	10.3	10.4	9.8
Net tangible capitalization [2]	9.6	8.7	9.8	9.9	9.4	8.8	9.1	9.3	9.4	9.7	10.2	9.1	9.3	9.6	9.9	10.4	10.5	9.9
Asset quality																		
Foreign exchange loans to total loans	50.5	43.0	41.1	37.2	34.3	29.7	27.8	25.5	23.7	20.1	18.5	18.4	20.9	20.0	17.9	18.7	17.8	17.1
Nonperforming loans to gross loans	2.3	4.3	4.2	3.8	4.1	6.9	6.4	5.5	5.4	5.6	5.3	8.1	8.3	9.2	8.3	9.3	9.6	9.5
Provisions as percentage of nonperforming loans	56.8	35.2	32.6	33.8	41.7	26.0	26.0	31.4	30.9	37.3	40.4	33.8	33.9	32.1	33.3	29.5	37.0	37.3
Provisions as percentage of total loans	1.3	1.5	1.4	1.3	1.7	1.8	1.7	1.7	1.7	2.1	2.2	2.7	2.8	3.0	2.7	2.7	3.5	3.5
Earnings and profitability																		
Return on assets (annualized)	5.3	3.0	-0.2	3.2	3.4	5.0	3.0	3.7	3.9	3.1	3.6	5.6	3.5	3.9	4.2	3.1	2.3	3.3
Return on equity (annualized)	55.1	35.4	-2.8	32.4	33.6	54.3	33.7	40.0	40.8	32.6	36.4	61.6	38.3	40.8	41.3	29.8	22.2	33.7
Interest margin to gross income	62.1	83.7	105.5	68.6	56.5	60.2	59.9	50.6	46.8	56.3	61.6	55.8	52.8	57.5	64.6	62.7	84.7	61.1
Noninterest expense to gross income	36.4	48.7	116.5	49.1	44.0	52.0	47.6	39.9	46.7	49.3	46.4	22.3	44.0	40.7	39.0	56.6	56.6	45.4
Net interest margin (annualized) [3]	5.1	4.8	4.2	4.0	3.1	3.6	3.4	3.1	3.0	3.5	4.2	3.9	3.6	3.5	3.9	4.1	4.3	3.9
Net noninterest margin (annualized) [4]	0.1	-1.9	-4.9	-1.0	0.0	-0.7	-0.4	0.6	0.4	-0.3	-0.5	1.5	0.3	0.2	0.1	0.0	-1.3	-0.6
Expense to income	52.3	62.2	111.2	58.0	53.0	58.0	53.6	46.6	50.8	53.6	50.1	28.5	44.7	45.4	45.4	46.4	57.0	52.1
Interest expense to gross income	33.2	35.8	47.1	21.2	19.0	14.2	12.8	12.5	8.5	9.3	7.4	8.7	9.3	9.7	10.9	11.8	20.0	17.0
Liquidity																		
Core liquid assets to total assets [5]	36.0	35.0	37.7	43.2	43.5	44.7	44.7	46.9	47.1	47.1	47.7	49.9	49.6	48.6	47.9	39.6	38.9	39.5
Broad liquid assets to total assets [6]	50.8	53.0	57.6	58.4	58.6	60.0	58.1	58.9	56.6	55.7	57.0	58.8	59.3	57.9	59.6	52.0	52.2	53.3
Liquid assets (broad) to short term liabilities	53.2	56.2	62.1	62.7	65.0	63.4	62.1	62.9	60.0	58.8	60.9	63.0	65.4	64.6	66.6	58.1	58.6	59.5
Liquid assets (broad) to total liabilities	56.2	58.0	63.8	64.7	64.7	65.7	63.8	64.9	62.4	61.6	63.4	64.7	65.3	64.0	66.1	58.0	58.2	59.1
Liquid assets to deposit liabilities	63.1	63.8	71.4	69.4	72.4	72.0	69.1	69.1	65.5	64.5	68.7	71.0	70.9	69.7	71.0	62.5	62.6	63.1
Foreign exchange exposure																		
Net open foreign exchange position to capital	44.4	32.4	21.9	33.1	22.2	24.7	29.2	5.6	3.8	2.2	1.5	1.9	2.9	-3.9	-0.8	7.9	6.8	-0.6

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: Schedule of Reviews and Purchases Under the Extended Arrangement, 2009–13

Program Review	Date of availability	Conditions	Amount (Millions of SDR)	Amount (Percent of quota)
	December 23, 2009	Board approval of the Extended Arrangement	0.88	8.1
	March 15, 2010	Compliance with end-December 2009 quantitative performance criteria and completion of a financing assurances review (if needed)	2.20	20.2
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	20.2
	September 15, 2010	Compliance with end-June 2010 quantitative performance criteria and completion of a financing assurances review (if needed)	2.20	20.2
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	16.1
Third	March 31, 2011	Compliance with end-December 2010 quantitative performance criteria and completion of a financing assurances review (if needed)	3.52	32.3
Fourth	September 30, 2011	Compliance with end-June 2011 quantitative performance criteria and completion of a financing assurances review (if needed)	3.08	28.3
Fifth	March 31, 2012	Compliance with end-December 2011 quantitative performance criteria and completion of a financing assurances review (if needed)	2.64	24.2
Sixth	September 30, 2012	Compliance with end-June 2012 quantitative performance criteria	1.32	12.1
Seventh	March 31, 2013	Compliance with end-December 2012 quantitative performance criteria	3.30	30.3
Eighth	September 30, 2013	Compliance with end-June 2013 quantitative performance criteria	3.30	30.3
Total			**26.4**	**242.3**

Table 7. Seychelles: Indicators of Fund Credit, 2008-21

(in millions of SDR)

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Existing Fund credit														
Stock [1]	6.2	11.9	20.2	23.8	27.2	25.2	22.8	20.9	18.3	14.8	10.9	7.1	3.5	1.5
Obligation	0.0	0.1	0.2	0.3	3.9	5.5	2.6	2.1	2.8	3.8	4.0	4.0	3.6	2.1
Principal (repayments/repurchases)	0.0	0.0	0.0	0.0	3.6	5.3	2.3	1.8	2.6	3.6	3.9	3.9	3.5	2.0
Charges and interest	0.0	0.1	0.2	0.3	0.3	0.3	0.3	0.2	0.2	0.2	0.2	0.1	0.1	0.0
Disbursements	6.2	5.7	8.4	3.5	7.0	3.3	...	...	...	...	...	...	...	...
Projected EFF														
Disbursement						3.3	...	...	...	...	...			
Stock [1,2]						3.3	3.3	3.3	3.3	3.3	2.8	2.2	1.7	1.1
Obligations [3]						0.0	0.0	0.0	0.0	0.0	0.6	0.6	0.6	0.6
Principal (repayments/repurchases)						0.0	0.0	0.0	0.0	0.0	0.6	0.6	0.6	0.6
Charges and interest						0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Stock of existing and prospective Fund credit [1, 2]	6.2	11.9	20.2	23.8	27.4	28.5	26.1	24.2	21.6	18.1	13.7	9.3	5.2	2.6
In percent of quota	70.0	135.0	230.0	218.0	251.3	261.4	239.2	222.4	198.4	165.7	125.3	85.0	47.6	24.0
In percent of GDP	1.0	2.2	3.2	3.5	4.1	3.4	2.9	2.6	2.2	1.7	1.3	0.8	0.4	0.2
In percent of exports of goods and services	1.0	2.2	3.7	3.9	4.5	4.2	3.6	3.2	2.7	2.1	1.5	1.0	0.6	0.3
In percent of gross reserves	12.9	9.6	12.2	13.3	13.7	10.8	9.1	8.5	7.6	6.4	4.9	3.1	1.6	0.7
Obligations to the Fund from existing and prospective Fund arrangements														
Disbursements	6.2	5.7	8.4	3.5	7.0	6.6	...	...	...	...	...	...	...	...
Obligations	0.0	0.1	0.2	0.3	3.9	5.6	2.6	2.1	2.9	3.8	4.6	4.5	4.2	2.6
Principal (repayments/repurchases)	0.0	0.0	0.0	0.0	3.6	5.3	2.3	1.8	2.6	3.6	4.4	4.4	4.1	2.6
Charges and interest	0.0	0.1	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.2	0.2	0.1	0.1	0.1
In percent of quota	0.3	0.9	2.0	2.8	36.0	51.0	23.9	19.4	26.2	34.9	42.0	41.7	38.2	24.0
In percent of GDP	0.0	0.0	0.0	0.0	0.6	0.7	0.3	0.2	0.3	0.4	0.4	0.4	0.3	0.2
In percent of exports of goods and services	0.0	0.0	0.0	0.1	0.6	0.8	0.4	0.3	0.4	0.5	0.5	0.5	0.4	0.3
In percent of gross reserves	0.1	0.1	0.1	0.2	2.0	2.1	0.9	0.7	1.0	1.3	1.6	1.5	1.3	0.7

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

[1] End of period.

[2] Assumes a disbursement of SDR 3.3 million in December 2013 following review of June 2013 test date.

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

APPENDIX I: Letter of intent

November 26, 2013

Christine Lagarde
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Madam Lagarde:

Significant progress has been achieved under the EFF program, which was approved by the IMF Executive Board on December 23, 2009. During the four year program, we have restored and maintained macroeconomic stability, improved debt sustainability outlook, and made considerable progress with structural reforms to strengthen public institutions and support private sector led growth.

In 2013 growth is estimated to reach 3.5 percent, supported by a strong performance of the tourism sector. We have achieved a strong increase in central bank gross official reserves, which by December 2013 are expected to reach 3.7 months of imports coverage. FDI continues to be buoyant. Inflation was contained at a projected average of 4.5 percent in 2013, underpinned by a strengthening of the exchange rate.

On the fiscal front we attained the primary surplus target of end-June and we are on track to reach a primary surplus of 5.2 percent of GDP by end-December, higher than the 5.1 percent program target. (The program's quantitative Performance Criteria and Indicative Targets, as described in the Technical Memorandum of Understanding and structural benchmarks are set out in Tables 1 and 2). The objective of a revenue-to-GDP ratio of 36.4 percent under the program is also expected to be broadly achieved. Expenditure is broadly in line with the program. As a result of the significant budgetary primary surpluses, we have reduced public debt from 84.7 percent in 2012 to a projected 71.6 percent in 2013.

We remain strongly committed to our structural reform agenda and completed all the policy measures identified as structural benchmarks in the program. The Value Added Tax was satisfactorily implemented in January 2013 despite a few teething problems. To ensure the financial viability of the state-owned utility company, we introduced quarterly automatic adjustment of utility tariffs in July and began implementing a tariff rebalancing exercise in November. Reforms in Public Finance Management are also on track, and we have started the piloting phase on Program Performance Based Budgeting. As part of our financial sector reforms, our National Assembly enacted the Financial Leasing Bill in October.

We met all our monetary policy objectives under the program in 2013. The net international reserves targets were exceeded by wide margins. The Central Bank of Seychelles (CBS) took advantage of strong foreign exchange inflows to rebuild the reserve buffer. Quarterly reserve money targets were also all met, contributing to stable inflation and exchange rates.

We remain strongly committed to maintaining macroeconomic stability through financial and fiscal discipline, particularly to attain our objective of bringing down the public debt to a more sustainable level of 50 percent of GDP by 2018. Our draft budget for 2014 targets a primary surplus of 4.4 percent of GDP (SR 721 million): excluding the net lending to the Public Utilities Corporation for investment to meet pressing water needs, the primary surplus would be equivalent to 5 percent. We will continue to gradually privatize non-strategic state enterprises and we intend to use proceeds to strengthen our capital budget. Moreover, primary current spending is projected to remain stable as a percentage of GDP in order to help protect investment spending, while still meeting our fiscal targets. Rebalancing civil service wages will result in a slight increase in the public wage-to-GDP ratio next year, but we intend to keep this ratio stable over the medium term. Monetary policy will continue to support stable inflation, gradual reserve accumulation, and an exchange rate that is generally stable and adjusts in line with economic fundamentals.

Monetary policy implementation by the central bank under the current monetary targeting framework has become more flexible and takes into consideration broader macroeconomic conditions. With the objective to improve the transmission mechanism and achieve interest rate stability, CBS targets banks' reserves which should improve liquidity management and pricing, as well as support the development of a benchmark yield curve.

Monetary policy discussions and decisions are to be elevated to the Board level and communicated to the general public on a quarterly basis. In addition, the imperative for coordination between monetary and fiscal policies is to continue to address the prevailing liquidity overhang.

CBS has also identified several challenges and constraints limiting financial sector development in Seychelles. To address this, the Bank with the support of other stakeholders has successfully secured funding and technical assistance from the FIRST Initiative to help develop a Secured Lending and Collateral Registry as well as a Financial Sector Development Strategy. The implementation of the Secured Lending System and Collateral Registry will permit financial institutions to expand their lending products against movable collateral, such as inventory, thus enabling enterprises to increased access to finance. This project will also support the recently approved Financial Leasing Bill, which will enhance competition in the financial sector.

The Financial Sector Development Strategy project will also assist CBS and other national agencies/authorities to adopt a coherent vision and strategy for local financial sector development including a clear and prioritized roadmap of actions and measures to contribute towards a sound, efficient and inclusive financial sector.

While significant progress has been achieved under the EFF supported program, we believe that a successor program would help provide policy continuity, anchor inflation as the monetary policy framework evolves, and further build buffers (particularly reducing public debt and raising reserves levels). On the structural front, it would support continuation of reforms underway, improve economic governance and transparency, financial sector deepening, and measures for sustained and inclusive economic growth. The new program would also facilitate dialogue with our international partners and contribute to strengthen investor confidence. We initiated discussions with the Fund staff at the time of the mission for the eighth review and will continue the discussions early next year.

Following the present arrangement, and as long as Seychelles has outstanding financial obligations to the IMF, we will maintain a close policy dialogue with the Fund and stand ready to take additional measures, as appropriate, to ensure the achievement of our objectives associated with the EFF-supported program. We will continue to consult with the Fund on the adoption of measures, and in advance of revisions of the policies contained in the LOI, in accordance with the Fund's policies on such consultation. We will also provide the Fund with information it requests for monitoring implementation.

Based on our performance under the program, we request that the IMF Executive Board complete the eighth review of the EFF-supported program and approve the associated disbursement of SDR 3.3 million.

We authorize the IMF to publish this Letter of Intent and its attachments, as well as the accompanying staff report.

Sincerely yours,

/s/

Pierre Laporte
Minister of Finance, Trade and Investment
Republic of Seychelles

/s/

Caroline Abel
Governor
Central Bank of Seychelles

Appendix 1. Table 1. Quantitative Performance Criteria Under the Extended Arrangement, 2013

	2013													
	March				June				September				December	
	Indicative Target	Adjusted	Actual (prog rate)	Actual (market rate)	Performance Criteria	Adjusted	Actual (prog rate)	Actual (market rate)	Indicative Target	Adjusted	Actual (prog rate)	Actual (market rate)	Projected (7th review)	Projected (new)
	(Millions of Seychelles rupees; end-of-period)													
Performance criteria														
Net international reserves of the CBS, millions of U.S. dollars (floor) [1]	227	227	243	243	236	238	269	266	234	235	300	300	241	312
Reserve money (ceiling)	1,950	...	1,879	...	1,980	...	1,884	...	2,010	...	1,921	...	2,040	2,288
Primary balance of the consolidated government (cumulative floor) [2]	136	...	229	...	412	...	482	...	684	...	766	...	785	789
Contracting or guaranteeing of new external debt by the public sector (Millions of U.S. dollars; cumulative ceiling) [2]	25	...	...	...	40	...	3	...	55	...	7	...	55	54
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
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
Accumulation of domestic payment arrears by the government (ceiling)	0.0	...	0.0	...	0.0	...	0.0	...	0.0	...	0.0	...	0.0	0.0
Memorandum items:														
Net external non-project financing (millions of U.S. dollars; cumulative) [2, 4]	-2.0	...	-2.0	...	-15.3	...	-13.9	...	-17.4	...	-16.4	...	-12.2	-10.3
External budget loans	0.0	...	0.0	...	0.0	...	0.0	...	0.0	...	0.0	...	17.0	17.0
Cash payments on foreign debt service	2.0	...	2.0	...	15.3	...	13.9	...	17.4	...	16.4	...	32.1	30.2
External budget grants	0.0	...	0.0	...	0.0	...	0.0	...	0.0	...	0.0	...	2.9	2.9
Program accounting exchange rates														
SR/US$ (end-of-quarter)	13.02	...	13.02	11.59	12.80	...	12.80	11.90	12.80	...	12.80	...	12.80	...
US$/Euro (end-of-quarter)	1.29	...	1.29	1.28	1.36	...	1.36	1.30	1.36	...	1.36	...	1.36	...
US$/UK pound (end-of-quarter)	1.62	...	1.62	1.52	1.59	...	1.59	1.52	1.59	...	1.59	...	1.59	...
US$/AUD (end-of-quarter)	1.04	...	1.04	1.04	1.04	...	1.04	0.91	1.04	...	1.04	...	1.04	...
US$/SDR (end-of-quarter)	1.54	...	1.54	1.50	1.54	...	1.54	1.50	1.54	...	1.54	...	1.54	...

Sources: Seychelles authorities and IMF staff estimates and projections.

[1] The NIR floor is adjusted as defined in the TMU.

[2] Cumulative net flows from the beginning of the calendar year; includes external non-project loans and cash grants net of external debt service payments.

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

[4] Includes external non-project loans and cash grants net of external debt service payments.

Appendix 1. Table 2. Structural Benchmarks, June 2012–13

Measure	Target Date	Macroeconomic Rationale	Status
Commission and complete a study on optimal tariffs for utilities (4th Review MEFP, ¶51).	End-June 2012	To ensure cost recovery and long-term sustainability of utilities.	Met. Final version received October 2012.
Cabinet approval of the Public Sector Investment Program to be used for the 2013 budget planning (4th Review MEFP, ¶28).	End-September 2012	To improve efficiency of public finance management and planning in capital investments by costing capital projects over the entirety of their implementation phase.	Met.
Implementation of Electronic Clearing House system (5th Review MEFP, ¶38).	End-September 2012	To improve transmission of monetary policy and reduce cost of financial transactions.	Met.
Introduce VAT.	January 1, 2013	To modernize the tax system and remove tax distortions.	Met.
Cabinet approval of the action plan to rebalance utility tariffs.	End-March 2013	To ensure cost recovery and long-term sustainability of utilities.	Met.
Cabinet approval of Financial Instructions and Accounting Manuals in line with new PFM Act and IPSAS standards (6th Review MEFP, ¶27).	End-June 2013	To improve efficiency of public finance management.	Met. Approved in November.
Approval of Leasing Bill by National Assembly (6th Review MEFP, ¶35).	End-June 2013	To improve access to credit.	Met. Approved in October.
Implement the first step of the utilities tariffs rebalancing (6th Review MEFP, ¶11).	July 1, 2013	To ensure long-term financial sustainability of utilities.	Met. Implemented in November.

ANNEX I: Relations with the Fund

(As of October 31, 2013)

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

B. General Resources Account	SDR Million	% Quota
Quota	10.90	100.0
Fund holdings of currency	36.72	336.86
Reserve Position in Fund	0.53	4.85

C. SDR Department	SDR Million	% Allocations
Net cumulative allocation	8.28	100.0
Holdings	6.21	75.01

D. Outstanding Purchases and

Loans:	SDR Million	% Quota
Stand-by Arrangement	3.25	29.77
Extended Arrangement	23.10	211.93

E. Financial Arrangements:

			SDR Million	
Type	Date of Arrangement	Expiration Date	Amount Approved	Amount Drawn
EFF	Dec 23, 2009	Dec. 22, 2013	26.40	23.10
Stand-By	Nov 14, 2008	Dec. 22, 2009	17.60	11.00

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

	Forthcoming				
	2013	**2014**	**2015**	**2016**	**2017**
Principal	1.27	2.31	1.83	2.60	3.57
Charges/interest	0.07	0.27	0.24	0.22	0.19
Total	1.34	2.58	2.08	2.83	3.77

G. Implementation of HIPC Initiative: Not applicable

H. Safeguards Assessments:

The Central Bank of Seychelles (CBS) was subject to a safeguards assessment with respect to the Stand-By Arrangement for Seychelles. The original assessment completed in 2008 found high risks in all areas of the CBS's safeguards framework, and several measures were included in the program. Two updated assessments related to the Extended Fund Facility (completed in July 2010 and in October 2013) found significant improvements and that the authorities had implemented most of the measures recommended in earlier assessments. In particular, the governance structure at the CBS has been strengthened, and accountability and transparency continue to be robust. Areas for further development include the internal audit procedures and capacity.

I. Exchange Rate Arrangement:

The exchange market was liberalized in November 2008, which resulted in the elimination of all 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 October 31, 2013 US$ 1 = SR 12.05 (mid rate).

J. Article IV Consultations:

Seychelles is currently under a 24 month consultation cycle.

K. Technical Assistance (2011–November 2013):

Department	Head of Mission	Subject	Date
STA	Ms. Razin	External Sector Statistics	January 2011
MCM	Mr. Sullivan	Central Bank Financial Reporting and Risk Management	February 2011
FAD	Mr. Kloeden	Tax Reform	February 2011
STA	Mr. Jones	Government Finance Statistics	March 2011
MCM	Mr. Bartholomew	Central Bank Capacity Building	April 2011
STA	Ms. Winston	Producer Price/Industrial Production Indices	April 2011
FAD	Mr. Ljungman	PFM Legal Framework	August 2011
STA	Ms. Razin	External Sector Statistics	January 2012
MCM	Ms. Radzewicz-Bak	Central Bank Capacity Building	March 2012

Department	Head of Mission	Subject	Date
AFS	Mr. Helis	PFM Regulatory Framework	March 2012
MCM	Mr. Robotham	Payments System	April 2012
FAD	Mr. Kloeden	Tax Reform	April 2012
FAD	Mr. Gillan	Customs administration	May 2012
AFS	Mr. Panda	Basel I compliance	June 2012
AFS	Mr. Ramachandran	PFM: Financial Management Information Systems and Chart of Accounts	June 2012
FAD	Ms. Penfold	Revenue Commission training function	June 2012
AFS	Mr. Mendes	Customs administration	July 2012
AFS	Mr. Hughes	Quarterly national accounts	September 2012
FAD	Mr. Le Leuch	Oil taxation regime	November 2012
MCM	Mr. Lutton	Bank Supervision/Risk Monitoring	November 2012
MCM	Mr. Robotham	Payment Systems	December 2012
MCM	Mr. Kovanen	FOREX and Monetary Operations	February 2013
STA	Ms. Razin	External Sector Statistics	April 2013
MCM	Mr. van der Wansem	Medium Term Debt Strategy	October 2013

L. Resident Representative: None

ANNEX II: Note on Revisions to Balance of Payments Data

The Balance of Payments Division of the IMF's Statistics Department (STA) has provided significant technical assistance in external sector statistics (ESS) to the Central Bank of Seychelles (CBS) in the course of 2013. As a result, the methodology for calculating a number of the series has been revised, resulting in a large number of changes to the balance of payments. Also, with STA's assistance, a number of new data sources have been employed that significantly improved the coverage of the ESS. Staff are working further with the authorities to assess these revisions and adjust projections as a result.[1] However, it should be noted that despite occasionally significant changes in levels, the broad outlines of the balance of payments' evolution are expected to remain unchanged.

The key methodological changes involve:

- **Imports of goods**: revised as a result of refining the methodology for converting from c.i.f. to f.o.b. basis.

- **Financial service debits and credits**: the data had been incorrectly compiled including financial flows rather than payments for financial intermediation. Data has been zeroed out given that the flows are expected to be very small, pending introduction of a survey which can collect the actual data.

- **Travel services**: revised to include data from foreign exchange bureaux (previously they had been estimated only on the basis of General Sales Tax paid by tourism service providers).

- **Construction services**: estimates of construction services have been reduced reflecting the dominance of domestic firms in the construction industry.

- **Compensation of employees**: estimation method revised based on data received from the Ministry of Labor and Human Resource Development on number of foreign workers registered in Seychelles and from construction and tuna cannery of payments and remittances of their employees.

- **Investment income**: revised to reflect new data on dividends paid and on reinvested earnings based on data from the income statement and from the surveys reported by the direct investment entities.

- **FDI:** FDI calculations have been revised to reflect revisions to the loan/equity component of investments and refinements to the calculations of reinvested earnings. The coverage has been significantly improved by including data on investment by nonresidents in real estate and on investment in oil exploration.

- **Trade credit and advances:** revised based on data from the financial statements of enterprises.

[1] Projections are further complicated by temporary disruptions to trade data stemming from a software change at the customs service.

INTERNATIONAL MONETARY FUND

COMMUNICATIONS DEPARTMENT

Press Release No. 13/530
FOR IMMEDIATE RELEASE
December 19, 2013

International Monetary Fund
Washington, D.C. 20431 USA

IMF Completes the Eighth and Final Review Under the Extended Fund Facility (EFF) for Seychelles

On December 19, 2013, the Executive Board of the International Monetary Fund (IMF) completed the eighth and final review under the Extended Fund Facility (EFF)[1] for Seychelles. The Executive Board's decision was taken on a lapse-of-time basis.[2] The completion of the review enables a disbursement of SDR 3.3 million (about US$5.1 million), which will bring total disbursements under the arrangement to SDR 26.4 million (about US$ 40.7 million).

The EFF was approved in December 2009 for an amount of SDR 19.8 million (see Press Release No. 09/472) and was extended by one year in 2012, with an augmentation of access of SDR 6.6 million (about US$10.0 million).

Strong policies have fostered economic growth, brightening Seychelles' near-term outlook. A robust rise in tourism earnings in 2013 supported growth, as well as a reduction in the current account deficit as a share of GDP. The exchange rate strengthened slightly, at the same time as the central bank accumulated more international reserves than expected. Inflation decelerated below 5 percent, and the government is on track to achieve its 5 percent of GDP primary surplus target, as a shortfall in tax revenue and grants

[1] The Extended Fund Facility under the Extended Arrangement is an instrument of the IMF designed for countries facing serious medium-term balance of payments problems because of structural weaknesses that require time to address. Assistance under the extended facility features longer program engagement—to help countries implement medium-term structural reforms—and a longer repayment period. (See http://www.imf.org/external/np/exr/facts/eff.htm). Details on Seychelles' arrangement are available at www.imf.org/seychelles

[2] The Executive Board takes decisions under its lapse-of-time procedure when the Board agrees that a proposal can be considered without convening formal discussions.

has been offset by lower-than-anticipated capital expenditure. All performance criteria under the EFF for end-June 2013 were met, as were the third quarter indicative targets. The measures in the structural benchmarks were also all completed, although there were short delays compared to initial plans for technical reasons.

The authorities' macroeconomic policy framework for 2014 provides a solid basis to continue to reinforce external and fiscal sustainability. The authorities remain on track with their objective to reduce public debt below 50 percent of GDP by 2018, while increasing allocations to address social needs. Monetary policy will continue to aim to stabilize inflation at low levels and to accumulate international reserves, and the authorities and staff agreed on the need to strengthen the monetary policy framework to improve the transmission mechanism. Structural reforms aim to extend improvements in financial discipline to the broader public sector, including through rebalancing utility prices to reduce implicit subsidies and through better oversight of parastatals, which staff stressed was key to avoiding potential future losses and ensuring better focus on their core mandates. Financial sector reforms seek to increase access to credit.

With the completion of this review, the EFF arrangement comes to an end. The program's key objective of placing the economy firmly on the path to external and fiscal sustainability has been achieved, based on the successful implementation of the debt restructuring, robust fiscal consolidation, and the resumption of growth. Public debt has been brought down from 124 percent of GDP at end-2009 to an estimated 71 percent at the end of 2013, reflecting an average primary surplus of over 6 percent of GDP and growth of 3½ percent. Inflation has fallen below 5 percent. External reserves, a vital buffer for such an open economy, have improved from just over 2 months of imports at the start of the program to over 3½ months at the end of 2013.

While substantial progress has been achieved under the current Extended Fund Facility (EFF), the economy faces continuing vulnerabilities from still high debt levels, low reserve coverage, and an unfinished reform process. The authorities indicated their intention to request a successor arrangement with the IMF to consolidate and extend the progress made during this EFF. Discussions on a possible successor arrangement will continue early next year.