INTERNATIONAL MONETARY FUND

IMF Country Report No. 15/201

SEYCHELLES

July 2015

2015 ARTICLE IV CONSULTATION, SECOND REVIEW UNDER THE EXTENDED ARRANGEMENT, AND REQUEST FOR WAIVER AND MODIFICATION OF PERFORMANCE CRITERIA—PRESS RELEASES; STAFF REPORT; STAFF STATEMENT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR SEYCHELLES

In the context of the Staff Report for the 2015 Article IV Consultation, Second Review Under the Extended Arrangement, and Request for Waiver and Modification of Performance Criteria, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board and summarizing the views of the Executive Board as expressed during its June 17, 2015 consideration of the staff report on issues related to the Article IV Consultation and the IMF arrangement.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on June 17, 2015, following discussions that ended on March 26, 2015, with the officials of Seychelles on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on May 26, 2015.
- An **Informational Annex** prepared by the IMF staff.
- A **Staff Statement** of June 17, 2015 updating information on recent developments.
- A **Statement by the Executive Director** for Seychelles.

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

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

*Also included in Staff Report

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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Press Release No. 15/294
FOR IMMEDIATE RELEASE
June 23, 2015

IMF Executive Board Concludes 2015 Article IV Consultation with Seychelles

On June 17, 2015, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Seychelles.

Macroeconomic outcomes remain solid, and most of the external pressures experienced in 2014 have abated. Weakness in the main exports combined with strong domestic demand in 2014 led to depreciation pressures on the exchange rate. Beginning in late 2014, tighter monetary policy, a recovery in tourism, and falling global fuel prices, together with the effects of the depreciation on imports, helped to contain the external pressures. The combination of spending discipline and buoyant fiscal revenues—driven by strong imports—resulted in a primary surplus of over 4½ percent of GDP in 2014, exceeding the target. However, disappointing tourism arrivals ensured that growth remained subdued in 2014. Financial sector soundness indicators remain in the comfortable range; the Central Bank of Seychelles had to take management control of a small off-shore bank in October 2014 after it lost its correspondent relationship, but there should be no significant repercussions on Seychelles' economy.

With a continuing recovery in tourism and the effect of lower fuel prices, projected growth for 2015 is slightly higher than earlier envisaged at 3½ percent; the exchange rate has recovered modestly against the dollar. The depreciation began to pass through to inflation, reaching 4.0 percent in May 2015 (year-on-year). The large current account deficit in 2014 is expected to contract sharply in 2015, helped by monetary policy tightening and lower fuel prices. In addition to a decline in FDI-related imports, import demand will be restrained by the depreciation, continued tight monetary policy, and a tight public sector wage round.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

Executive Board Assessment[2]

Executive Directors agreed with the thrust of the staff appraisal. They commended the authorities for the strong implementation of their Fund supported economic program, notwithstanding a difficult external environment. The growth outlook is favorable, but the economy remains vulnerable to global developments while domestic risks are linked to state owned enterprises. Against this background, Directors underscored the importance of continued sound policies and structural reforms to strengthen macroeconomic and financial stability, build policy buffers, and foster sustained and inclusive growth.

Directors welcomed the authorities' commitment to reducing public debt below 50 percent of GDP by 2018. They observed, however, that achieving this target while continuing to address critical infrastructure needs will require improving revenue mobilization and spending efficiency in the context of a sound medium term budget framework.

Directors considered that the authorities' tight monetary stance has been appropriate in light of the recent external pressures and the rapid credit growth. Noting the risks to financial and macroeconomic stability that continued credit expansion would entail, Directors welcomed the authorities' commitment to develop macro prudential tools and stressed the need for a determined implementation of reforms in this area.

Directors welcomed plans to develop a more forward looking monetary policy framework, based on liquidity and inflation forecasting and a strong coordination with the fiscal authorities. Directors encouraged the authorities to further strengthen international reserves while maintaining appropriate exchange rate flexibility, which has served the economy well.

Directors noted that the fragile financial situation of some state owned enterprises represents a significant fiscal risk. Accordingly, they encouraged the authorities to push ahead with their strategy to strengthen governance and performance of public enterprises. Directors also stressed that any new expansions of state owned enterprise operations or mandates should be carefully vetted and based on a strong and clear rationale for public sector involvement.

Directors agreed that further reforms are necessary to promote a dynamic private sector. They supported measures to further improve the business and investment climate, including by opening up key sectors so far protected from competition. Addressing skills mismatches in the labor market remains an important policy priority.

Directors welcomed Seychelles' subscription to the IMF's Special Data Dissemination Standard and its recent accession to the World Trade Organization.

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[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

Seychelles: Selected Economic and Financial Indicators, 2012–18

		2013	2014		2015		2016	2017	2018
	Prel.	Est.	1st Rev.	Est.	1st Rev.	Proj.	Proj.	Proj.	Proj.
National income and prices									
Nominal GDP (millions of Seychelles rupees)	15,544	17,015	18,342	18,133	19,539	19,168	20,434	21,796	23,233
Real GDP	6.6	6.0	2.8	3.3	3.0	3.5	3.7	3.6	3.5
CPI (annual average)	7.1	4.3	2.3	1.4	5.2	4.3	2.9	3.0	3.0
CPI (end-of-period)	5.8	3.4	4.8	0.5	2.5	4.9	3.8	2.5	3.3
GDP deflator average	10.5	3.2	2.5	3.1	3.4	2.1	2.8	3.0	3.0
Money and credit									
Broad money	-0.6	23.7	12.0	17.5	5.3	5.7	...	...	...
Reserve money (end of period)	6.9	15.4	16.5	13.9	5.6	8.0	...	...	...
Reserve money (average of last quarter)	...	...	-17.4	-14.5	5.6	2.1	...	...	...
Velocity (GDP/broad money)	2.1	1.8	1.8	1.7	1.8	1.7	...	...	...
Money multiplier (broad money/reserve money)	4.2	4.5	4.3	4.6	4.3	4.5	...	...	...
Credit to the private sector	8.5	4.5	15.2	25.2	3.3	12.4	...	...	...
Savings-Investment balance									
External savings	19.9	11.5	22.5	21.0	20.5	15.2	14.6	15.0	13.6
Gross national savings	17.5	26.5	14.7	16.3	15.2	18.6	19.4	18.6	18.7
Of which: government savings	8.6	5.2	6.1	6.6	6.1	5.4	7.5	7.9	9.5
Gross investment	37.4	37.9	37.2	37.3	35.8	33.7	34.1	33.5	32.3
Of which: public investment [1]	10.4	8.9	6.2	6.3	6.8	6.7	6.8	6.6	7.0
Government budget									
Total revenue, excluding grants	34.2	31.9	31.6	32.4	31.0	31.6	31.4	31.3	31.4
Expenditure and net lending	36.1	36.0	32.3	32.7	32.6	33.6	32.0	31.6	31.2
Current expenditure	25.7	26.7	26.1	26.5	25.8	26.8	25.3	24.9	24.2
Capital expenditure [1]	10.4	9.3	6.2	6.3	6.8	6.7	6.8	6.6	7.0
Overall balance, including grants	2.2	0.3	2.1	2.0	0.3	0.3	1.2	1.4	1.5
Program primary balance	5.7	4.6	4.3	4.6	3.7	3.8	3.8	3.8	3.8
Total public debt	77.1	64.1	64.9	65.3	62.3	63.7	59.5	54.7	49.9
Domestic [2]	32.0	27.2	28.2	29.9	23.8	25.1	23.0	20.5	17.1
External	45.1	36.9	36.7	35.5	38.5	38.6	36.5	34.3	32.8
External sector									
Current account balance including official transfers	-19.9	-11.5	-22.5	-21.0	-20.5	-15.2	-14.6	-15.0	-13.6
Total external debt outstanding (millions of U.S. dollars) [3]	1,556	1,583	...	1,670	...	1,788	1,881	2,010	2,123
(percent of GDP)	137	112	...	117	...	130	128	129	129
Terms of trade (-=deterioration)	-0.1	-0.2	-0.6	2.0	0.8	12.0	-3.4	-1.5	-0.6
Real effective exchange rate (average, percent change)	-0.8	17.9	0.0	-2.8	...	...	...	...	...
Gross official reserves (end of year, millions of U.S. dollars)	307	425	452	463	453	463	476	505	521
Months of imports, c.i.f.	2.8	3.7	4.1	4.6	4.0	4.3	4.2	4.3	4.2
Exchange rate									
Seychelles rupees per US$1 (end of period)	13.0	12.1	13.3	14.0	...	...	...	...	...
Seychelles rupees per US$1 (period average)	13.7	12.1	12.6	12.7	...	...	...	...	...

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

[1] Includes onlending to the parastatals for investment purposes.

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

[3] Includes private external debt.

INTERNATIONAL MONETARY FUND

COMMUNICATIONS DEPARTMENT

Press Release No. 15/280
FOR IMMEDIATE RELEASE
June 17, 2015

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IMF Executive Board Completes Second Review Under the EFF with Seychelles and Approves US$2.3 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) completed today the second review of the arrangement under the Extended Fund Facility (EFF) with Seychelles. The completion of the review enables the disbursement of an amount equivalent to SDR 1.635 million (about US$2.3 million) bringing the total disbursements to SDR 4.905 million (about US$6.9 million).

In completing the review, the Executive Board also approved the authorities' request for waiver and modification of performance criteria. The 36-month, SDR 11.445 million arrangement under the EFF (about US$16.1 million, the equivalent of 105 percent of Seychelles' quota) was approved by the Executive Board in June 2014 (see Press Release No. 14/262.).

Following the Executive Board's discussion, Mr. Min Zhu, Deputy Managing Director and Acting Chair issued the following statement:

"Sound macroeconomic management has strengthened the Seychelles' economy significantly. The near-term growth outlook is favorable and prospects in the tourism sector remain strong, with noticeable gains in both traditional and non-traditional markets.

"Policies have aimed at reinforcing resilience and entrenching macroeconomic stability. The authorities remain on track to achieve their objective of reducing the debt burden below 50 percent of GDP by 2018. Balancing this objective with the need to address critical infrastructure needs will require tight control of current expenditure and improved governance and financial performance of state-owned enterprises. Further progress in building international reserves has ensured an effective buffer against external pressures.

"The authorities should continue to improve the forward-looking elements of their monetary policy framework, including inflation forecasting and liquidity management. The exchange rate should continue to be allowed to adjust freely to changes in the economic external and internal conditions.

"To support sustained and inclusive growth, structural reforms should aim to increase the role for the private sector in the economy and enhance competition. In this regard, caution should be exercised in expanding the roles and mandates of public enterprises. Accession to the World Trade Organization is welcome, while further improvements in the business climate should aim to make growth more inclusive by broadening access to credit, enhancing infrastructure, and reducing skills mismatches in the labor market."

SEYCHELLES

May 26, 2015

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION, SECOND REVIEW UNDER THE EXTENDED ARRANGEMENT, AND REQUEST FOR WAIVER AND MODIFICATION OF PERFORMANCE CRITERIA

KEY ISSUES

Context: The robust recovery from the 2008 balance of payments and debt crisis has resulted in improved economic and social outcomes. Continued policy discipline and reforms are needed for the microstate to mitigate its geographical and population constraints and maintain momentum in developing a diversified and resilient economy.

Focus: With the fiscal stance anchored by the authorities' debt reduction objective, macroeconomic discussions concentrated on the smooth functioning of monetary and exchange rate policies. On the structural agenda, the dialogue focused on policies to promote sustained and inclusive growth, particularly on the appropriate role for state-owned enterprises (SOEs).

Review: The program is on track. The authorities met the end-December quantitative performance criteria except for narrowly exceeding the ceiling on reserve money. The structural agenda remains broadly on track despite some delays. Staff recommends completion of the second review under the Extended Arrangement and modification of the performance criteria for end-June and end-December 2015, and supports the authorities' request for a waiver for the end-December 2014 performance criterion for reserve money.

Outlook and risks: With the external position having stabilized since the last review, fundamentals are strengthening. However, the economy remains highly vulnerable to global developments, including weakness in the key European markets, while domestic risks center on the role of the SOEs.

Recommendations: The authorities' objective of reducing public debt below 50 percent of GDP by 2018 remains an appropriate and attainable anchor for fiscal policy. The monetary policy framework should be further enhanced by increasing its forward orientation in the context of a flexible exchange rate. Structural measures should focus on fostering inclusiveness and private sector-led growth, while improving economic governance and the focus of SOEs.

Data: Data provision is broadly adequate for surveillance. Priority areas include improved GDP statistics, strengthening external sector statistics, and extending coverage of the international investment position.

Approved by
David Robinson and Luis Cubeddu

Discussions were held in Victoria during March 11-26, 2014. The staff team comprised Mr. Mills (head), Messrs. Dallari, Jammeh, Roy, and Thornton (all AFR). The mission met the President, Vice President, Finance Minister, Governor of the Central Bank, other senior officials, banks, private sector representatives, civil society, and parliamentarians.
The three-year Extended Arrangement under the Extended Fund Facility (EFF) for SDR 11.445 million (105 percent of quota) expires on June 4, 2017. The program aims to bolster the foundations for sustained and inclusive growth, while addressing remaining vulnerabilities.

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CONTEXT: MICROSTATE RECOVERING FROM CRISIS

1. **Seychelles is an upper middle-income country—the smallest in sub-Saharan Africa—successfully rebuilding resilience following a debt crisis in 2008-09.**[1] Per capita income has risen over time, bringing it close to the World Bank threshold for high income status. However, income inequality also appears to be high (as measured by the Gini coefficient).[2] At the same time, absolute poverty appears to be low,[3] and most economic and social indicators compare well to other microstates and advanced small island economies. In the aftermath of the 2008 balance of payments and debt crisis, the authorities enacted an extensive set of reforms that quickly restored fiscal and monetary credibility, with external support and Paris Club debt restructuring, and reduced the role of the state in the economy. Historically, growth has been driven largely by capital accumulation, with significant productivity gains evident primarily since 2008, when the reforms began (Annex 6).

Text Table 1: Selected Indicators in Small States
(2014 or latest available year)

	Bahamas	Barbados	Fiji	Maldives	Mauritius	Singapore	Seychelles
GDP per Capita (USD)	24,014	15,311	4,712	7,030	9,715	56,113	15,887
Real GDP growth (average 2004-2014)	1	1	2	7	4	6	5
Human Development Index	0.789	0.776	0.724	0.698	0.771	0.901	0.756
Public debt (as a percentage of GDP)	56	98	51	83	54	105	64
Current account balance (as a percentage of GDP)	-16.6	-8.8	-10.2	-19.6	-9.2	17.6	-21.0
Adult Literacy Rate	96	100	94	98	89	96	92
Life expectancy (years)	75	75	70	78	74	82	73
Infant mortality (per 1,000 live births)	10	13	20	8	13	2	12

Sources: World Development Indicators, UNDP, IMF staff estimates

2. **Presidential elections are due by May 2016**. Elections have been freely contested since the 1990s, although the ruling party candidate for president has won each election. In February 2015, President Michel announced his candidacy for re-election to a third and final term. Despite a cabinet reshuffle in January, the authorities have stressed continuity in economic policy, particularly the commitment to macroeconomic stability and the EFF-supported program.

3. **The authorities' policies have largely aligned with advice from previous Article IV consultations.** Fiscal policy has been appropriately tight to support continued reduction of the public debt, monetary and exchange rate policies have allowed for an increase in the build-up of foreign reserves, and Fund advice on mopping up the structural excess liquidity in the banking system has been followed, supporting an evolving and more forward-looking monetary policy framework. Structural reforms have also been implemented to improve the management of the public enterprises, including the introduction of a Public Enterprise Monitoring Commission (PEMC).

[1] Seychelles is a micro-state (i.e., population less than 200,000). While the overall area is 455 km^2, the population and economic activity are concentrated on three mostly mountainous islands totaling 203 km^2, comparable to the size of Washington, DC (177 km^2).

[2] The 2006/7 household survey measured the Gini of income inequality at 65.8 percent: while the results from the 2013 household survey are still being analyzed, they are also expected to yield a relatively high level.

[3] Only 0.25 percent of the population was living on $1.25 or less a day in 2007. This measure may not be well adapted to Seychelles and the World Bank is assisting the authorities in estimating a poverty line using the 2013 household survey.

However, further progress is needed in implementation of the Public Financial Management Act, particularly ensuring that all public enterprises submit audited accounts by end-March of the following year.

RECENT DEVELOPMENTS, OUTLOOK AND SPILLOVERS

4. *Background and macroeconomic outlook*. Macroeconomic outcomes remain solid, with signs that most of the external pressures experienced in 2014 have abated. Output growth was subdued in 2014, reflecting weakness in the main exports, tourism and canned tuna. Weak exports combined with strong domestic demand[4] led to depreciation pressures on the exchange rate, which resulted in a 16 percent drop against the dollar from August through October 2014. Beginning in late 2014, tighter monetary policy, a recovery in tourism, and falling global fuel prices, together with the effects of the depreciation on imports, helped to contain the external pressures and stabilize the exchange rate. The combination of spending discipline and buoyant fiscal revenues—driven by strong imports—resulted in a primary surplus of over 4½ percent of GDP in 2014, exceeding the target, albeit with lower infrastructure investment than had been planned. The depreciation began to pass through to inflation in 2015, with year-on-year inflation reaching 5.8 percent in March.[5] In early 2015, the exchange rate began to recover modestly against the dollar (bringing depreciation from July 2014 through April 2015 down to 9 percent). With a continuing recovery in tourism and the effect of lower fuel prices, projected growth for 2015 is slightly higher than earlier envisaged at 3½ percent.

5. Financial sector soundness indicators remain in the comfortable range; the Central Bank of Seychelles (CBS) intervened in a small off-shore bank in November 2014, with no significant repercussions on the domestic economy (Table 5 and Annex 7). Financial soundness indicators for the domestic banking system continue to be solid despite the recent rapid rise in private sector credit, with capital adequacy ratios substantially above the regulatory minimum, strong profitability indicators, and a roughly stable non-performing loan ratio. In the wake of worldwide de-risking associated with the increased attention given to AML/CFT obligations, Bank of Muscat International Offshore (BMIO) – a joint venture between a government owned Seychelles bank (Nouvobanq) and a Bahrain based subsidiary of Bank Muscat – lost its correspondent relationship, and the CBS took management control. As an offshore bank with funds primarily invested in liquid securities, there were no significant linkages with or repercussions on the economy in Seychelles. The CBS continues to manage the institution, pending a reorganization plan to be approved by its shareholders.[6]

6. The large current account deficit in 2014 is expected to contract sharply in 2015, helped by monetary policy tightening and an improvement in the terms of trade. Weak export revenues combined with strong imports pushed the current account deficit to 21.0 percent of GDP in

[4] The domestic demand pressures that led to the sharp rise in imports were fueled both by a 13 percent (year-on-year) rise in personal earnings economy-wide, associated with a large public sector wage increase, and a 26 percent expansion in private sector credit. The demand pressures came despite the continuation of a generally tight fiscal stance.

[5] Historical pass-through data suggest a pass-through of 65 percent over 18 months.

[6] The CBS has found a new correspondent relationship and has commissioned KPMG Mauritius to formulate a reorganization plan, including strengthening its internal controls. MCM has offered advice on the process.

2014. In 2015, the current account deficit is projected to shrink nearly 6 percentage points of GDP, thanks to lower world commodity prices (especially for fuel),[7] lower import demand, and a recovery in export volumes. In addition to a decline in FDI-related imports, import demand will be restrained by the lagged effects of the 2014 depreciation, continued tight monetary policy (which is expected to gradually contain private sector credit growth), and a public sector wage freeze.[8] Rising volumes for tourism and canned tuna are expected to partially offset falling prices in dollar terms. A recovery in European tourism and continued growth from emerging markets (EMs) will likely boost tourist arrivals, although downside risks are considerable (see below). However, tourism and tuna export revenues in dollar terms are suffering from significant downward price pressures, offsetting the measured improvement in the terms of trade.[9] Beyond 2015, macroeconomic stability and resilience are expected to strengthen as policies further anchor expectations and build buffers.

7. *Spillovers.* As a small, extremely open, tourism-dependent economy, Seychelles remains highly sensitive to inward spillovers. The most important ones are falling fuel prices, the appreciation of the US dollar against the euro, and weak growth in Europe and certain EMs. Lower fuel prices have lessened pressures on the balance of payments. No major fiscal impact is expected from lower fuel prices, however, since consumer prices adjust automatically and fuel taxes are specific rather than ad valorem. With over a third of the public debt stock in Euros and SDR, the balance sheet impact of the change in dollar/Euro cross-rate is partially mitigated. On the other hand, the margins in the tourism sector are coming under pressure from the fall in the Euro relative to the dollar—most hotels sell their rooms through international tourism operators, fixing prices in Euros for the year ahead, while the bulk of costs for the hotels are in US dollars and Seychellois Rupees. Tourism arrivals are closely linked to economic performance in Europe and increasingly certain EMs (Annex 3).

8. *Risks*. As an extremely open economy, Seychelles faces an inherently high vulnerability to external shocks, as well as domestic risks, stemming for example from policy slippages or the SOE sector. The successful management of the external pressures last year demonstrated the authorities' commitment to the flexibility built into the program, as well as some resilience in the economy. However, the external environment continues to pose multiple risks (see Risk Assessment Matrix (RAM), Box 1); tourism revenues are vulnerable to numerous developments, including a weak recovery in the Euro zone and geopolitical risks in the Middle East and Russia; the latter risks could add to balance of payments pressures through their knock-on effects on fuel prices. Moreover, experience has shown that domestic policy loosening can quickly destabilize Seychelles' open economy. The large wage increases in 2014 and losses in SOEs in 2011-2012 translated quickly into

[7] Seychelles has not benefitted fully from the fall in world fuel prices; since it buys in small quantities and has a long-term supply contract, its purchase prices have not fallen as much as world market prices.

[8] While there is a slight fiscal easing expected in 2015, the public sector wage freeze will have a more significant impact on the current account, given its impact on private sector earnings and consequently on credit (for example through debt to income ratios).

[9] Tourism prices are not included in the terms of trade measure. The CBS, with the support of the IMF's Statistics Department (STA), has implemented a new methodology to estimate tourism earnings, based on tourism-related transactions reported by authorized foreign exchange dealers. Under this methodology, tourism earnings have been revised up by a significant amount, which contributes to the current account improvement.

external pressures.[10] Over the medium term poor operating results from key state-owned enterprises could also place additional pressures on the budget (see below).

Box 1. Seychelles: Risk Assessment Matrix (2015)

Source of threat	Likeli-hood	Severity	Impact	Policy response
			Domestic risks	
Financial distress at major SOEs	M	M	*Either* a falling fiscal balance, a spike in public debt and/or a squeezing of priority expenditure areas as the government bails out SOEs, *or* potential economic disruption and increased investment uncertainty if SOEs are allowed to fail.	Improve capacity at PEMC to monitor and assess performance of SOEs. Strengthen governance structures, including independent oversight role for SSI can perform. Support Development Committee's role in assessing large investment projects.
Relaxation of fiscal discipline	L	M	Any relaxation of fiscal discipline in the run-up to the election could quickly feed through to the balance of payments and threaten the targets for reserve accumulation and debt reduction.	Ensure continuity in current policy.
			External risks	
Protracted period of slow growth in advanced and emerging economies	H	M	If slow growth in Europe and the previously fast-growing Asian and Middle Eastern markets led to a drop in tourism receipts, the result would be lower growth and weaker balance of payments.	Ensure exchange rate flexibility to act as shock absorber. Encourage continued diversification of tourism markets.
Persistent dollar strength	M	M-H	Continued strength of the dollar vs. the Euro would have a negative impact on the profitability of the tourism sector, which prices in Euros and faces costs largely in dollars.	Avoid ad-hoc measures to support the tourism sector while undermining long-term revenue potential.
Outbreak of disease/ perception of health risks	L	M-H	Any outbreak of contagious disease in Seychelles or one of the Gulf hubs that channels tourists could adversely affect the tourism industry.	Support diversification of source of tourists and travel connections; ensure appropriate health checks.
Geopolitical fragmentation that erodes the globalization process (Middle East and Russia/Ukraine)	M	M	If instability in the Middle East were to impact the key hubs in the Gulf region, tourism arrivals could be adversely affected, and higher fuel prices would put pressure on the balance of payments. Similarly, deterioration in the Russia/Ukraine situation could reduce tourist arrivals.	Support an open, competitive air transport policy which encourages diversification in the source of tourists and travel connections. Adjust macroeconomic policies to account for the effects of higher fuel prices and rely on exchange rate flexibility to keep exchange rate in line with changing fundamentals.

[10] In late 2011 and 2012, rising losses in SEYPEC's tanker business and the effects of Air Seychelles' financial difficulties, along with rising fuel and food prices leading to a deterioration in the balance of goods and services, contributed to pressures on the exchange rate (Country Report No. 13/24, page 4, and Country Report No. 13/202, page 4).

GOOD PERFORMANCE UNDER THE EFF

9. The program is broadly on track, bolstering sustainability and resilience. The fiscal balance benefited from revenue overperformance driven by the strong import demand. Spending levels were roughly as anticipated, though with some decline in quality, as unexpected support of $8.5 million to Air Seychelles[11] was offset by reduced lending to the Public Utilities Corporation due to delays in project implementation. The net result was the performance criterion (PC) on the fiscal primary surplus was exceeded by ⅓ percent of GDP. After the rupee stabilized against the dollar in November, the CBS was able to purchase nearly US$10 million and comfortably exceed the net international reserves (NIR) PC. However, this purchase, equivalent to 6 percent of base money, boosted liquidity. Following difficulties in policy coordination, operation of liquidity management tools, and end-year liquidity forecasting,[12] the PC on the ceiling for daily average reserve money was breached by 0.4 percent. Nonetheless, inflation remained contained, well below program projections, and reserve money was brought down below the program ceiling in January. Since the deviation from the target was minor and temporary, staff support the authorities' request for a waiver.

10. Some program targets for 2015 are proposed to be strengthened. Considering the improved external conditions, the previously conservative NIR targets for 2015 have been revised upward to lock in last year's overperformance and maintain stable reserve levels, despite downward pressure due to the valuation effect.[13] The average daily reserve money ceiling for the second quarter has been lowered slightly to help rein in private sector credit growth. Other macroeconomic program targets remain appropriate.

11. Implementation of the structural agenda is generally proceeding as planned, despite some delays (Tables 2a and 2b of Attachment 1, Appendix I)**.** The authorities met the two end-December 2014 structural benchmarks (SBs) on time, while they met the end-March 2015 and the end-June 2014 SBs with a delay—a substantial one in the latter case. The National Assembly amended the Seychelles Revenue Commission (SRC) Act to align the legislation with OECD guidelines in December 2014 and ratified the Multilateral Convention on Mutual Administrative Assistance in Tax Matters in April 2015 (SB, end-June 2014)[14] To maintain momentum in reforming this sector, the authorities are proposing a new benchmark on submitting legislation to the National Assembly on international corporate providers and trusts by end-December, which is being developed in consultation with the OECD and other international partners. Measures aimed at enhancing SOE oversight, including outside review of investment decisions (end-March 2015 SB),

[11] This amount had been agreed in the 2012 restructuring but it was not expected it would be needed in 2014 and thus had not been incorporated into the 2014 budget.

[12] In early November, the CBS and Treasury completed the agreed issuance of T-bills for monetary purposes. The price-based deposit auctions proved insufficiently flexible to attract buyers in rapidly evolving conditions. T-bill auctions for monetary purposes resumed in late December 2014 with the objective of bringing reserve money under the ceiling but failed to attract enough interest, as banks preferred to hold liquidity for end-year contingencies.

[13] Because the public sector foreign exchange cash flow is negative, the CBS must make significant purchases in the market just to maintain stable NIR levels. The valuation effect reduces the dollar value of stable reserves in other currencies, as the dollar appreciates.

[14] These measures are considered macro-critical, because they are essential to the sustainability of the off-shore global business services sector, which accounts for 4 percent of GDP.

were adopted in early May; further efforts, including capacity building and rigorous evaluation of new investments, are needed to contain the risks from the sector. It is proposed that the end-October benchmark on a macroprudential framework be revised to accommodate the need for legal changes. Other benchmarks have been met or are on track to be met.

MACROECONOMIC POLICY: BUTTRESSING STABILITY

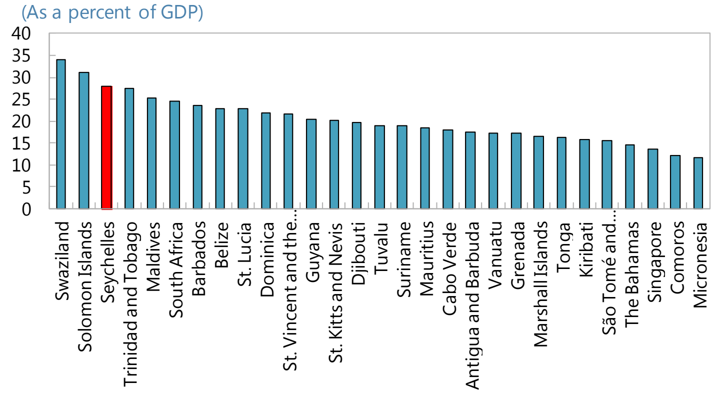
Fiscal policy: Stay the course on debt reduction while improving the quality of spending

12. The 2015 budget target of a 3.7 percent of GDP primary surplus remains appropriate and attainable. Spending plans maintain stable domestically-financed investment, relative to GDP, thanks in part to restrained current spending. Revenues are projected to fall relative to GDP as the overperformance in 2014 due to strong imports is not expected to be repeated; tax policy has remained largely unchanged, apart from some increases in fees and excises. The depreciation of the Euro also poses some risks to revenues as hotel yields come under pressure in rupee terms, though this should be offset by the impact of some reduced Euro-denominated government spending.

13. The authorities' medium term goal of reducing public debt below 50 percent of GDP by end-2018 provides a strong anchor for macroeconomic policy. Last year's depreciation will require a slight increase in the primary surplus path relative to the program request to preserve the debt dynamics (Annex 1). Fiscal discipline is essential to further reduce vulnerabilities, as well as supporting monetary and exchange rate policy in the context of a floating exchange rate in a small open economy (one of the smallest in the world with a floating exchange rate).

14. The tax system has been successfully overhauled since the crisis, and the tax take is high relative to comparators (Text Figure 1). Overall, these reforms, most notably the introduction of a VAT and a flat-rate personal income tax, succeeded in generating revenue with less distortions. However, business tax collections have been disappointing, falling from 6.9 percent of GDP in 2009 to 4.2 percent last year: the authorities are increasing tax audits (SB, end-September 2015) to help assess the causes. Staff suggested that the authorities reassess the need for investment incentives in the tourism sector. Accession to the WTO in April will result in relatively minor changes to the overall tax regime, and there will be little immediate impact on revenues.

Text Figure 1. Tax Revenue in Seychelles and selected comparators
(As a percent of GDP)



15. Staff noted that the progress made on the quality of expenditures in the immediate post-crisis period has come under some pressure as a result of wage growth. Primary current spending was 10 percent of GDP lower in 2013 than in the pre-crisis period. Government wages reached their nadir relative to GDP in 2010, falling to 5.9 percent of GDP, less than half their pre-crisis level. Since then however, wages have risen again to 7 percent of GDP—or just under 9 percent if wages of workers in government agencies are included.[15] In the context of the debt reduction goal and no major gains expected in revenues, staff highlighted that any further increase in the public wage to GDP ratio risks crowding out investment spending or other current spending priorities, as well as potentially weakening competitiveness.[16]

16. The authorities reiterated their commitment to the debt reduction goal. On revenues, they noted the efforts they were making to audit large businesses, as well as recent initiatives introduced to improve compliance and collect tax arrears. However, while they accepted the need for restraint on current expenditures, they also noted that expenditure on public sector wages as a percent of GDP remained relatively low in Seychelles compared to other small island states, and they stressed that growth prospects depended importantly on investments in education. Staff agreed with the need for a high quality and adequately staffed educational system but suggested further efficiencies could be sought across public sector, for example by more efficient use of personnel or greater use of technology.

Monetary, financial and exchange rate policies: Further reinforce foundations for stability

17. Monetary policy should continue to remain tight to contain potential inflationary pressures and strong private sector credit growth. By the third quarter of 2015, the pass-through of exchange rate depreciation is expected to have largely dissipated, and private sector credit growth should settle into a more sustainable pace (10-to-15 percent range). The CBS consequently decided to tighten the reserve money targets for the second quarter. The tight monetary stance will also be conducive for market conditions for foreign exchange purchases, although active sterilization policies will be needed to avoid volatility in monetary conditions and interest rates.

18. While the monetary policy framework has improved, staff and the authorities agreed that further strengthening in liquidity management is warranted. The immediate problems experienced in the last quarter of 2014 were corrected in the first quarter of 2015 through improved coordination with the Treasury, which agreed to provide the amounts of T-bills deemed necessary by the CBS for monetary sterilization, and quarterly average of daily reserve money moved back into the target corridor. The CBS has also moved back to quantity-based deposit auctions. In the context of an evolving monetary policy framework and a shallow financial sector, some initial difficulties are to be expected, and the IMF's Monetary and Capital Markets department (MCM) is providing ongoing technical assistance (TA), particularly in liquidity management.

19. The CBS is working to establish an effective macroprudential framework to broaden the tools available to detect and contain risks in the financial sector.[17] Overall, financial soundness

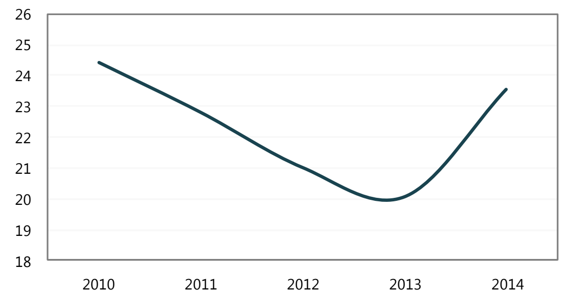
[15] There was a significant reclassification for the 2015 budget as a result of the creation of the Healthcare Agency: costs equivalent to 2 percent of GDP that would have been classified as salaries and goods and services were reclassified as transfers. Transfers to SOEs are not rising in 2015, beyond a previously planned transfer to Air Seychelles.

[16] The World Bank's Public Expenditure Review Policy Note on the education sector in 2012 found that salary costs accounted for over 90 percent of all education costs, leaving little for other vital spending such as learning materials.

[17] A February MCM TA mission focused on plans to develop the macroprudential framework and stress tests.

indicators remain strong; although the recent rapid private sector credit growth has reduced some capital adequacy ratios, they remain well above minimum levels. Discussions did not reveal any reports of weakening lending standards, some of the increase in private sector credit was a revaluation of foreign exchange denominated debt,[18] and private sector credit as a proportion of GDP was only returning to previous levels (Text Figure 2). Nevertheless, given the pace of growth, asset quality merits careful monitoring, especially if it does not moderate as planned. With TA from MCM, the CBS is working to enhance its capacity to assess and monitor systemic risk, as well as to develop appropriate capital-based, liquidity, and sectoral policy tools. They also intend to establish a Financial Stability Committee that encompasses all supervisory agencies. Pending necessary legal changes, an interim committee will be established using executive authority (SB, end-October 2015). With advice from MCM, the CBS is also working to draw on the lessons from BMIO to strengthen the frameworks for offshore banking supervision and bank resolution.

Text Figure 2. Credit to the Private Sector
(in percent of GDP)



20. The flexible exchange rate facilitated Seychelles's adjustment to a volatile external environment in 2014 and 2015, but the small size of the market contributed to the occasional emergence of backlogs in clearing transactions. As balance of payments pressures developed in August 2014, backlogs materialized and then the Rupee began to depreciate. Small backlogs occurred sporadically thereafter, especially when a large market player would decline to execute a transaction – presumably out of fear of moving the rate more than desired or hoping for interventions from the government or the CBS (there were no exchange restrictions causing the backlogs). Market actors fear that the small size of the foreign exchange market, combined with a shallow and concentrated financial system, can leave the market prone to large swings. Over time, as it became clear that the authorities were unwilling to intervene to stop an orderly adjustment of exchange rate to fundamentals, the backlog cleared and the exchange rate eventually stabilized. Moreover, the exchange rate has demonstrated two-way flexibility, with the large depreciation in August-October of 2014 followed by a partial recovery since then. The exchange rate now appears broadly in line with medium-term fundamentals (Box 2 and Annex 4).

21. Staff and the authorities agreed on the need to allow market forces to play their role in equilibrating demand for foreign exchange. Throughout the depreciation episode, staff and the authorities concurred on the need to intervene only in case of excess volatility. In addition, there was agreement that reserves remain broadly adequate (given Seychelles' vulnerabilities, the levels of coverage exceeds adequacy according to standard metrics, Box 2 and Annex 4).[19] There was also

[18] The valuation impact on nominal credit growth is estimated to have contributed 2 to 4½ percentage points of the 25 percent increase in nominal credit to the private sector (given that the data for domestic bank lending in foreign currency are not broken down into their US dollar and Euro components, only a range estimate can be given).

[19] The uptick in reserve import coverage in 2014 is due to a transitory fall in imports during 2015 that is expected to unwind in future years, as oil prices rebound and the tight monetary policy stance is relaxed. Similarly, the temporary dip in projected reserve coverage in 2016 reflects a transitory increase in imports in 2017 related to large FDI projects.

agreement on the need to continue gradual accumulation on an opportunistic basis (i.e., when market conditions are propitious) over the medium-term to maintain coverage. Under the terms of Seychelles' public debt restructuring, external debt service will rise by 1½ percentage points of GDP over the next two years. Making this debt service will require significant purchases in the market, supported by macroeconomic discipline.

Box 2. External Stability Strengthening Despite Continuing Vulnerabilities

The immediate risks to external stability appear contained. The level of reserves exceeds all metrics for adequacy by a comfortable margin, marking a steady improvement in comparison to the post-crisis years (Annex 4). Reserves are sufficient to cover more than four months of imports and exceed the amount of external public and private short-term debt. Nevertheless, continuing efforts to build the stock of external reserves will be necessary over the medium term in order to preserve adequacy, in light of the intrinsic vulnerabilities of the economy and expected increase in debt service payments.

Seychelles remains competitive in tourism, its main export. Its share in world tourism arrivals has been growing gradually over time. Improving the business climate and continuing the marketing efforts to promote Seychelles' brand globally can sustain competitiveness and bring additional benefits to the tourism sector and the economy.

The two-way flexibility in the exchange over the past year has proven helpful in adjusting to external shocks while avoiding the need for excessive fiscal adjustments. While the exchange rate assessment pointed to some potential overvaluation in 2014, the real depreciation in the latter part of the year and the subsequent sharp consolidation of the current account deficit suggests that the real exchange rate now appears to be broadly in line with fundamentals (Text Table).

Box Table. Estimated REER Misalignment[1]

	2014	2016	2018
Macroeconomic Balance	15.4	5.6	4.6
External Sustainability	12.5	3.0	1.5
Equilibrium Real Exchange Rate	-6.5	-6.6	-7.2

[1] Overvaluation (+); undervaluation (-)

STRUCTURAL REFORMS: REDUCING RISKS AND PROMOTING GROWTH

Generating sustained and inclusive growth in the Seychelles will require mitigating structural disadvantages stemming from geography and size. In this context, discussions on the structural reform agenda focused on three priority objectives: (i) sustaining inclusive growth; (ii) enhancing quality of fiscal policy; and (iii) improved oversight and efficiency for SOEs (Tables 8 and 9 for Structural Benchmarks).

Buttressing the foundations for sustained and inclusive growth

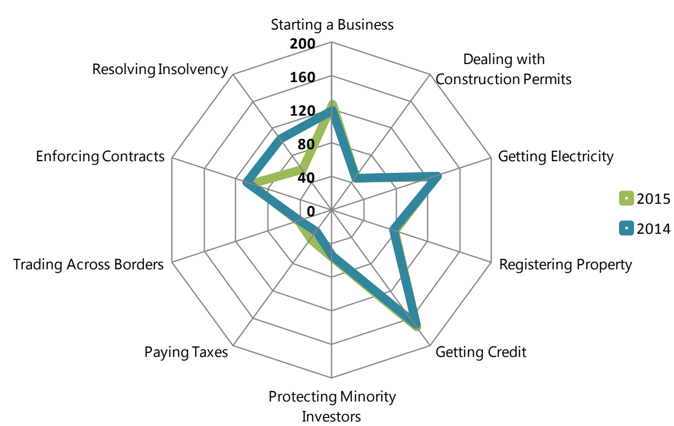
22. **While social outcomes are favorable, inequality appears to be high.** Spending on health, education and social programs account for one-third of government expenditure, allowing for free access to primary, secondary and most tertiary education, as well as to healthcare; as a result, literacy rates are very high and rates of maternal and infant mortality very low. Yet despite very low

unemployment levels (below 5 percent), income inequality is high.[20] However, non-Seychellois workers fill many skilled and professional jobs, suggesting a skills mismatch despite high literacy. Progress in reducing inequality will require fundamental economic and educational reforms to support broader-based economic growth over the medium term. In the meantime, it is important to safeguard against measures that restrict non-Seychellois workers from providing services necessary to ensure competitiveness.

23. To sustain growth and distribute its benefits more broadly, Seychelles needs to strengthen the drivers for private sector-led growth. The recently adopted Medium-Term National Development Strategy (MTNDS) identified the priorities for medium-term growth, including most notably governance, the environment, and energy. The tourism sector has driven growth historically, yet Seychelles' small size and higher-end market niche limit the potential for expansion through increasing the number and density of hotels. Medium-term structural reforms need to focus on higher value-added tourism activities, more diversification of source markets, and broader, competitive air transport connections, including direct links to Europe and China where profitable. To help make growth more inclusive (Annex 6), the tourism sector could have more linkages to the local economy, including for example promoting guesthouses and other tourist services provided by local SMEs (Annex 5), and the generous tax incentives for investment in the industry should be reviewed.

24. Sectoral diversification beyond tourism depends critically on improving the business climate. Progress in this area is lagging—Seychelles' ranking in the World Bank's doing business indicators was 85th (up only two places from 2014) (Text Figure 3). Businesses complain that they are held back by the high cost of electricity, which results in part from cross-subsidies that the government plans to reduce over the next 8-10 years. Staff encouraged the authorities to look for ways to accelerate the reduction in cross-subsidies. In addition, staff stressed that successfully expanding the global business services sector as planned will depend on strengthening the governance of the sector, ensuring that it is brought into conformity with international norms. Some large infrastructure projects, for example in the port, could boost growth sustainably, provided they are carefully planned and financed; staff stressed that Public Private Partnerships need to minimize risks to the public balance sheet. In the port, reducing restrictive practices to enhance competition (cabinet approval of a strategy, SB, end-May 2015) would also boost activity and support increased fishing activity—part of the "Blue Economy" that is integral to the MTNDS. Staff welcomed a focus on entrepreneurship and small and medium sized enterprises as a means to promote the private sector and improve income distribution; however, they cautioned that support should concentrate on removing the key impediments to

Text Figure 3. Seychelles Doing Business Indicators



Source: World Bank Doing Business Indicators 2015

[20] The authorities highlighted that social outcomes are better than one would expect at this high level of inequality.

establishing new businesses, such as financial literacy and red tape, rather than providing tax incentives that could distort behavior and erode the revenue base.

25. The authorities agreed on the need to improve the business climate. A new Ministry of **Entrepreneurship** Development and Business Innovation is considering measures to support new enterprises, including working with other departments and the private sector to overcome hurdles to establish new businesses, and refocusing the government's SME loan guarantee scheme. The authorities acknowledged that the price of electricity was an issue but highlighted the potential distributional impact of speeding up the planned rebalancing. They also highlighted that in March 2015 Seychelles completed the WTO ratification process and has become its 161st member, which should support policy stability and access to foreign markets. Concerning on Public Private Partnerships (PPPs), the authorities were working with the African Development Bank and other partners to formulate a policy, which would ensure transparency and accountability in taking any risks on the public balance sheet.

26. Improving access to finance is a key goal for robust and inclusive growth, motivating the authorities' Financial Sector Development Implementation Plan (FSDIP). Approved by cabinet last year (SB, end-October 2014), the plan was developed with World Bank support. Its most macroeconomically important elements are enhancing the legal and supervisory frameworks for financial institutions (banks, nonbank financial institutions, offshore banks, and other offshore financial services) and fostering capital market development. Other important elements of the FSDIP include developing financial infrastructure, in particular the payments and credit information systems, and improving access to credit for SMEs and households. Staff and the authorities agreed on the need to maintain momentum in implementation. The authorities are in discussions with partners, including the IMF, on accessing technical support for this effort.

27. Staff and the authorities agreed that improving the quality of public finances and spending will be vital in the context of continued debt reduction and expenditure restraint. Public financial management reforms are advancing well (Annex 5); following the adoption of a Medium-Term Fiscal Framework (SB, end-September 2014), the next step is to adopt a Medium-Term Budget Framework, which sets ministerial budgets in line with MTNDS' priorities. The extension of Program Performance Based Budgeting (PPBB) will promote more cost-effective spending and medium-term planning. While a priority for reform and growth, public investment spending still suffers from chronic under-execution of capital expenditure, despite the recent introduction of a Public Sector Investment Plan.[21] A new Public Expenditure and Financial Accountability (PEFA) assessment will provide an assessment of progress since the 2011 assessment and suggest areas for improvement. Over the medium term, public spending will also have to adjust to face new challenges. Healthcare, for example, will have to shift towards addressing diseases of affluence and an ageing population, at the same time as education needs to refocus on the serious skills mismatch.

28. Notwithstanding progress on SOE reform, further action is needed to contain fiscal risks, ensure efficiency, and protect the role of private business. Although the PEMC regularly receives

[21] The PSIP does not include some large infrastructure projects that may be needed over the medium term (notably the rehabilitation and extension of the main port).

data on SOEs' financial performance, its role could be strengthened by enhancing its capacity to analyze data and audit SOE governance (SB, end-June 2016).[22] The authorities have approved plans to strengthen oversight, including of new investment plans (SB, end-March 2015). However, fiscal risks are rising as key SOEs expand their activities: Seychelles Trading Company (STC) is expanding into a new larger retail outlet; Air Seychelles has added new destinations despite large operating losses; and Seychelles Public Transport Corporation (SPTC) recorded a loss last year despite its government subsidy.

29. Staff stressed that the role of the state holding company, *Société Seychelloise d'Investissement* (SSI), should focus on government oversight and not the creation of new sources of risk. The SSI was established to amalgamate commercial public enterprises in order to provide more effective oversight. In addition, the authorities are considering a new investment mandate for SSI proposed by its management, relying on dividends and leveraging its balance sheet. Staff recommended that the mandate be limited to clear instances of market failure or public goods in short supply, with careful vetting of proposed investments. Staff noted that unnecessary expansion by SOEs into commercial ventures had led to major financial losses in the past and contended that the private sector was better placed to engage in such activities. Continued improvements in the governance of SSI are also important in the view of staff, particularly strengthening the independence of its board from the management of its component companies.

30. The authorities acknowledged the need for careful oversight of the SOE sector. They pointed to the enhanced role of PEMC, and the progress made in establishing the division of labor between the SSI and PEMC. In the case of Air Seychelles, they have worked with the management to establish a clear plan to return the airline to profitability without budgetary support over three years, including clear milestones by which progress could be assessed. They agreed that any public support should be transparently budgeted, accommodated within the agreed medium-term fiscal balances, and subject to review in the event that the milestones were not met. However, given Seychelles' dependence on tourism, they saw a strategic need for a strong state-owned company in preventing over-reliance on foreign carriers. In light of the country's small size and the relatively-undeveloped private sector, they also saw a need for government to play a large role in developing the economy, overcoming weaknesses in competition and scale. However, the authorities agreed to work with the World Bank and IMF in defining the SSI's new mandate, which they stressed was not designed to compete with the private sector.

OTHER ISSUES

31. In February 2015, the Paris Club agreed on an innovative proposal by the Seychellois authorities for financing marine conservation through a debt buyback operation (Box 3)**.** While the operation does not reduce the country's nominal obligations, debt service is re-profiled, reducing a near-term hump, and foreign currency debt service is reduced, as a portion of estimated $27 million of debt bought back from the Paris Club (out of total public external debt of $512 million) will be replaced by local currency denominated obligations to the conservation project.

[22] While all SOEs are required to submit audited accounts to the PEMC by end-March, only four have done so this year, albeit an improvement on the one company that submitted on time last year.

Most significantly, debt service payments will go to marine conservation that protects Seychelles' rich fisheries and supports tourism.

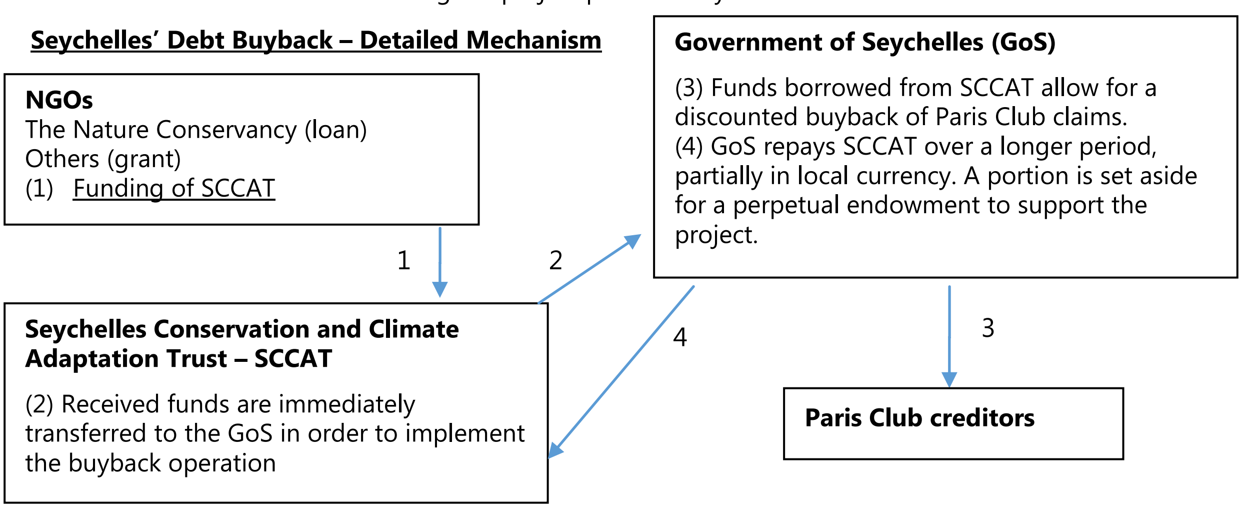
32. Seychelles' capacity to repay the Fund remains strong, as obligations remain small relative to exports and reserves (Table 6). The adequate level of international reserves and the authorities' continued commitment to achieving their debt objective provide a strong anchor for macro-stability, but the economy remains vulnerable to external shocks. In addition, the recent follow up safeguards mission found that safeguards were broadly adequate, although the central bank's legal framework and audit functions need to be further strengthened in the course of ongoing institutional development.

Box 3. Seychelles' Debt Buyback for Conservation and Climate Adaptation

Seychelles has reached preliminary agreement with its Paris Club creditors (including South Africa as an ad hoc participant) on an innovative debt operation which aims to ensure a continuing stream of resources to support marine conservation while reducing its external debt burden. The operation involves a buyback of a portion of Seychelles' Paris Club debt (around $30 million is eligible) with financing from a marine conservation NGO. The mechanics of the operation are as follows:

1. The Nature Conservancy, a global environmental NGO, funds a new trust in Seychelles (Seychelles Conservation and Climate Adaptation Trust, or SCCAT) through its own resources and additional grants raised from donors.
2. SCCAT lends the funds to the government, which then proceeds with the Paris Club buyback.
3. The government agrees to repay SCCAT at the face value of the claims over an extended period of time, partly in local currency.
4. A marine conservation initiative is funded with these regular payments, with a fraction set aside to establish an endowment dedicated to funding the project permanently.

Seychelles' Debt Buyback – Detailed Mechanism



Benefits :

- **The SCCAT** is the final beneficiary of the negotiated discount on Seychelles' debt and receives annual flows, as well as a permanent endowment to support the environmental project. In this way, debt service is re-directed to marine conservation.
- **The GoS** extends its repayment period and partially converts the payment of the claims into rupees. It will also benefit from the implementation of the marine conservation initiative.
- **The Paris Club** obtains the immediate payment of a share of its claim, at a moderate discount.

33. Seychelles' macroeconomic data are broadly adequate to conduct surveillance despite some weaknesses. The authorities achieved compliance with SDDS on May 1, 2015. Further work is underway to improve the compilation of external statistics and the international investment position (IIP).

STAFF APPRAISAL

34. The authorities continue to implement their macroeconomic program in the face of some difficulties. Several years of fiscal discipline has led to a significant reduction in the public debt burden. Fiscal and monetary authorities have cooperated to mop up substantial structural excess liquidity, enabling monetary policy to play a growing role in managing demand and supporting stability. The evolving monetary policy framework has understandably faced some difficulties, yet the authorities have demonstrated their resolve and ability to manage successfully the pressures that led to the depreciation in the second half of 2014; the sharp tightening of liquidity conditions was both effective and appropriate. The accumulation and maintenance of an adequate level of reserves—an important achievement in the face of volatile external conditions—can act as an effective bulwark against shocks, boosting resilience.

35. Nevertheless, as a very open economy, Seychelles remains vulnerable to external developments despite the considerable progress made in recent years. The outlook for tourist arrivals remains highly susceptible to external developments, such as the fitful recovery in the Euro Area, weakness in the Euro, and geopolitical tensions disrupting the Middle Eastern travel hubs and causing higher oil prices. The authorities in Seychelles are acutely aware of these vulnerabilities and risks. In addition to actively developing multiple tourism markets to diversify, they are also rightly focused on building macroeconomic buffers—in terms of robust debt dynamics and reserves—to manage the impact of shocks. These vulnerabilities highlight the central importance of continued macroeconomic discipline, sustained debt reduction, and preservation of adequate reserve coverage. These policies, combined with exchange rate flexibility, have strengthened external stability recently, and external risks appear contained. In particular, the exchange rate appears broadly in line with fundamentals.

36. The authorities should maintain the appropriately tight monetary policy stance until inflation and private sector credit growth slows appreciably. The rapid growth of private sector credit in 2014 weakened macroeconomic stability and was not sustainable. The authorities should continue to make progress on the technical elements underpinning a forward-looking monetary policy framework, including liquidity and inflation forecasting and strong policy coordination. While the recent credit growth to date does not appear to have weakened financial sector soundness, it is important to develop the macro-prudential tools to be able to safeguard the strength of the financial sector if necessary. Further financial deepening remains desirable over the medium term, including robust private sector credit growth that is consistent with macroeconomic and financial sector stability. Improved guidance of market expectations through a stronger monetary policy framework over the medium term will facilitate financial intermediation and access to credit, thereby supporting growth in the private sector.

37. The continued commitment to the debt reduction target provides a clear and transparent anchor to the authorities' fiscal strategy, as well as to policy more broadly. Lower public debt is key to building the resilience of the economy. Similarly, close control over current expenditure is necessary to ensure spending levels remain sustainable and leave sufficient room for making investments in infrastructure, which are crucial to supporting growth. Improving the execution and efficiency of planned investment spending is a high priority. In this context, further progress on medium-term budget framework would provide a stronger basis for resource allocation in what will continue to be a relatively tight fiscal environment.

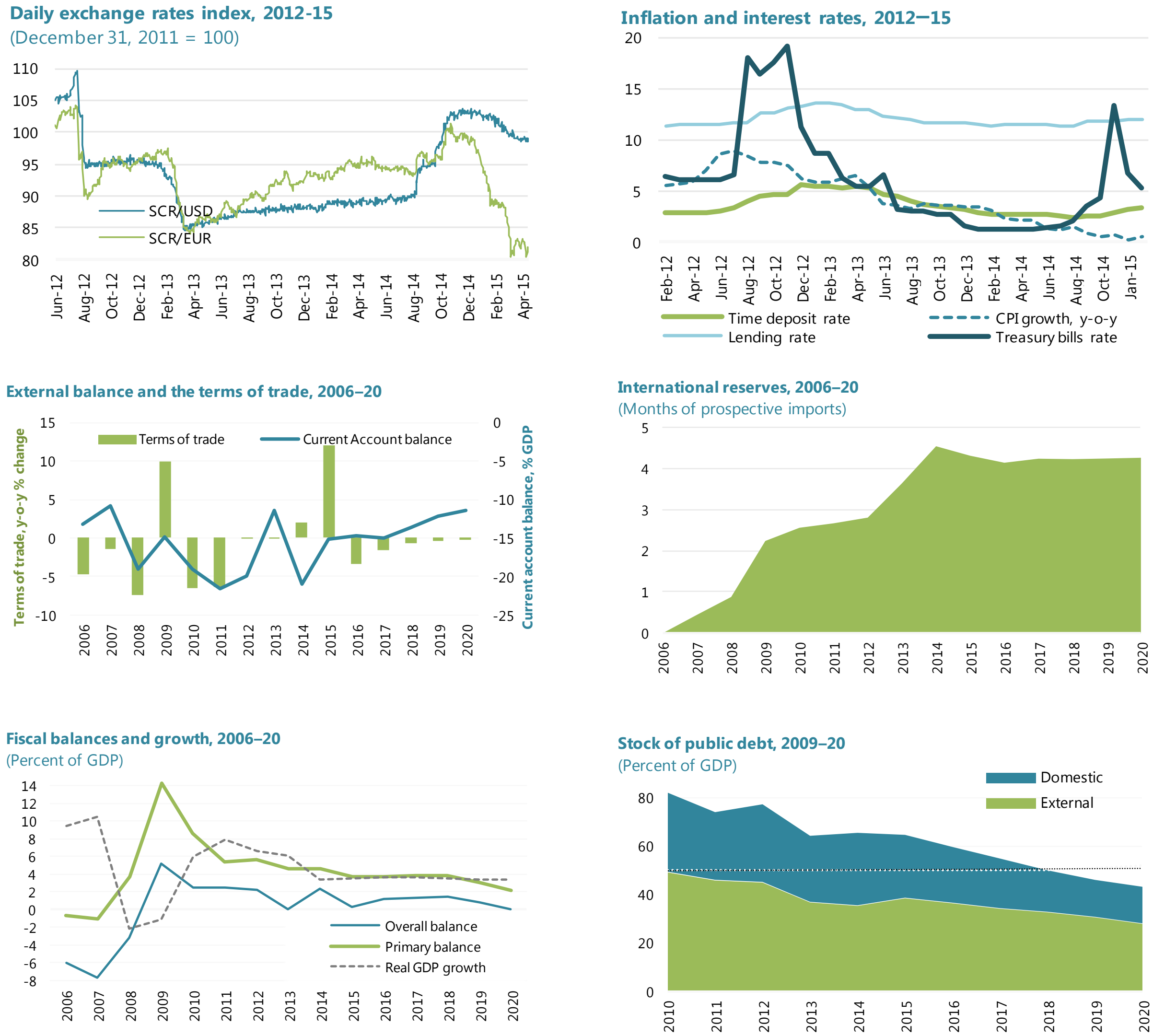
38. **Domestic risks center on the performance and role of the SOEs, where potential mistakes could imperil the hard-won macroeconomic progress.** Air Seychelles is developing a plan to eliminate operating losses and budget support by the end of 2018, which will require a substantial turnaround. The authorities should assess any failure to achieve the milestones in the plan and consider prompt corrective action, including the option of rationalizing operations to profitable routes. Similarly, the expansion plans of STC should be carefully vetted and monitored to minimize risks. Being mindful of unprofitable public sector investments in commercial enterprises in the past, the new investment mandate for the SSI should focus exclusively on areas where public involvement is essential. Transparency and accountability in its investment decisions will be important; in this regard it is vital to strengthen the independence of SSI's Board.

39. **Sustained and inclusive growth in Seychelles will require further reforms to support an increased role for the private sector and competition.** Key sectors that have been protected from competition, such as in the provision of port services, should be opened up. Rapidly reducing cross-subsidization in electricity prices would enable the private sector to be more competitive and foster growth. Development of the financial sector, entrepreneurship and SMEs will promote a dynamic private sector that leads to a broad distribution of benefits. Staff commend the authorities for the completion of the WTO accession process, which can help provide a more transparent and predictable environment for both exporters and inward investment. Finally, inclusive growth will require addressing skills mismatches in the labor market, as well as improved targeting of social programs to support higher labor force participation.

40. **Data are broadly adequate for surveillance.** The recent achievement of compliance with the SDDS is an important step forward in signaling commitment to timely and quality statistics, though additional progress could be made improving the compilation of external statistics and the IIP.

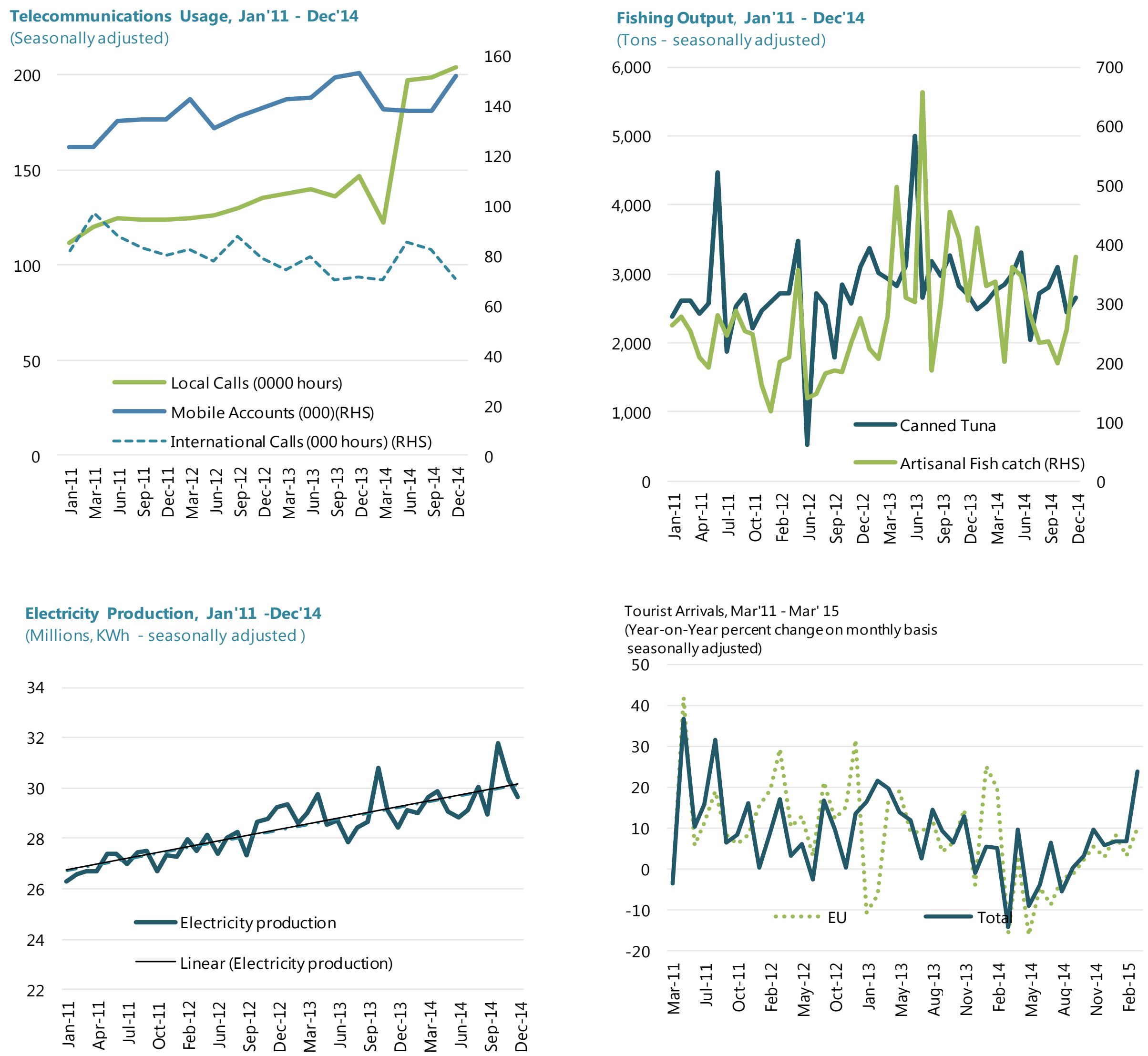
41. **In light of the authorities' continued strong program implementation and determined policy response to safeguard macroeconomic stability, staff supports the authorities' request for a waiver for end-2014 performance criterion on reserve money, for the completion of the second review under the Extended Arrangement, and the modification of the quantitative performance criteria for end-June and end-December 2015**. It is recommended that the next Article IV consultation with Seychelles be held in accordance with the decision on Article IV Consultation Cycles adopted on September 28, 2010, as amended.

Figure 1. Seychelles: Macroeconomic Developments 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, 2012–20

Nominal GDP (2014): US$ 1,423 million
Per Capita GDP (2014): US$15,887
Population, end-year (2012): 88,303
Literacy rate (2010): 94 percent
Main products and exports: Tourism, Canned Tuna

Quota: SDR 10.9 millions (0.03 percent of total)
Outstanding use of IMF resources: SDR 29.16 millions (267.49 percent of quota)
Membership status: June 30, 1977

	2012	2013	2014		2015		2016	2017	2018	2019	2020
	Prel.	Est.	1st Rev.	Est.	1st Rev.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
National income and prices	(Percentage change, unless otherwise indicated)										
Nominal GDP (millions of Seychelles rupees)	15,544	17,015	18,342	18,133	19,539	19,168	20,434	21,796	23,233	24,740	26,355
Real GDP	6.6	6.0	2.8	3.3	3.0	3.5	3.7	3.6	3.5	3.4	3.4
CPI (annual average)	7.1	4.3	2.3	1.4	5.2	4.3	2.9	3.0	3.0	3.0	3.0
CPI (end-of-period)	5.8	3.4	4.8	0.5	2.5	4.9	3.8	2.5	3.3	2.9	3.1
GDP deflator average	10.5	3.2	2.5	3.1	3.4	2.1	2.8	3.0	3.0	3.0	3.0
Money and credit	(Percentage change, unless otherwise indicated)										
Broad money	-0.6	23.7	12.0	17.5	5.3	5.7	...	...	...	...	...
Reserve money (end of period)	6.9	15.4	16.5	13.9	5.6	8.0	...	...	...	...	...
Reserve money (average of last quarter)	...	...	-17.4	-14.5	5.6	2.1	...	...	...	...	...
Velocity (GDP/broad money)	2.1	1.8	1.8	1.7	1.8	1.7	...	...	...	...	...
Money multiplier (broad money/reserve money)	4.2	4.5	4.3	4.6	4.3	4.5	...	...	...	...	...
Credit to the private sector	8.5	4.5	15.2	25.2	3.3	12.4	...	...	...	...	...
Savings-Investment balance	(Percent of GDP)										
External savings	19.9	11.5	22.5	21.0	20.5	15.2	14.6	15.0	13.6	12.2	11.5
Gross national savings	17.5	26.5	14.7	16.3	15.2	18.6	19.4	18.6	18.7	19.6	21.2
Of which: government savings	8.6	5.2	6.1	6.6	6.1	5.4	7.5	7.9	9.5	8.4	7.1
Gross investment	37.4	37.9	37.2	37.3	35.8	33.7	34.1	33.5	32.3	31.8	32.3
Of which: public investment[1]	10.4	8.9	6.2	6.3	6.8	6.7	6.8	6.6	7.0	7.4	7.6
Government budget											
Total revenue, excluding grants	34.2	31.9	31.6	32.4	31.0	31.6	31.4	31.3	31.4	31.3	31.0
Expenditure and net lending	36.1	36.0	32.3	32.7	32.6	33.6	32.0	31.6	31.2	31.7	32.3
Current expenditure	25.7	26.7	26.1	26.5	25.8	26.8	25.3	24.9	24.2	24.3	24.6
Capital expenditure[1]	10.4	9.3	6.2	6.3	6.8	6.7	6.8	6.6	7.0	7.3	7.6
Overall balance, including grants	2.2	0.3	2.1	2.0	0.3	0.3	1.2	1.4	1.5	0.8	0.0
Program primary balance	5.7	4.6	4.3	4.6	3.7	3.8	3.8	3.8	3.8	3.0	2.1
Total public debt	77.1	64.1	64.9	65.3	62.3	63.7	59.5	54.7	49.9	45.9	43.1
Domestic[2]	32.0	27.2	28.2	29.9	23.8	25.1	23.0	20.5	17.1	15.2	15.1
External	45.1	36.9	36.7	35.5	38.5	38.6	36.5	34.3	32.8	30.7	28.0
External sector	(Percent of GDP, unless otherwise indicated)										
Current account balance including official transfers	-19.9	-11.5	-22.5	-21.0	-20.5	-15.2	-14.6	-15.0	-13.6	-12.2	-11.5
Total external debt outstanding (millions of U.S. dollars)[3]	1,556	1,583	...	1,670	...	1,788	1,881	2,010	2,123	2,225	2,320
(percent of GDP)	137	112	...	117	...	130	128	129	129	128	127
Terms of trade (-=deterioration)	-0.1	-0.2	-0.6	2.0	0.8	12.0	-3.4	-1.5	-0.6	-0.3	-0.2
Real effective exchange rate (average, percent change)	-0.8	17.9	0.0	-2.8	...	...	...	...	...	...	...
Gross official reserves (end of year, millions of U.S. dollars)	307	425	452	463	453	463	476	505	521	539	544
Months of imports, c.i.f.	2.8	3.7	4.1	4.6	4.0	4.3	4.2	4.3	4.2	4.3	4.3
Exchange rate											
Seychelles rupees per US$1 (end of period)	13.0	12.1	13.3	14.0	...	...	...	...	...	...	...
Seychelles rupees per US$1 (period average)	13.7	12.1	12.6	12.7	...	...	...	...	...	...	...

Sources: Central Bank of Seychelles; Ministry of Finance; and IMF staff estimates and projections.
[1] Includes onlending to the parastatals for investment purposes.
[2] Includes debt issued by the Ministry of Finance for monetary purposes.
[3] Includes private external debt.

Table 2. Seychelles: Balance of Payments, 2012–20

	2012	2013	2014		2015		2016	2017	2018	2019	2020
			1st Rev.	Est.	1st Rev.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
	(Millions of US Dollars)										
Current account balance (+ surplus; - deficit)	-226	-162	-328	-299	-307	-209	-215	-233	-224	-211	-209
(percent of GDP)	-19.9	-11.5	-22.5	-21.0	-20.5	-15.2	-14.6	-15.0	-13.6	-12.2	-11.5
Balance of goods and services (+ surplus; - deficit)	-189	-104	-304	-215	-246	-138	-136	-147	-142	-126	-113
Exports of goods	497	578	595	539	579	448	487	530	549	573	592
Of which: oil re-exports	201	202	191	193	170	140	164	172	177	189	196
Of which: tuna exports	249	351	341	318	344	279	293	311	323	333	343
Imports of goods	967	1,024	1,156	1,081	1,075	937	987	1,061	1,091	1,119	1,150
Of which: oil imports	301	269	304	282	251	216	244	256	262	279	288
FDI-related	12	71	172	133	138	93	94	140	116	114	113
grants- and loans-related	142	127	87	84	90	78	89	92	107	102	100
other	512	556	593	582	597	550	560	573	606	625	649
Exports of services	555	628	506	643	509	633	662	697	734	773	815
Of which: tourism earnings[1]	388	430	327	398	328	380	399	423	448	474	502
Imports of services	274	286	249	316	259	282	298	313	335	353	370
Balance on primary income (+ surplus; - deficit)	-62	-72	-58	-87	-78	-74	-85	-91	-90	-96	-105
Of which: interest due	27	32	23	39	27	35	38	40	42	47	55
transfers of profits and dividends	18	17	19	16	21	19	19	19	19	19	19
Balance on secondary income (+ surplus; - deficit)	25	15	33	3	17	3	5	4	8	11	9
Of which: general government, net	55	52	54	57	42	38	39	43	46	50	55
Capital account	64	71	42	39	39	37	34	33	33	33	33
Financial account	-173	-185	-313	-286	-266	-170	-193	-232	-213	-204	-188
Direct investment, net[2]	-135	-132	-296	-201	-259	-149	-142	-198	-175	-170	-169
Abroad	9	8	8	8	8	8	9	9	9	10	10
In Seychelles	138	133	304	201	267	149	141	197	172	166	165
Of which: offshore sector	6	7	59	8	70	8	10	11	12	13	14
Portfolio investment, net	7	0	5	2	0	0	0	0	0	0	0
Other investment, net	-45	-53	-21	-87	-7	-22	-51	-34	-39	-34	-19
Government and government-guaranteed	-15	19	-14	-23	-33	-25	-6	1	-14	0	14
Disbursements	19	24	31	21	53	45	34	35	49	40	32
Project loans	12	11	14	3	26	18	34	35	49	40	32
Program loans	7	20	17	27	27	27	0	0	0	0	0
Amortization	-9	-34	-20	-16	-21	-20	-28	-37	-35	-40	-47
Private sector [3]	-29	-72	-7	-64	25	4	-45	-35	-24	-34	-34
Net errors and omissions	13	22	0	10	0	0	0	0	0	0	0
Overall balance	24	116	26	36	-1	-2	12	32	22	26	13
Financing	-24	-116	-26	-36	1	2	-12	-32	-22	-26	-13
Change in net international reserves (increase: –)	-25	-116	-26	-36	1	2	-12	-32	-22	-26	-13
Change in gross official reserves (increase: –)	-31	-118	-27	-38	-1	0	-13	-29	-15	-19	-5
Liabilities to IMF, net	5	2	2	1	2	2	1	-3	-7	-7	-8
Other net foreign assets (increase: –)	0	0	0	0	0	0	0	0	0	0	0
Exceptional financing	1	0	0	0	0	0	0	0	0	0	0
Financing gap	0	0	0	0	0	0	0	0	0	0	0
Memorandum items:											
Exports G&S growth, percent	3.1	14.6	2.0	-2.0	-1.2	-8.6	6.4	6.8	4.5	4.9	4.5
Tourism growth, percent	6.6	10.8	-5.0	-7.5	0.6	-4.4	5.0	5.9	5.9	5.9	5.9
Exports of goods volume growth, percent	2.1	25.6	…	-4.8	…	-6.8	3.9	4.5	3.3	2.8	2.8
Imports G&S growth, percent	4.5	5.5	11.0	6.6	-5.0	-12.7	5.4	6.9	3.7	3.3	3.2
Imports of goods volume growth, percent	4.9	7.2	…	8.3	…	0.0	1.3	5.1	1.4	1.7	2.0
Exports G&S, percent of GDP	93	85	75	83	73	79	78	79	78	77	77
Imports G&S, percent of GDP	109	93	96	98	89	89	87	88	86	85	83
FDI, percent of GDP [4]	11.9	9.4	20.3	14.1	17.3	10.8	9.6	12.8	10.6	9.8	9.3
Gross official reserves (stock, e.o.p.)	307	425	452	463	453	463	476	505	521	539	544
Of which: program definition[5]	277	395	422	433	423	433	445	475	490	509	514
(Months of imports of goods & services)	2.8	3.7	4.1	4.6	4.0	4.3	4.2	4.3	4.2	4.3	4.3
Months of non-FDI imports of G&S excl. oil re-exports	3.6	4.9	5.3	5.2	5.1	5.7	5.6	5.8	5.6	5.6	5.4
Percentage of IMF reserve adequacy metric	90	119	182	130	175	128	129	134	136	139	140
Government and government-guaranteed external debt	512	521	535	505	575	531	537	533	541	534	511
(Percent of GDP)	45.1	36.9	36.7	35.5	38.5	38.6	36.5	34.3	32.8	30.7	28.0
GDP	1,134	1,411	1,460	1,423	1,495	1,375	1,471	1,555	1,649	1,738	1,825

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

[1] The authorities have adopted a new methodology based on data from banks and bureau de change, combined with monetary data used to assess the sums originating from tourism but deposited in foreign currency. This has led to a significant increase in estimated tourism earnings – in 2013, the most recent year with final data available, the upward revision amounted to USD 86 million, or 6 percent of GDP; the average annual

[2] From 2015 onwards the data reflect the findings of the IIP survey, which indicated that the proportion of equity to debt in FDI flows was being signi

[3] Includes parastatals for which data are available.

[4] Per STA recommendations, renewals of off-shore licenses are excluded.

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

Table 3. Seychelles: Consolidated Government Operations, 2012–16[1]

	2012	2013	2014		2015					2016
					Q1	Q2	Q3	Q4		
		Act.	1st Rev.	Prel.	Est.	Proj.	Proj.	Proj.	1st Rev.	Proj.
	(Millions of Seychelles rupees; cumulative from the start of the year)									
Total revenue and grants	6,024	6,111	6,358	6,413	1,337	3,041	4,616	6,551	6,477	6,829
Total revenue	5,322	5,420	5,788	5,870	1,230	2,845	4,325	6,063	6,050	6,409
Tax	4,600	4,676	5,162	5,294	1,124	2,608	3,955	5,446	5,433	5,751
Personal income tax	702	754	893	878	210	442	670	921	930	983
Trade tax	401	411	353	376	62	128	198	283	277	291
Excise tax	726	652	843	858	182	431	658	907	861	938
Goods and services tax (GST) / VAT [2]	1,465	1,623	1,770	1,803	397	859	1,316	1,808	1,821	1,933
Business tax [3]	816	816	770	782	120	433	632	826	850	881
Corporate Social Responsibility Tax (CSR) [3]	…	44	76	84	14	33	53	69	68	74
Marketing Tourism Tax (MTT) [3]	…	22	50	40	12	25	38	54	53	57
Other	491	354	407	472	128	256	390	578	574	593
Nontax	722	744	626	576	106	238	370	617	617	658
Fees and charges	398	297	337	347	83	160	247	332	332	353
Dividends from parastatals	266	402	213	151	17	65	105	262	262	279
Other	58	46	76	78	6	12	18	24	24	25
External grants	702	691	570	543	107	196	291	488	427	421
Expenditure and net lending	5,682	6,111	5,966	5,981	1,469	2,993	4,550	6,489	6,415	6,587
Current expenditure	3,992	4,536	4,785	4,798	1,137	2,389	3,714	5,146	5,045	5,160
Primary current expenditure	3,452	3,746	4,384	4,393	985	2,095	3,188	4,488	4,387	4,637
Wages and salaries	998	1,129	1,280	1,229	280	563	844	1,137	1,333	1,176
Goods and services	1,134	1,218	1,493	1,288	190	472	721	1,059	1,148	1,115
Transfers	1,298	1,366	1,583	1,855	509	1,050	1,604	2,263	1,877	2,315
Social program of central government	290	307	349	343	62	131	234	359	361	377
Transfers to public sector from central government	660	663	799	1,070	332	687	1,024	1,443	1,059	1,443
Benefits and programs of Social Security Fund	348	396	436	442	115	231	346	461	457	495
Other	23	31	28	21	6	11	20	29	29	31
Interest due	540	790	401	404	152	294	526	658	658	524
Foreign interest	174	189	179	175	69	100	193	223	224	256
Domestic interest	366	601	222	229	83	194	333	434	434	267
Capital expenditure	1,613	1,508	1,014	1,011	254	494	698	1,181	1,152	1,105
Domestically financed	872	770	620	656	164	327	491	655	589	663
Foreign financed	741	738	394	355	90	166	207	526	563	441
Net lending	-6	6	123	120	67	88	104	117	173	277
Contingency	83	62	45	53	11	23	34	45	45	45
Primary balance	882	790	793	836	21	342	592	720	720	766
Overall balance, commitment basis [4]	342	0	392	431	-132	49	66	62	62	243
Change in float	0	51	0	-70	0	0	0	0	0	0
Overall balance, cash basis (after grants)	343	51	392	361	-132	49	66	62	62	243
Financing	-343	22	-392	-361	132	-49	-66	-62	-62	-243
Foreign financing	53	112	123	8	83	147	160	349	417	29
Disbursements	168	277	378	230	111	285	325	624	692	417
Project loans	79	152	164	4	13	89	130	248	339	417
Program/budget support	89	125	214	226	98	195	195	377	353	0
Scheduled amortization	-121	-165	-254	-222	-28	-138	-165	-275	-276	-388
Domestic financing, net	-493	-126	-500	-414	39	-214	-254	-448	-515	-272
Bank financing	-642	334	-500	-875	35	-193	-228	-403	-464	-245
CBS	-1,194	-56	-1,042	-1,076	10	-53	-63	-112	-129	-68
Commercial banks	552	390	542	201	25	-139	-165	-291	-335	-177
Nonbank financing	148	-460	0	461	4	-21	-25	-45	-52	-27
Privatization and long-term lease of fixed assets	84	53	76	77	9	18	27	36	36	0
Statistical discrepancy	14	-89	-92	-32	0	0	0	0	0	0
Memorandum item:										
Transfer of assets of SSF to SPF					336					
Pension Fund contribution	105	145	188	180	48	97	145	194	194	204
Pension Fund benefits payment	100	133	144	77	36	71	107	143	143	149
Pension Fund operating expenses	…	0	23	21	7	15	22	29	29	30
External debt service due	294	354	433	397	97	237	358	498	499	645

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] CSR and MTT were subsumed into Business Tax in CR 14/186.

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

Table 3. Seychelles: Consolidated Government Operations, 2012–16[1] (concluded)

	2012	2013	2014		2015					2016
			Q4		Q1	Q2	Q3	Q4		
			1st Rev.	Prel.	Est.	Proj.	Proj.	Proj.	1st Rev.	Proj.
	(Percent of GDP; cumulative from the start of the year)									
Total revenue and grants	38.8	35.9	34.7	35.4	7.0	15.9	24.1	34.2	33.2	33.4
Total revenue	34.2	31.9	31.6	32.4	6.4	14.8	22.6	31.6	31.0	31.4
Tax	29.6	27.5	28.1	29.2	5.9	13.6	20.6	28.4	27.8	28.1
Personal income tax	4.5	4.4	4.9	4.8	1.1	2.3	3.5	4.8	4.8	4.8
Trade tax	2.6	2.4	1.9	2.1	0.3	0.7	1.0	1.5	1.4	1.4
Excise tax	4.7	3.8	4.6	4.7	0.9	2.3	3.4	4.7	4.4	4.6
Goods and services tax (GST) / VAT [2]	9.4	9.5	9.7	9.9	2.1	4.5	6.9	9.4	9.3	9.5
Business tax	5.2	4.8	4.2	4.3	0.6	2.3	3.3	4.3	4.3	4.3
Corporate Social Responsibility Tax (CSR)	…	0.3	0.4	0.5	0.1	0.2	0.3	0.4	0.3	0.4
Marketing Tourism Tax (MTT)	…	0.1	0.3	0.2	0.1	0.1	0.2	0.3	0.3	0.3
Other	3.2	2.1	2.2	2.6	0.7	1.3	2.0	3.0	2.9	2.9
Nontax	4.6	4.4	3.4	3.2	0.6	1.2	1.9	3.2	3.2	3.2
Fees and charges	2.6	1.7	1.8	1.9	0.4	0.8	1.3	1.7	1.7	1.7
Dividends from parastatals	1.7	2.4	1.2	0.8	0.1	0.3	0.5	1.4	1.3	1.4
Other	0.4	0.3	0.4	0.4	0.0	0.1	0.1	0.1	0.1	0.1
External grants	4.5	4.1	3.1	3.0	0.6	1.0	1.5	2.5	2.2	2.1
Expenditure and net lending	36.6	35.9	32.5	33.0	7.7	15.6	23.7	33.9	32.8	32.2
Current expenditure	25.7	26.7	26.1	26.5	5.9	12.5	19.4	26.8	25.8	25.3
Primary current expenditure	22.2	22.0	23.9	24.2	5.1	10.9	16.6	23.4	22.5	22.7
Wages and salaries	6.4	6.6	7.0	6.8	1.5	2.9	4.4	5.9	6.8	5.8
Goods and services	7.3	7.2	8.1	7.1	1.0	2.5	3.8	5.5	5.9	5.5
Transfers	8.3	8.0	8.6	10.2	2.7	5.5	8.4	11.8	9.6	11.3
Social program of central government	1.9	1.8	1.9	1.9	0.3	0.7	1.2	1.9	1.8	1.8
Transfers to public sector from central government	4.2	3.9	4.4	5.9	1.7	3.6	5.3	7.5	5.4	7.1
Benefits and programs of Social Security Fund	2.2	2.3	2.4	2.4	0.6	1.2	1.8	2.4	2.3	2.4
Other	0.2	0.2	0.2	0.1	0.0	0.1	0.1	0.1	0.1	0.1
Interest due	3.5	4.6	2.2	2.2	0.8	1.5	2.7	3.4	3.4	2.6
Foreign interest	1.1	1.1	1.0	1.0	0.4	0.5	1.0	1.2	1.1	1.3
Domestic interest	2.4	3.5	1.2	1.3	0.4	1.0	1.7	2.3	2.2	1.3
Capital expenditure	10.4	8.9	5.5	5.6	1.3	2.6	3.6	6.2	5.9	5.4
Domestically financed	5.6	4.5	3.4	3.6	0.9	1.7	2.6	3.4	3.0	3.2
Foreign financed	4.8	4.3	2.1	2.0	0.5	0.9	1.1	2.7	2.9	2.2
Net lending	0.0	0.0	0.7	0.7	0.3	0.5	0.5	0.6	0.9	1.4
Contingency	0.5	0.4	0.2	0.3	0.1	0.1	0.2	0.2	0.2	0.2
Primary balance	5.7	4.6	4.3	4.6	0.1	1.8	3.1	3.8	3.7	3.8
Overall balance, commitment basis [3]	2.2	0.0	2.1	2.4	-0.7	0.3	0.3	0.3	0.3	1.2
Change in arrears	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Change in float	0.0	0.3	0.0	-0.4	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance, cash basis (after grants)	2.2	0.3	2.1	2.0	-0.7	0.3	0.3	0.3	0.3	1.2
Financing	-2.2	0.1	-2.1	-2.0	0.7	-0.3	-0.3	-0.3	-0.3	-1.2
Foreign financing	0.3	0.7	0.7	0.0	0.4	0.8	0.8	1.8	2.1	0.1
Disbursements	1.1	1.6	2.1	1.3	0.6	1.5	1.7	3.3	3.5	2.0
Project loans	0.5	0.9	0.9	0.0	0.1	0.5	0.7	1.3	1.7	2.0
Program/budget support	0.6	0.7	1.2	1.2	0.5	1.0	1.0	2.0	1.8	0.0
Scheduled amortization	-0.8	-1.0	-1.4	-1.2	-0.1	-0.7	-0.9	-1.4	-1.4	-1.9
Change in amortization arrears	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic financing, net	-3.2	-0.7	-2.7	-2.3	0.2	-1.1	-1.3	-2.3	-2.6	-1.3
Bank financing	-4.1	2.0	-2.7	-4.8	0.2	-1.0	-1.2	-2.1	-2.4	-1.2
CBS	-7.7	-0.3	-5.7	-5.9	0.1	-0.3	-0.3	-0.6	-0.7	-0.3
Commercial banks	3.6	2.3	3.0	1.1	0.1	-0.7	-0.9	-1.5	-1.7	-0.9
Nonbank	1.0	-2.7	0.0	2.5	0.0	-0.1	-0.1	-0.2	-0.3	-0.1
Privatization and long-term lease of fixed assets	0.5	0.3	0.4	0.4	0.0	0.1	0.1	0.2	0.2	0.0
Statistical discrepancy	0.1	-0.5	-0.5	-0.2	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:										
Nominal GDP (millions of Seychelles Rupees)	15,544	17,015	18,342	18,133	19,168	19,168	19,168	19,168	19,539	20,434
Transfer of assets of SSF to SPF					1.8					
Pension Fund contribution	0.7	0.9	1.0	1.0	0.3	0.5	0.8	1.0	1.0	1.0
Pension Fund benefits payment	0.6	0.8	0.8	0.4	0.2	0.4	0.6	0.7	0.7	0.7
Pension Fund operating expenses	…	0.0	0.1	0.1	0.0	0.1	0.1	0.2	0.2	0.1
Public domestic debt (% GDP) [4]	32.0	27.2	28.2	29.9	27.6	26.3	26.1	25.1	23.8	23.0
Excluding t-bills issued for monetary purposes	25.9	22.4	18.1	19.5	18.0	16.6	16.4	15.4	14.3	13.7
Publicly guaranteed domestic debt (% GDP)	2.3	1.5	1.1	1.1	1.0	1.0	1.0	1.0	0.9	0.5

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 debt issued by the Ministry of Finance for monetary purposes.

Table 4. Seychelles: Monetary Survey and Central Bank Accounts, 2012–15

	2012	2013	2014		2015							
			Dec.		Mar.		Jun.		Sep.		Dec.	
			1st Rev.	Act.	1st Rev.	Prel.	1st Rev.	Proj.	1st Rev.	Proj.	1st Rev.	Proj.
	(Millions of Seychelles rupees)											
Monetary survey												
Net foreign assets	5,297	7,247	8,117	9,326	8,151	9,553	7,974	9,397	7,925	9,371	8,032	9,389
Central bank	3,434	4,580	5,449	5,906	5,471	6,092	5,282	5,895	5,221	5,829	5,317	5,806
Deposit money banks	1,863	2,667	2,668	3,420	2,680	3,461	2,692	3,502	2,704	3,542	2,715	3,582
Net domestic assets	2,257	2,093	2,342	1,646	2,479	1,851	2,675	1,888	2,802	2,036	2,985	2,210
Domestic credit	5,295	5,825	5,818	5,784	5,841	5,874	5,579	5,724	5,646	5,864	5,485	5,909
Net claims on the government	1,786	2,335	1,835	1,414	1,870	1,449	1,616	1,221	1,582	1,186	1,371	1,011
Credit to the economy	3,510	3,490	3,983	4,370	3,971	4,425	3,962	4,502	4,064	4,678	4,114	4,899
Of which: credit to the private sector	3,266	3,412	3,929	4,273	3,917	4,328	3,909	4,406	4,010	4,581	4,060	4,802
Other items, net	-3,039	-3,732	-3,476	-4,138	-3,362	-4,023	-2,904	-3,836	-2,844	-3,828	-2,501	-3,700
Broad money	7,554	9,340	10,459	10,972	10,630	11,404	10,649	11,285	10,727	11,407	11,016	11,598
Currency in circulation	629	757	797	875	795	817	805	824	827	842	849	925
Foreign currency deposits	2,441	2,948	3,669	4,110	3,916	4,350	3,938	4,377	3,960	4,404	3,981	4,430
Local currency deposits	4,484	5,635	5,993	5,987	5,919	6,237	5,906	6,084	5,940	6,161	6,186	6,244
Central bank												
Net foreign assets	3,434	4,580	5,449	5,906	5,471	6,092	5,282	5,895	5,221	5,829	5,317	5,806
Foreign assets	3,972	5,103	6,025	6,498	6,036	6,651	5,868	6,475	5,797	6,399	5,908	6,392
Foreign liabilities	538	524	576	592	565	559	586	580	576	570	591	586
Net domestic assets	-1,617	-2,484	-3,007	-3,519	-3,016	-3,637	-2,804	-3,440	-2,730	-3,351	-2,738	-3,228
Domestic credit	-1,113	-2,082	-2,212	-2,475	-2,268	-2,644	-2,101	-2,494	-2,070	-2,450	-2,120	-2,371
Government (net)	-358	-414	-1,456	-1,491	-1,447	-1,481	-1,517	-1,544	-1,527	-1,554	-1,585	-1,603
Commercial banks	-636	-1,570	-580	-885	-646	-1,063	-409	-850	-368	-796	-360	-669
Other (parastatals)	-119	-98	-175	-100	-175	-100	-175	-100	-175	-100	-175	-100
Other items, net	-504	-401	-796	-1,044	-748	-993	-703	-946	-661	-901	-618	-857
Reserve money	1,816	2,096	2,442	2,388	2,455	2,455	2,478	2,455	2,491	2,478	2,578	2,578
Currency in circulation	629	757	797	875	795	817	805	824	827	842	849	925
Commercial bank reserves (includes cash in vault)	1,187	1,339	1,645	1,513	1,660	1,638	1,673	1,631	1,664	1,636	1,729	1,653
Of which: vault cash	110	143	151	143	150	133	152	135	156	138	…	…
Of which: excess reserves (excl. bank vault cash)	59	-59	63	-71	84	0	91	7	69	-7	…	…
Of which: required reserves in foreign currency [1, 2]	350	385	533	555	537	596	540	600	543	603	545	607
required reserves in domestic currency [2]	667	870	898	886	890	909	890	890	897	902	931	914
Memorandum items:												
Gross international reserves (millions of U.S. dollars) [3]	307	425	452	463	456	476	445	465	442	462	453	463
Foreign currency deposits (millions of U.S. dollars)	188	244	276	293	296	311	299	314	302	318	306	321
Broad money growth (12–month percent change)	-0.6	23.7	12.0	17.5	4.9	12.5	4.1	10.3	1.2	7.6	5.3	5.7
Credit to the private sector (12–month percent change)	8.5	4.5	15.2	25.2	12.3	24.1	7.0	20.6	2.1	16.6	3.3	12.4
Reserve money (end of period; 12–month percent change)	6.9	15.4	16.5	13.9	1.6	1.6	-2.2	-3.1	0.3	-0.2	5.6	8.0
Reserve money (daily average over quarter; 12–month perce	…	…	-17.4	-14.5	-13.9	-13.9	-6.4	-7.2	0.3	-2.4	5.6	2.1
Money multiplier (broad money/reserve money)	4.2	4.5	4.3	4.6	4.3	4.6	4.3	4.6	4.3	4.6	4.3	4.5
Velocity (GDP/broad money; end of period)	2.1	1.8	1.8	1.7	1.8	1.6	1.8	1.7	1.8	1.7	1.8	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.

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Table 5. Seychelles: Financial Soundness Indicators for the Banking Sector, 2011–14 [1]

	2011				2012				2013				2014			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
	(Percent, end of period)															
Capital adequacy																
Regulatory capital to risk weighted assets	23.3	24.8	26.3	24.2	24.9	25.9	26.2	26.7	26.9	26.0	26.1	26.7	26.7	24.6	22.4	21.7
Regulatory tier 1 capital to risk weighted assets	16.8	21.0	21.1	17.3	18.1	21.6	19.9	19.3	18.6	22.0	20.8	21.0	19.5	21.0	17.5	16.3
Capital to assets (net worth)	9.3	9.6	10.1	9.0	9.1	9.5	9.8	10.3	10.4	9.8	9.4	9.7	9.5	9.2	8.6	8.5
Net tangible capitalization [2]	9.4	9.7	10.2	9.1	9.3	9.6	9.9	10.4	10.5	9.9	9.6	9.8	9.6	9.3	8.7	8.6
Asset quality																
Foreign exchange loans to total loans	23.7	20.1	18.5	18.4	20.9	20.0	17.9	18.7	17.8	17.1	18.6	18.7	17.9	18.5	19.9	23.8
Nonperforming loans to gross loans	5.4	5.6	5.3	8.1	8.3	9.2	8.3	9.3	9.6	9.5	12.5	9.4	10.3	6.2	8.3	8.2
Provisions as percentage of nonperforming loans	30.9	37.3	40.4	33.8	33.9	32.1	33.3	29.5	37.0	37.3	27.6	39.2	36.2	57.4	44.6	43.9
Provisions as percentage of total loans	1.7	2.1	2.2	2.7	2.8	3.0	2.7	2.7	3.5	3.5	3.4	3.7	3.7	3.6	3.7	3.6
Earnings and profitability																
Return on assets (annualized)	3.9	3.1	3.6	5.6	3.5	3.9	4.2	3.1	2.3	3.3	2.7	1.9	2.3	2.0	2.1	3.3
Return on equity (annualized)	40.8	32.6	36.4	61.6	38.3	40.8	41.3	29.8	22.2	33.7	28.3	19.6	23.6	22.3	23.7	38.2
Interest margin to gross income	46.8	56.3	61.6	55.8	52.8	57.5	64.6	62.7	84.7	61.1	56.9	56.6	54.7	57.3	51.0	57.5
Noninterest expense to gross income	46.7	49.3	46.4	22.3	44.0	40.7	39.0	56.6	56.6	45.4	46.3	65.1	52.7	55.2	57.1	50.3
Net interest margin (annualized) [3]	3.0	3.5	4.2	3.9	3.6	3.5	3.9	4.1	4.3	3.9	3.3	3.2	2.6	2.7	2.7	2.8
Net noninterest margin (annualized) [4]	0.4	-0.3	-0.5	1.5	0.3	0.2	0.1	0.0	-1.3	-0.6	-0.4	-0.4	0.1	-0.1	-0.1	0.0
Expense to income	50.8	53.6	50.1	28.5	44.7	45.4	45.4	46.4	57.0	52.1	51.9	54.5	51.2	53.7	53.1	52.6
Interest expense to gross income	8.5	9.3	7.4	8.7	9.3	9.7	10.9	11.8	20.0	17.0	16.4	15.3	11.0	10.5	10.5	10.7
Liquidity																
Core liquid assets to total assets [5]	47.1	47.1	47.7	49.9	49.6	48.6	47.9	39.6	38.9	39.5	41.4	41.6	41.5	42.0	36.9	40.8
Broad liquid assets to total assets [6]	56.6	55.7	57.0	58.8	59.3	57.9	59.6	52.0	52.2	53.3	53.0	54.7	53.9	57.3	52.9	54.2
Liquid assets (broad) to short term liabilities	60.0	58.8	60.9	63.0	65.4	64.6	66.6	58.1	58.6	59.5	58.9	61.2	59.6	64.0	57.7	60.0
Liquid assets (broad) to total liabilities	62.4	61.6	63.4	64.7	65.3	64.0	66.1	58.0	58.2	59.1	58.5	60.6	59.6	63.2	57.9	59.2
Liquid assets to deposit liabilities	65.5	64.5	68.7	71.0	70.9	69.7	71.0	62.5	62.6	63.1	62.4	64.3	62.9	67.5	62.0	62.7
Foreign exchange exposure																
Net open foreign exchange position to capital	3.8	2.2	1.5	1.9	2.9	-3.9	-0.8	7.9	6.8	-0.6	3.7	8.9	-2.6	0.1	4.3	8.8

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: Indicators of Fund Credit, 2013-22

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
					(in millions of SDR)					
Existing Fund credit										
Stock [1]	28.3	29.2	27.5	24.9	21.3	16.8	11.9	7.2	4.1	1.8
Obligation	5.8	2.7	1.9	2.9	3.8	4.8	5.1	4.7	3.2	2.4
Principal (repayments/repurchases)	5.5	2.4	1.6	2.6	3.6	4.5	5.0	4.6	3.1	2.3
Charges and interest	0.3	0.3	0.3	0.3	0.3	0.2	0.2	0.1	0.1	0.0
Disbursements	6.6	3.3								
Prospective Fund credit										
Disbursement			3.3	3.3	1.6					
Stock [1]		0.0	3.3	6.5	8.2	8.2	8.0	7.4	6.1	4.8
Obligations [2]		0.0	0.0	0.1	0.1	0.1	0.2	0.8	1.3	1.4
Principal (repayments/repurchases)		0.0	0.0	0.0	0.0	0.0	0.1	0.7	1.2	1.4
Charges and interest		0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Stock of existing and prospective Fund credit [1]	28.3	29.2	30.8	31.4	29.5	25.0	19.9	14.6	10.3	6.6
In percent of quota	259.4	267.5	282.4	288.5	270.7	229.1	182.4	133.9	94.1	60.1
In percent of GDP	3.0	3.1	3.2	3.0	2.7	2.2	1.6	1.1	0.8	0.5
In percent of exports of goods and services	3.6	3.6	4.0	3.9	3.4	2.8	2.1	1.5	1.0	0.6
In percent of gross reserves	10.2	9.2	9.4	9.4	8.3	6.9	5.3	3.9	2.7	1.7
Obligations to the Fund from existing and prospective Fund arrangements										
Obligations	5.8	2.7	2.0	3.0	3.9	4.8	5.3	5.5	4.5	3.8
Principal (repayments/repurchases)	5.5	2.4	1.7	2.6	3.6	4.5	5.1	5.3	4.3	3.7
Charges and interest	0.3	0.4	0.3	0.4	0.3	0.3	0.3	0.2	0.1	0.1
In percent of quota	52.8	25.1	18.2	27.1	35.9	44.4	48.9	50.4	41.1	34.9
In percent of GDP	0.6	0.3	0.2	0.3	0.4	0.4	0.4	0.4	0.3	0.3
In percent of exports of goods and services	0.7	0.3	0.3	0.4	0.5	0.5	0.6	0.6	0.4	0.4
In percent of gross reserves	2.1	0.9	0.6	0.9	1.1	1.3	1.4	1.5	1.2	1.0

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

[1] End of Period.

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

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Table 7. Seychelles: Schedule of Reviews and Purchases Under the Extended Arrangement, 2014–17

Program Review	Date of availability	Conditions	Amount	
			(Millions of SDR)	(Percent of quota)
	June 4, 2014	Board approval of the Extended Arrangement	1.635	15
First	September 15, 2014	Completion of first review and compliance with end-June 2014 quantitative performance criteria	1.635	15
Second	March 31, 2015	Completion of second review and compliance with end-December 2014 quantitative performance criteria	1.635	15
Third	September 15, 2015	Completion of third review and compliance with end-June 2015 quantitative performance criteria	1.635	15
Fourth	March 31, 2016	Completion of fourth review and compliance with end-December 2015 quantitative performance criteria	1.635	15
Fifth	September 15, 2016	Completion of fifth review and compliance with end-June 2016 quantitative performance criteria	1.635	15
Sixth	March 31, 2017	Completion of sixth review and compliance with end-December 2016 quantitative performance criteria	1.635	15
Total			**11.445**	**105**

Source: IMF

Annex I. Public Debt Sustainability Analysis

Seychelles' debt trajectory remains sustainable. Under the baseline scenario the country is on-track to attain its longstanding goal of reducing debt below 50 percent of GDP by 2018, further strengthening sustainability. At 18 percent of GDP, gross financing needs are high but are expected to decline as domestic debt is reduced. External public financing needs are also significant but can be readily met from financing expected from official multilateral and bilateral creditors. Nevertheless, as a small island economy Seychelles remains vulnerable to a number of shocks which could prevent the 2018 target from being realized.

Macroeconomic and fiscal assumptions. The assumptions underpinning the DSA are those of the baseline scenario of the staff report, and broadly similar to those underlying the DSA at the time of the program request. Real GDP growth is projected at 3.5 percent in 2015, remaining around that level in the medium term. Inflation is projected at around 3 percent over the medium term. The program primary fiscal surplus is expected to remain just under 4 percent until the authorities' overarching debt target is attained, after which it is projected to decline somewhat.[1]

Realism of baseline assumptions. The median forecast error for real GDP growth was 0.01, with no significant upward or downward bias. While the projected primary balances imply a surplus in the top quartile, Seychelles' strong performance in the past means that this does not require any significant fiscal adjustment.

The definition of public debt in this DSA includes: (i) central government debt as reported by the authorities; (ii) government guarantees issued for loans extended to state-owned enterprises; and (iii) obligations to the IMF. In view of the persistent excess liquidity in the Seychelles, debt issued by the central government for monetary purposes is included in the public debt stock in this analysis: for while there is an offsetting unremunerated deposit in the central bank, the debt does impose an interest cost and rollover need for the public sector, and there is limited potential for this debt to be unwound over the medium term.[2] This DSA does not incorporate the impact of the recent debt buy-back operation agreed with the Paris Club, given that the details of the repayments to be made to the Seychelles Conservation and Climate Adaptation Trust have yet to be finalized. However, given that the operation replaces obligations to the Paris Club with broadly similar obligations (in PV terms) to the Trust, the net impact on debt sustainability will be limited, albeit positive, and the conclusions of the DSA unchanged.[3]

[1] The program primary surplus includes net lending to SOEs, reflecting the consideration that the PUC's tariff structure is insufficient to cover its capital costs.

[2] In order to illustrate the impact of excluding debt issued for monetary purposes, the "net public debt" figures shown in the tables consist of gross debt less the government deposits held at the central bank as a counterpart to the sterilization operations. The net debt does not exclude other, smaller, government deposits which may be required for cash management purposes etc.

[3] The operation is expected to achieve a modest re-profiling and small shift to debt service in local currency. Debt service is expected to fall by around $1.5-2.0 million per year in the period up to 2022 as a result of the operation, but increase by a similar amount in the decade thereafter.

The DSA framework suggests that Seychelles' public debt is currently slightly below the high-risk benchmark and is falling rapidly. The DSA indicates that the debt remains high at around 65 percent of GDP at end-2014, close to the 70 percent indicative threshold used in the DSA framework to highlight high risk debt levels (red in the standardized heat map on page 4). The slight increase from 2013 came despite the large primary budget surplus, and reflected the depreciation of the rupee and the issuance of significant debt to mop up the structural excess liquidity in the banking system. However, assuming the authorities' commitment to debt reduction and fiscal discipline remains unchanged, and that the economy suffers no major negative shocks, the debt level is projected to fall by almost 25 percentage points in the medium term under the baseline scenario, reaching 40 percent in 2020.

Gross financing needs, at 18 percent of GDP, are high but are expected to fall over the medium term. Since the last DSA, the primary balance path has been revised upward in order to attain the debt target in the face of the depreciation. The higher fiscal surpluses are assumed to pay down short term domestic debt, in light of its higher interest rate and the rollover risks posed.[4] This reduction of short-term debt is also projected to improve the composition of debt over the medium term, as the average maturity lengthens.

However, external public debt service will increase significantly over the medium term as payments come due on the rescheduled Eurobond. In 2010, a new Eurobond was exchanged for an existing bond, as part of Seychelles' debt restructuring; with the new bond having a 6-year grace period, 16 year maturity, and stepped-up interest rate schedule. The first payments on the outstanding principal of $169 million fall due in the second half of 2016. While the resulting higher debt service payments will put some additional pressure on the balance of payments, the amounts – biannual principal payments in equal installments over a decade (i.e., $17 million a year) – are expected to remain manageable in view of the country's comfortable reserve position and the expected external inflows.

While a large and growing proportion of the debt is owed to non-residents in foreign currency, the risks are mitigated by the significant finance available on favorable terms from official creditors. Similarly, while the economy's large external financing needs pose risks, in the past these needs have in large part been met through FDI (Annex 2). Any reduction in FDI should also serve to reduce the FDI-related imports that account for a significant proportion of the trade deficit.

Under a number of individual shock scenarios the debt-to-GDP ratio remains below the corresponding high-risk benchmark of 70 percent. Under the growth shock, the debt-to-GDP ratio would peak in 2017 and fall thereafter, but would remain 10 percentage points above the 50 percent target for 2018. A real exchange rate shock would see the debt increase slightly in 2016 but fall rapidly thereafter. Other one-time shocks to the primary balance and the real interest rate would merely moderate the pace of the fall in the debt-to-GDP ratio, but would delay the authorities' attainment of their debt reduction goal by one or two years. A combined macro-fiscal shock would send the debt-to-GDP ratio above the critical value of 70 percent. This

[4] Staff will discuss the authorities' debt plans over the medium term, including whether retaining some short term debt would be advisable for market development purposes.

combined shock is an aggregation of the shocks to real growth, the interest rate, the primary balance and the exchange rate. Under this scenario the debt-to-GDP ratio would peak close at around 85-90 percent before falling gradually, while the debt-to-revenue ratio would increase to almost 270 percent.

The public enterprises continue to pose risks to the achievement of the 2018 debt reduction goal. The SOE contingent liability shock assumes that the government would have to assume costs equivalent to five percent of GDP in 2017, equivalent to the liabilities assumed during the Air Seychelles restructuring in 2012. Under this scenario, the 2018 debt target would be exceeded by almost five percent of GDP, although over the medium term it would resume its downward trajectory.

The baseline scenario and the numerous shocks produced by the DSA template indicate that, while Seychelles remains very vulnerable to exogenous shocks, continued strong policy implementation should see these risks diminish over the medium term. Under the baseline, gross financing fall below the 15 percent indicative threshold by the end of the projection period. While public debt as a percent of revenues remains at broadly sustainable levels under the shock scenarios, gross financing needs increase significantly, especially under the combined macro-fiscal shock or the real GDP growth shock, highlighting the need for continued fiscal consolidation and growth to reduce risks. The authorities agreed with the broad conclusions of the debt sustainability analysis, and stressed their commitment to continued debt reduction.

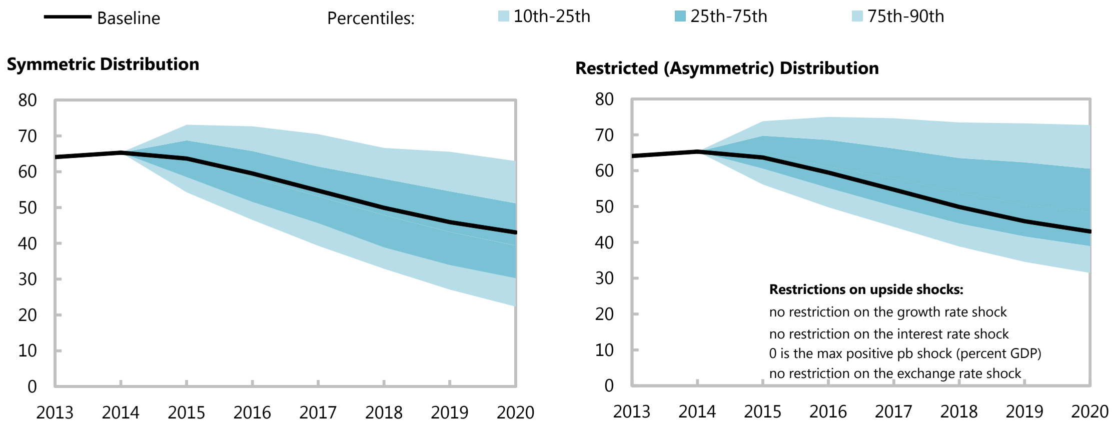
Seychelles Public DSA Risk Assessment

Heat Map

Debt level 1/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs 2/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile 3/	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

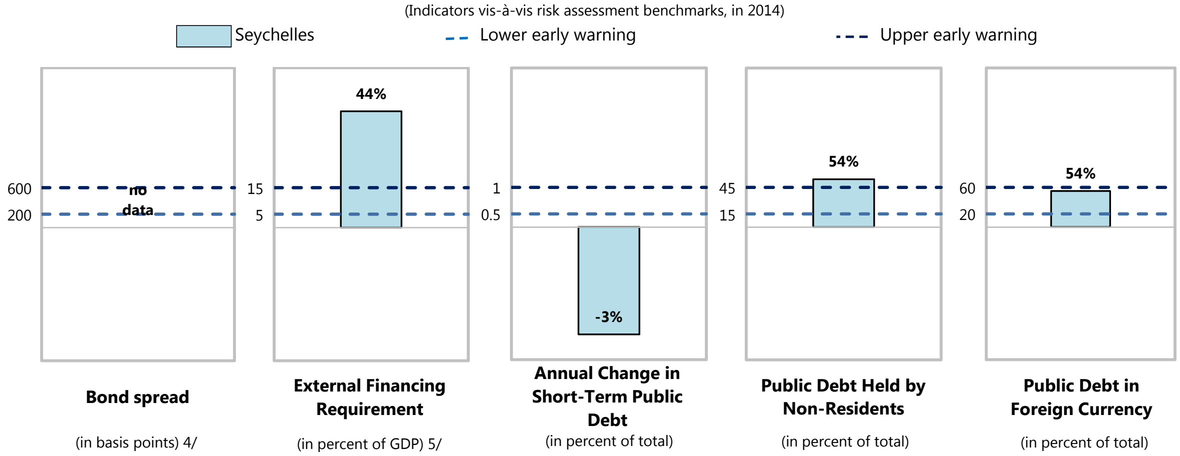
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2014)



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.
Lower and upper risk-assessment benchmarks are:

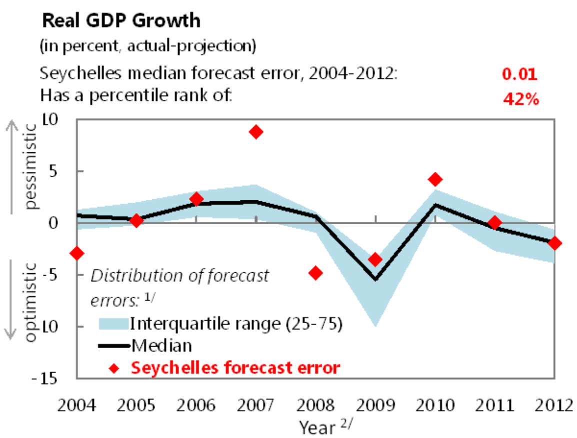
200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

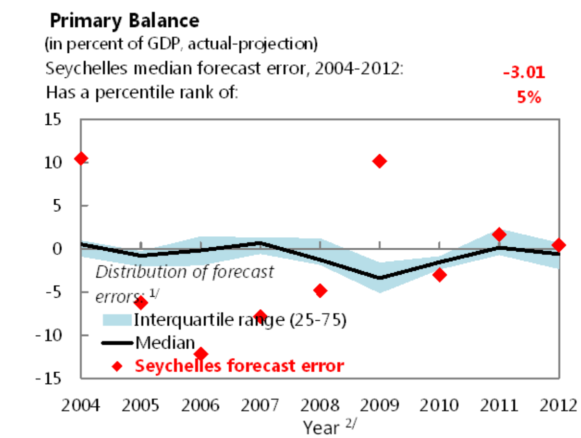
4/ Long-term bond spread over German bonds, an average over the last 3 months, 12-Nov-14 through 10-Feb-15.

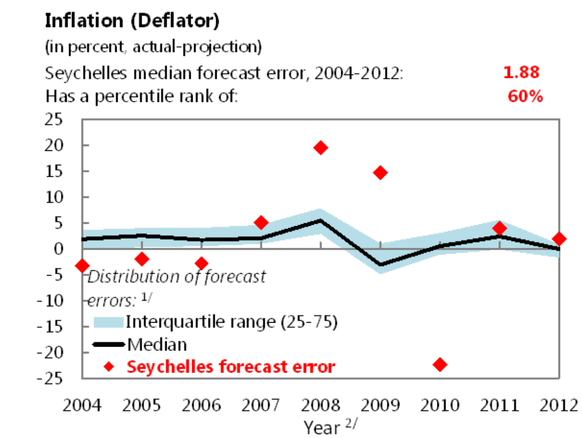
5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

Seychelles Public DSA - Realism of Baseline Assumptions

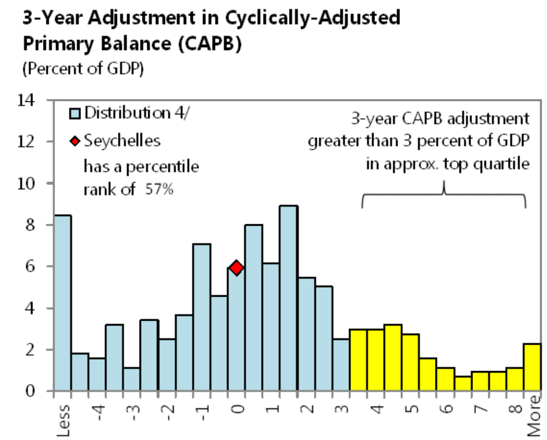
Forecast Track Record, versus program countries

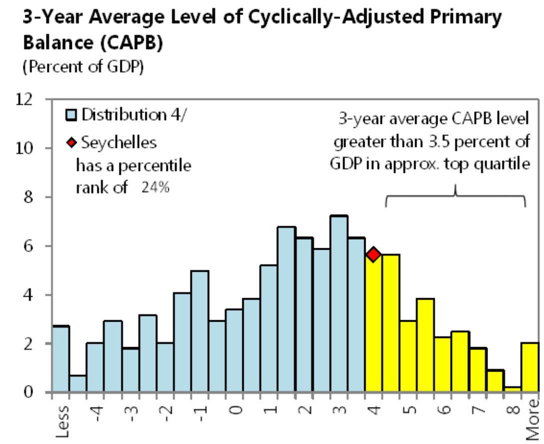




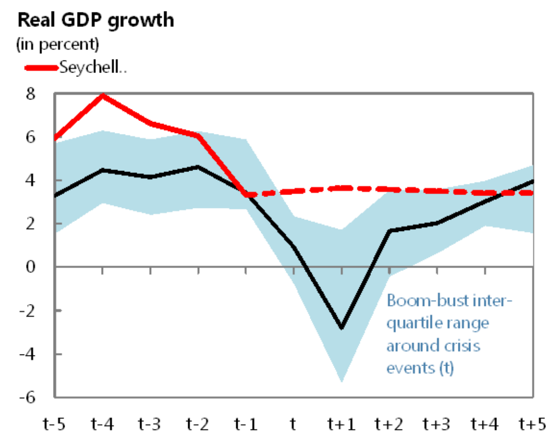


Assessing the Realism of Projected Fiscal Adjustment





Boom-Bust Analysis 3/



Source : IMF Staff.

1/ Plotted distribution includes program countries, percentile rank refers to all countries.

2/ Projections made in the spring WEO vintage of the preceding year.

3/ Seychelles has had a positive output gap for 3 consecutive years, 2012-2014. For Seychelles, t corresponds to 2015; for the distribution, t corresponds to the first year of the crisis.

4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Seychelles Public Sector Debt Sustainability Analysis (DSA) - Baseline Scenario

(in percent of GDP unless otherwise indicated)

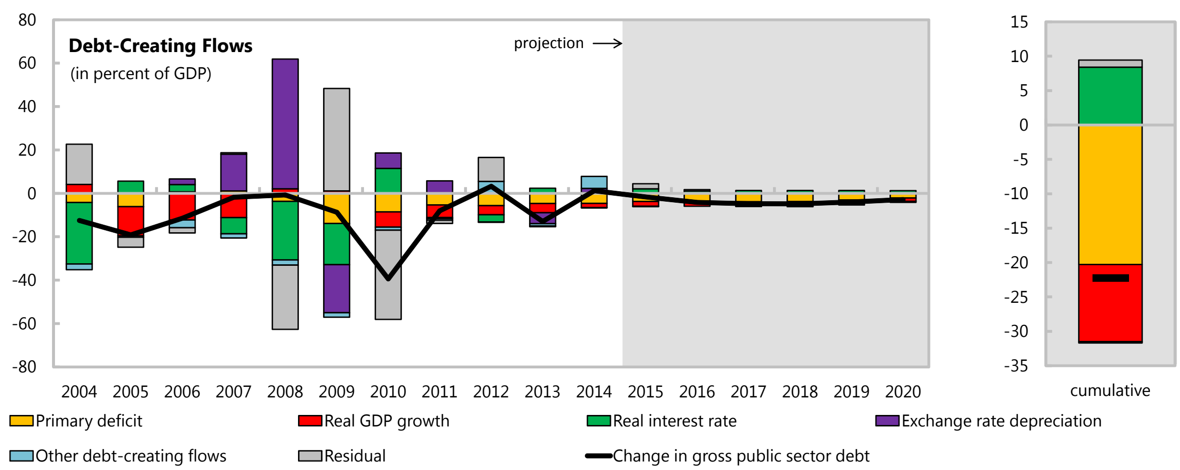
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2004-2012 [2/]	2013	2014	2015	2016	2017	2018	2019	2020
Nominal gross public debt	117.2	64.1	65.3	63.7	59.5	54.7	49.9	45.9	43.1
Of which: guarantees	0.9	1.5	1.1	1.1	1.0	0.9	0.9	0.8	0.8
Public gross financing needs	32.8	23.1	17.8	19.4	17.0	16.5	14.4	11.4	10.6
Net public debt	116.5	59.3	54.9	53.8	50.3	46.1	41.8	38.3	35.9
Real GDP growth (in percent)	4.8	6.0	3.3	3.5	3.7	3.6	3.5	3.4	3.4
Inflation (GDP deflator, in percent)	12.4	3.2	3.1	2.1	2.8	3.0	3.0	3.0	3.0
Nominal GDP growth (in percent)	17.2	9.5	6.6	5.7	6.6	6.7	6.6	6.5	6.5
Effective interest rate (in percent) [4/]	5.5	6.8	3.8	5.7	4.7	5.4	5.6	5.9	6.1

As of February 10, 2015		
Sovereign Spreads		
EMBIG (bp) 3/		n.a.
5Y CDS (bp)		n.a.
Ratings	Foreign	Local
Moody's	n.a.	n.a.
S&Ps	n.a.	n.a.
Fitch	B+	BB-

Contribution to Changes in Public Debt

	Actual			Projections							
	2004-2012	2013	2014	2015	2016	2017	2018	2019	2020	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	-11.0	-13.0	1.2	-1.6	-4.2	-4.8	-4.8	-4.0	-2.9	-22.3	
Identified debt-creating flows	-10.8	-12.7	1.2	-4.0	-4.9	-4.5	-4.3	-3.3	-2.3	-23.3	
Primary deficit	-5.0	-4.6	-4.6	-3.8	-3.8	-3.8	-3.8	-3.0	-2.2	-20.3	-0.2
Primary (noninterest) revenue and grants	37.3	35.9	35.4	34.2	33.4	33.1	32.9	32.7	32.3	198.6	
Primary (noninterest) expenditure	32.3	31.3	30.8	30.4	29.7	29.3	29.1	29.7	30.2	178.3	
Automatic debt dynamics [5/]	-4.6	-7.0	0.4	0.0	-1.1	-0.7	-0.5	-0.3	-0.2	-2.8	
Interest rate/growth differential [6/]	-12.4	-1.9	-1.7	0.0	-1.1	-0.7	-0.5	-0.3	-0.2	-2.8	
Of which: real interest rate	-7.2	2.4	0.3	2.2	1.0	1.3	1.3	1.3	1.3	8.4	
Of which: real GDP growth	-5.2	-4.3	-2.0	-2.2	-2.2	-2.0	-1.8	-1.6	-1.5	-11.2	
Exchange rate depreciation [7/]	7.8	-5.1	2.0	…	…	…	…	…	…	…	
Other identified debt-creating flows	-1.1	-1.1	5.5	-0.2	0.0	0.0	0.0	0.0	0.0	-0.2	
Privatization Proceeds (negative)	-1.8	-0.3	-0.4	-0.2	0.0	0.0	0.0	0.0	0.0	-0.2	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Domestic debt issuance for monetary pu	0.7	-0.8	5.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [8/]	-0.2	-0.3	0.0	2.3	0.7	-0.3	-0.5	-0.7	-0.5	1.0	



Source: IMF staff.

1/ Public sector is defined as central government and includes public guarantees, defined as .

2/ Based on available data.

3/ Long-term bond spread over German bonds.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as [(r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as r - π (1+g) and the real growth contribution as -g.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).

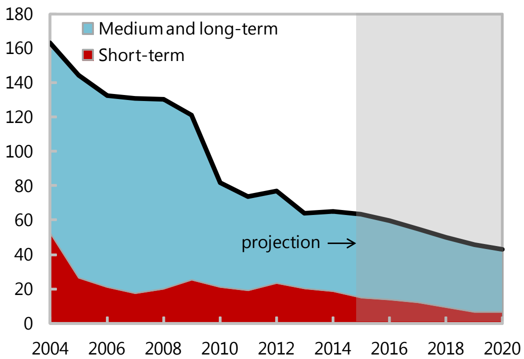
8/ Includes changes in the stock of guarantees, asset changes, and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

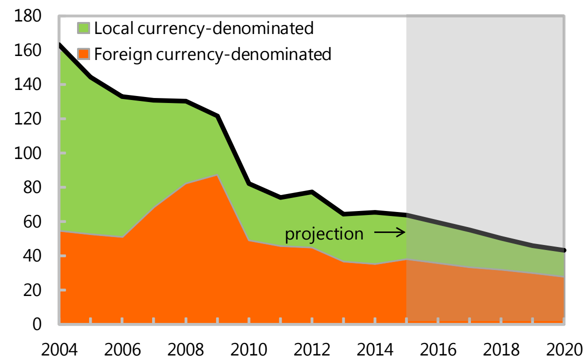
Seychelles Public DSA - Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



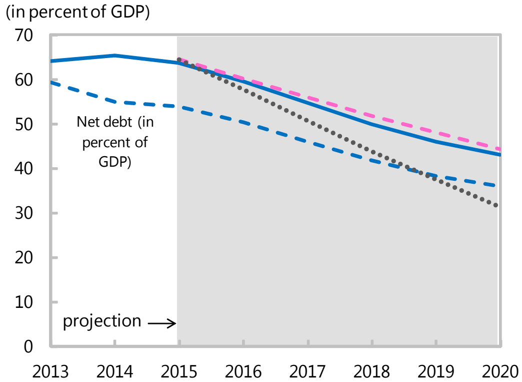
By Currency
(in percent of GDP)



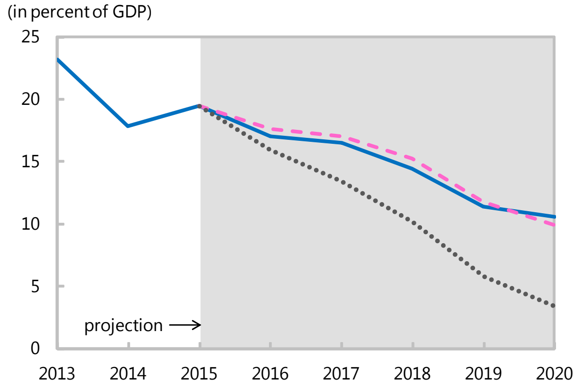
Alternative Scenarios

Baseline Historical Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions
(in percent)

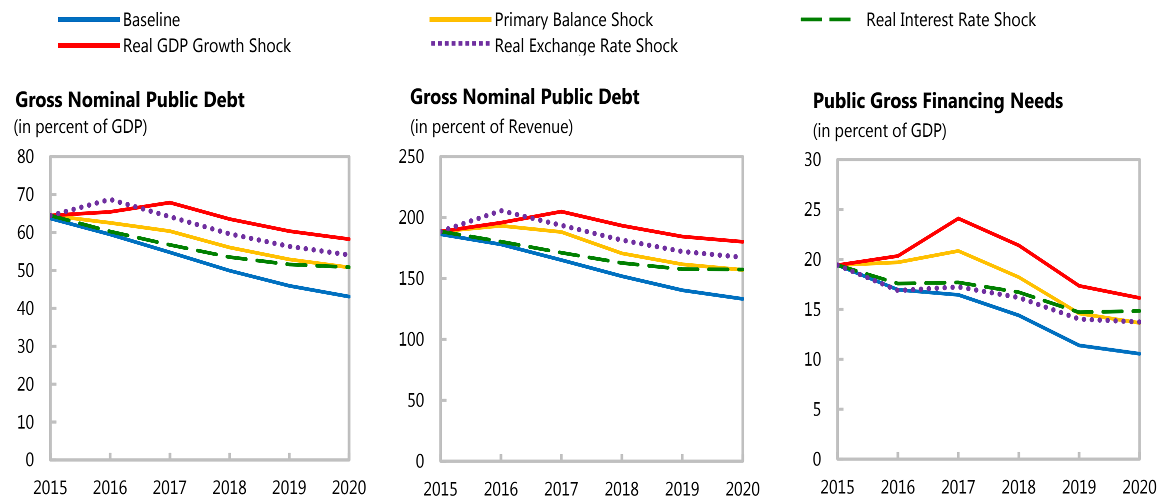
Baseline Scenario	2015	2016	2017	2018	2019	2020
Real GDP growth	3.5	3.7	3.6	3.5	3.4	3.4
Inflation	2.1	2.8	3.0	3.0	3.0	3.0
Primary Balance	3.8	3.8	3.8	3.8	3.0	2.2
Effective interest rate	5.7	4.7	5.4	5.6	5.9	6.1
Constant Primary Balance Scenario						
Real GDP growth	3.5	3.7	3.6	3.5	3.4	3.4
Inflation	2.1	2.8	3.0	3.0	3.0	3.0
Primary Balance	3.8	3.8	3.8	3.8	3.8	3.8
Effective interest rate	5.7	4.6	5.4	5.6	5.8	5.9

Historical Scenario	2015	2016	2017	2018	2019	2020
Real GDP growth	3.5	5.5	5.5	5.5	5.5	5.5
Inflation	2.1	2.8	3.0	3.0	3.0	3.0
Primary Balance	3.8	5.0	5.0	5.0	5.0	5.0
Effective interest rate	5.7	4.6	4.5	4.5	4.6	4.8

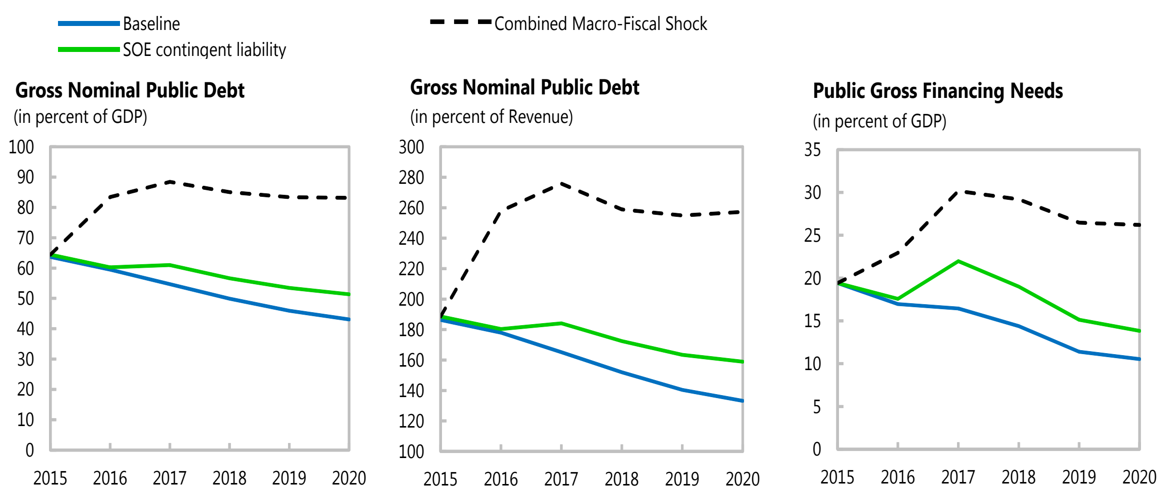
Source: IMF staff.

Seychelles Public DSA - Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

(in percent)

	2015	2016	2017	2018	2019	2020
Primary Balance Shock						
Real GDP growth	3.5	3.7	3.6	3.5	3.4	3.4
Inflation	2.1	2.8	3.0	3.0	3.0	3.0
Primary balance	3.8	1.6	1.7	3.8	3.0	2.2
Effective interest rate	5.7	4.6	5.4	5.5	5.7	5.8
Real Interest Rate Shock						
Real GDP growth	3.5	3.7	3.6	3.5	3.4	3.4
Inflation	2.1	2.8	3.0	3.0	3.0	3.0
Primary balance	3.8	3.8	3.8	3.8	3.0	2.2
Effective interest rate	5.7	4.6	6.7	7.4	8.2	8.7
SOE contingent liability						
Real GDP growth	3.5	3.7	3.6	3.5	3.4	3.4
Inflation	2.1	2.8	3.0	3.0	3.0	3.0
Primary balance	3.8	3.8	-1.2	3.8	3.0	2.2
Effective interest rate	5.7	4.6	5.4	5.4	5.7	5.8

	2015	2016	2017	2018	2019	2020
Real GDP Growth Shock						
Real GDP growth	3.5	-0.6	-0.7	3.5	3.4	3.4
Inflation	2.1	1.8	1.9	3.0	3.0	3.0
Primary balance	3.8	2.1	0.6	3.8	3.0	2.2
Effective interest rate	5.7	4.6	5.4	5.5	5.7	5.7
Real Exchange Rate Shock						
Real GDP growth	3.5	3.7	3.6	3.5	3.4	3.4
Inflation	2.1	13.5	3.0	3.0	3.0	3.0
Primary balance	3.8	3.8	3.8	3.8	3.0	2.2
Effective interest rate	5.7	5.6	5.0	5.1	5.4	5.5
Combined Shock						
Real GDP growth	3.5	-0.6	-0.7	3.5	3.4	3.4
Inflation	2.1	1.8	1.9	3.0	3.0	3.0
Primary balance	3.8	1.1	-0.5	3.8	3.0	2.2
Effective interest rate	5.7	5.6	6.1	6.8	7.7	8.2

Source: IMF staff.

Annex 2. External Debt Sustainability Analysis

For the first time, this DSA includes data from the private sector and commercial SOEs.[1] Consequently, the debt-to-GDP ratio at end-2014 is now estimated to be around 117 percent (this newly collected data may very well be subject to revisions in the future). Despite this high number, staff view the risks as mitigated in light of the composition of external debt and maturity profile. The analysis suggests that the external debt burden remains stable and is projected to be on a downward trajectory under the baseline scenario. However, given the country's small size, large external debt, and heavy import dependence, the debt trajectory remains sensitive to exogenous shocks, especially in the exchange rate.

Seychelles' debt stock consists largely of borrowing by the public and tourism sectors. As of end 2014, one third of the country's external debt is long-term government borrowing, largely from official sources (Table 1). A further third is FDI-related borrowing, largely to the hotel sector, and less than 20 percent of the debt is short-term, largely trade credits and other lines of credit. The intra-company lending that accounts for a large portion of the debt stock is believed to pose lower risks than unrelated lending, due, for example, to the greater ease of rescheduling in the event of a downturn.[2]

The country's external debt burden increased slightly in 2014, following a widening current account deficit and the rupee depreciation. External debt stood at 117.1 percent of GDP in 2014, 4.9 percentage points higher than in the previous year but considerably below the levels prevailing during 2010-12 (Table 2). Large FDI inflows, lower-than-projected public borrowing, and the fall in the Euro (over a quarter of the country's debt stock is Euro-denominated) offset the wider current account deficit and the effect of the currency depreciation.

As a result of the compilation of data on the IIP, the CBS has revised the relative composition of FDI from 2015 and beyond. While it had previously been assumed that approximately 2/3 of FDI consisted of equity investments and the remaining fraction of debt liabilities, recent data suggest that the debt component is larger. While the data for past years have not yet been revised, the projections for 2015 and beyond incorporate the modified assumption. This explains the increase in the stock of external debt to 130 percent of GDP in 2015 and the more modest contribution of non-debt creating capital inflows compared to previous years. Under current policies, the external debt level is projected to fall gradually over time.

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[1] As a result of data constraints, previous external DSAs for Seychelles focused exclusively on external government and government-guaranteed debt. However, a Statistics TA mission conducted in February 2014 supported IIP compilation, including improved coverage of the accounting data of SOEs, hotels, construction companies, deposit taking institutions and other entities with considerable external assets and liabilities.

[2] See for example "FDI in Tourism: The Development Dimension", UNCTAD, 2007, p61.

Table 1. Stock of Gross External Debt at end-2014
(US$ Millions)

Total Gross External Debt	1,670
Government and government guaranteed debt	505
Of which multilateral	161
Bilateral Paris club	77
Bilateral non-Paris club	45
Commercial and Bonds	222
Private debt (including commercial SOEs)	1,165
Direct investment	653
Portfolio investment	0.4
Other investment	512
Long-term loans	178
Short-term loans	232
Trade credit and advances	103

Sources: Seychelles authorities and IMF staff estimates.

Standardized stress tests confirm that the country's external debt is particularly sensitive to currency depreciation shocks. A 30 percent depreciation of the domestic currency would increase the external debt-to-GDP ratio almost 60 percent in the first year after the shock, and is projected to remain considerably higher than the baseline by the end of period. While this scenario does not account for beneficial second round effects coming from the improved competitiveness and trade balance, it is reasonable to assume that these gains would be smaller than in other countries, given the structural constraints to which a small, tourism-dependent island economy like Seychelles is subject.

Interest rate, growth and current account shocks would have a more muted effect on the debt profile. A ½ standard deviation increase in nominal external interest rates on new debt over the period 2015–2020 would have minor consequences on the profile of the external debt stock. This outcome is partly due to the relatively low and fixed interest rates that the country contracted in the past, thanks in large part to the official sources that lent and restructured debt at favorable rates, along with the current global low interest rate regime. A permanent ½ standard deviation shock to either growth or the current account (excluding interest payments) would lead to a slow build up of the external debt-to-GDP ratio over time, overshooting the baseline projection by about 10 percentage points in 2020.

Figure 1. External Debt Sustainability: Bound Tests[1/ 2/]

Sources: IMF, Country desk data, and staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one -half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.

3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

4/ One-time real depreciation of 30 percent occurs in 2015.

Table 2. External Debt Sustainability Framework, 2010-2020

(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	**Debt-stabilizing non-interest current account 6/**
1 **Baseline: External debt**	142.7	156.5	137.2	112.2	117.4	**130.0**	**127.9**	**129.3**	**128.7**	**128.0**	**127.2**	**-8.2**
2 Change in external debt	-48.7	13.9	-19.4	-25.0	5.2	12.7	-2.2	1.4	-0.5	-0.7	-0.9	
3 Identified external debt-creating flows (4+8+9)	-16.2	1.1	-0.7	-25.5	11.4	6.7	6.1	5.7	4.8	4.1	3.7	
4 Current account deficit, excluding interest payments	15.6	20.5	18.8	10.4	20.0	14.0	13.4	13.8	12.4	11.0	10.0	
5 Deficit in balance of goods and services	14.2	15.6	16.6	7.4	15.1	10.1	9.2	9.4	8.6	7.3	5.9	
6 Exports	93.8	95.8	92.8	85.5	83.1	78.6	78.1	78.9	77.8	77.5	77.1	
7 Imports	108.0	111.4	109.4	92.9	98.2	88.7	87.4	88.4	86.4	84.7	83.0	
8 Net non-debt creating capital inflows (negative)	-11.1	-7.7	-11.2	-10.1	-8.6	-4.2	-4.1	-4.9	-4.6	-3.9	-3.3	
9 Automatic debt dynamics 1/	-20.7	-11.8	-8.3	-25.8	0.0	-3.1	-3.2	-3.1	-3.1	-3.0	-3.0	
10 Contribution from nominal interest rate	3.4	1.0	1.1	1.1	1.0	1.2	1.3	1.2	1.2	1.2	1.2	
11 Contribution from real GDP growth	-9.9	-10.2	-9.7	-6.7	-3.7	-4.2	-4.4	-4.3	-4.3	-4.2	-4.2	
12 Contribution from price and exchange rate changes 2/	-14.2	-2.6	0.3	-20.2	2.8	...	...	...	...	...	...	
13 Residual, incl. change in gross foreign assets (2-3) 3/	-32.5	12.8	-18.6	0.6	-6.3	5.9	-8.3	-4.3	-5.3	-4.8	-4.6	
External debt-to-exports ratio (in percent)	152.1	163.5	147.9	131.2	141.3	165.4	163.6	163.8	165.4	165.3	164.9	
Gross external financing need (in billions of US dollars) 4/	229.0	494.8	627.2	528.5	620.8	570.4	585.6	615.2	618.7	616.2	623.9	
in percent of GDP	23.6	46.4	55.3	37.5	43.6	41.5	39.8	39.6	37.5	35.5	34.2	
Scenario with key variables at their historical averages 5/						**130.0**	**132.6**	**136.7**	**140.6**	**144.8**	**149.3**	**-8.0**
Key Macroeconomic Assumptions Underlying Baseline												
Real GDP growth (in percent)	5.9	7.9	6.6	6.0	3.3	3.5	3.7	3.6	3.5	3.4	3.4	
GDP deflator in US dollars (change in percent)	8.0	1.8	-0.2	17.3	-2.4	-6.6	3.2	2.1	2.4	1.9	1.5	
Nominal external interest rate (in percent)	2.1	0.8	0.8	1.0	0.9	1.0	1.1	1.0	1.0	1.0	1.0	
Growth of exports (US dollar terms, in percent)	-0.6	12.2	3.1	14.6	-2.0	-8.6	6.4	6.8	4.5	4.9	4.5	
Growth of imports (US dollar terms, in percent)	5.6	13.3	4.5	5.5	6.6	-12.7	5.4	6.9	3.7	3.3	2.9	
Current account balance, excluding interest payments	-15.6	-20.5	-18.8	-10.4	-20.0	-14.0	-13.4	-13.8	-12.4	-11.0	-10.0	
Net non-debt creating capital inflows	11.1	7.7	11.2	10.1	8.6	4.2	4.1	4.9	4.6	3.9	3.3	

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

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

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

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

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

Annex 3. Inward Spillovers and the Tourism Sector

Being a small and very open economy that relies heavily on imports and counts only one major export service sector, Seychelles is naturally highly exposed to inward spillovers from the rest of the world. This annex quantifies the domestic transmission mechanism to exogenous growth shocks and assesses the business cycle properties of tourism flows conditional on the identified shock. To this end, a vector autoregressive model (VAR) is estimated on annual data covering the period from 2000 to 2013. Bayesian methods are adopted to cope with short sample problems, while the prior distributions of the parameters are centered to the posterior values obtained from a panel-VAR for Seychelles, Mauritius and Maldives in order to further tailor the model to regional-specific characteristics.[1] *The results suggest that the domestic multiplier to an expansionary output shock in the Euro Area exceeds unity. The short-run dynamics of private investment and trade are influenced to a considerable extent by the economic performance of key source markets for tourists, which can be a source of vulnerability. Diversification of tourism markets away from Europe would decrease sensitivity to economic developments in a single region and enhance resilience. The creation of domestic value added can be facilitated by further integrating domestic businesses into the tourism value chain.*

Seychelles is considerably exposed to growth shocks coming from Europe. A one standard deviation negative shock to Euro Area output reduces the number of tourist arrivals in Seychelles, and has a contractionary effect on domestic output, which remains below its equilibrium level for several years (Figure 1). Private investment falls on impact, as plans to improve the existing stock of tourism facilities and the launch of new ones are temporarily reduced. The external balance improves, which suggests that the imports of goods fall more than the exports of tourism services in response to the shock.[2]

The domestic business cycle is linked to traditional source markets in Europe, although this may change in the future as arrivals from emerging markets pick up. Domestic output in Seychelles moves more than one-to-one in response to a growth shock in Europe, a fact that confirms the strong link between the Seychelles and its traditional tourist source markets (Table 1). The largest growth multiplier is observed with France (1.59), while Germany and Italy score 1.32 and 1.02 respectively. Therefore, the economy in Seychelles remains primarily exposed to growth impulses from Europe, while emerging market countries are marginal for the domestic business cycle as their growth, investment and current account multipliers are lower[3]. However, the situation may change in the future as the number of arrivals from emerging markets rises further, and businesses from those regions consolidate their presence in Seychelles. This will help to reduce the sensitivity of

[1] Identification of the shock is obtained by means of a Cholesky decomposition of the posterior variance-covariance matrix of the residuals. The variables are ordered as follows: source country output, tourist arrivals, real effective exchange rate, domestic output, investment and the ratio of exports over imports of goods and services. For a similar application see F. Canova and P. Dallari "How important is tourism for the international transmission of cyclical fluctuations? Evidence from the Mediterranean", ECB Working Paper No. 1553.

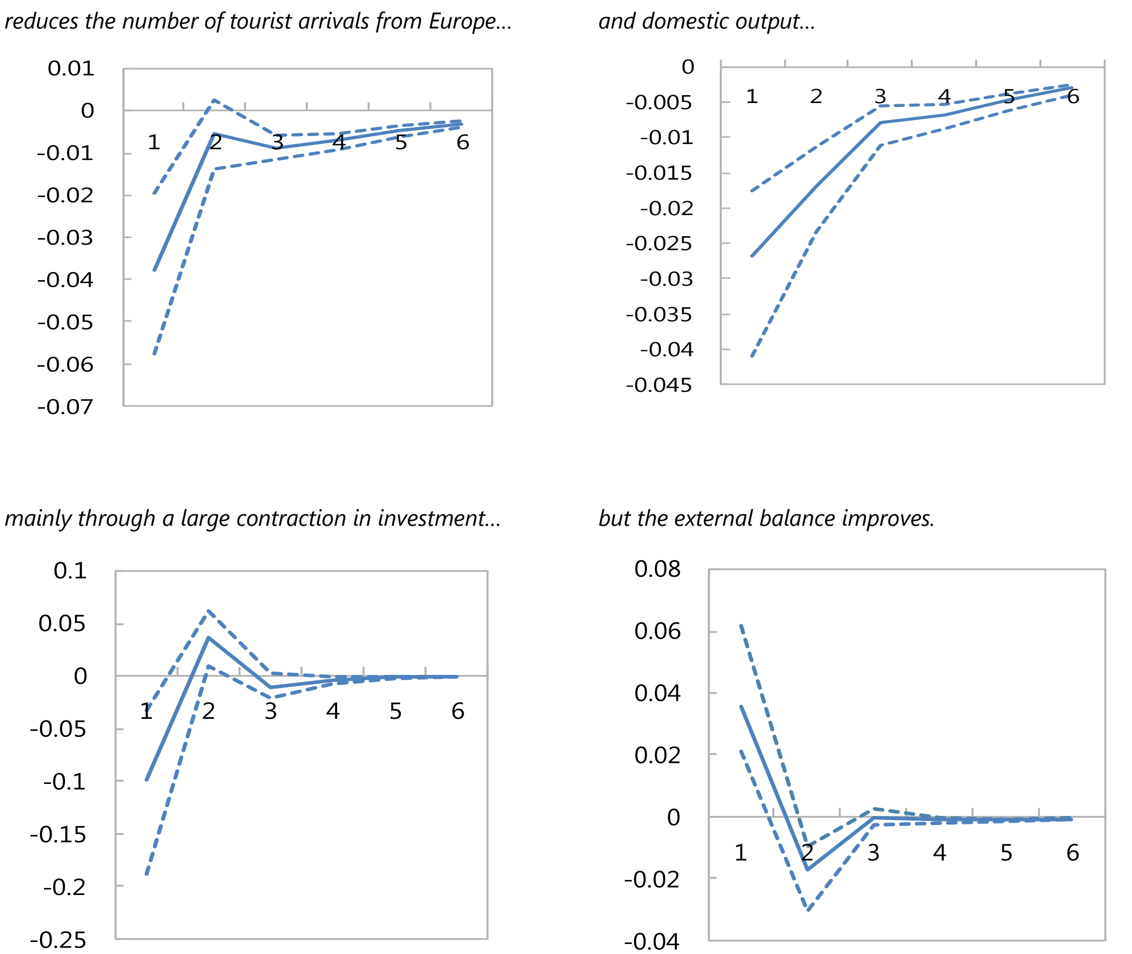
[2] As most goods for consumption and investment are imported from abroad, a slowdown in domestic output is closely reflected in imports' dynamics. In fact, the correlation of imports with domestic (0.87) output is higher compared to the correlation between exports and output (0.67) over the estimation sample.

[3] Table 1 considers the example of Russia, which ranked fourth in 2014 in terms of number of tourist arrivals.

the domestic cycle to economic developments in a single region, to increase the level of income generated by tourism-related activities, and to make tourism flows more stable throughout the year. In fact, compared to European tourists, tourists from the UAE have higher per capita expenditures, and they reportedly tend to engage in high value added activities more often than Europeans tend to do, such as shopping and sport fishing.[4] Importantly, the geographical proximity to tourist markets in Africa and the Arab peninsula can help to increase the share of repeat visitors in Seychelles, which was only 10 percent of total tourist arrivals in 2014.

Figure 1. Impulse responses to a Euro Area output shock

A one standard deviation negative shock to Euro Area output…



Note: Continuous line median IRF; dotted lines 64 percent confidence interval.

[4] In 2013, average per capita expenditures of tourists from the UAE were more than four times higher than those of French tourists.

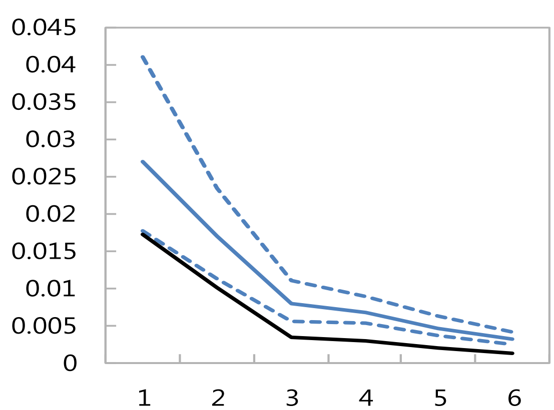
Table 1. Multipliers to Source Country Output Shocks

	Tourism		Growth		Investment		Current Account	
	Short run	Long run	Short run	Long run	Short run	Long run	Short run	Long run
Euro Area	2.118*	0.169*	1.511*	0.169*	5.579*	0.039*	-2.000*	0.034*
France	2.202*	0.147*	1.595*	0.172*	4.890*	0.043*	-2.227	0.031*
Germany	1.953*	0.121*	1.316*	0.153*	5.549*	0.047*	-2.084*	0.028*
Italy	2.086*	0.129*	1.019*	0.158*	3.215	0.038*	-1.632*	0.029*
Russia	-0.144	0.063	0.275	0.129	2.016	-0.014	-0.682	0.027

Note: Stars denote the results are statistically different from zero using a 64 percent confidence interval. These results do not control for changes in tourism flows from other countries.

The tourism sector is a key channel for the transmission of inward spillovers from abroad, as more than 30-60 percent of the international transmission of the shock can be traced to tourism. The responses of domestic variables to a shock in output in the Euro Area are the sum of two distinct effects: a pure output shock effect and an effect due to changes in tourism flows. The first measures spin-offs due to the fact that shocks in source and destination country output may be correlated; the second the indirect effect that source country output fluctuations may have via tourism flows. A counterfactual simulation is used to estimate the response of domestic output in Seychelles to the shock assuming that no change in tourist arrivals is observed.[5] Absent the tourism channel, domestic output would increase on impact 36 percent less than under the baseline according to the central estimate, and 58 percent less compared to the upper bound of likely outcomes (Figure 2, black line). In other words, within the first year from the shock, up to almost two thirds of the expansion in domestic output occurs through tourism-related activities. As the growth differential under the two scenarios is not limited to the first year, but instead remains stable throughout the projection period, the cumulated (central) losses in terms of unrealized growth potential can be substantial.

Figure 2. Contribution of Tourism to Output Growth



Year from the shock	Output loss
1	-36.4
2	-40.8
3	-56.4
4	-58.2
5	-60.9
6	-60.0

[5] Equivalently, the indirect contribution to the growth multiplier coming from tourism is zeroed out, leaving only the pure output shock effect.

Income sensitive tourism flows and high concentration of investment plans in the tourism sector constitute major vulnerabilities. The short-run elasticity of tourist arrivals to output shocks is around two in all top European source markets (Table 1). The high elasticity of tourism flows to available income may result from several factors, including the fact that Seychelles is perceived as a luxury destination, a "once-in–a-lifetime" experience that European households undertake when disposable income is high. Clearly, this leaves the domestic economy highly exposed to headwinds from Europe. Also, the large elasticity of private domestic investment to the European business cycle suggests that a relevant part of investment opportunities in Seychelles are related to the tourism sector and dependent on factors that are exogenous to the local economy. This can jeopardize the contribution of investment to growth, as private funds are used to finance facilities to serve the tourism market, rather than projects aimed at improving the country's infrastructure needs.

Future analysis should focus on linkages, especially the contribution of the tourism sector to the domestic economy and on identifying ways to maximize the creation of value added on-site. The interconnectedness of Seychelles with the rest of the world is substantial, and it occurs for the most part through the tourism industry. Future work will aim at identifying strategies to augment the domestic component of tourism-related activities, and to maximize the benefits to the local community that is generated from the industry. In principle, this may encompass a wide array of topics, such as tax policies, financing incentives, or entertainment activities for tourists envisaging a strong engagement from locals. Some progress in this direction has already been realized. The number of guest houses has been increasing recently; compared to international hotel groups, guest houses are more often managed by locals and have stronger linkages to the local economy. The hotels too are increasingly focused on the local content and "flavor" of their product, whether it be local fresh fish or offering excursions and water sports provided by local businesses.

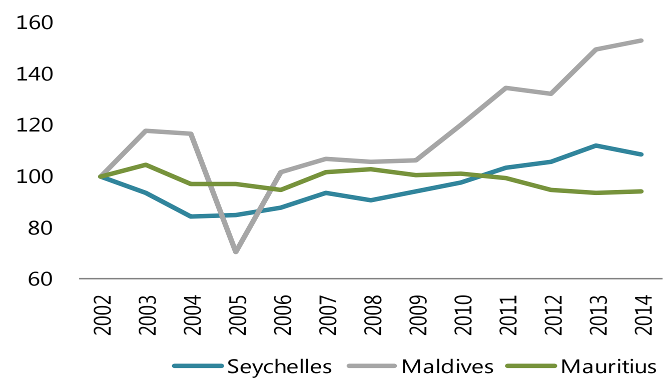
Annex 4. External Stability and Competitiveness Assessment

Under the current policy plans, external stability is strengthening and near-term risks appear contained. Reserve coverage is projected to remain at adequate levels, taking into account Seychelles' vulnerabilities. Exchange rate flexibility has allowed the value of the Seychellois Rupee to remain broadly in line with fundamentals.

Staff's analysis suggests that the immediate risks to the external position appear manageable. The balance of payments pressures that led to a 16 percent depreciation in the rupee percent against the dollar in the second half of 2014 have abated as tourism recovered, such that the Central Bank was able to make additional international reserves purchases. The current account deficit is expected to fall over the medium term as FDI flows moderate, policy tightening has an effect, and the oil price stabilizes at levels lower than those prevailing in the recent past. However, medium-term vulnerabilities remain significant and need to be addressed through continued fiscal discipline, structural reforms to support diversification of the economy, and exchange rate flexibility.

Seychelles remains a competitive destination for tourism. Its share in global tourist arrivals has been growing gradually, during the last six years, though after an exceptional 2013 there was a slight dip in 2014. Arrivals recovered towards the end of the year and closed 1 percent higher compared to the previous year. As Seychelles' traditional source markets are located in Europe, development of the tourism sector has suffered from the region's protracted slow growth. However, increased arrivals from Germany partially offset the reduction in tourist flows from France and Italy. Preliminary evidence for the first quarter of 2015 points to a good start of the year, with arrivals up 14 percent compared to previous year, with a recovery from France and Italy offsetting a drop of 25 percent in arrivals from Russia. For the years ahead, the projected recovery in Europe and the marketing strategy that is in place to penetrate new markets (China, India, and the Gulf) point towards a positive medium-term outlook for the island's tourism industry.

Share in world tourism arrivals, normalized (2002 = 100)

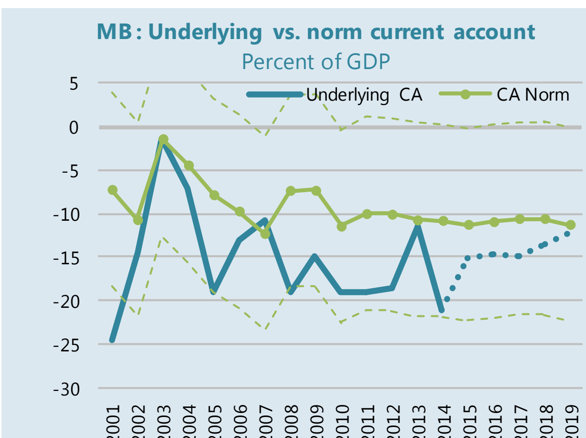


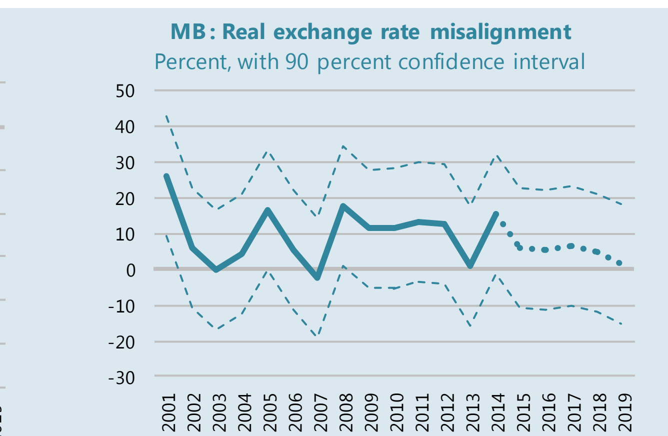
More could be done to improve Seychelles' attractiveness to investors, both foreign and domestic. According to the World Bank Doing Business indicators, access to electricity, starting a business and credit availability are particular areas of weakness, although the country's scores improved in contract enforcement and the process of resolving insolvency, both relevant for the tourism industry as they are conducive to foreign investments (see Text Figure 3). However, additional actions from the authorities, leading to a more expeditious improvement in the overall doing business indicators, are recommended.

The path of international reserves is projected to remain at adequate levels over the medium term, after taking account of expected pressures. Seychelles' reserves as of end-2014 appear comfortable by the IMF's composite metric, as well as the other commonly-used rules of thumb, even after reflecting the higher private debt in the new International Investment Position data (which might be subject to revision). The import coverage ratio reached 4.6 months in 2014, higher than projected, thanks to the rapid decline of the oil price which contributed to reducing the country's import bill (Table 1). At the same time, the Central Bank of Seychelles capitalized on favorable developments in the market for foreign exchange to further strengthen its international reserves buffer.[1] The projections for outer years indicate a marginal decline in reserve coverage as the debt service due on the Eurobond begins to fall due, and as inflows of foreign capital stabilize.

As of end-2014, the real exchange rate of the Seychellois Rupee appears to be in line with medium-term fundamentals. Staff's empirical strategy follows Vitek's "Exchange Rate Assessment Toolkit" (2012), based on the application of three CGER approaches: macroeconomic balance (MB), external sustainability (ES) and equilibrium real exchange rate (ERER).[2] The results are broadly congruous across the three methodologies. The estimated exchange rate misalignment is comparable to past trends, and it falls within the statistical confidence interval. The forecasts carried over the projection horizon point to the beneficial role that the rupee depreciation played starting from end 2014 to help contain an incipient exchange rate misalignment that had built up in the first half of the year.

The MB approach shows that the measured real exchange rate misalignment, which was around 5 percent in 2013, increased in 2014 but is expected to recover promptly in the following years.

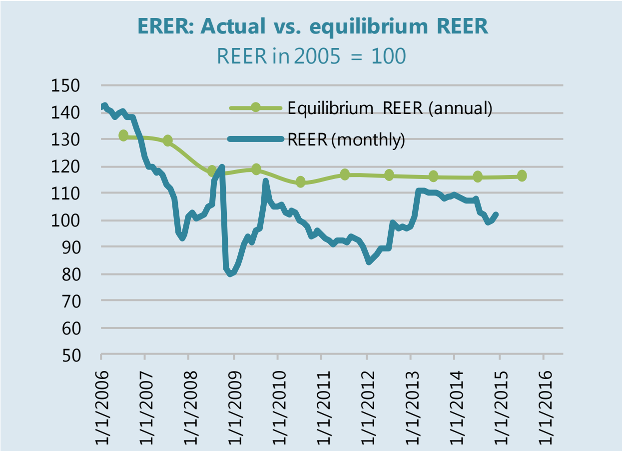


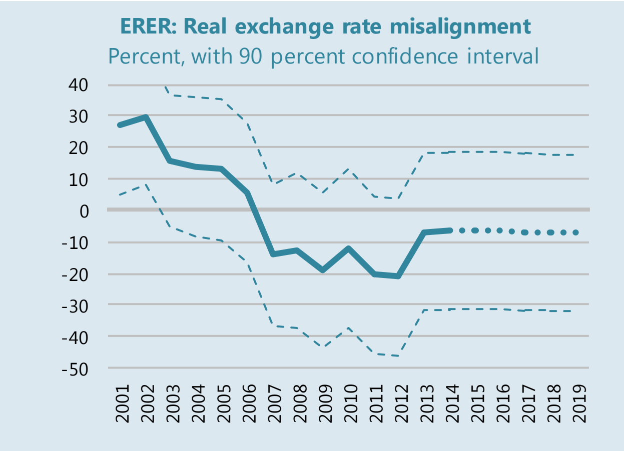


[1] See Country Report No. 14/186 for a more detailed discussion of reserve adequacy issues in Seychelles.

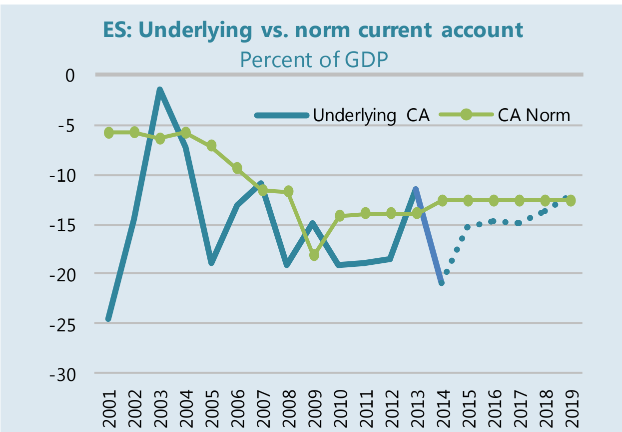
[2] The EBA-lite approach suggested a current account norm close to balance, which in staff's view is not consistent with Seychelles' position as a tourism-dependent small island state.

According to the ERER results, the equilibrium exchange rate has remained fairly constant since 2008, while the monthly observations capture the rising undervaluation, which bottomed by the last quarter of 2014. The estimated real exchange rate misalignment remains roughly stable compared to the previous year, and the confidence bands around the central estimate encompass the zero line.





The ES approach also captures the widening current account deficit and correspondingly detects a real exchange rate overshooting. However, the widening current account is temporary in nature and the misalignment small in size. As the newly adopted methodology to estimate tourism earnings led to a remarkable increase in the value of service exports, the current account norm under the ES approach is now estimated around -12 percent of GDP, in line with the MB approach.



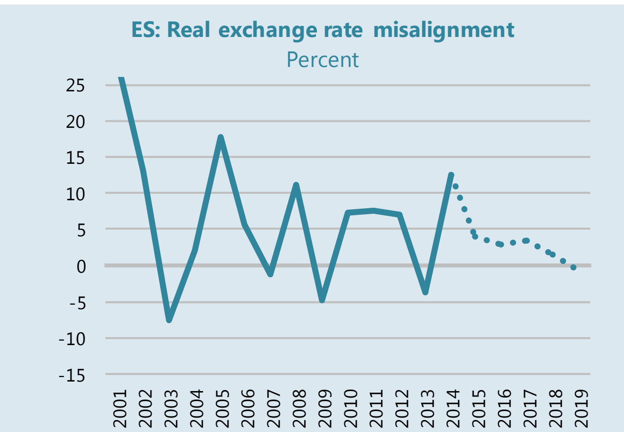


Table 1. Seychelles Gross International Reserves Coverage: Traditional Metrics

	2011	2012	2013	2014	2015	2016	2017	2018	2019
				Prel			Proj		
In months of prospective imports of G & S	2.7	2.8	3.7	4.6	4.3	4.2	4.3	4.2	4.3
In percent of:									
ST external debt remaining maturity (Greenspan rule)	52	89	129	128	125	124	128	131	132
Gross PPG External Debt (contracted, ex. IMF)	61	65	89	101	105	115	134	152	175
Broad money	50	53	55	59	55	54	54	52	52
GDP	26.0	27.1	30.1	32.5	33.7	32.3	32.5	31.6	31.0
Ratio to:									
FX deposits	1.6	1.6	1.7	1.6	1.4	1.4	1.4	1.4	1.4
Tourism receipts	0.8	0.8	1.0	1.2	1.2	1.2	1.2	1.2	1.1
Oil and food imports 1/	0.6	0.6	0.8	0.9	1.0	1.0	1.0	1.0	1.0
Reserve adequacy metrics (IMF)									
Floating: 30% STD + 15% OPL + 5% M2 + 5% X (G&S)	411	343	359	356	361	370	377	382	387
150 percent range	*616*	*514*	*538*	*535*	*541*	*555*	*565*	*573*	*580*
Seychelles, percent of the metric	*67*	*90*	*119*	*130*	*128*	*129*	*134*	*136*	*139*
Memorandum items:									
International reserves ($ million)	**277**	**307**	**425**	**463**	**463**	**476**	**505**	**521**	**539**
Nominal GDP ($ million)	1.07	1.13	1.41	1.42	1.37	1.47	1.56	1.65	1.74

1/ Excluding oil re-exports.

Source: authorities, WEO, and staff calculations.

Annex 5. The Medium-Term Fiscal Challenges

Seychelles has made considerable progress over the last six years in restoring fiscal discipline, reducing debt, and improving public financial management. In order to ensure that fiscal policy continues to support inclusive growth over the medium term, the authorities should focus on: avoiding an erosion of the revenue base; improving the quality of expenditures by tying the budget process, and in particular capital expenditure, more closely to the medium-term priorities; and improving the governance structure of the SOEs to minimize risks to the public balance sheet.

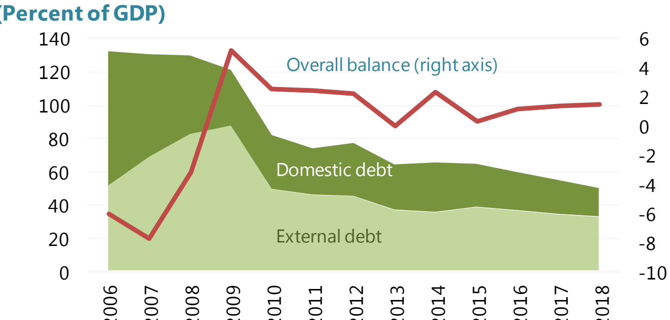
Introduction

In response to the 2008 public debt crisis, the Seychellois authorities undertook a comprehensive reform of their fiscal framework. The reforms aimed to deliver a sustainable and effective public sector while at the same time reducing the country's vulnerabilities by cutting the public debt burden by nearly two-thirds, to below 50 percent of GDP by 2018. The introduction of a VAT and income tax and reform of business tax modernized the tax system by broadening the revenue base, and simplifying and reducing rates. Revenue administration was overhauled with the incorporation of risk assessment and improved technology. The legal basis for taxation was also reformed with the passage of a new Revenue Management Act in 2011 and legislation introducing the new taxes.

At the same time fiscal expenditures were rationalized. This effort included a voluntary departure and early retirement scheme which led to a reduction in government employment by some 2,500 employees (about 15 per cent of the public sector workforce). Primary current expenditure, which had averaged 38 percent of GDP in 2000 to 2008, fell by 16 percentage points to 22 percent in 2009–2014 as the overall balance swung from a deficit to a large surplus. The management of public expenditure was reformed with the introduction of a Treasury Single Account, a new chart of accounts to allow for functional classification, and a new Public Enterprise Monitoring and Control Act that established financial reporting obligations and corporate governance guidelines for all public entities and laid the groundwork for the preparation of IPSAS cash-based financial statements for all SOEs.

Thanks to these policies, considerable progress was made in reducing the country's public debt stock, which fell by more than half between 2008 and 2014 in GDP terms. However, attaining the remaining debt reduction, while at the same time maintaining the essential investments in critical infrastructure and human capital, will require not just continued fiscal discipline, but also continued efforts to enhance the efficiency of public expenditure.

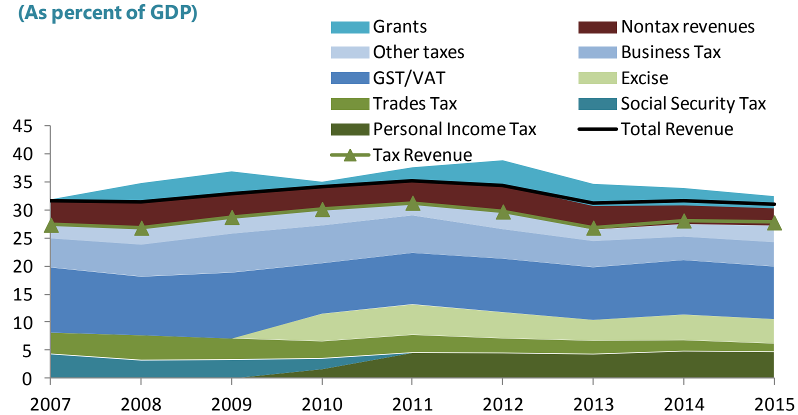
Figure 1. Overall Fiscal Balance and Debt, 2006–18
(Percent of GDP)



Revenue effort in Seychelles

Government revenue as a percentage of GDP in Seychelles is relatively high compared with other countries in the region as well as other small island states (Text table 1). From 2008–2012 the tax system was reformed with a view to broadening the base and reducing rates: a flat-rate personal income tax replaced the social security tax, the sales tax was replaced with a VAT, and business taxation was overhauled and simplified. These reforms appear to have been carried out with little loss of revenue: the average tax-to-GDP ratio for 2010-2014 was the same as for 2005-2009 (29 percent of GDP). Importantly, Seychelles has been able to avoid introducing a lower VAT rate for the tourism sector, a measure which was reduced the revenue base in many other tourism-dependent island economies.[1]

Figure 2. Revenues and Grants
(As percent of GDP)



This overall positive picture, however, conceals some less favorable trends. In particular, business taxes have been somewhat disappointing, falling from a peak of 6.9 percent of GDP in 2009 to 4.2 percent in 2014. This fall cannot be wholly ascribed to major policy changes during these years, so it must reflect either lower declared profitability of domestic companies or reduced compliance. Given Seychelles' relatively robust growth in the post-crisis period, some issues of compliance and transfer pricing seem likely. Seychelles' business tax is relatively narrowly based, with 30 companies accounting for over two-thirds of the tax business tax take, with tourism-related companies substantially underrepresented.

In part, the relatively low business tax take from the hotel industry reflects the lingering effects of generous incentives. Under the revised taxation system, tourism-related services (along with some other industries such as agriculture and fisheries) continue to benefit from a special rate of business tax: 15 percent compared with the regular 30-33 percent rate. Moreover, accommodation providers benefit from a generous schedule of accelerated depreciation on investments. In this context the authorities introduced two turnover taxes, a Marketing Tourism Tax payable by tourism operators, banks, telecom operators and insurance companies, and a Corporate Social Responsibility charge, applied more generally to businesses with a turnover in excess of SR1 million. While turnover taxes avoid many of the tax evasion strategies that can be applied to corporate income taxes, they have a disproportionate impact on high turnover/low margin businesses, and their lack of deductibility implies some regression towards the cumulative taxation that characterized the pre-reform period.

[1] Several countries justify lower VAT on hotels in light of the potential for job creation, particularly in a context of high youth unemployment, whereas Seychelles already imports significant labor for the hotel industry.

Over the medium term the authorities should consider further measures to streamline business taxation. The continued existence of three different business tax rates (15 percent, 30 percent, and 33 percent) is suboptimal and can distort economic decision-making. A single, harmonized rate would therefore be preferable, assuming that this could be achieved in a way that does not undermine revenue efforts. Allowing the turnover taxes to be deducted against business tax should also be considered, as this would eliminate the aspect of cumulative taxation. While there would be some decline in revenue, this could potentially be offset by an increase in the rates to bring them closer to the rates for the non-tourism sector.

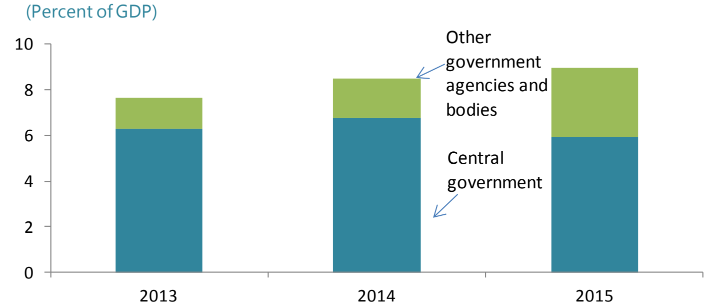
One further element of tax reform that was recommended by Fund technical assistance but not yet implemented was adjusting specific tax rates on excisables for inflation. The Fund's review of taxes noted that excise on fuel in particular was low by international standards, and recommended an immediate increase above and beyond inflation, and inflation indexation thereafter. However, while excise on tobacco and spirits was increased in the 2014 budget, the tax rate on fuels remains unchanged in nominal terms since 2008, at 8 SR/liter for motor spirits, although the CPI has doubled since then.[2] Measures to halt this erosion of the real value of fuel taxes would support the debt reduction objectives, benefit the environment, and be particularly apposite given the very low global fuel prices.

The government has also expressed interest in introducing a measure of progressivity to income tax over the medium term: **at present the income tax is a flat rate with zero exemptions**. Introducing different marginal tax rates could be desirable from a social equity perspective, particularly given the large income disparities revealed by the past household survey. However, staff stressed the important consideration that successful introduction will require overcoming capacity constraints at the SRC, as well as supporting the employers that will be required to help administer the system. The authorities might also consider other measures such as a real estate tax with a high exemption, either as an alternative or complement: this would be simpler to administer and harder to evade, while still generating the desired social outcomes.

Key Trends in Government Expenditure

Between 2009 and 2014 total government expenditure increased by less than one percent of GDP, at the same time as primary current expenditure increased by over four percent of GDP. This was made possible by the sharp fall in interest payments, the result of the government's successful debt reduction strategy and a fall in global interest rates. Transfers have been the main beneficiary, with a four-fold nominal increase in transfers to regulatory bodies. Wages also increased by half a percent of

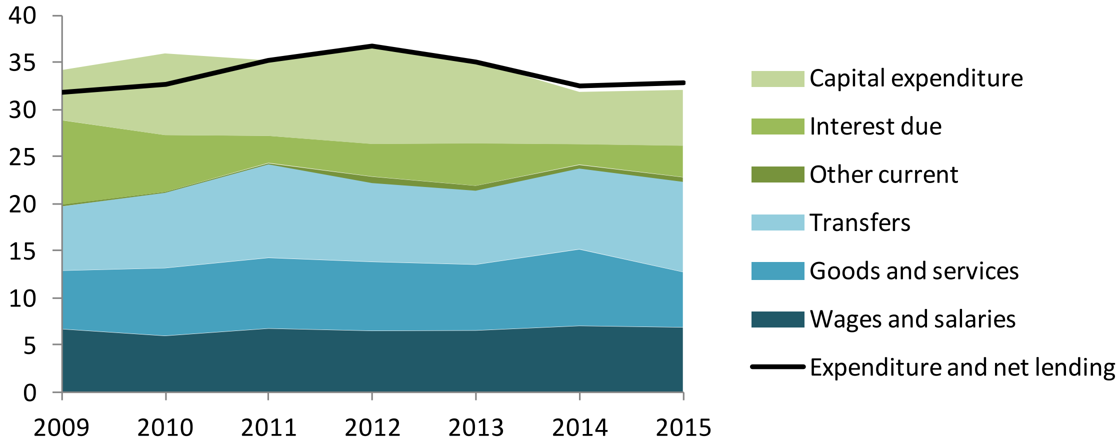
Figure 3. Wages and Salaries of Central Government and Government Entities
(Percent of GDP)



[2] While the total tax take is unchanged, there has been some shift in the composition of the taxes, e.g. the specific GST on fuel was abolished and shifted to an excise.

GDP: however this understates the true cost, since administrative and accounting changes meant that part of the increased wage bill was reclassified as transfers.

Figure 4. Government expenditures
(Percent of GDP)



Whilst the post-crisis period was characterized by a growth in primary spending enabled by falling interest payments, this pattern will not be repeated in the coming years. At only just over two percent of GDP, interest payments have limited room to fall further. Moreover, with pressing investment needs including in water, sewage and electricity, the share of capital expenditure and net lending as a percentage of GDP should be increasing.[3] In this context, maintaining a firm grip on current spending will be essential. While expenditure on wages and salaries is not out of line with other small island states, the rate of increase over the last two years could not be sustained long into the future, since other expenditures are already being crowded out: the World Bank's Public Expenditure Review on the education sector noted that in 2012 over 90 percent of current expenditures were being spent on staff wages and benefits, reducing the room for vital investments in learning materials and training.

Public Financial Management Reforms

The reform program also encompassed major changes to public financial administration. The adoption of a Treasury Single Account and a forecasting and analysis bureau represented major improvements to cash management and budget credibility. The monitoring of SOEs was overhauled with the 2010 passage of the Public Enterprise Monitoring and Control Act, which mandated comprehensive reporting to the Public Enterprise Monitoring Division, which was later established as a separate commission. Considerable progress has been made in improving the accounting framework, and more comprehensive financial statements are now being prepared in accordance with the cash-based IPSAS methodology. The previously ad hoc approach to public investment was improved with the introduction of a Public Sector Investment Program (PSIP) in 2013 to set out planned capital investment over the medium term.

[3] Much of the investment program of the Public Utilities Corporation is supported by on-lending from the central government.

Despite this considerable progress, more remains to be done to deliver an efficient and effective public sector. Adoption of a full medium-term budget framework will require moving towards a more comprehensive, top-down budget process, wherein rolling multi-year expenditure plans are prepared, and indicative ceilings are issued to ministries at the beginning of the annual budget process to guide ministries' budget submissions. Budget credibility must also be improved by reducing forecasting error: while revenue projections are much improved and generally accurate, expenditures—and in particular investment spending—remains an area of concern. Some of the PUC's larger projects, for example, have been significantly delayed, while other projects (such as the purchase of replacement generation capacity) were brought forward.

Improvements to the capital expenditure process are warranted throughout the project cycle: in project selection, implementation, operation, monitoring and evaluation. The establishment of a Development Committee to oversee implementation of the PSIP, and ensure its consistency with the National Development Strategy, is a critical step, but it will be important to ensure that it has a clear role, and the ability to exercise that role. In particular, it will need the capacity to conduct an independent assessment of the economic feasibility of large projects before they can proceed. At the same time, it will be important to ensure sufficient training of staff at the Finance Ministry and project-implementing ministries and agencies to implement, monitor, and evaluate the capital expenditures.

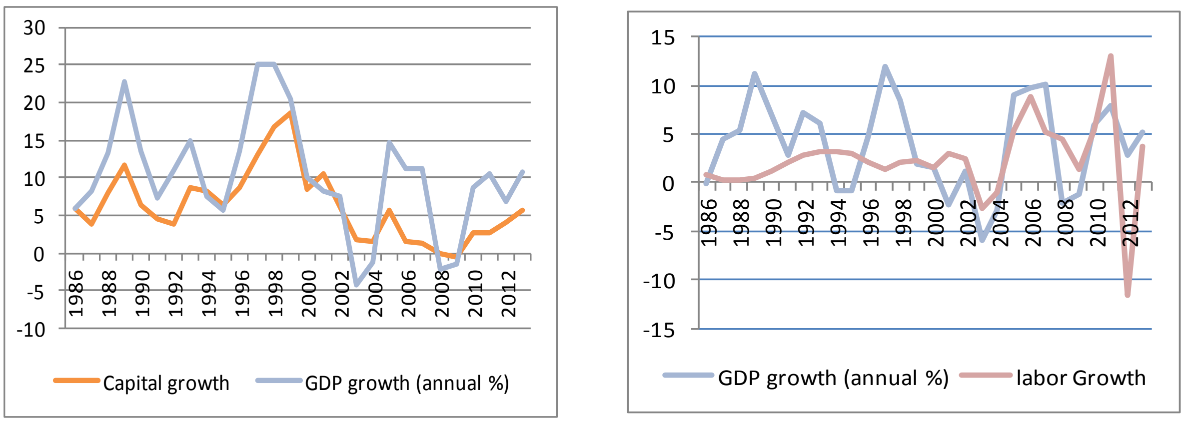
Capacity-building will also be important if the Public Enterprise Monitoring Commission is to exercise effective vigilance over the SOE sector. Strong accounting skills in particular are essential to assess where risks are emerging and flag concerns early. Moreover, the entire governance framework should be reconsidered if early warning signs of financial problems are to be translated into action and if new investment or expansion projects are to be properly vetted. At present, *Société Seychelloise d'Investissement* (SSI) is intended to exercise a fiduciary role over the commercial SOEs. However, the Board of the SSI consists largely of the CEOs of the very companies which it oversees. These companies are also engaged in transactions with the SSI itself, for example over the use of its land resources. These circumstances raise questions about it playing a role of genuinely independent oversight and control.

Annex 6. Sources of Growth

Introduction

Growth in Seychelles averaged 4.5 percent between 1969 and 2013, compared to 3.8 percent for Sub-Saharan Africa. To determine drivers of growth in Seychelles, this study used the Cobb-Douglas production function which assumes constant returns to scale. The production function was augmented for skilled labor.

Figure 1. GDP growth, Labor and Capital (1986-2013)



The production function is as follows:

$Y_t = A_t K_t^{\alpha} L_t^{1-\alpha}$

Y =domestic output,

K = capital stock

L= labor

α is the partial elasticity of output with respect to capital. Since we assume constant returns to scale, 1- α is the partial elasticity of output with respect to labor and t is time. A, is total factor productivity. We can differentiate the production function as follows:

$dY/Y = dA/A + \alpha\, dK/K + (1-\alpha)dL/L$

The contribution to domestic output by each factor can now be determined and total factor productivity (TFP), is calculated as residual—captures the impact of other factors such as institutions, infrastructure etc on growth.

$L^s = SL$

Where L^s = skill augmented labor.

$dY/Y = dA/A + \alpha\, dK/K + (1-\alpha)dL^s/L^s$

Capital Stock

Capital stock was derived following the equation below:

$K_t = (1-\delta)K_{t-1} + I_t$

δ is the depreciation rate and I is gross capital formation. The data were sourced from the World Development Indicators of the World Bank. These data were then used to calculate the initial capital stock following the Harberger approach. Also three depreciation rates were used in the analysis. Choice of depreciation rate is of particular importance as errors in the choice of depreciation rate could accumulate in subsequent years.

Analysis of Results

Table1. Seychelles TFP (δ=7 percent)

	1986-89	90s	2000s	1986-2013
Labor	0.32	1.65	1.97	1.62
Capital	2.59	3.34	1.28	2.20
TFP	2.29	-0.12	-0.44	0.06
A	3.28	-0.17	-0.63	0.09

Labor is not augmented and 2000s include 2013.

Using a depreciation rate of 7 percent in the traditional model in which labor is not augmented, output has been driven more by capital accumulation (Figure 1). Total Factor Productivity has been negative in both 90s and 2000s. Low or even negative TFP is not uncommon in middle income small island economies, with the exception of Mauritius (Figure 2).

Table 2. Seychelles TFP (δ=7 percent and labor augmented)

	1986-89	90s	2000s	1986-2013
Labor	0.64	1.94	0.47	1.02
Capital	2.59	3.34	1.28	2.20
TFP	1.98	-0.41	1.06	0.66
A	2.82	-0.59	1.51	0.95

Analysis using augmented labor changes the results, increasing the contribution of TFP. However, since Seychelles does not readily have data on average years of schooling, enrolment rate was used as a proxy. As could be seen above, production has been mainly capital driven in Seychelles from the 1980s to 2013. The results also indicate that skilled labor is of particular importance to Seychelles. Inclusion of skilled augmented labor in the model led to positive TFP in 2000s. Two other scenarios were examined—depreciation rate of 5 percent and 10 percent which also gave similar results.

Table 3. Seychelles TFP (δ=5 percent and labor augmented)

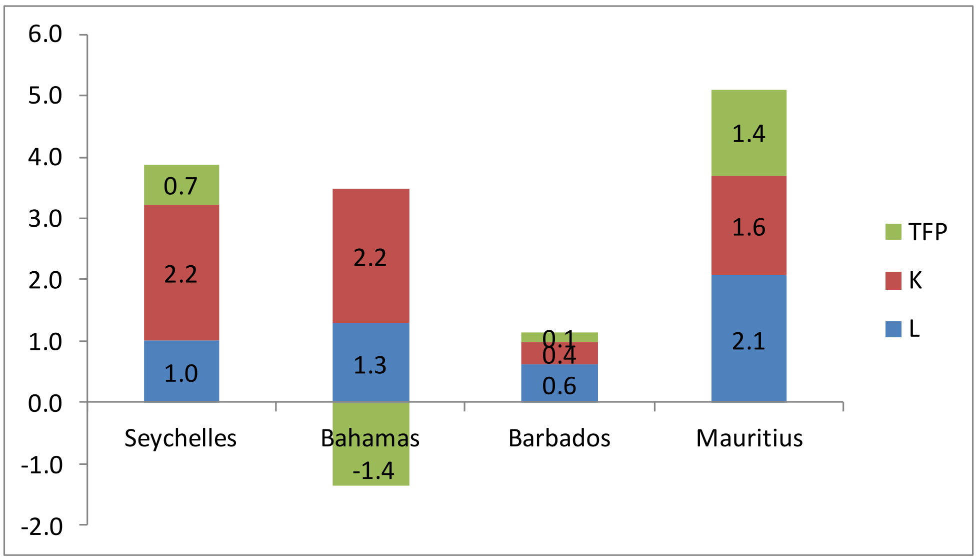
	1986-89	90s	2000s	1986-2013
Labor	0.64	1.94	0.47	1.02
Capital	2.46	3.18	1.44	2.21
TFP	2.10	-0.26	0.90	0.66
A	3.00	-0.37	1.28	0.94

Our results suggest that the reforms of the 2000s, and particularly those implemented following the 2008/9 crisis, have supported productivity growth (TFP for 2008-2013 reached 2.0 percent). In line with the existing literature,[1] continued macroeconomic stability is likely to be an

[1] In particular, see a discussion of TFP in chapter 4 of the forthcoming book "Africa on the Move: Unlocking the Potential of Small Middle-Income States" in Africa, edited by Ali Mansoor and Lamin Leigh.

essential precondition for further growth. However, in order for the economy to achieve its full potential, further measures should be considered, including: 1) increasing savings and investment rates, including improving access to credit, 2) reforms to encourage greater labor market participation , 3) accelerating investment in education to address existing skills mismatches, and 4) broader reforms to improve the business climate, including strengthening for the role of the private sector by reducing regulation and enhancing competition, and improving governance of the SOEs to strengthen their finances and focus their activities on their core mandates.

Figure 2. Cross Country TFP



1) Average for Bahamas and Barbados (1981-2007) were from Nita Thacker, Sebastian Acevedo and Roberto Perrelli (Caribbean Growth in an International Perspective: The Role of Tourism and Size), IMF Working Paper (WP/12/235)

2) Mauritius: The Drivers of Growth—Can the Past be Extended? Katsiaryna Svirydzenka and Martin Petri, IMF Working paper (WP/14/134)

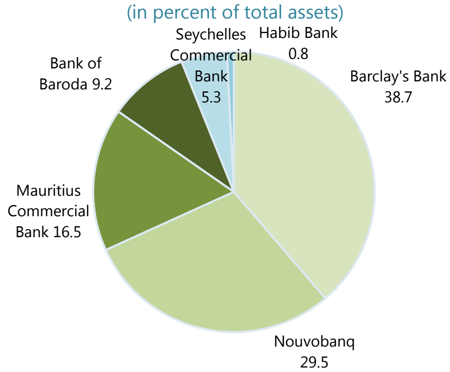
Annex 7. Establishing a Macroprudential Framework

In response to rising concerns about financial stability risks going forward, the Seychelles authorities have decided to move expeditiously toward the creation of a macroprudential framework. Available indicators do not, as of now, signal a need to activate additional policy measures to address bank exposure to macrofinancial risks (see figure below), but the fast increase of bank credit to the private sector requires close monitoring. Moreover, gaps in available data need to be addressed as a precondition to comprehensive analysis of financial vulnerabilities. Policy responses should be considered and implemented by a Financial Stability Committee (FSC) to be established in the near future.[1]

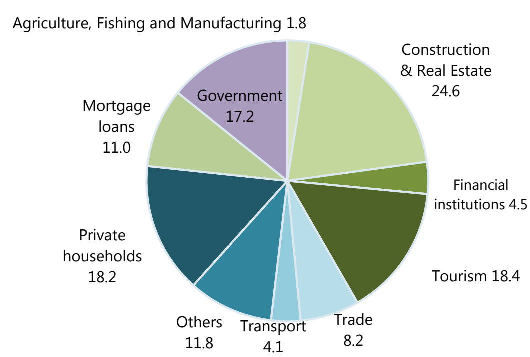
Structure of the financial system in Seychelles. The financial system in Seychelles is small and dominated by three commercial banks. Bank and nonbank lending amount to 32 percent of GDP. Bank assets comprise 97 percent of all financial sector assets. Three banks (two of which are majority foreign-owned, the other majority government-owned) hold 85 percent of all bank assets. While interconnectedness between banks appears to be weak, the high concentration implies substantial systemic risk for each of the larger banks. The sectoral distribution of bank credit reflects the undiversified structure of the economy: 43 percent of bank lending is directed to construction, real estate, and tourism. Banks are regulated and supervised by the CBS, following Basel I.[2] Banks report aggregate data on core financial soundness indicators (CAR, ROA, ROE, NPL, as well as some liquidity and cost indicators) on a monthly basis.

Figure 1. Structure of Banking System and Bank Lending

Composition of the banking sector
(in percent of total assets)



Sector composition of bank lending (in percent)



[1] This annex draws on the findings by a February 2015 TA mission, led by Srobona Mitra (MCM), with participation of Mindaugas Leika (external expert in stress-testing) and Tobias Roy (AFR).

[2] Efforts are underway, with Technical Assistance from the Fund, to migrate to Basel II, with appropriate elements from Basel III included.

Cyclical, balance sheet, and capital exposures. A snapshot of selected indicators for credit cycle, balance sheet risks, and loss-absorbing buffers indicates that rapid credit growth appears to have been the main driver of potential exposure to the build-up of systemic risk in 2014. Measured against economic activity, credit to the private sector suffered from a steady decline since 2010, before recovering in 2014. Tourism, real estate, mortgage, and trade are the most prominent drivers of overall credit growth, which nevertheless did not increase concentration risks. Moreover, other available indicators of bank balance-sheet health and capital buffers are broadly benign and do not indicate a build-up of systemic risk.

Major sources of risk and stress-testing. The analysis of the structure of the commercial banking system's balance sheet reveals vulnerabilities from credit exposure to the tourism sector, potential real estate bubbles, and (to a lesser extent) foreign-exchange funding withdrawals in the offshore sector. Stress-testing exercises undertaken in the past focused on sensitivity analysis of isolated shocks to the capital-adequacy ratio of banks. While useful, the lack of granular data and of models to calibrate shocks and their impacts has revealed the need to move toward a more systemic approach. A TA mission from MCM in early 2015 introduced to CBS staff improved templates for conducting stress test exercises, with a view to using scenarios derived from a globally and domestically informed risk-assessment matrix (RAM); work on this is continuing. First-glance systemic indicators appear benign, but they are surrounded by considerable uncertainty. Further analysis, tools, and institutions need to be set up for an in-depth assessment and treatment of systemic risks that transcend monetary policy.

Figure 2. Credit Cycle and Bank Balance Sheet Heat Map, 2014 (Selected Indicators) 1/

Indicator	Policy Action Needed	On Alert	No Policy Action Needed
Annual Increase in Credit-to-GDP ratio in percentage points (p.p.)	> 5 p.p.	3 < x < 5 p.p.	< 3 p.p.
Seychelles 2/		3.5	
Deposit-to-loan-ratio in percent	< 85	85 < x < 100	> 100
Seychelles			307.1
Share of FX loans/Total loans (percent)	> 40	25 < x < 40	< 25
Seychelles			23.8
Annual Change in NPL (percent)	> 20	5 < x < 20	< 5
Seychelles			3.4
Leverage	< 3.0	3.0 < x < 7.0	> 7.0
Seychelles			8.6

1/ Excludes offshore items
2/ Includes valuation effect of exchange rates on FX-denominated loans

Currently available data and indicators have limitations. With shallow financial markets, price indicators from secondary markets are largely nonexistent. Macroprudential surveillance will need to rely primarily on balance sheet-based indicators rather than market price-based indicators.[3] However, the current balance sheet-based core indicators, as provided by banks through the

[3] While balance sheet-based indicators are good at measuring risk build-up, market price-based indicators are comparatively better at identifying potential spillovers.

monthly reporting system, are not yet sufficient for comprehensive monitoring of financial stability. First, the reported data lack granularity. For example, NPLs are currently not broken down by sector. Second, important information reflecting lending standards (such as LTV, DSTI) is not reported. Third, and perhaps most importantly, there are no data reports on changes in the prices of houses and real estate properties. However, there is considerable unrealized potential for improving indicators: Large banks already base their lending practices on internal standards on LTV, LTI, and DSTI, and an efficient reporting system that would allow cross-dimensional analysis of loan data appears feasible. With technical assistance, the National Bureau of Statistics should be able to collect data and construct an index on real estate and house prices.

Policy tools. Given the volatile external environment of Seychelles, it appears that broad-based policy tools, such as countercyclical buffer adjustments to the CAR, would not appear to be very efficient and practical (though sector-specific adjustments in risk-weights might be). In comparison, LTV and DSTI ratios for household lending could be adjusted more rapidly and forcefully, for example when there are mutually supporting indications of rising house prices, credit increase, a widening current account deficit in conjunction with rising imports, and an appreciating real exchange rate.

Institutional setup. The Seychelles authorities are addressing these challenges by setting up a macroprudential framework. Given the overlap between monetary policies and financial stability measures, the division of labor between different regulators (such as the FSA for nonbank financial services), and the strong role of the public sector in the banking system, the best solution appears to create an inter-agency Financial Stability Committee (FSC), in which the CBS would take a leading role. A small macroprudential technical unit in the CBS, forged from bank supervisors and macroeconomists, would inform the FSC on an ongoing basis.

Appendix I. Letter of Intent

Ms. Christine Lagarde
Managing Director
International Monetary Fund
May 14, 2015

Dear Ms. Lagarde:

1. The attached Memorandum of Economic and Financial Policies (MEFP) describes Seychelles' recent performance as well as our policies for the period 2015–16.

2. The IMF Executive Board on June 4, 2014 approved our request for a 3-year arrangement under the Extended Fund Facility (EFF) for an amount of SDR 11.445 million (105 percent of quota). Seychelles has met all the quantitative Performance Criteria for end-December 2014 in the EFF-supported program (Table 1), with the exception of the performance criterion on reserve money, for which we are requesting a waiver. We met the two end-December 2014 structural benchmarks (SBs) on time, as well as the one from end-June 2014, albeit with a substantial delay. We have met the end-March SB with some delay as Cabinet only approved the policy paper on the 6th of May 2015. We are on track to complete the other measures envisioned in the SBs for end-May and end-June (Table 2). Based on our performance under the program and the sustainability of our planned policies, we are requesting through this letter that the IMF Executive Board complete the second review of the EFF-supported program and approve the associated purchase of the third tranche of SDR 1.635 million (15 percent of quota).

3. We believe that the economic and financial policies set forth in the MEFP are sufficient to ensure that the objectives of the program will be met. The program's proposed quantitative Performance Criteria and Indicative Targets, as described in the Technical Memorandum of Understanding, and proposed structural benchmarks for end-December 2015 are set out in Tables 1 and 2. We stand ready to take any further measures that may prove necessary to meet our objectives. We will consult with the Fund on the adoption of these measures, and in advance of revisions to the policies contained in the MEFP, in accordance with the Fund's policies on such consultations.

4. In line with our commitment to transparency, we request that the IMF publish this letter, the MEFP, the technical memorandum of understanding (TMU, which is unchanged from the last review), and the staff report. We will simultaneously publish these documents in Seychelles.

Sincerely yours,

/s/	/s/
Jean Paul Adam	Caroline Abel
Minister of Finance, Trade and the Blue Economy	Governor
Republic of Seychelles	Central Bank of Seychelles

Attachments: Memorandum of Economic and Financial Policies
Technical Memorandum of Understanding

Attachment 1. Memorandum of Economic, Financial and Structural Policies for 2015-16

A. Recent economic developments and performance under the program

1. The implementation of the program supported by the Extended Fund Facility approved by the Executive Board of the IMF on June 4, 2014 is proceeding with determination, and we have respected all but one of the quantitative performance criteria established for end December 2014. The end-December ceiling for average reserve money was exceeded by 0.4 percent, and we are requesting a waiver for this minor and temporary non-compliance. In particular, the net international reserves target for end-2014 was exceeded by the equivalent of US$22 million, when reserves are valued at the program exchange rate. In the structural reform area, we implemented the agreed reform program; we met the two end-December 2014 structural benchmarks (SBs) on time, as well as the one from end-June 2014, albeit with a substantial delay. We have met the end-March SB with a delay; this was mainly because of further discussions required with stakeholders, as the policy includes the commercial enterprises that are established as limited liability companies under and subject to the Companies Act.

2. As we described in the Letter of Intent of November 14, 2014, macroeconomic performance in 2014 has met some challenges, in particular in the balance of payments area, as the wage increase to civil servants granted at the beginning of 2014 and the acceleration in credit to the private sector led to an increase in import in the third quarter and the emergence of pressures on the exchange rate starting in July. The pressures abated towards the end of the year, as the result of tightening of monetary policy and also because of the decline in the international petroleum prices that led to significant savings in the monthly petroleum import bill. In 2014 the real GDP growth rate, at 3.3 percent, was somewhat higher than projected at the time of the first review, while the decline in international petroleum prices resulted in an almost stable consumer price index in the 12 month to end- December 2014. The external current account deficit was lower than projected at the time of the first review by 1.5 percentage points of GDP, because of lower oil prices and higher estimate for tourism earnings resulting from a revised methodology.

3. In the budgetary area, in 2014 we achieved a higher primary surplus target than programmed (4.6 percent of GDP as against 4.4 percent programmed), owing to overachievement in revenue collection. Revenue and grants reached 35.7 percent of GDP compared with a target of 35.3 percent, and revenue, at 32.8 percent of GDP, exceeded the target also by 0.3 percent of GDP.

4. **On the tax revenue side**, there was a strong overperformance of receipts under value added tax, trade tax and excise tax because of strong growth of imports and domestic demand, spurred by (i) the wage increase granted to public sector workers at the beginning of the year which was matched in the private sector, and, (ii) by the government-backed incentive scheme for borrowing by small and medium scale enterprises. Income tax and business tax receipts fell modestly below the target. Non-tax revenues were lower than targeted by 10 percent, as a result of lower dividends.

5. **On the expenditure side** primary current expenditures were in line with the target at 24.7 percent of GDP, while capital expenditure, at 5.5 percent of GDP, modestly exceeded the target (by 0.2 percent of GDP). Wages and salaries reached 6.8 percent of GDP, up from 6.1 percent in 2013 as a result of the wage increase granted at the beginning of the year. The government focused on implementing the capital budget and was able to improve the execution rates of domestically financed capital projects, while projects with external loan financing encountered delays due to technical difficulties in implementation.

B. Policies for 2015

I. Macroeconomic prospects

6. In 2015 we expect real GDP growth to accelerate modestly to 3.5 percent, up from 3.3 percent in 2014. Inflation for the 12 months of 2015 is expected to come close to 5 percent, because of the pass-through of the depreciation of the exchange rate, which is however partially offset by the decline in international prices of fuel. We expect the balance of payments deficit on current account to show a marked decline from 2014 (from 21 percent of GDP to 15 percent), as petroleum import costs will decline significantly. Tourism earnings valued in US dollars could decline modestly, because a large part of hotel tariffs are priced in the weakening euro. In line with program objectives, we are targeting stable net international reserves, in dollar terms, which offsets a substantial negative valuation effect from international exchange rate movements of early 2015. Debt policy will be prudent, with the aim to reduce the public debt/GDP ratio by around three percent to 62 percent of GDP.

II. Fiscal policies

7. **The budget for 2015 aims at achieving a primary surplus target of SR 720 million, as indicated in the previous letter of intent.** This is equivalent to 3.7 percent of projected GDP. Following the strong performance of consumption taxes in 2014, we aim to strengthening in 2015 revenue performance in the area of business tax, and to that end we are taking a number of measures which include: (i) online submission of tax returns and expanded e-payment facilities; (ii) strengthening capability to analyze transfer pricing; (iii) conducting 60 audits of large businesses (SB), with the assistance of externally recruited auditors, and using a risk management process to prioritize audits; (iv) improve collection of tax arrears; (v) improving customs compliance; (vi) simplifying procedures of excise tax collection at customs.

8. **On the expenditure side**, primary current expenditure as a share of GDP would decline by 1 percentage point to 23.6 percent, thanks to wage restraint and tight control of expenditure on goods and services. Capital expenditure would rise by 0.7 percentage points to 6.2 percent of GDP, with significantly higher capital grants, owing to larger external assistance.

III. Tax policy and Improvements in tax administration

9. SRC is undertaking a comprehensive action plan to improve compliance level and enhance revenue collection for 2015, as detailed below.

III.1. Introducing online submission of Business Tax Returns and expand e-payment facilities

10. To facilitate and improve voluntary compliance SRC will be introducing online submission of Business Tax Returns and expanding e-payment facility to include two additional banks (MCB and Nouvobanq) in 2015. The online submission of business tax return is on schedule for testing in mid-March and expected to become operational in April 2015.

III.2. Building Transfer Pricing Analysis Capability

11. As transfer pricing becomes a growing concern nationally and in the region, SRC are taking steps to combat and deter transfer pricing. SRC has developed an action plan to build capacity to tackle the risks posed by transfer pricing. The plan includes:-

a) Public Ruling of Section 54 of the Business Tax – to explain SRC's view on when and how SRC will use Section 54 of the Business Tax Act. This will also include requirement of transfer pricing documentation. The ruling is currently in draft and will be distributed to tax practitioners for input as part of the consultation process.

b) Training of staff – development of a Transfer Pricing Manual/Procedure guide that explains SRC's audit transfer pricing issues. On the job training and mentoring of local staff will be conducted by expatriate auditors and other technical specialists as appropriate.

c) Enhance working relationship between Customs and Tax - improve sharing of information and the working relationship between Post Clearance Audit (PCA) and intelligence/audit section in tax. Work to train Tax staff in the use of ASYCUDA World has commenced to support this process.

d) FIU Assistance/Training – Liaise with recently recruited FIU advisor for potential assistance and training.

III.3. Conducting Business Tax Audits of 60 businesses from January to September 2015 to improve revenue collection especially business tax

12. SRC have identified the list of 60 businesses that will be audited from January to September 2015. Some of the cases have already been allocated to the auditors.

III.4. Improving collection of tax arrears

13. SRC have introduced a strategic approach to dealing with outstanding tax debt. An enforcement strategy for reduction of debt has been developed.

The SRC strategy has two parts:

First, an amnesty on business tax due as at December 2013, and other taxes (including taxes outstanding with Customs) due as at December 2014. The amnesty will apply on arrears due as at December 2013, as follows:

- 100 percent of penalties to be waived on arrears cleared by May 31, 2015;
- 50 percent of penalties to be waived on arrears cleared by August 31, 2015;

- 25 percent of penalties to be waived on arrears cleared by October 31, 2015. SRC is proactively promoting the amnesty in their dealings with clients (tax payers and importers) to encourage them to pay outstanding debts during the amnesty period.

Second, to complement the amnesty other measures have been proposed including:

- Proactively seeking payment of taxes that are due monthly, especially VAT & Income Tax (stop the growth of debt)
- Monitoring the top 100 Business taxpayers (Pay As You Go) for early warning/weak signal analysis
- Using more frequent and intensive field visits to enforce payment
- Proactively managing the outstanding debts with Customs by introducing a unit to manage, monitor and undertake field work for Customs debts
- Undertaking a reconciliation process of outstanding and duplicate Bills of Entry created in the period of transition from ASYCUDA ++ to ASYCUDA World (June 2013 – June 2014)
- More extensive use of Legislative Provisions such as:
    - Garnishee Notices
    - Seizure of Assets
    - Departure Prohibition Order (some success in late 2014)
    - Tax Clearance Certificate prior to awarding Government contract
    - Liquidation of persistent non-complying companies or bankruptcy.

III. 5. Capacity building in Post Clearance Audit (PCA) and Investigation

14. To address the increasing issue of fraudulent documents provided to Customs in attempts to evade correct payment of duty and/or taxes both the PCA and investigation capability has been improved through formal training through international agencies (e.g. INTERPOL) and specialist mentoring from SRC's Customs Advisors and other agencies (e.g. IMF TAs). The PCA function will be focused on working with importers to improve compliance.

III. 6. Customs Compliance Program

15. SRC acknowledge that the level of non-compliance in relation to Customs requirements is intrinsically linked to the poor levels of professional knowledge in the Customs Agent and Direct Trader/importer population. Customs have plans to develop the Customs Compliance Program, which is a Diploma level course aimed at addressing the deficiencies that cause delays for trade and result in the incorrect taxes and duties being applied to imports.

The Customs Compliance Program will also help Customs move closer to developing an Authorized Economic Operator program and move to a true risk-based approach to trade facilitation.

III. 7. Excise

16. Excise has been a main focus for SRC since the first IMF mission in November 2013 when estimated excise leakage in Seychelles was thought to be at a level of up to 60 percent. Although the first stage of changes have been made, there are still a number of important projects that need to be

completed for Customs to gain control over alcohol, tobacco and fuel to ensure that due excise is collected including:

- Alignment of the Seychelles excise tax regime with the other SADC member states with the view to harmonize excise tax laws within the region. scheduled to commence in June 2015
- Implementation of a 'Customs registration process' for licensed excise operators
- Establishment of a framework for the removal of excise collection through CMS and enabling electronic collection through ASYCUDA World (i.e. Customs to take full ownership of excise)
- Drafting legislative amendments to provide excise officers with the required powers to effectively monitor excise manufacturers and enforce penalties for non-compliance
- Proposed implementation of the tax stamp initiative as a control tool
- Apply findings of the recent SEYPEC systems audit and implement Customs control measures to eliminate the non-sanctioned use of duty-free fuel in Seychelles.

IV. Public Financial Management and Expenditure Reform

IV.1. MTFF

17. The Medium Term Fiscal Framework benchmark was approved by the Cabinet in November 2014. In 2015, the MTFF will mark the first step in the formulation of the 2016 Budget by establishing indicative Budget ceilings over a five year period. A Fiscal working group has been established, comprising of members from MoFTBE divisions to ensure the consistent updating of the MTFF variables and resolve issues.

18. Moving forward, the major task remaining is setting up the proper policy framework to incorporate in the medium term. This will establish integrated multi-year policy-based targets for the main fiscal aggregates—debt, financing, primary balance, revenues and expenditures—consistent with the overall macroeconomic framework. With this incorporated, the MTFF will provide the foundation for a full MTBF, which will allow for an improved process for the allocation of budgetary resources.

IV.2. PPBB

19. The Program Performance Based Budgeting (PPBB) has been adopted for the first two pilot ministries in 2015. Despite some challenges to migrate towards this new method of budgeting the two portfolios are operating with the continuous support of the World Bank (WB) and the Ministry of finance. In addition three other pilot ministries and their related agencies have also joined the piloting process with their second technical assistance from the WB that had completed in March 2015, which resulted in finalizing the program structures and migration of their spending to PPBB baselines. Next mission will cover developing portfolio medium term expenditure strategies.

IV.3. PFM Action Plan

20. The authorities will also ensure continuous improvement in the public financial management (PFM) by adopting a new PFM action plan 2015–2018. This updated plan is geared towards improvement in capital project cash and asset management as well as an improved medium term

budget framework (MTBF) so as to better improve on medium term budgeting across MDAs. More emphasis will also be placed on the management of state-owned enterprises though management and governance audits so as to further enhance SOE transparency and governance and enhance SOE efficiency and delivery of public services. A new Public Expenditure and Financial Accountability assessment, to be carried out in 2015, will help set these priorities.

IV.4. PIM

21. A Development Committee has been appointed in March 2015 to ensure that all public sector capital projects over R10 m in the Public Sector Investment Program, PSIP are coordinated and appraised before final approval and funding is catered. With key technical assistance from the World Bank guidelines on capital project management with templates for project submission and appraisal for various types/groups of projects are to be developed. The authorities will also ensure that adequate training for projects officers and decision makers in project appraisal are provided.

IV.5. IPSAS

22. Government for the second year will be producing the annual audited financial reports in accordance to internationally recognize public sector accounting standards (IPSAS). The aim for the 2014 audited financial report is to have a full consolidation of State-Owned Enterprise with central Government. This will enable Government to have a consolidate overview of the cashflows of central Government and SOEs. For the year 2014 accounts, Government is working closely with Auditor General to ensure all queries are discussed early so that the audited accounts are submitted around July 2015.

IV.6. Cash Management

23. The government will further re-enforce the Treasury single account (TSA) by improving the reporting of all balances of commercial bank accounts outside of the TSA. This will allow comprehensive reporting of all commercial bank balances held by the MDAs and subordinate agencies through Quarterly reconciliation of all government's budget dependent entities' commercial bank accounts which is to be submitted to Treasury.
This will therefore facilitate annual reporting of the government financial statement as all such accounts will be captured and account balances disclosed.

IV.7. Public Private Partnership (PPP)

24. **Development of a Public Private Partnership Framework**
The Government remains committed to putting in place a comprehensive Public Private Partnership (PPP) framework to support the transition of the Seychelles economy towards greater private sector participation and economic contribution. The framework also aims at ensuring value for money from PPPs as well as limiting fiscal risks.
The first phase for the development of the framework which is the preparation of a PPP policy has been launched with the assistance of the Investment Climate Facility for Africa (ICF).
A needs assessment has been conducted involving the following:

1. Reviewing the current legal , institutional and regulatory framework
2. Examination of past and ongoing PPP experiences in Seychelles
3. Assessment of Government agencies capacities to develop and implement PPP projects
4. Identification of potential sectors for PPP in Seychelles

Following the needs assessment, a policy has been drafted by the consultant, reviewed by the Government, and discussed by relevant stakeholders in the economy through a validation workshop on the 15th of April. The final national PPP policy is expected to be submitted to cabinet for approval in Q2 2015. The policy will set clear country definition of PPP, sectoral coverage as well as clear guidelines and principles for the implementation of PPP projects in Seychelles. The next phase is the development of the PPP Legal, Regulatory and Operational framework with technical assistance from AFDB.

V. State-owned Enterprise Reform and Performance

25. **To strengthen the overall corporate governance, the Public Enterprise Monitoring Commission (PEMC) will undertake the task of developing a Code of Governance** to be adopted by Public Enterprises upon approval of the Cabinet. To facilitate Board nomination process on PE boards, the Commission shall initiate the creation of an Institute of Directors as well as providing training for Board appointees. The Commission with the assistance of the World Bank shall also conduct governance reviews and operational/business assessments on the Public Enterprises (three by end-June, 2016, revised SB).

26. For effective government oversight and to enhance accountability a State Ownership Policy separating the state's ownership function from its policy and regulatory functions will be developed which would further enhance the Commission's monitoring role. The government intends to strengthen the supervision of SOEs investments. To that end, the government proposes that the Development Committee that was established to approve all investments above SR10M in the Public Sector Investment Program, be tasked by the *Société Seychelloise d'Investissement* to review all investments of SOEs above the same threshold. A cabinet paper on strengthening SOE oversight (SB, end-May) has been approved on the 6th of May 2015.

27. Comprehensive asset registers for five state owned enterprises were published via the PEMC website (SB for End December 2014) and the Commission intends to publish the asset register for the remaining Public Enterprises in an effort to ensure transparency.

28. The operational performance of SEYPEC and PUC improved in 2014. Air Seychelles recorded operational losses in 2014, which were offset by contributions previously committed by the government of Seychelles, and by its other shareholders Etihad as part of Air Seychelles' restructuring program. SEYPEC tankers' business recorded a modest loss after loan repayment, much lower than in 2013, and could break even in 2015, resulting in overall profitability for the company. PUC benefits from a decline in the cost of fuel oil, which it will pass on to the consumer in April. Air Seychelles recorded significant losses on its European route, via Abu Dhabi, because of very modest load factor, which were not offset by profits on its regional network. It has announced the introduction of a direct route to Europe from July 1, codeshared with Air France, the success of which

will depend on the ability of attracting a high load factor. The route is highly welcome by the hotel operators. The government is considering the possibility to extend a time bound and limited contribution to the company for a limited time period, to support the marketing of this route in the initial phase of operation of the new route. The precise amount of this marketing support will be defined in the coming months, but will be incorporated within the existing fiscal balances, and will be dependent on the company achieving key milestones. The marketing effort of the new route will also be supported by the Seychelles Tourism Board. The company has redesigned its regional network in December 2014, with the aim to attract new regional customers to channel to its direct route to India. It has intensified the monitoring of operating results by individual routes, and strengthening the reporting of operation of results to PEMC.

29. The SSI has been established to guide the strategy and oversees the performance and objectives of all government owned commercial parastatals. It can serve as an investment vehicle for the government in key strategic sectors and also operates as a government holding company for all commercial ventures. To improve the governance of SSI and its supervisory role, the participation in the board of any CEO will be phased out. The government is committed to ensure that the dividends paid by the SOEs accrued to the State budget, and they are not diverted for investment purposes. Any new investments will have to be based on a clear justification for government intervention. To strengthen the effectiveness of SSI in supervising major investments by SOEs, the SSI will use the services of the Development Committee as specified above. The government is drawing on advice from the World Bank, IMF, and other development partners to define SSI's mandate consistent with these principles.

VI. Promoting growth and private sector development

30. **The government is committed to promote competition and increased private sector involvement in key sectors, including infrastructure, fisheries and port services.** Regarding the development of the Port of Victoria, which plays a key role in economic activity, the government has taken the decision to build a new quay for use by commercial fishing activity on the basis of a public private partnership with a private operator. To that purpose a joint venture was established, with government 40 percent share which will be in the portfolio of SSI. The private partners are providing most of the funds for the building of the quay. As far as current operation of the Port are concerned, the government has benefited from an IFC report examining the options regarding the existing concession agreement with Land Marine, that runs up to 2022, and which currently gives an exclusive right to that company to run port services. The government is reviewing the different options on renegotiation of terms of the concession, to open up more services to competition, and plan to present them to Cabinet before end of May 2015 (SB).

31. The government will also facilitate title registration, by adopting an automated system, in order to speed up the provision of housing financing by financial institutions.

32. **The EITI Board admitted Seychelles as an EITI Candidate country on the 6th August 2014**. In accordance with the EITI Standard, Seychelles is required to publish its first EITI Report within 18 months after being accepted as Candidate Country (6th February 2016).

VII. Public Debt Management Strategy

33. **Seychelles is on track with its strategy of reducing public debt to sustainable levels.** With the strong fiscal performance and GDP growth forecast in the medium term, public debt is expected to be reduced below 50 percent of GDP in 2018. The aim is to continue with the borrowings on favourable terms and gradually extend maturities of the debt portfolio. Medium term Treasury bonds issued locally in 2014 for a total amount of SR813 million were fully subscribed and most external borrowings have been from multilaterals. With debt service set to rise sharply in the near term as grace periods on principal come to an end, it will create increased pressures on the external accounts. Consequently, one of the key debt management goals is to smooth out the external debt service profile and shift public borrowing to local currency wherever possible. It is with these objectives in mind that we are implementing a partial swap/buyback of Paris Club debt maturities at a fair market price.

34. **On 25th February 2015, Paris Club creditors with the participation of South Africa agreed to an early repayment scheme for the debts of Seychelles rescheduled by the Paris Club in 2009, in support of marine conservation efforts.** Under the partial buyback agreement, an amount of US$30 million will be transferred in terms of a fund for the protection and development of the marine space of Seychelles. The transaction will enable Seychelles to buy back a portion of the debt maturities falling due to the Paris Club between 2015 and 2021 at a 5 percent discount to face value. The debt to be bought back will be converted into new Government of Seychelles debt obligations, which will be partly repaid in local currency, to be issued to the Seychelles Conservation and Climate Adaptation Trust (SCCAT) – the local trust created to fund and manage the marine conservation.

VIII. Foreign Trade Regime

35. In December 2014 the General Council of WTO approved Seychelles' Accession Package. The Package has been presented to the Seychelles National Assembly in the third week of March 2015 for ratification. On the 24th of March 2015, the National Assembly unanimously enacted into law the Protocol on the accession for Seychelles to the WTO. Following the Act of Parliament, His Excellency, President James Michel signed the Instrument of Acceptance of the Protocol of Accession of the Republic of Seychelles at a plenary meeting of the Cabinet of Ministers on the 25th March 2015 and subsequently deposited to the WTO Director General. On the 26th April, Seychelles became the 161st Member of the WTO.

36. In March 2015 the National Assembly ratified Seychelles' accession to the SADC Trade Protocol. Upon gazettal of the SADC FTA Regulations under the Customs Management Act, 2011, Seychelles shall also become a member of the SADC FTA.

IX. Monetary, Exchange Rate, and Financial Sector Policies

37. **The quarterly average value of reserve money will continue to serve as the nominal anchor in monetary policy implementation.** Under the current flexible monetary policy framework, there is an important focus on short-term liquidity conditions as CBS lays the foundation to move

towards a more forward-looking framework. The interest rate corridor has been introduced so that more guidance is provided to the market and to allow commercial banks to improve liquidity management whilst also strengthening interest rate transmission. To improve monetary policy analysis and forecasting, which will eventually further strengthen the monetary policy framework, CBS has requested technical assistance from the IMF.

38. **As per the Memorandum of Understanding between the Ministry of Finance and the Central Bank of Seychelles, the Ministry will continue to issue T-Bills and T-Bonds for monetary policy purposes.** To that end, the Ministry has agreed to issue government securities as needed during 2015 in support of monetary policy.

39. **CBS is to maintain a tight monetary policy stance as long as necessary to mitigate possible inflationary pressures and support external balance.** The data from the recently revised CPI basket for January 2015 suggest some inflationary risks starting 2015. In addition, growth in credit to the private sector remained strong in recent months. We aim to bring such growth down over the full year 2015 to a level that is more sustainable over the medium-term. Inflationary pressures are expected to be dampened by the recent appreciation of the domestic currency and by the fall in key prices such as fuel and utility, reflecting the recent fall in oil and commodity prices internationally. Monetary policy will be relaxed once inflation starts to recede, which is forecasted to happen in the second half of 2015. CBS stands ready to adjust policy as circumstances require.

40. **The Bank is committed to a floating exchange rate regime**. Following a sharp depreciation in the second half of 2014 during which the market gradually cleared the existed backlogs in meeting demand for foreign exchange, the rupee has been trading in a relatively narrow range against its main counterpart but remains vulnerable to excess demand, a weakened Euro and downside risk emanating from the Euro area. On a positive note, lower energy and commodity prices are expected to dampen the value of imports and reduce potential demand pressure on the domestic currency. The exchange rate flexibility will ensure adjustments are in line with economic fundamentals. The Bank remains vigilant and ready to take necessary measures to ensure orderly conduct in the foreign exchange market and hence will only intervene in the event of excessive volatility.

41. **In order to build further resilience against external shocks, reserves accumulation remains an important objective of the authorities**. During 2015, CBS is to accumulate international reserves through opportunistic purchases from the market without influencing the exchange rate. We will seek to exceed our reserves targets if conditions allow.

42. **The Bank remains committed to improve its reserves management capacity during the year**. In December 2014 the Board approved the engagement on the Reserves Advisory and Management Programme (RAMP) with the World Bank. Moreover, in the first quarter of 2015, staff concerned with reserves management intends to complete the first part of a training provided by Crown Agents Investment Management (CAIM), which is offered as part of the external investment management agreement.

X. Financial Sector Development and Stability

43. **A strong macro prudential policy framework is important to continue to safeguard the financial sector.** In this regard CBS will implement a Financial Stability Framework with the establishment of Financial Stability Committee (FSC). The FSC will have the primary responsibility of taking action to reduce systemic risks and enhancing the resilience of the Seychelles financial system. It will have a secondary objective to support the economic policy of the Government and could issue guidance on on-going surveillance, diagnostic assessment and policy actions. The basic elements of the framework will be set up by October 2015. In particular, the CBS will establish a macroprudential unit within the Financial Services Supervision Division (FSSD) and achieve Board approval for the set of macroprudential policies and measures that can be implemented under the existing legal framework. In addition this will involve the setting up of a Financial Stability Committee under the Chairmanship of the Central Bank.

44. **With the aim that financial services be used more effectively and in responsible and sustainable manner the CBS will enhance its mandate for consumer protection and develop a strategy for financial literacy.** With Technical assistance from World Bank, the options for establishing a financial ombudsman function in Seychelles with adequate enforcement powers will be explored based on international experience and trends. CBS will also be the focal point for financial literacy in Seychelles. As a first step, a financial literacy baseline study will be commissioned to identify the target groups and design a comprehensive and cost effective strategy and implementation plan for reaching them.

45. **CBS will continue to pursue its effort to upgrade banking regulations.** In this regards a complete review of the Financial Institutions Act will be effected. This will cater for implementation of Basel 2 and 3 as per the revised road map (*proposed to push to 2017*) prepared with assistance of the IMF TA. Moreover, drawing on recent experiences with CBS' bank intervention, an enhanced resolution framework for banks will be developed to ensure that it is in line with new developments both domestically and internationally. TA from the IMF has been requested to implement such.

46. **In line with emerging risk from the offshore sector CBS and other authorities such as the Financial Intelligence Unit and Financial Services Authority will strengthen the regulation of the offshore sector.** Consistent with new developments in AML regulatory framework internationally, Seychelles authorities will take necessary steps to ensure that the industry and local regulatory standard are in line with the above. The CBS will undertake joint inspections with the FIU. Moreover, the regulation of the 'offshore banking' sector will be enhanced to ensure that any contagion effect emanating from the offshore is mitigated. In this regards CBS is currently receiving TA from the IMF.

47. **With regard to the CBS' Credit Information System (CIS), significant reforms will be undertaken to increase its usefulness for lenders**. The CBS will enhance the overall scope of the CIS by including credit data from all relevant lenders, including those that do not fall under its regulatory purview, and eventually other types of data providers such as utilities companies. The frequency and type of data that is collected by the CIS and the information that is distributed back to

lenders will be improved. In the medium term, another structural improvement will be a more comprehensive legal and regulatory framework for credit reporting activities in Seychelles.

48. **Work on a modern payment system continues.** Following the successful implementation of the first phase of the Seychelles Electronic Funds Transfer (SEFT) project across all banks in mid-August 2013, the second phase of the project currently under implementation since July 2014 is progressing well, with a new scheduled date of completion set for June 2016. Since the launch of phase one, the majority of participants have now integrated their CORE banking systems to SEFT to allow for straight through processing of incoming and outgoing payments and CBS is continuing its efforts to encourage other participants to follow suit prior to the launch of the second phase. This second phase of the SEFT project will further modernise and increase the efficiency of the country's payments systems by extending the new internet based online platform from the banks domain to the general public.

49. **CBS remains committed in its endeavour to modernize the country's national payment system.** Work is ongoing to formalize the Terms of Reference for the National Payments Task Force and the National Payments Committee which amongst others provides for a regular schedule of meetings and sets out the objectives of the two forums which are key drivers in the modernization process. Moreover, the bank in collaboration with other stakeholders, is working on a new vision and strategy for modernization of the national payment system covering the period from 2015 to 2018. The CBS is also engaging the assistance of AfDB for external consultants to undertake a feasibility study in 2015 and subsequently, assist with the introduction of a Central Securities Depository (CSD) as well as a Real Time Gross Settlement System (RTGS).

50. **The regulatory framework for oversight of payment systems in Seychelles is being enhanced.** With the creation of a new division within CBS in 2014 to regulate payment systems in Seychelles, the CBS has issued the National Payment Systems Act in August 2014 and the Licensing and Authorisation Regulations in December the same year. It is further expected that Regulations on the continuous oversight of payment systems will be issued in 2015 with the help of Technical Assistance being received from the World Bank. In regards to alignment with international standards, work has commenced with the aid of technical assistance from the IMF in order to assess the national payment system's compliance with the Principles for Financial Market Infrastructures in April 2015.

XI. Financial Services Authority and Non-Bank Financial Services Sector

51. The work of the Global Forum on transparency and exchange of information in tax matters remains priority of the FSA for the coming years. In order to satisfy the recommendations made by the Global Forum in the Seychelles' report on the effectiveness of sanctions and monitoring of the availability of ownership and accounting information, new obligations have been imposed on International Corporate Service Providers (ICSPs) to monitor compliance by specified entities and foundations under their administration, with certain record-keeping requirements (e.g. ownership registers, directorship registers and annual returns) and report any non-compliance to the FSA. The FSA completed its focused onsite inspections on all ICSPs in April 2015 and is currently using a risk-based approach to rank the ICSPs accordingly in terms of risk levels.

52. The new IBC law is undergoing final industry consultation and is expected to be submitted to the National Assembly by the end of June 2015. A new piece of legislation, Global Corporations, to replace the Companies (Special Licence) Act is also undergoing industry consultation and is expected to be enacted by September 2015. A new International Corporate Service Providers Act and Trusts Act is expected to be submitted to National Assembly by December 2015 (new SB). The Seychelles Gambling Act has been enacted in January this year and the FSA will be administering this piece of legislation, mainly the regulation of casinos, slot machines and online gambling. However, this Act is expected to be operational in the last quarter of 2015 which will allow the FSA to build capacity and allow sufficient time for existing licensees to comply with the requirements of the new law when the latter becomes operational. In order to strengthen the regulation of insurance and pensions sector, ADB through ICF will be providing technical assistance to the FSA in the form of capacity support. In addition, the FSA will also be seeking technical assistance from the IMF or World Bank to review the existing laws on Insurance, Securities, and Mutual and Hedge Funds in order to identify gaps or weakness in these laws and bring them in line with international standards and best practices.

XII. Implementation of the Convention on Mutual Administrative Assistance in Tax Matters

53. The Convention on Mutual Administrative Assistance in Tax Matters is a multilateral agreement, developed jointly by the OECD and the Council of Europe in 1988, to promote international co-operation for a better operation of national tax laws and has the ultimate goal of combating tax avoidance and evasion. 84 countries so far have signed the Convention and is open for signatures. The aim of this Convention is to enable the Seychelles Revenue Commission (SRC) to engage in exchange of information, assistance in recovery of tax, and service of documents to the tax authorities of other signatory countries.

54. At its sixth meeting in Jakarta on 21st to 22nd November 2013, the Global Forum on Transparency and Exchange of Information for Tax Purposes (the “Global Forum”) published Seychelles’ ratings on the level of compliance with the internationally agreed standard for exchange of information in tax matters. Seychelles alongside three other countries was assigned the overall rating *“non-compliant”*. The ratings for the element C.2 (amongst ten other elements) relating to Exchange-of-information mechanisms with all relevant partners, was deemed Partially Compliant**,** as it was seen that Seychelles was not encouraging tax information exchange agreements. To this effect and upon acquiring Cabinet approval (Cabinet Minutes Ref No. C13/M21), on 30th October 2013, the Government of Seychelles on 22nd November 2013, in Jakarta, signed a letter of intent expressing Seychelles’ commitment to become party to the OECD Multilateral Convention on Mutual Administrative Assistance in Tax Matters. For the Agreement to be signed, however, it was required that an amendment be made to the Seychelles Revenue Commission Act to satisfy that all information received under the terms on the Convention, will be treated with high confidentiality. On 19th January 2015, the mentioned Amendment was gazetted and on 24th February 2015, the Convention was signed. Following submission by the government, the National Assembly ratified the SRC Act amendments and the Convention on 14th April, 2015. Signing and ratifying this Convention complements Element C of our Peer Review so that it could be utilised to trigger Seychelles’ supplementary review and subsequently bring Seychelles to a compliance status.

XIII. National Statistics

SDDS Subscription

55. An SDDS assessment mission by the IMF was undertaken in early February 2015. Individual meetings were held with the agencies for the respective sectors namely NBS (Real Sector), Ministry of Finance, Trade and the Blue Economy (Fiscal Sector), Central Bank of Seychelles (Financial and External Sectors). A template has been agreed upon and finalised for the SDDS National Summary Data Page (NSDP) and the Advance Release Calendar (ARC). These have been populated with data for the relevant periods and uploaded on the NBS website.

56. The link to the populated template was submitted to the IMF at the end of February as per agreed actions and timelines. The template is being further polished to include relevant hyperlinks for more detailed access by users to underlying data and will be updated periodically in line with the ARC dates.

57. Based on the assessment and discussions between the IMF and all national agencies at the end of the mission, an agreement was reached that Seychelles could graduate to the SDDS at the end of April 2015, a couple of months earlier than the initially agreed upon time frame. On account of our discipline and performance, we officially graduated to the SDDS starting on May 1st, 2015.

Major recommendations include**:**

- Monthly compilation of the Industrial Production Index (IPI) and the Producer Price Index (PPI). These are currently being compiled and published on a quarterly basis through the use of a flexibility option on both frequency and timeliness
- Incorporation of offshore activities in the BOP, IIP and external debt position of the country
- Creation of a website for the MFT&BE
- Reviewing all metadata and submission of the same to the IMF by end of March 2015

2013 Household Budget Survey (HBS)

58. The results of the 2013 HBS have been incorporated in the compilation of the monthly CPI as from January 2015. This includes new basket and weights.

59. Work has also started to use 2013 HBS results to compile Household Final Consumption Expenditure (HFCE) as part of our short to medium term objective of compiling GDP using the expenditure approach GDP (E), in addition to the production approach. This is being done with the assistance of the NA expert from the IMF-AFRITAC South institute.

60. The data from the 2013 HBS will also be further exploited and used to calculate a poverty line. This poverty study is being supported by the World Bank through technical assistance missions

and will include training in the use of the ADEPT software. This project is planned to take place in April and May 2015 and the Agency for Social Protection (ASP) is expected to participate in this exercise.

Table 1. Quantitative Performance Criteria Under the Extended Arrangement, 2014-2015

	2014		2015							
	End-December		End-March		End-June		End-September		End-December	
			Indicative Targets		Performance Criteria		Indicative Targets		Performance Criteria	
	Performance Criteria	Actual	First Review	Est.	First Review	Proposed	First Review	Proposed	First Review	Proposed
	(Millions of Seychelles rupees; end-of-period)									
Performance criteria										
Net international reserves of the CBS, millions of U.S. dollars (floor) [1]	350	363	356	373	345	367	345	364	345	363
Net international reserves (adjusted targets; outcomes)	351	373	...	...	...	...	...	...	...	...
Reserve money (ceiling on daily average) [2]	2,515	2,526	2,529	2,529	2,552	2,529	2,566	2,552	2,656	2,655
Primary balance of the consolidated government (cumulative floor)	793	836	-3	21	311	311	539	539	720	720
Contracting or guaranteeing of new external debt by the public sector (Millions of U.S. dollars; cumulative ceiling)	45	45	60	60	70	70	70	70	90	90
Contracting or guaranteeing of new short-term external debt by the public sector (Millions of U.S. dollars; cumulative ceiling)	0.0	0.0	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	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	0.0	0.0
Memorandum items:										
Net external non-project financing (millions of U.S. dollars; cumulative) [4]	-16.3	-15.5	6.4	8.2	-2.5	-2.6	-5.3	-4.8	-8.8	-3.9
External budget loans	17.3	17.3	7.0	7.0	14.0	10.0	14.0	10.0	27.0	27.0
Cash payments on foreign debt service	35.8	35.8	2.6	1.9	18.6	17.4	21.3	19.6	37.9	35.7
External budget grants	2.2	3.0	2.1	3.1	2.1	4.8	2.1	4.8	2.1	4.8
Reserve money target (daily average)	2,442	2,526	2,455	2,455	2,478	2,455	2,491	2,478	2,578	2,578
Program accounting exchange rates [5]										
SR/US$ (end-of-quarter)	13.43	13.43	13.43	13.74	13.43	13.74	13.43	13.74	13.43	13.74
US$/Euro (end-of-quarter)	1.26	1.26	1.26	1.12	1.26	1.12	1.26	1.12	1.26	1.12
US$/UK pound (end-of-quarter)	1.62	1.62	1.62	1.54	1.62	1.54	1.62	1.54	1.62	1.54
US$/AUD (end-of-quarter)	0.87	0.87	0.87	0.78	0.87	0.78	0.87	0.78	0.87	0.78
US$/CAD (end-of-quarter)	0.89	0.89	0.89	0.80	0.89	0.80	0.89	0.80	0.89	0.80
US$/SDR (end-of-quarter)	1.48	1.48	1.48	1.41	1.48	1.41	1.48	1.41	1.48	1.41

Sources: Seychelles authorities and IMF staff estimates and projections.

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

[2] As per TMU, the ceiling is the upper bound of a symmetrical band of three percent in both directions around the reserve money target.

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

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

[5] Program exchange rates have been set according to prevailing market rates at the last available update on projected external public financing flows.

Table 2a. Structural Benchmarks Under the Extended Arrangement, 2014

Measure	Target Date	Macroeconomic Rationale	Status Report
Real Sector			
Cabinet approval of the Medium-Term National Development Strategy (MTNDS).	End October, 2014	To provide common guidance for national and international actors supporting development, including ensuring that medium-term fiscal framework has adequate financing for priority investment projects.	Met with a delay. Cabinet approved the MTNDS on November 24.
Submission to National Assembly of (i) amendment of Seychelles Revenue Commission Act to be consistent with international standards; and (ii) ratification of the Multilateral Convention on Mutual Administrative Assistance in Tax Matters.	End June, 2014	To safeguard the global business sector by harmonizing domestic legislation with international best practice.	Met with a delay. National Assembly approved the amendments to the SRC act and the ratification of the Multilateral Convention on Tax Matters on April 14, 2015.
Financial Sector			
Cabinet approval of a Strategic Plan on Financial Sector Development.	End October, 2014	To deepen the financial system and reinforce inclusiveness.	Met with delay. The Cabinet approved the Financial Sector Development Implementation Plan (FSDIP) on November 12.
Fiscal Policy			
Cabinet approval of a Medium-term Fiscal Framework (MTFF).	End September, 2014	To ensure medium-term fiscal framework is sustainable and has adequate financing for priority public investment projects, including SOEs.	Met with delay. The Cabinet approved the MTFF on November 24.
Public Financial Mgmt. Policy			
Establish and publish comprehensive asset register for the following 5 state-owned enterprises (Air Seychelles, Seypec, SCAA, STC, PUC), including state land	End December, 2014	To ensure transparency in use of state assets.	Met. The asset register was published on December 16.
State-Owned Enterprises			
Endorsement by the National Tender Board of the procurement policies of all those state-owned enterprises incorporated under the companies act.	End September, 2014	To bring procurement policies of SOEs in line with provisions of the procurement act.	Met with a delay. The National Tender Board endorsed the procurement policies of all the SOEs in November. Extra time was required for a necessary regulatory change.
Approval by PEMC Board of a plan for carrying out governance audits of SOEs, including a plan for ensuring sufficient capacity	End December, 2014	To enhance management practices and accountability in SOEs.	Met. The PEMC Board approved the plan in October.

Table 2b. Seychelles. Structural Benchmarks Under the Extended Arrangement, 2015-2016

Actions	Timing	Objectives/Status
Fiscal and Public Financial Mgmt. Policy		
Enhance collection of business tax by conducting at least 60 tax audits of businesses from January 2015 to end-September 2015.	End September, 2015	Strengthen compliance and enhance revenue collections, especially in business taxes.
Update and publish on-line a government asset register, including state land.	End December, 2015	Safeguard public finances and enhance economic governance through better management of state assets.
State-Owned Enterprises (SOEs)		
Approval by Cabinet of a policy to further strengthen supervision of SOEs that operate on commercial terms, including independent review of large investment plans.	End March, 2015	Met with a delay. Cabinet approved measures in May 2015.
Conduct governance reviews and operational/business assessments of three SOEs.	End June, 2016	Reinforce the monitoring and oversight of SOEs. (The benchmark was revised considering operational adjustments for PEMC.)
Real Sector and Private Sector Development		
Cabinet approval of a strategy to reduce restrictive practices at the Port of Victoria.	End May, 2015	The strategy is under development and is planned for Cabinet consideration by end May.
Financial Sector Development		
Establishment of a macroprudential unit within the Central Bank of Seychelles, Board approval of a set of macroprudential policies and measures that can be implemented under the existing legal framework, and the setting up of a financial stability committee under the chairmanship of the CBS.	End October, 2015	Strengthen financial stability. (The benchmark was revised, pending legislative changes necessary for further progress.)
International Financial Services Sector		
Submission to National Assembly of new legislation on International Business Companies consistent with international standards.	End June, 2015	Safeguard the global business sector, following the OECD finding, and lay the foundation for sustained growth through best practice regulation.
Submission to National Assembly of new legislation on International Corporate Service Providers and Trusts consistent with international standards.	End December, 2015	Safeguard the global business sector, following the OECD finding, and lay the foundation for sustained growth through best practice regulation.

Attachment 2: Technical Memorandum of Understanding

1. This technical memorandum of understanding presents the definitions of variables included in the quantitative performance criteria and indicative targets set out in the letter of intent (LOI), the key assumptions, and the reporting requirements of the Government and the Central Bank of Seychelles (CBS) needed to adequately monitor economic and financial developments. The quantitative performance criteria and indicative targets, and the benchmarks for 2015 are listed in Tables 1 and 2 attached to the MEFP, respectively.

I. QUANTITATIVE PERFORMANCE CRITERIA

A. Net International Reserves of the CBS (Floor)

DEFINITION

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

Calculation method

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

Monitoring and reporting

4. Semiannually, at each test date for program performance criteria, the net international reserves data submitted by the CBS to the IMF will be audited by the CBS' internal audit division in accordance with International Standards on Auditing, to ensure conformity with the program definition and calculation methods. Reports will be submitted to the IMF no later than two months after each test date.

Adjusters

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

B. Reserve Money and Reserve Money Band (Ceiling)

Definition

6. Reserve money is equivalent to currency issued and deposits held by other depository corporations at the central bank (bank reserves), including those denominated in foreign currencies. The reserve money targets are the projected daily averages of the quarter preceding the test date, surrounded by a symmetrical band of three percent in both directions. The upper bound of the band serves as performance criterion or indicative target (ceiling). Quarterly average reserve money will be calculated as the arithmetic average of reserve money observed on all days over the quarter. The resulting value will be compared with the program ceiling.

Monitoring and reporting

7. Daily reserve money data will be submitted by the CBS to the IMF on a weekly basis with a time lag no later than one week. The cumulative average over the quarter will also be monitored by the CBS and reported to the IMF on a weekly basis.

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

8. The program consolidated government primary balance from above the line on a commitment basis is defined as total consolidated government and social security fund revenues (excluding privatization and long-term lease income receipts) less all noninterest (primary) expenditures and net lending of the government and social security fund. For program purposes the transfer of assets from the Social Security Fund to the Seychelles Pension Fund planned for 2015 will be excluded from expenditures.

D. Public External Debt (Ceiling)

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

10. For the purposes of this performance criterion, the definition of debt is set out in Point 9 of the "Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements," attached to Executive Board Decision No. 6230-(79/140), as amended. Debt is understood to mean a current, non contingent liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future points in

time; these payments will discharge the principal and/or interest liabilities incurred under the contract. The ceiling on contracting official and officially guaranteed external debt includes all form of debt, including:

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

b. suppliers credits, that is, contracts where the supplier permits the obligor to defer payments until sometime after the date on which the goods are delivered or services are provided; and,

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

d. arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g. payment on delivery) will not give rise to debt.

E. External Arrears of the Public Sector

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

F. Domestic Arrears of Government

12. The nonaccumulation of budget expenditure arrears will be a performance criterion under the program and will be measured on net basis from the beginning of a calendar year. Budget expenditure arrears are defined as the sum of (1) any invoice that has been received by a spending agency from a supplier of goods, services, and capital goods delivered and verified, and for which payment has not been made within the contractually agreed period, or in the absence of a grace period, within 30 days; (2) unpaid wages, pensions, or transfers, pending for longer than 30 days to domestic or foreign residents, irrespective of the currency denomination of the debt; and (3) debt service payment on domestic debt of the government or guaranteed by the government that has not been made within the contractually agreed period.

II. DATA AND INFORMATION

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

The CBS will report

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

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

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

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

The Ministry of Finance will report

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

- Consolidated government operations on a commitment basis and cash basis in the IMF-supported program format and in GFSM2001 format.
- The detailed revenues and expenditures of the central government and social security fund.
- Import and export data from the customs department.
- Public debt report, reconciled with the cash operations to minimize any statistical discrepancy.
- Consolidated creditors schedule on domestic expenditure arrears of the government.

Quarterly (within one month from the end of the quarter)

- Accounts of the public nonbank financial institutions.

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

SEYCHELLES

May 26, 2015

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION, SECOND REVIEW UNDER THE EXTENDED ARRANGEMENT, AND REQUEST FOR WAIVER AND MODIFICATION OF PERFORMANCE CRITERIA—INFORMATIONAL ANNEX

Prepared By | The African Department
(In consultation with other departments)

CONTENTS

RELATIONS WITH THE FUND

(As of March 31, 2015)

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

General Resources Account	SDR Million	% Quota
Quota	10.90	100.0
Fund holdings of currency	39.35	360.97
Reserve Position in Fund	0.53	4.85

SDR Department	SDR Million	% Allocations
Net cumulative allocation	8.28	100.0
Holdings	5.73	69.12

Outstanding Purchases and Loans:		
Extended Arrangement	28.97	265.81

Financial Arrangements:

			SDR Million	
Type	Arrangement	Expiration	Amount Approved	Amount Drawn
EFF	Jun 04, 2014	Jun 03, 2017	11.45	3.27
EFF	Dec 23, 2009	Dec. 23, 2013	26.40	26.40
Stand-By	Nov 14, 2008	Dec. 22, 2009	17.60	4.84

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

	Forthcoming				
	2015	**2016**	**2017**	**2018**	**2019**
Principal	1.47	2.60	3.57	4.54	4.95
Charges/interest	0.23	0.28	0.25	0.21	0.16
Total	1.69	2.89	3.83	4.75	5.11

Implementation of HIPC Initiative: Not applicable

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. The 2014 follow up safeguards mission assessed that the safeguards are broadly adequate. Areas for further development include the bank's legal framework and internal audit procedures and capacity.

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 de jure exchange rate regime is floating.[43] On March 31st, 2015 US$1 = SR 13.637 (mid rate).

Article IV Consultations:
Seychelles is currently under a 24 month consultation cycle.

Technical Assistance (2013–April 2015):

Department	Head of Mission	Subject	Date
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
STA	Ms. Hashimoto and Mr. Balyozov	SDDS Assessment Mission	February 2013
FAD	Mr. Radev	Medium Term Fiscal Framework	March 2014
STA	Ms. Razin	Balance of Payments Statistics	March 2014
MCM	Mr. Pooley	Basle II/III Implementation	April 2014
MCM	Mr. Naseer	Strengthening the Monetary Framework	October 2014
STA	Ms. Razin	External Sector Statistics	January 2015

[43] From mid-March 2013 to end-March 2014, the rupee depreciated within a 2 percent band against the U.S. dollar. Accordingly, the de facto exchange rate arrangement was reclassified from floating to crawl-like, effective March 12, 2013. Since end-March 2014, the exchange rate has departed from the 2 percent band. Accordingly, the de facto exchange rate arrangement has been reclassified to a floating arrangement, effective March 27, 2014.

Department	Head of Mission	Subject	Date
MCM	Mr. Sullivan	Central Bank Accounting	February 2015
MCM/AFRITAC	Ms. Elliott and Mr. Ramakrishnan	Risked Based Supervision of Offshore Banks	March 2015
AFRITAC South	Mr. Helis	Follow-up Assistance on Implementing Cash Basis IPSAS	April 2015
MCM	Mr. Wendt	Strengthen the Oversight of Financial Market Infrastructures	April 2015

Resident Representative: None

JOINT WORLD BANK-IMF WORK PROGRAM, 2015

(As of April, 2015)

Title	Products	Provisional timing of mission	Expected delivery date
	A. Mutual Information on Relevant Work Programs		
Bank	**A. Strategy**		
	Systematic Country Diagnostic	July 2015	January 2016
	B. Lending Program		
	Sustaining Reforms For Inclusive Growth	June 2015	September 2015
	Accelerated Program for Economic Integration DPL	--	September 2015
	C. Analytical work, Technical Assistance and Capacity Building		
	TA on Program Performance Based Budgeting	May 2015	December 2015
	TA on strengthening Financial sector regulatory framework	August 2015	June 2016
	Improving Electricity Planning Info.	June 2015	June 2016
	Poverty statistics and inequality analysis	May 2015	July 2015
	Labor market and social protection study	July 2015	June 2016
	Strengthening supply chain linkages to tourism industry	August 2015	June 2016

Title	Products	Provisional timing of mission	Expected delivery date
Fund	**A. Program and surveillance work**		
	Request for support under EFF	February 2014	May 2014
	First Review under EFF	September 2014	December 2014
	Second Review under EFF	March 2015	July 2015
	B. Technical assistance and capacity building		
	MCM technical assistance on reforming the monetary policy framework, strengthening technical capabilities of CBS' research and policy analysis divisions	Ongoing	Ongoing
	MCM/AFRITAC South technical assistance on strengthening bank supervision	Ongoing	Ongoing
	FAD/AFRITAC South technical assistance on tax and customs reform	Ongoing	Ongoing
	FAD/AFRITAC South technical assistance on public financial management, including the Medium-Term Expenditure Framework and improvements to the public accounts.	Ongoing	Ongoing
	STA technical assistance on external sector statistics	Ongoing	Ongoing
	STA/AFRITAC South technical assistance on GDP and price statistics	Ongoing	Ongoing
	B. Requests for Work Program Inputs		
Bank request to Fund	Medium-term macroeconomic and fiscal framework to inform Public Expenditure Reviews and Development Policy Lending	n.a.	Ongoing
Fund request to Bank	Assist authorities in reviewing governance arrangements of parastatals.	n.a.	Ongoing

RELATIONS WITH THE AFRICAN DEVELOPMENT BANK GROUP

The Bank commenced operations in Seychelles in 1978 and has since approved 31 operations, comprising 13 projects, 3 lines of credit and 1 partial credit guarantee as well as numerous studies, capacity building, technical assistance and emergency relief operations (14 in total). The cumulative value of approvals, net of cancellations, as at March 2015 was UA 110.56 million, of which 80.8% from the ADB, 7.6% from the ADF, 9.7% from the NTF, and the remaining 1.9% from the AWF and the Fund for Africa Private Sector Assistance (FAPA).

The current Country Strategy Paper (CSP) covers the period 2011–15 and focuses on one pillar of support, "Strengthening Private Sector Development and Competitiveness", which is divided into three complementary sub-pillars; infrastructure development, enabling financing and regulatory environment, and human capacity development. Following the Mid- Term Review of the Strategy in 2013, the areas of support were expanded to also include public financial management.

The total number of approvals under the CSP 2011-15 is expected to reach 13 operations, with total commitments amounting to UA 46.43 million (USS$64.23 million).

The lending program under the 2011-2015 CSP included UA 20million (US$30million) towards budget support operations focused on economic competitiveness and public finance management reforms - an operation of US$20million for 2013-2014, The Inclusive Private Sector Development and Competitiveness Programme, was prepared and disbursed across two tranches in December 2013 and December 2014, against satisfactory fulfillment of conditions of disbursement. Phase two of this operation, for an amount of US$10 million, is being prepared for approval in July 2015 and disbursement by end December 2015. The operation targets reforms aimed at improving the investment climate, through an improved legal framework and systems for business facilitation; initiatives to increase access to credit for MSMEs; and an improved regulatory framework for non-banking financial sector. The operation also targets reforms aimed at enhancing public sector efficiency, including through the establishment of a regulatory framework for PPPs and improved transparency and participation in procurement and budget processes.

In addition to the budget support operations, the Bank supported the Seychelles East Africa Submarine (SEAS) cable ICT PPP project, amounting to US$39 million, of which the Bank financed US$12million, which was successfully implemented and completed in 2012. The most recent project approval by the Bank, on 1 April 2015, was for a US$20.6 million loan in support of the Mahe Sustainable Water Augmentation Project (MSWAP).

The on-going non-lending program includes two new technical assistance packages in support of the reforms targeted by the budget support operation, including support to Private Sector Development, particularly access to finance and skills development for small and medium enterprises, valued at approximately US$1.5million, as well as a project provided jointly with the Investment Climate Facility in support of PPP legal, regulatory and operational framework, for approximately US$740,000. The Bank is also preparing a Technical Assistance package to support the implementation of the Financial Sector Development Implementation Plan for approval this year.

The AfDB is currently preparing the next Country Strategy Paper for Seychelles. The proposed overarching objective of the Bank's new CSP for Seychelles 2016-20 is to accelerate diversified economic growth by focusing on the private sector as the main engine of inclusive and green growth and employment creation. Two main pillars of support are being proposed, Pillar 1 – **"Strengthening energy infrastructure to support green and inclusive growth"** and Pillar 2 – **"Promoting private and financial sector development to support economic diversification"**.

STATISTICAL ISSUES

SEYCHELLES—STATISTICAL ISSUES APPENDIX

As of January 5, 2015

I. Assessment of Data Adequacy for Surveillance

General: Data provision has some shortcomings, but it is broadly adequate for surveillance. The country participates in the General Data Dissemination System (GDDS) since December 2006 and in government finance statistics modules of the Anglophone Africa project funded by the U.K. Department for International Development (DFID). Good progress has been achieved in improving statistical capacity, though sustained technical assistance and additional resources will be required for statistical development over the medium term in order to improve the quality of economic statistics. Having met all Special Data Dissemination Standard (SDDS) requirements and following review of metadata by the IMF Statistics Department, Seychelles subscribed to the SDDS on May 1, 2015.

National accounts: National accounts data are prepared on a calendar-year basis with 2006 serving as the base year for constant price measures. The NSB has developed quarterly national accounts data for the period 2006-14. Further technical assistance is being provided to allow for a rebasing of the national accounts to 2013 (reflecting the results of the new Household Budget Survey), compilation of the quarterly national accounts using the expenditure approach, and production of seasonally-adjusted quarterly GDP figures. Tourism statistics are compiled on a weekly and monthly basis. Production indicators are compiled quarterly, and both are reported to the IMF in a timely manner. Data on average earnings and employment by sector are collected on a quarterly basis by the NSB, but there are no data on unit labor costs.

Price statistics: A new consumer price index (CPI) was introduced in January 2015 based on expenditure weights derived from the 2013 household budget survey.

Government finance statistics: Seychelles reports to STA the cash flow statements and financial balance sheet data based on the Government Finance Statistics Manual (GFSM 2001). Main recommendations of the 2011 GFS mission were: (i) establish a GFS task force among Treasury, Financial Planning and Control Division (FPC), Debt Management staff, and other relevant agencies to discuss and resolve technical and methodological issues; (ii) establish a strategic plan that specifies how to address weaknesses in terms of: (1) augmenting the cash recording of transactions in the execution of the budget with relevant accrual-based measures; (2) improving data on other economic flows for financial assets and liabilities; and, (3) addressing the lack of stock data on government holdings of nonfinancial assets, beginning with fixed assets and non-produced assets (lands). While substantial progress has been made, further work will be needed to support a full move to GFSM 2001.

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

Financial sector surveillance: The authorities are compiling financial soundness indicators and report them to the Fund on a monthly basis. Work is ongoing to establish a macroprudential framework under the aegis of a financial stability committee, with TA provided by the Fund.

External sector statistics: The authorities have adopted the methodology of the sixth edition of the *Balance of Payments and International Investment Position Manual,* and are expected to compiled the international investment position in 2015 for the first time. Annual balance of payments data are reported to the Statistics and African Departments nine months after the reference period, but provisional estimates are provided to missions earlier. Quarterly BOP data have been compiled since 2009, and were made publicly available and also reported to STA in 2015. Merchandise trade data are reported on a quarterly basis. Considerable progress has been made in collecting and updating data on public sector external debt and debt-service and payments of external arrears. Remaining priority areas include improving the coverage of external sector statistics, and compiling private sector debt data.

II. Data Standards and Quality	
	No ROSC has been carried out.

Seychelles: Table of Common Indicators Required for Surveillance

	Date of latest observation (For all dates in table, please use format dd/mm/yy)	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]
Exchange Rates	30/04/15	30/04/15	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	24/04/15	28/04/15	D	W	M
Reserve/Base Money	24/04/15	28/04/15	D	W	M
Broad Money	28/02/15	10/04/15	M	M	M
Central Bank Balance Sheet	24/04/15	28/04/15	D	W	M
Consolidated Balance Sheet of the Banking System	28/02/15	10/04/15	M	M	M
Interest Rates[2]	28/02/15	10/04/15	M	M	M
Consumer Price Index	31/03/15	10/04/15	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	28/02/15	21/04/15	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	28/02/15	21/04/15	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	28/02/15	28/03/15	M	M	M
External Current Account Balance	31/12/14	15/03/15	Q	Q	Q
Exports and Imports of Goods and Services	31/12/14	15/03/15	Q	Q	Q
GDP/GNP	31/12/14	31/03/15	Q	Q	Q
Gross External Debt	31/12/14	01/02/15	Q	Q	Q
International Investment Position[6]	31/12/14	15/03/15	Q	Q	Q

[1] Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.
[7] Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).

Statement by the Staff Representative on Seychelles
Executive Board Meeting
June 17, 2015

1. Since the issuance of the staff report, the following information has become available. This information does not alter the thrust of the staff appraisal.

2. Macroeconomic outcomes have been somewhat stronger than projected. Tourism arrivals in the first four months of the year have been 13 percent higher than during the same period in 2014, driven by the buoyant growth of the Indian market and continued expansion of the traditional French and Italian markets. With monetary and fiscal policies in line with program targets, the recovery in tourism, and lower commodity import prices, the balance of payments has strengthened, with the exchange rate rising to 13.2 SCR/Dollar, a nominal appreciation of around 6 percent against the dollar since the start of the year. Inflation, which had reached 5.8 percent in March, fell to 4.0 percent in May, largely as a result of lower fuel prices feeding through to the electricity tariff.

3. Program performance appears to be on track to exceed targets. Preliminary data suggest that the Q1 fiscal primary surplus exceeded the target by around ¾ of a percent of GDP, supported by strong revenues. The authorities have taken advantage of the improved external environment to purchase foreign exchange and boost gross international reserves to $512 million on June 8 (implying NIR of $406 million comfortably above the end-June target of $367 million). Cumulative quarterly reserve money has stayed within the target corridor during the second quarter of 2015. Growth of credit to the private sector has begun to moderate, with annual growth decreasing from 25 percent in December 2014 to 23 percent in March 2015.

4. The authorities have also made progress on the structural agenda. On June 3 the Cabinet approved a strategy aiming to reduce restrictions and encourage competition in the provision of port services, meeting a structural benchmark with a small delay. Consultations on new legislation on International Business Companies for submission to the National Assembly (structural benchmark, end-June) are advancing more slowly than expected, and the legislation is expected to be submitted in the second half of the year.

Statement by Ms. Plater, Executive Director for Seychelles and Mr. South, Advisor to Executive Director for Seychelles June 17, 2015

After experiencing a debt crisis in 2008-09, the very small archipelago state of Seychelles has pursued ambitious and wide-ranging reforms aimed at stabilizing the economy and reorienting fiscal and monetary policies to lift and entrench growth. The authorities have made significant progress in building a resilient and more diversified economy under successive programs supported by the Extended Fund Facility. Macroeconomic stability has been restored, growth has returned, inflation has moderated, the exchange rate has stabilized, public debt has declined sharply, and net international reserves have been steadily accumulated. These outcomes have been underpinned by the floating of the exchange rate, and tighter monetary and fiscal policies. However, the authorities are keenly aware that continued efforts are needed. As a very small, highly open economy that is heavily reliant on tourism and imports, Seychelles remains particularly vulnerable to external shocks. The authorities continue to focus on strengthening macroeconomic stability by further reducing public debt from high levels, accumulating additional international reserves, and pursuing deep structural reforms to promote inclusive growth.

The authorities remain firmly committed to the program and request the completion of the second review. The authorities successfully met all but one of their quantitative program targets for end-December 2014. Importantly, public debt remains on track to fall below 50 percent of GDP by 2018, which has been a target firmly embedded in the authorities' reform program since 2008. The targets for the fiscal primary surplus and higher net international reserves were surpassed comfortably last year, while the reserve money ceiling was exceeded by a very small margin, which was later corrected. The authorities request a waiver for this minor and temporary breach. The authorities have made considerable progress on the structural benchmarks, which remain broadly on track albeit with some delays.

RECENT ECONOMIC DEVELOPMENTS AND OUTLOOK

With stronger fundamentals now in place, the Seychellois economy proved better equipped to deal with external challenges in 2014. Real GDP grew by 3.3 percent in 2014, while the decline in oil prices contributed to stable inflation outcomes. External pressures heightened through 2014, with weaknesses in key exports. The economy adjusted successfully, benefitting from the reforms of recent years. The exchange rate depreciated by 16 percent in the three months to October 2014 before stabilizing and appreciating by around 6 percent since the start of this year. The balance of payments pressures abated towards the end of 2014 as a result of tightened monetary policy, the decline in oil prices and in response to the exchange rate depreciation. The current account deficit of 21 percent of GDP was lower than projected at the time of the first review, largely due to lower oil prices. It continues to be financed by strong FDI inflows. For 2014, the primary fiscal surplus exceeded program targets, as indirect tax collections reflected strong import growth and domestic demand. Income tax and business tax collections fell modestly below initial targets. Non-tax revenues were lower than targeted, as a result of lower dividends from SOEs. Primary current expenditures were in line with program targets, while capital expenditure modestly exceeded the target. While expenditure on wages and salaries increased following the pay increase to civil servants granted at the beginning of 2014, such expenditure remains relatively low compared to other small island states and the authorities have maintained appropriate wage restraint more recently.

The outlook for 2015 is positive, though substantial risks remain. In 2015, the authorities expect real GDP growth to accelerate modestly to 3.5 percent. Inflation is likely to be around 5 percent, with the effect of the depreciation of the exchange rate being partially offset by the decline in oil prices. The current account deficit is expected to contract to 15 percent of GDP in 2015, again largely reflecting the falling cost of petroleum imports. The US dollar value of tourism earnings has declined modestly, reflecting the pricing of most hotel tariffs in the weakening euro. Given the considerable reliance on tourism from Europe, Seychelles remains vulnerable to the faltering recovery in Europe.

FISCAL AND STRUCTURAL POLICIES

Seychelles is continuing to make good progress in restoring fiscal discipline, reducing debt, and strengthening public financial management. The 2015 budget aims to achieve a primary surplus of SR 720 million, equivalent to 3.8 percent of projected GDP. Prudent debt policy aims to reduce public debt to 63.7 percent of GDP in 2015, and is on track to achieve the target of 50 percent of GDP by 2018. Considerable progress has been made in implementing public financial management reforms, including the adoption of a Medium-Term Fiscal Framework that has anchored Seychelles' fiscal strategy and the medium-term national development strategy. However, the authorities are conscious that more remains to be done. A new PFM action plan for 2015-18 is geared towards improvement in capital project cash and asset management as well as a further enhanced medium-term budget framework.

The introduction of a VAT and flat-rate personal income tax has yielded sound revenue collections and the authorities are now focused on improving business tax collections. Tax collections are relatively high compared with other countries in the region as well as other small island states. Reforms implemented between 2008 and 2012 improved the efficiency of the tax system by broadening the base and reducing rates, while maintaining the overall tax burden. The authorities continue to modernize tax administration and are now focusing on improving business tax compliance, including by undertaking risk-based audits of 60 large businesses, and improving the revenue administration's capacity to analyze transfer pricing arrangements. They are also focusing on simplifying payment procedures and improving the collection of arrears.

The authorities are focused on ensuring the quality of spending and that ongoing investments in health, education and social programs support growth prospects and social

outcomes. Seychelles has achieved sound outcomes for its citizens in education, health, poverty eradication, and the environment. Underpinning these outcomes has been a policy of free access to healthcare and education. The authorities are taking steps to improve the training of functional skills, as a means to address the skills shortage and mismatches.

The authorities are continuing to strengthen the accountability, monitoring and control of SOEs to improve the efficiency of SOEs and reduce fiscal risks. As a microstate of many small islands, the lack of competition and need for scale in some sectors of the economy call for a larger role for government. Accordingly, SOEs exist in Seychelles to deliver a range of essential services in electricity, water, roads, seaports, fuel supply, transport and aviation. The authorities are mindful of the need for accountability, monitoring and control so that SOEs do not present undue risks to public finances. In particular, the authorities are placing more emphasis on applying best practices to SOEs through management and governance audits so as to further enhance transparency and efficiency in the delivery of public services. The operational performance of the state-owned petroleum (SEYPEC) and utilities (PUC) companies improved in 2014. However, Air Seychelles recorded large operational losses, which were offset by contributions previously committed by the government of Seychelles and by the airline's other private shareholder. Air Seychelles has announced the introduction of a direct route to Paris from 1 July 2015, codeshared with Air France, aimed at boosting arrival numbers from this key market. The government of Seychelles has worked with Air Seychelles to establish a clear plan to return the airline to profitability, including milestones by which progress will be assessed.

The authorities also recognize that the private sector is the engine of growth and are committed to ensuring that the operation of SOEs does not obstruct the participation of private sector in competitive markets. The authorities agree on the need for SOEs to focus on core mandates in order to minimize risks to the public finances and to allow for the development of the private sector. Furthermore, recognizing the need for a vibrant and competitive private sector, the authorities will continue to promote competition in key sectors such as fisheries and port services. The authorities are pursuing a PPP model for the participation of private investors in the expansion of the port of Victoria, and are working to appropriately balance the share of risks and incentives for the private involvement. More generally, the authorities are working with the African Development Bank and other partners to develop a PPP policy, which would ensure transparency and accountability in the risks to the public balance sheet.

Seychelles is on track with its strategy of reducing public debt to sustainable levels. The strong fiscal performance and forecast of GDP growth in the medium term mean that public debt is expected to fall below 50 percent of GDP in 2018. The authorities aim to place borrowings on favorable terms and gradually extend maturities of the debt portfolio. With debt service set to rise sharply in the near term as grace periods come to an end, one of the key debt management goals is to smooth out the debt service profile and shift borrowings on to local currency wherever possible. It is with these objectives in mind that the authorities have agreed on a debt reorganization to smooth and reduce debt service obligations while providing a stream of resources to support marine conservation. Under this agreement, Paris Club creditors and South Africa will receive the immediate repayment of a share of claims, at a moderate discount. The government of Seychelles benefits from an extended period over which it will make repayments, which are partially converted into domestic currency. A portion of the repayments will be set aside for marine conservation activities through a global environmental NGO.

Seychelles continues to deepen its integration with the global economy. Seychelles joined the WTO in April 2015, an important step given the economy is reliant on open access to trade in goods and services. The authorities also ratified the Convention on Mutual Administrative Assistance in Tax Matters, bringing Seychelles into line with existing international standards on the exchange of tax information. Seychelles has also joined the group of early adopters of the new global standard to automatically exchange tax information. Seychelles is strongly committed to transparency through the adoption of internationally accepted best practices in statistics, and has recently graduated from the GDDS to subscribe to the SDDS. As an EITI Candidate country, Seychelles will publish its first EITI Report by February 2016.

MONETARY POLICY AND THE FINANCIAL SECTOR

The Central Bank of Seychelles (CBS) intends to maintain a tight monetary policy stance as long as necessary to guard against possible inflationary pressures and support external balance. Recent data suggest some emerging inflationary risks and the aim is to moderate the recent strong growth in private sector credit to more sustainable levels. While the small size of the foreign exchange market led to some backlogs in the last 12 months, these delays were short-lived and the CBS remains committed to a floating exchange rate regime to ensure adjustments reflect economic fundamentals.

In order to build further resilience to external shocks, reserves accumulation remains an important objective of the authorities. In line with program objectives, the authorities are targeting a modest increase in net reserves. During 2015, CBS plans to make opportunistic purchases of international reserves that do not influence the exchange rate. The CBS remains committed to improve its reserves management capacity with the help of the World Bank.

The CBS continues to move towards a more forward-looking monetary policy framework. An interest rate corridor is providing guidance to the market and allowing commercial banks to improve liquidity management while also improving the transmission of monetary policy. The CBS and the Ministry of Finance have agreed that the Ministry will continue to issue T-Bills and T-Bonds for monetary policy purposes. The CBS learnt from the experience in late 2014 that led to the temporary breach of the reserve money ceiling and is receiving technical assistance from the IMF to further strengthen its liquidity management.

The authorities continue to bring financial regulation into line with evolving international standards. The CBS continues to upgrade banking regulations to cater for implementation of Basel II and III standards. Moreover, a new resolution framework for banks will be developed to ensure that it is in line with new developments, both domestically and internationally. Given emerging risks from the offshore sector, the authorities are bringing the AML regulatory framework in line with international standards.

The CBS is also working to draw on recent experience to strengthen the frameworks for offshore banking supervision and bank resolution. In November 2014, the CBS took over management control of the Bank of Muscat International Offshore (BMIO), which had lost its foreign correspondent banking relationship as a result of worldwide de-risking associated with the increased focus on AML/CFT obligations. By December 2014, the CBS had re-established a correspondent banking relationship for BMIO. However, given tighter international risk management requirements, the CBS decided to reorganize BMIO and retained full management control over BMIO during this process. Despite its operational difficulties, BMIO remained financially sound throughout and as an offshore bank with funds primarily invested in liquid securities, there were no significant impacts on the economy.

The authorities agree on the need for a strong macro-prudential policy framework to continue to safeguard the financial sector. In this regard the CBS is establishing a Financial Stability Committee that will be responsible for taking action to address systemic financial system risks. The recent strong private credit growth is expected to moderate to more sustainable levels following the policy tightening of the CBS. While there are no indications of weakening lending standards and the recent growth comes after a period where the supply of credit appeared to be overly restrained, the authorities are closely monitoring these trends.

The CBS is continuing to develop the financial infrastructure, in particular the payments and credit information systems, and improving access to credit for SMEs and households. Work on a modern payment system is being accelerated. In 2013, Seychelles implemented a system for the electronic transfer of funds across all banks. In 2015, a further phase in this project will extend this online platform from banks to the general public. The CBS is also focused on enhancing consumer protection and financial literacy.

CONCLUSION

The authorities are very appreciative of the continued close engagement with the IMF, which has supported the considerable progress they have made in restoring inclusive growth and resilience to the economy. They wish to thank the Article IV team, led by Mr. Marshall Mills, for the constructive discussions, analysis and advice. In addition, the IMF's technical assistance continues to be highly valuable to the authorities as they make progress on their reform agenda.