



RATING ACTION COMMENTARY

Fitch Affirms Seychelles at 'BB-'; Outlook Stable

Fri 31 Mar, 2023 - 5:01 PM ET

Fitch Ratings - London - 31 Mar 2023: Fitch Ratings has affirmed Seychelles' Long-Term Foreign-Currency Issuer Default Rating (IDR) at 'BB-' with a Stable Outlook.

A full list of rating actions is at the end of this rating action commentary.

KEY RATING DRIVERS

Ratings Affirmed: Seychelles' 'BB-' rating is supported by relatively high income levels (3x the peer median), strong World Bank Governance Indicators, support from multilateral creditors and stable policymaking. These strengths are balanced by the exceptionally high concentration of the economy in the tourism sector, which heightens vulnerability to external shocks, and long-term risks associated with climate change.

Solid Tourism Recovery: Seychelles' tourism sector recorded a solid recovery in 2022, with tourist arrivals surging by 82% yoy and reaching 86.4% of 2019 levels. Global economic uncertainty and competition from other high-end tourism destinations should lead to a slowdown in visitor growth to an estimated 5% in 2023-2024.

However, despite continued visitor growth, Fitch expects tourism receipts will decline by about 14% in 2023 and 7% in 2024, reaching 41.3% of GDP, given the expected tapering in arrivals of high-spending tourists from Russia and other countries. There is upside from a larger than expected fall in oil prices - translating into lower airfares - and shallower than projected recessions in major European economies.

Stable Growth Prospects: Following real economic growth of 8.9% in 2022, Fitch expects growth of 3.6% in 2023 and 4.2% in 2024, as tourism growth normalises. In early 2023, the authorities revised recent years' real GDP growth figures in consultation with the IMF, which cut the 2021 outturn from 8% to 2.4% (though the IMF's latest staff statement signals a new revision in this figure back to 5.4%). Fitch projects medium-term growth of about 4%, and sees upside mainly from investment, which has lagged in recent years due to execution challenges, rather than a boost to productivity or the labour force.

Low Inflation, Stable Macro Framework: Inflation is highly responsive to fluctuations in the rupee, which is freely floating, with a passthrough to prices typically observed with a lag of six to eight months. A trend of currency appreciation since mid-2021 led to inflation falling to 2.6% on average in 2022 (2021: 9.8%). While macroeconomic and monetary policy is stable and largely predictable, in Fitch's view, transmission of monetary policy is somewhat constrained by the high levels of dollarisation in the economy.

Current Account Deficits: Fitch expects the current account deficit to continue to decline to 3.9% of GDP in 2023 and 3.5% in 2024 (current 'BB' median: 3.7%), from 7.5% in 2022, as tourism inflows continue to normalise. Seychelles' exceptionally high reliance on tourism for FX inflows, and heavy reliance on imports for most basic goods, remain a key weakness.

External Liquidity Support: Fitch expects FX reserves to stabilise at about 4.4 months of coverage of current external payments in 2023-24, in line with the peer median. Seychelles also benefits from strong liquidity support from multilaterals. In December 2022, the IMF completed the third review of Seychelles' 32-month Extended Fund Facility (EFF), enabling Seychelles to draw down a cumulative USD80.6 million (4.4% of GDP) since 2021. Assuming continued progress with meeting targets on fiscal consolidation, the IMF expects to disburse up to another USD26 million in 2023 and USD35 million in 2024, which would bolster Seychelles' external liquidity.

Stable Fiscal Performance Projected: The fiscal deficit shrunk by 5pp to 1.7% of GDP in 2022 (current 'BB' median: 3%), while the primary balance returned to surplus for the first time since 2019, boosted by very strong revenue growth and capex under-execution. Fitch expects the fiscal deficit to widen to 2.1% of GDP in 2023, given slowing growth and a pick-up in capex performance, before improving to 0.2% of GDP in 2024.

Falling Public Debt: Public debt fell by 16pp to 69% of GDP in 2022 (current 'BB' median: 55.7%), aided by strong nominal GDP growth, a favourable exchange rate effect, and the recovery of a primary surplus. Fitch expects debt to continue declining to

around 63% in the forecast period through 2024, barring a growth or exchange rate shock. About 82% of external debt is owed to multilateral and bilateral creditors at preferential rates, reducing interest rate risks. The borrowing pipeline in 2023 includes budget and project financing from multilateral and bilateral sources, with no external issuances planned.

Climate Change Vulnerabilities: Seychelles is heavily exposed to risks from rising sea levels, although a significant impact will likely only be felt in the medium to long term. In the short term, Seychelles' tourism industry faces constraints in expansion due to the saturation of coastal infrastructure, and various risks of environmental and biodiversity degradation. Climate-change adaptation measures are currently not factored into fiscal planning, although Seychelles receives technical assistance from international bodies in this regard.

Seychelles has an ESG Relevance Score (RS) of '5+' for both Political Stability and Rights and for the Rule of Law, Institutional and Regulatory Quality and Control of Corruption, as is the case for all sovereigns. These scores reflect the high weight that the WBGI have in our proprietary Sovereign Rating Model (SRM). Seychelles has a high WBGI ranking at the 71st percentile, reflecting a recent record of peaceful political transitions, a moderate level of rights for participation in the political process, moderate institutional capacity, established rule of law and a moderate level of corruption.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to negative rating action/downgrade:

Public Finances: Increases in gross general government debt (GGGD)/GDP, for example, due to sharply slower growth prospects or a sharp reversal of fiscal consolidation.

External Finances: Rising balance-of-payment pressures, for example, from a sharp drop in tourism receipts, that lead to a sustained deterioration in external liquidity.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

Public Finances: A sustained fall in GGGD/GDP, supported by continued fiscal consolidation.

External Finances: Reduction in external vulnerabilities resulting from a significant buildup in international reserves; for example, from a durable narrowing of the current account deficit and increase in foreign direct investment.

SOVEREIGN RATING MODEL (SRM) AND QUALITATIVE OVERLAY (QO)

Fitch's proprietary SRM assigns Seychelles a score equivalent to a rating of 'BB' on the Long-Term Foreign-Currency (LT FC) IDR scale.

Fitch's sovereign rating committee adjusted the output from the adopted SRM score to arrive at the final LT FC IDR by applying its QO, relative to SRM data and output, as follows:

Fitch has removed the -1 notch previously assigned to External Finances, in light of data revisions that resulted in substantially improved external balance sheet metrics relative to peers and better current account balances.

Macro: -1 notch to reflect the high vulnerability of the economy to shocks, given high reliance on tourism.

Fitch's SRM is the agency's proprietary multiple regression rating model that employs 18 variables based on three-year centred averages, including one year of forecasts, to produce a score equivalent to a LT FC IDR. Fitch's QO is a forward-looking qualitative framework designed to allow for adjustment to the SRM output to assign the final rating, reflecting factors within our criteria that are not fully quantifiable and/or not fully reflected in the SRM.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit <https://www.fitchratings.com/site/re/10111579>.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Seychelles has an ESG Relevance Score of '5+' for Political Stability and Rights as WBGI have the highest weight in Fitch's SRM and are highly relevant to the rating and a key rating driver with a high weight. As Seychelles has a percentile rank above 50 for the respective governance indicators, this has a positive impact on the credit profile.

Seychelles has an ESG Relevance Score of '5+' for Rule of Law, Institutional & Regulatory Quality and Control of Corruption as WBGI have the highest weight in Fitch's SRM and are therefore highly relevant to the rating and are a key rating driver with a high weight. As Seychelles has a percentile rank above 50 for the respective governance indicators, this has a positive impact on the credit profile.

Seychelles has an ESG Relevance Score of '4+' for Human Rights and Political Freedoms as strong social stability and voice and accountability are reflected in the WBGI that have the highest weight in the SRM. They are relevant to the rating and a rating driver. As Seychelles has a percentile rank above 50 for the respective governance indicators, this has a positive impact on the credit profile.

Seychelles has an ESG Relevance Score of '4' for Creditor Rights as willingness to service and repay debt is relevant to the rating and is a rating driver for Seychelles, as for all sovereigns. As the last default/restructuring event occurred less than 20 years ago, this has a negative impact on the credit profile.

Except for the matters discussed above, the highest level of ESG credit relevance, if present, is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or to the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY / DEBT ↕	RATING ↕		PRIOR ↕
Seychelles	LT IDR	BB- Rating Outlook Stable	BB- Rating Outlook Stable
	Affirmed		
	ST IDR	B Affirmed	B

	LC LT IDR		BB- Rating Outlook Stable		BB- Rating Outlook Stable
	Affirmed				
	LC ST IDR	B	Affirmed		B
	Country Ceiling	BBB-	Affirmed		BBB-
senior unsecured	LT	BB-	Affirmed		BB-

[VIEW ADDITIONAL RATING DETAILS](#)

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APPLICABLE CRITERIA

[Country Ceilings Criteria \(pub. 01 Jul 2020\)](#)

[Sovereign Rating Criteria \(pub. 12 Jul 2022\) \(including rating assumption sensitivity\)](#)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Country Ceiling Model, v1.7.3 (1)

Debt Dynamics Model, v1.3.2 (1)

Macro-Prudential Indicator Model, v1.5.0 (1)

Sovereign Rating Model, v3.13.2 (1)

ADDITIONAL DISCLOSURES

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Seychelles

UK Issued, EU Endorsed

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Sovereigns Africa Seychelles
